M-CRIL

Micro-Credit Ratings International Limited

M-CRIL Investment Rating

as of end-December 2009

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INCOFIN CVSO RIF

Financial	**Strongly recommended** for good management and investment in a diversity of MFI types and investment instruments; excellent use of risk mitigation tools	
Social	**Strongly recommended** for systematic double-bottom line screening and monitoring of investments; proactive engagement with investees on aspects of social performance; transparent terms; pioneering investments in new regions; client protection and environmental issues a focus in equity investment	
	Invests in some MFIs (30% of portfolio) that are not yet profitable	Substantial rural outreach, with systematic tool to measure at branch level (not at client level)

M-CRIL's Opinion

Financial performance

Reasons for investment	Issues/concerns
▪ Experienced management and skilled analyst team ▪ Good financial performance ▪ Comprehensive risk mitigation tools – skillfully applied	• High geographic concentration levels – CVSO in Bolivia/Peru; RIF in Bosnia, Kyrgyzstan – and simultaneous lending across funds to the same MFIs • Need to tighten portfolio monitoring

Social performance

Reasons for investment	Issues/concerns
▪ Systematic, comprehensive scoring tool (ECHOS) to screen investments on social performance, balancing financial assessment ▪ Pioneering investments in underserved regions ▪ Beginning to be proactive with investees on managing growth and client protection ▪ Positive feedback from investees, especially equity partners ▪ Introducing environmental issues with RIF investees ▪ Opportunities for small private investors (CVSO)	• Can deepen use of ECHOS for social reporting and monitoring specific issues such as client protection • Poverty issues stated as a social goal but poverty levels are not defined or tracked beyond proxies of loan size • Can adapt MIS to track investee performance over time • Scope to integrate guidance to debt investees as part of due diligence and monitoring

A rating score sheet is attached as an Annex file in excel. This scores the MIV on core dimensions of financial and social performance, and provides options to the user to apply weights to arrive at an overall score. For example, the user can increase or reduce the weights for social performance relative to financial, or adjust weights on specific dimensions.

NOTE: This is one of three pilot reports undertaken by M-CRIL, with support from Anthos Amsterdam and Swiss Development Cooperation, to develop a framework for MIV rating, covering both financial and social performance. The full preliminary rating report is on Incofin's website at http://www.incofin.be/en/knowledge_center/Detail.aspx?newsId=29

Incofin Investment Management			
Total Staff	**Non-OECD Staff**	**Years Active**	**Structure**
16	1 (India)	9	Cooperative with social objectives

Incofin Funds under Management			
Funds	**Total assets** (€ mln)	**Investors**	**Shareholders**
5 (including 1 only debt)	136	Financial institutions Labour unions DFIs, individuals	CVSO: 308 RIF: 39

Financial Snapshot

Compared with CGAP MIV benchmarks for 2009

Selected indicators		Incofin cvso (cooperative)	RIF (private placement funds – mixed) [a]	Benchmarks: Coops	Benchmarks: [a]PPF-m	Benchmarks: All MIVs
Net assets ($ million)		30.0	36.2	111.6	37.9	80.3
MFI investments/total assets, %		92.9	92.8	60.9	75.0	69.7
MFI investees (number)		30	23	87.9	15.3	29.7
Average investee	Assets	$47 million	$42 million			
Avg investment size,$	Equity	459,000	980,000	1.1mn	700,000	2.1 mn.
	Debt		125,000	800,000	1.5 mn	1.7 mn.
Average loan term, months		31.7	33.6	32.9	24.6	30.6
Outstanding investments,	Eqty	12	3			
	Loans	30	17 + 4 sub-loans			
Local currency assets, %		32.6	19.9	46.7	31.0	31.1
Countries in mf portfolio		22	17			
Return & Expenses						
Target return, %		None stated	Equity: 12 Mezz: IRS+2.5 Debt: LIBOR + 1			
Realised return, % NAV growth		2009: 4.2 5 years: 4.3	3.6	4.5	1.4	3.2
Expense ratio, %		1.53	3.0	4.0	2.2	3.1
Portfolio quality						
Loss provisions		4.2	2.5	3.3	3.2	2.0
Write-offs		0.0	0.0	0.5	0.5	0.1
Exposure, %						
Top 5 MFIs		36.0	33.0	11.4	50.0	35.7
Top 10 MFIs		51.6	55.7			

FINANCIAL PERFORMANCE RATING

1 Incofin organisation

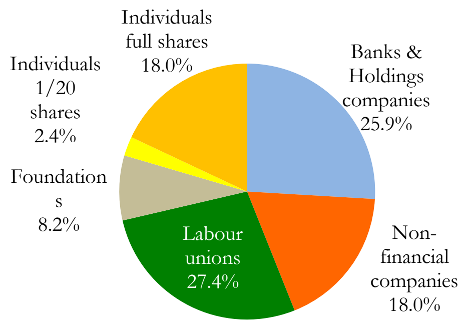
Incofin cvso was founded in 1992 as a cooperative with social objectives. Since 2001, it has been exclusively focused on microfinance and has undergone a period of expansion that has seen its assets under management grow from just under €900,000 to over €200 million today. With reorganization in mid-2009, the fund management activity of Incofin was spun off into a separate company Incofin Investment Management (IIM), which oversees four funds along with Incofin cvso. Combined, Incofin's four new funds grew its total assets under management (including CVSO) by 101% per annum over the past five years to €136 million as of year-end 2009 (though growth in 2009 was less than 6%).

2 Structure and corporate profile

This rating report focuses on two funds: Incofin cvso (CVSO) and the Rural Impulse Fund (RIF) though the two funds are not distinct since over half the MFIs in CVSO or RIF are funded by the other fund; a few by other Incofin funds.

CVSO is a cooperative which currently has 308 highly diverse shareholders. The top five shareholders hold 36% of share capital and consist of three financial institutions and two labour unions.

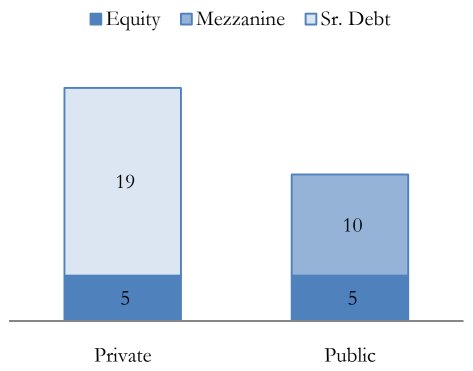
Figure 1 Shareholding pattern of CVSO (amount)



The fund also offers reduced share sizes (1/20th of share) to encourage individual investors, who comprise 20.4% of total capital, at the end of 2009 (**Figure 1** – full + 1/20th shares).

For the Rural Impulse Fund (RIF), the share-holding structure (**Figure 2**) differs substantially from CVSO, consisting of three tranches: equity, mezzanine notes and senior debt subscribed to by private and public investors (mostly DFIs).

Figure 2 RIF funding structure (US$ million)



The CVSO **board of directors** is entirely owner driven, with shareholders owning more than 100 shares automatically inducted into the board, currently consisting of 31 people. Thus the board includes individuals of different backgrounds reflective of the broad spectrum of the shareholders described above. Due to its size, the Board of Directors itself is rather unwieldy, so to facilitate organizational management, the board is constituted into executive, investment and audit committees.

RIF has a dual board structure, consisting of a supervisory board (7 persons) and a board of directors (3 persons). The former is responsible for strategy and overall supervision and meets twice annually, whereas the latter has more operational responsibilities. RIF also has an investment committee similar to that of CVSO.

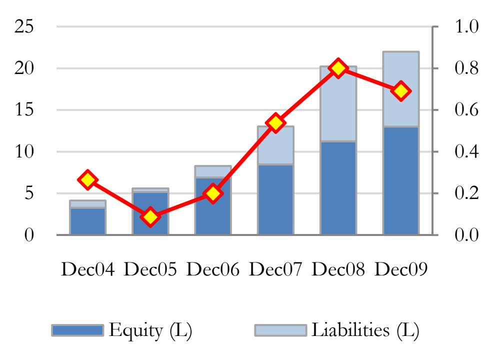
Incofin has a three-person senior management team with the staff consisting mainly of nine investment analysts, who specialize in either loan or equity deals. Unlike the loan analysts, the five equity analysts come from a commercial capital background, with only two having some experience in microfinance and socially-responsible investing prior to Incofin. On equity investments, the two analyst teams collaborate substantially, with equity analysts being responsible for the valuation and technical aspects, while the loan analysts take the lead in evaluating the organizational capacity of the potential investee.

The core defining element of Incofin's ethos is an insistence on practical assessment of both sides of the double bottom line. Incofin is one of the first MIVs to develop a scoring system for social return the same weight it does for financial sustainability. As with the financial risk score, the social score can disqualify a potential investee from further consideration. Another strong distinguishing element, applied to the RIF, is a focus on MFIs that serve rural areas.

3 Fund considerations

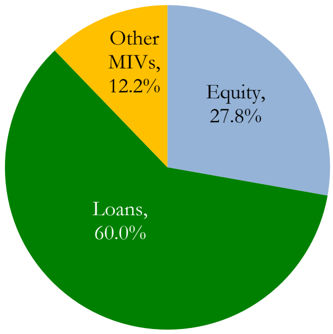
The growth of CVSO has been strong, with a compound growth rate of 40% during 2004-2009, although a significant part of that was due to increasing leverage. The compound annual growth rate of NAV over the same period was 31%.

Figure 3: CVSO growth (€ million)



The growth of CVSO has been fuelled by increasing leverage. CVSO has tapped debt more quickly than equity with the debt-equity ratio rising to 0.8 by December 2008 (**Figure 3**). The market downturn caused this ratio to decline in 2009, but this is likely to reverse in 2010.

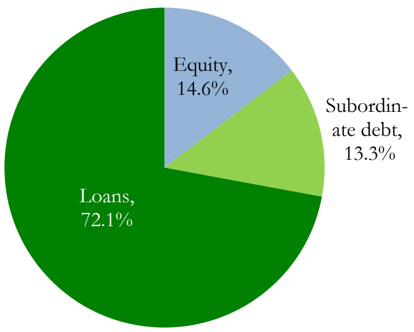
Figure 4: Asset composition: Incofin CVSO



CVSO and RIF are significantly more committed to equity investments than most other MIVs with VSO's 27.8% being particularly high (**Figure 4)**.

The RIF is more focused on debt though it also has a higher proportion of investments in equity (**Figure 5**) than other MIVs of its class (see table below figure).

Figure 5 Asset composition – RIF



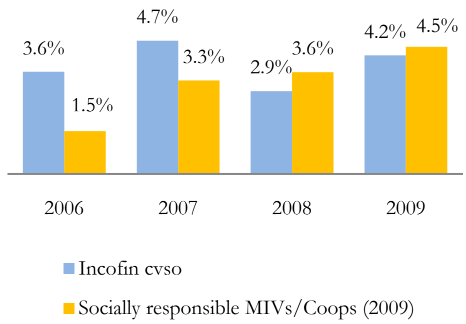
Benchmarks			
	Coops	PPF-m[a]	All MIVs
MFI Equity	6.0	8.6	9.8
MFI Loans	92.6	63.7	84.9
Other MIVs	1.1	27.7	5.3

a-Private placement funds – mixed as classified by the MIV survey

Incofin has competitive levels of efficiency relative to its peers: despite lower loan sizes than MIV averages, Incofin turns in a staff efficiency of €11.3 million of funds under management per employee, while its 9 Investment Managers are responsible for 8 MFIs each. The near doubling of Incofin's combined portfolio in 2008 (over 2007) means the operating expense ratio fell to 1.08% in 2008 from 2.14% in 2007. This compares with the Total Expense Ratio of 4.5% for MIVs established as cooperative companies reported in the CGAP MIV Survey for 2009.

The returns to CVSO have been variable (**Figure 6**). The average annual return since 2004 has been 4.4%, inclusive of dividends and general provisions. The fund's returns have actually exceeded the average returns of socially-responsible MIVs in two of the four years 2006-08 and (cooperative MIVs) in 2009 though returns include revenue from both its own portfolio as well as fee income for managing other funds, making direct comparisons with other MIVs misleading. For RIF, the return for 2009 was 3.6% (LUX GAAP), the low return being largely a consequence of a one-time increase in general provisions by 1.5% to a maximum of 2.5% provided by the fund's prospectus.

Figure 6: Annual Returns



The CVSO management fee amounts to 1.75% on debt investments and 2.5% on equity investments per year. For RIF, the prospectus indicates a management advisory fee formula yielding around 2.15%. However, in 2009, the management fee on the average outstanding assets was 1.84%. Including additional management-related fees (custodian fee, audit, etc.), the combined fee is 2.38%. For investors, the financial upside of CVSO is limited to a modest dividend, currently at 2% and expected to remain at that level. For RIF, the fund's track record has not been long enough to forecast a return.

4 Market positioning

CVSO and RIF are positioned to invest across the MFI tier categories, with around 50% of total portfolio in Tier 2 and Tier 3 MFIs, (those with total assets below US$30 million), accounting for 64% of investees for CVSO and 55% for RIF

The geographic distribution of the portfolio across funds is relatively consistent with peer-group MIVs though with a particular emphasis on Latin America by CVSO, and the former Soviet Union by RIF (**Figure 7** & table below).

Figure 7a Regional concentration, CVSO

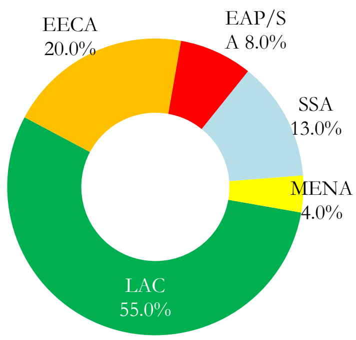
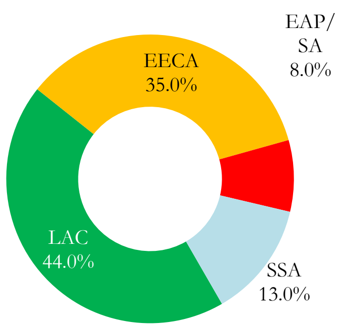


Figure 7b Regional concentration, RIF



Benchmarks			
Regional Concentration,%*	**Coops**	**PPF-mª**	**All MIVs**
LAC	42.2	37.7	36
EECA	22.9	43.6	43
EAP/SA	22.9	12.6	15
SSA	11.4	5.7	4.3
MENA	0.7	0.4	1.8

* MIV peer group data includes fund investments, and therefore does not add up to 100%

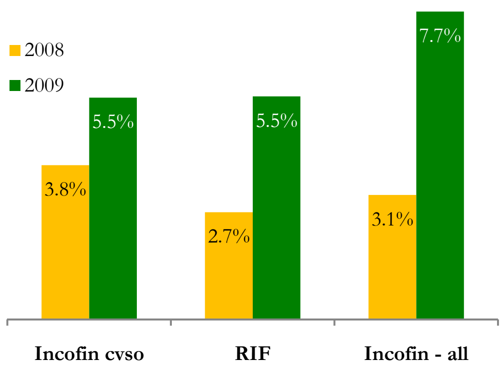
Incofin makes significant investments in local currency, which comprises 33% of CVSO portfolio and 20% of RIF. However, these are held mainly via equity or quasi-equity. CVSO is a relatively small fund (around US$30 million), within the cooperative companies MIV cohort while RIF's $36 million is just below the average for mixed private placement funds.

5 Risk management

Incofin cvso does not conduct internal audits, which is appropriate relative to the organization's size but, in the case of RIF, the fund is administered by an outside custodian who has full audit functions and oversight as a regulated financial entity. Within Incofin, well defined procedures and an active separation of roles is regularly practiced. The investment guidelines are well-specified, and each investment requires approval by the Investment Committee designated by the fund's board.

Like many MIVs, Incofin's performance across its family of funds has suffered in 2009, as MFIs in a number of markets have seen increases in delinquent loans. However, that decline has not been identical across the Incofin funds with CVSO and RIF significantly outperforming the rest (**Figure 8** wherein PAR30 equals Portfolio at Risk at 30 days; Restrict – restructured loans .)

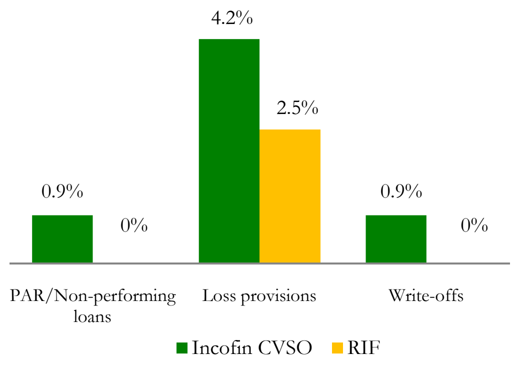
Figure 8: MFI portfolio declines
PAR30 + restruct + write off, wgt by exposure)



Both funds are well provisioned relative to the risk in their portfolios. (**Figure 9**).

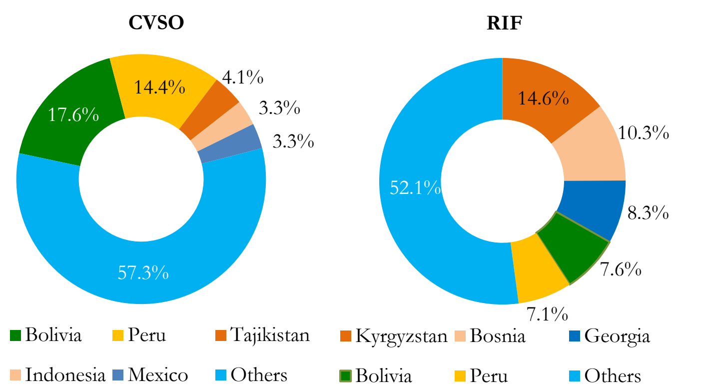
Nicaragua and Bosnia are two markets where MFIs in the CVSO and RIF portfolios are in severe distress. However, the three MFIs themselves have support from their shareholders and other sources of capital and the combined exposure to these is limited at 5.1% of CVSO and 7.4% of the RIF portfolio. Consistent with this increase in delinquency, Incofin MFIs have shown a strong decline in growth, with the median MFI's portfolio growing just 7% in 2009 (41% in 2008).

Figure 9: Portfolio indicators



Both funds appear to be more concentrated even than their size would suggest: of CVSO's 35 investments, the top three (all MFIs) represent 25.6% of the fund's assets. In RIF, the top five MFIs account for 33% of assets. Concentration of CVSO assets is of particular concern at the country level, where Bolivia and Peru comprise 32% of the total (**Figure 10**).

Figure 10: Country concentration



The fact that they are neighbours that share significant market characteristics as well as macroeconomic and poverty trends makes the concentration more notable. Though RIF has country concentration levels lower than CVSO, its exposure to the top two countries is still high: Bosnia (10.3%) currently has a severe delinquency crisis while Kyrgyzstan (14.6%) has an unstable political environment. Georgia (8.3%) too poses a potential risk from its dispute with Russia.

Incofin does, however, have a number of risk mitigation measures in place including a unique country risk insurance that has helped cover most of its losses in Nicaragua (recently) and Haiti (earlier). However, portfolio monitoring could be strengthened through a consolidated consideration of the funds' portfolio quality and asset/liability management. These are currently considered only at the investment manager level.

6 Financial assessment, investee level

The performance of the portfolio MFIs of the two funds is good with a weighted average return on assets of 1.50% and 1.55% for CVSO and RIF respectively. These compare with a median performance of 1.53% for all MFIs in the MIX database for 2009 and 2.75% for financially sustainable institutions in that year.

Similarly, the portfolio quality indicators for the Incofin funds – around 5.5% PAR_{30} – are not far from the MIX indicators, 4.8% for all MFIs and 4.0% for financially sustainable institutions in 2009.

The capital adequacy ratios and ratio of loan loss reserve to PAR were not collected at this (pilot) stage of the MIV rating but will be obtained when future ratings are undertaken.

The Incofin funds' investments amount to very small proportions of the funds of portfolio MFIs – average 2.38% in the case of RIF and just 1.32% for CVSO – limiting the risk to MFIs from the concentration of fund sources.

Social Performance Snapshot			
Compared with CGAP MIV Benchmarks for 2009; CC= Cooperative Companies/NGOs; PPF= Private Placement Funds (CGAP Peer Groups) ; Information in [ ]=MIX social performance median for all reporting MFIs-2008			
Mission CVSO	Developing microfinance initiatives that have demonstrable social impact		
Mission RIF	Financial services to the rural poor; contributing to alleviation or rural poverty		
Social Performance- MIV level		**Social Performance- Investee level**	
Social indicators reported	Overall ECHOS scores, Rural location, Loan use, Women clients, Av. loan outstanding	Legal Form	NGO 33%, Coop -, NBFI 62%, Bank 5%
MFI categories	Tier 1- 50% Tier 2 Tier 3	Total investee clients	CVSO 2.08 m RIF 1.44 m
SP Due diligence	Yes, Echos Scorecard covers key dimensions of SP	MFI loans usage by sector	CVSO / RIF Non Farm 75% / 53% Agriculture 18% / 37% Other 7% / 10%
SPI Tool used	Social Rating-9 investees	Reported drop-out rates	64% report >20% [24%]
Technical guidance	Active in case of equity investments (CPP and environmental risk mgmt.)	MFI Portfolio Yield	CVSO 33% RIF 30%
MIV endorses CPP	Signatory of Smart Campaign	MFIs reporting compliance on CPP	80%

Outreach	Cvso	Rif	CC	PPF	MI V		Cvso	Rif	CC	PPF	MI V
Rural clients	37%	58%	60%	49%	45%	Women*	75%	83%	77%	73%	64%
Investee O/S Loan Amt	$684*	$517*	$756	$925	$1,259	Financed clients (000's)	44	47	210	33	84

*Weighted by investee total clients

SOCIAL PERFORMANCE RATING

The approach and systems to support social performance are the same for Incofin's different funds. These are therefore assessed at the institutional level of the fund manager. Social objectives and outreach results are assessed separately for the two funds.

FUND MANAGER - INCOFIN

Institutional approach to social performance

Balanced and integrated approach

Incofin has a clearly stated double bottom line orientation that it applies to all funds under management, aiming to maintain commercial terms of investment while supporting the social goals and values of microfinance.

Incofin was among the very first microfinance investors to establish an approach to social performance measurement, for screening and annual reporting, to balance the financial performance assessment of MFI investees. The score card has evolved to represent a triple bottom line approach, including client protection and environmental issues. All investment analysts are trained to apply the tool (ECHOS ©) to collect validated information from investees. The tool is publicly available.

The tool – and the investment analysts (though not the equity team) – are mostly up to date with current initiatives in social performance. ECHOS covers 5 dimensions of social performance, as seen in **Table 1**, with highest weight to quality of customer service (which includes range of products, market research along with client protection issues).

Table 1: Incofin – ECHOS score card

	Weights
Quality of customer service	30%
Outreach and access	25%
Human resources	20%
Environment and CSR	15%
Social mission and vision	10%

Incofin uses the ECHOS reports along with investee Counterpart Risk Scores (financial assessment) to profile the scores and analyse the correlation between 'social and financial' performance'. This analysis is published and is a useful contribution to the sector. The analysis indicates a positive correlation, though this has to be qualified by the apparent overlap between some of the 'financial' and 'social' indicators (range of products, HR, growth projections are in both CRS and ECHOS).

Incofin is an active member of the Social Performance Task Force.

Mission orientation – social goals

Mission reflects accepted social goals; partially monitored

"Incofin invests in sustainable microfinance institutions that provide well adapted financial services to small local enterprises and emphasize high social added value. Incofin supports MFIs that help enterprising people to set up their own businesses, improve their living conditions and thus break the vicious circle of poverty."

Incofin Annual Report 2006

Incofin's mission statement reflects the broad potential of microfinance. Different annual reports have referred to microfinance targeting people who live on less than US$1/day, with a variety of customized financial products, apart from micro-enterprise credit such as savings, micro-insurance, loans for education, housing or starting a small business.

However, Incofin does not have specific goals and objectives for poverty outreach or range of services, nor does it monitor and report on these directly. The ECHOS tool includes related indicators, though with only a proxy for depth of outreach (minimum loan size).

Client protection

Prudent and quite active approach; ECHOS tool needs strengthening to capture client protection issues

A signatory to the Smart campaign, Incofin supports application of the six principles for client protection. These are partially included in ECHOS for all investments; for equity investments they are now included in the terms sheet and shareholder agreement, and there are clear examples of Fund Advisors taking specific steps at the Board level of MFI investees.

In recent country situations (in Nicaragua and Bosnia) of high growth and aggressive competition between MFIs Incofin has taken steps to coordinate a prudent response by all investors involved. Learning from this experience, Incofin has begun to advise MFIs in other countries too against 'very high' portfolio growth rates. Incofin is still to develop a consistent policy on recommendations for growth, to balance the aim for financial inclusion with a prudent approach to systems development, inclusive outreach and quality services.

Incofin is an investor in the publicized case of an MFI from Nigeria which received a negative rating on account of illegal savings, very high and non-transparent pricing. Incofin responded with a letter to its MFI investee, but it is instructive that the negative aspects were not reflected in the ECHOS scoring for this MFI.

In terms of costs to end clients, Incofin monitors the financial data for yield on portfolio at MFI level. This is compared with the cost drivers (cost of funds, operating expenses and loan loss provision), to calculate and monitor the yield margin.

Incofin collects information on the salaries of investees, but (as in the industry overall) is yet to form a policy on an appropriate level of CEO salary.

Other social responsibility

Human Resources (HR)/employee issues for investees: questions on HR are included in the ECHOS and cover key elements of effective HR systems (HR designated manager, policies, delegation, non-discriminatory policies, fair remuneration to staff, training opportunities and staff retention). The average investee score for HR (81%) is the highest of the five dimensions covered in ECHOS. Nevertheless this is an area that may need attention in future.

There is no monitoring of investee staff gender profile.

Within Incofin, women's representation on the Board at 16% is above the Belgian average (7%); and in management/investment team at 25%, just below the Belgian average (30%)

Outreach at investee level to number of women clients is monitored, but there is no further gender analysis or perspective.

Environment and community: on the ECHOS score card this is the least scoring dimension (46% average for CVSO/RIF investees). Three members of Incofin's investment team have completed the course on Environmental and Social Risk Management, developed by FMO with a focus on health, safety and environment issues for financed enterprises. Under RIF the tools are being shared with investees, and some MFIs are beginning to introduce these elements into their loan appraisal process. At a minimum, MFIs agree to and sign an exclusion list (as developed by IFC). Beyond this, Incofin notes a lack of expertise with MFIs, which they are trying to address in case of equity investees.

Emergency response: CVSO is one of few foreign investors in Haiti. After the earthquake in January 2010, Incofin launched an internet campaign, was able to leverage grant support in Belgium to provide grant support to its investee in Haiti

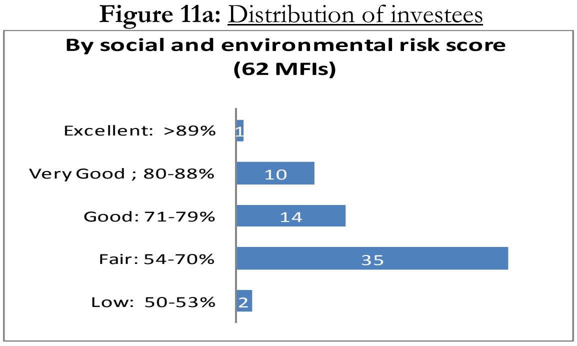
Investment processes and social value

Robust processes

Screening process: Incofin accepts an MFI for investment if it scores over 50% on both financial indicators (CRS) and social indicators (ECHOS). MFIs scoring less than 50% are not accepted. (Two MFIs have been rejected – they scored over 50% on financial but under 50% on social. They went to other investors. Please see **Figure 11a & 11b**.)

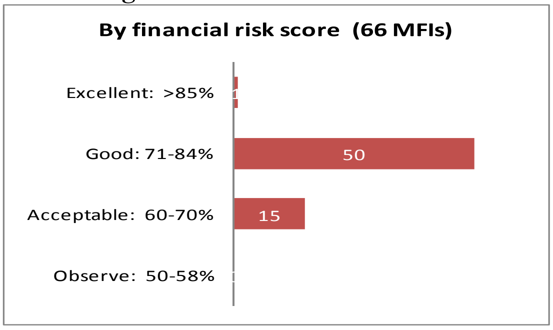
Data for the current pool of funds shows lower average MFI scores on social performance (majority below 70%) compared to financial performance (majority above 70%).

Figure 11a: Distribution of investees



[Incofin categories: 'excellent' – 'low']

Figure 11b: Distribution of investees



Investment terms: Incofin emphasizes professional interaction with investees and a customer oriented approach with agreements (whether debt or equity) tailored to the requirements of the MFI. This is reflected in practice.

- Loans: tenure ranges from 1-5 years, average 2.6 years (longer tenure supports stability for the investee). Repayments - principal may be bullet (single payment) or amortized, with interest paid quarterly of half yearly. Apart from RIF investment which specifies no reduction in rural outreach, there is otherwise no social covenant, but Incofin is reviewing how to include this.
- Equity is undertaken with an expected IRR of 12-15%. Social covenants include reference to client protection principles and environmental risk management. Incofin requires a board position, and for this engages with local representatives so as to maintain participation in meetings.

Engagement with investees: Incofin sees some degree of guidance to investees taking place through the due diligence and reporting process – with reference both to financial performance and to social performance through the ECHOS score card. This may or may not take place in case of debt, depending on the staff involved. As an equity investor, with representation on the Board, there is a clear and strong approach to guiding the MFI. Specific initiatives include introducing the Client Protection Principles and elements of environmental and social risk management (as noted above), and advising for a Social Rating.

Reporting: Incofin annually updates the ECHOS scorecard for all its partners, involving its own staff in collecting and verifying the information. This makes for quite robust and consistent social reporting. Public reporting is based on aggregate analysis – of the dimensions and the overall portfolio. There is scope for disaggregated analysis on specific indicators and to track change over time for investees, to give a clearer profile on key issues as well as the evolution of MFIs. This should include % MFIs with repeat investment to document a continuing relationship with investees.

Investees - feedback

Very positive feedback – with some suggestions

This rating included an on-line questionnaire to MFI partners of CVSO and RIF. 23 (out of total 45) MFIs responded. (**Table 2**)

The feedback is very positive, especially from (5) equity partners. On a scale of 1-5 (5="strongly agree"), the overall average score is 4.3 (4.6 for equity investees, 4.1 for debt investees). MFIs value the relationship with Incofin and the professional and quick approach to due diligence, though there are some mixed responses on shared values, suggesting a less than consistent message.

Asked about the relative importance of financial and social, the average perception of equity investees is balanced at '50:50'. For debt investees the balance is tilted to financial ('63:37'). This is reflected in the reported conditions for investment with under half mentioning social indicators; less than 35% mentioned poverty outreach, effective client protection and diversification of products. Most of the equity investees reported Incofin engagement on issues of governance, operational systems, addressing competition, client protection and tracking impact. Over half of debt investees reported engagement on improving operational systems; under half reported engagement on other issues, including social performance.

Table 2: Investee Feedback

Statements - agreement on scale 1-5 Incofin…	**Score** (range)
Application process was straightforward	**4.5** (4-5)
Fair negotiation setting terms of investment	**4.5** (4-5)
Transparent financial terms (charges, earning, time-frame)	**4.8** (4-5)
Reasonable conditions in investment agreement	4.2 (3-5)
shares my institution's values	**4.6** (3-5)
cares about my staff	3.5 (2-5)
cares about my clients	3.8 (2-5)
cares about environmental issues	3.9 (2-5)
Straightforward reporting - financial indicators	**4.6** (3-5)
- social performance indicators	3.6 (2-5)
Compared to other sources of capital, the relationship with Incofin important to my MFI	**4.4** (2-5)
I recommend Incofin as a funding provider	**4.4** (3-5)
Overall	4.3

Open-ended feedback about what investees like about Incofin highlights the professional business relationship, the transparent and fast approach to concluding transactions, and good monitoring in **Tables 3 & 4**.

Table 3: What I like most about Incofin

- ✓ Understanding my institutional requirements
- ✓ Knowledge of microfinance
- ✓ Speedy transactions
- ✓ Transparency
- ✓ Professionalism
- ✓ Plays the partnership role well
- ✓ Trust and cordiality
- ✓ Willingness to fund – where others are cautious
- ✓ Non-bureaucratic approach
- ✓ Good monitoring process
- ✓ Participates in solving problems

Table 4: How Incofin could serve me better

Main
- ⇒ Technical assistance, workshops, training, internships for MFI staff
- ⇒ Provide debt in local currency

Other
- ⇒ Lower fees/interest rates
- ⇒ Information and experience-sharing through the website or quarterly reports
- ⇒ Support for methodologies to reach the poorest

Investees – social performance systems

The existence and strength of social performance management (SPM) at MFI level, is increasingly recognized as part of effective management, and relevant to ensuring social returns at the level of the end clients. This data is included in Social Performance Standards reporting to the MiX which will serve to provide benchmark information in future.

Incofin, uniquely, through the ECHOS system, has relevant information though this data is not specifically analysed by Incofin. It is used to profile MFI investees of CVSO and RIF in **Tables 5 & 6** below. (ECHOS data for 39 investees was available.)

Table 5: SPM profile of investee MFIs

SPM systems - %MFIs	*Yes*	*Partially*
⇒ Policies/procedures to target poor people	21%	
⇒ Measure fulfillment of mission in some way	28%	31%
⇒ Assess client satisfaction/ exit surveys	85%	
⇒ Can measure client exit rate	92%	
⇒ *Had social rating or audit (prev. 2 yrs)*	9 (23%)	

Table 6: CPP adherence of investee MFIs

Adherence to client protection principles - % MFIs	*Yes*	*Partially*	*No*
⇒ Policies to address over-indebtedness	41	54	5
⇒ Policies for transparent communication with clients	69	26	5
⇒ Guidelines for appropriate collection practices	15	56	28
⇒ Ethical codes of conduct for staff	62	3	36
⇒ Responsive mechanisms for client complaint	51	23	26

FUNDS – CVSO & RIF

CVSO and RIF are more socially oriented than the other Incofin funds in terms of smaller size of investment, outreach to less developed regions, to less profitable (CVSO) and to rural (RIF) MFIs.

Objectives of the funds

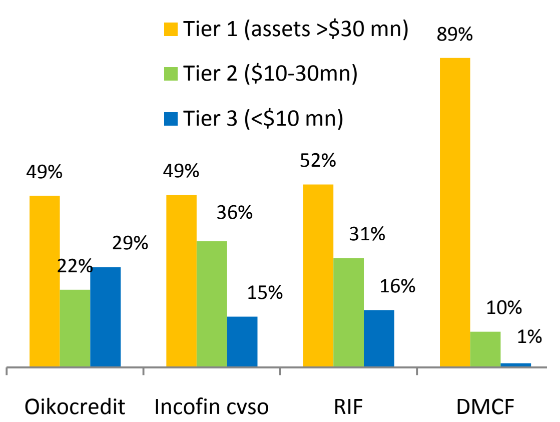
Table 7: Fund objectives

CVSO	*RIF*
Same mission as Incofin overall (page)	To contribute to the alleviation of poverty in rural areas underserved by the microfinance industry, providing debt and/or equity financing to MFIs which provide financial services to the rural poor
Geographic outreach: Developing countries	25% of fund (after 3 years) in Africa, Caribbean and Pacific, principally sub-Saharan Africa
MFIs Urban and rural	MFIs with at least 20% rural branches
Tiers 1-3 Include early stage, non-profitable MFIs	Tiers 1-3
Portfolio > $1.4m	Portfolio >$2.8m

Investees – pattern of MIV investment

Tier 2 and Tier 3 MFIs comprise around 50% of investees of both funds. Though the MIV survey does not provide a benchmark, comparing with the other pilot rating MIVs, CVSO and RIF have a similar level of focus on Tier 2 and Tier 3 investments as Oikocredit, though comparatively lower focus on Tier 3 (**Figure 12**). Outreach to Tier 3 and Tier 2 represents substantial social value.

Figure 12: Size distribution of MIV investee MFIs



Figures 13 & 14 analyze outreach to different countries by level of development, as measured by the Human Development Index (HDI). Trend data for CVSO and RIF combined shows expansion in countries of Medium Development > 0.700. This reflects increasing investment in Latin America, Eastern Europe and Central Asia.

Figure 13: Portfolio Distribution by HDI

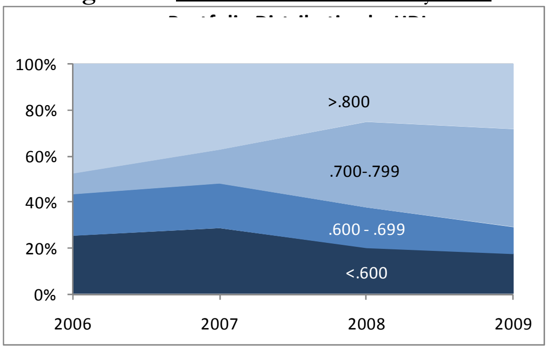
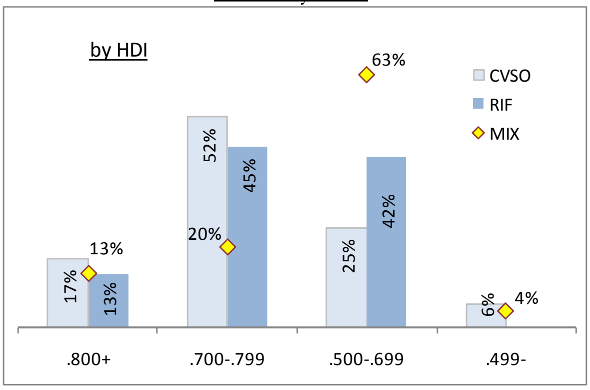


Figure 14: Distribution of MIV supported end-clients by HDI



Note: Calculation of supported end-clients = MFI total clients * (MIV amount invested/MFI total assets)

Similarly, the majority of supported end clients are in countries of medium-high development. This compares with a majority of overall MFI clients, as reported to the MiX, being in countries of medium-low development (0.500-0.699) in S Asia and Africa. 42% of end-clients supported by RIF are in such countries. CVSO has 31% of its clients in low developed countries including 6% in the poorest countries of sub-Saharan Africa (<0.500).

Investees – structure and portfolio information

Incofin data on investee legal form, services and portfolio is summarized in the following **Tables 8-10**. [Note: this data is treated as descriptive profiling; it is not scored as part of the rating]

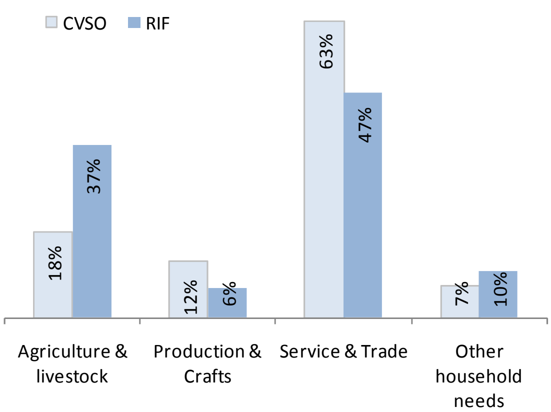
Table 8: Legal form and services offered

	% MFIs	*CVSO/RIF*	*MIVs*
Legal form:			
NBFI		62	
NGO		33	
Bank		4	
Cooperative		-	
Services offered:			
different credit products		92	
other financial products		49	
non-financial services		41	45

The majority of investees are NBFIs with a few Banks. Nevertheless, one-third are NGOs. Most offer more than one type of credit product. Over half offer other financial services (savings or insurance). And 41% link their clients to non-financial services (such as business development, medical programmes) though there may be varying access by clients.

Reported data on loan use by end clients in **Figure 15** provides a broad pattern of loan use, since actual use is known to be fungible (used for particular needs that a household faces at the time of accessing credit). Both funds report highest loan use in typical microcredit activities – trade and services. RIF reflects substantial use in agriculture and livestock.

Figure 15: Client Loan Use (by amount funded)



CVSO and RIF investees are substantially below the MIV benchmark for average loan outstanding to end clients.

Table 9: Average Loan Outstanding

MFIs'	*CVSO*	*RIF*	*MIVs*
Average loan outstanding	684	517	1,259

Average yield for MFI investees (which is a proxy for cost to end clients) appears relatively high, particularly for RIF – and especially in African investees (46%). This may be due to smaller loan size, as well as to more rural outreach – but requires closer monitoring by the MIV.

Table 10: Average yield

MFIs'	CVSO	RIF	MiX
Average yield on portfolio	32%	36%	27%

Investees and end clients – outreach of the funds

Substantial outreach to rural clients, and to women

Overall outreach, based on the total number of MFI end clients is just over 2 million for CVSO and 1.4 million for RIF as seen in **Table 11**. Adjusting this to reflect the relative contribution of the funds to an MFI, the number of end clients 'financed' by each MIV is around 45,000.

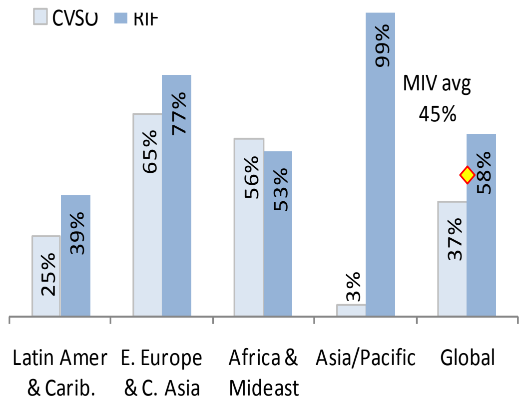
Table 11: MIV End-clients and portfolio

End clients	CVSO	RIF
Total MFI end clients	2.08m	1.44m
End clients 'financed' by MIV	44,220	47,055

Calculated following the MIV benchmarks (2009), as outstanding MIV investment/average loan outstanding

Data on rural outreach for CVSO and RIF investees is based on the location of MFI branches, recorded by Incofin as a Rural Point of Sale (POS) proportion. RIF averages 58% rural branches, compared to CVSO's 37%. This compares with the MIV average (reported for 49 MIVs with such data – out of 73) of 45% rural clients. Rural outreach is highest in Asia and EECA; lower in LAC. (**Figure 16**).

Figure 16: Rural outreach



Data on outreach to women shows a high proportion – RIF at 83%, CVSO at 75% - compared to the MIV average of 63%, and around the average of MFIs reporting to the MiX (76%).

Limited additional information

Incofin (as other MIVs) does not have information about poverty level of end clients when they join an MFI – or over time. It does collect some information on client exit through ECHOS, which can be used as a proxy for client satisfaction and appropriate microfinance services. The ECHOS reports indicate a relatively high exit rate with 64% of CVSO/RIF investees reporting an exit rate of more than 20%. This is on par with MFIs reporting to the MiX Social Performance Standards, who had an average client exit rate of 27%, reflecting a high figure for the sector overall. Though, Incofin applies a slightly different formula which understates the exit rate in comparison with the MiX formula.

APPENDIX 1: INCOFIN cvso
Restrictions on Capital Use

Concentration risk:

a) The Fund will finance no more than 10% of the portfolio of any investee.
b) The Fund will concentrate no more than 15% of its own portfolio in any investee.

Duration risk:

c) The Fund limits debt instruments to a maximum tenor of five years.

Equity instruments risk:

d) The Fund will be an equity shareholder (preferably an active minority shareholder) of no less than 5% of any investee's equity.

Geographic risk:

e) The Fund concentrates no more than 20% of it own portfolio in any country.

Instrument risk:

f) The fund concentrates at least 75% of its own portfolio in debt instruments.
g) The Fund concentrates no more than 75% of its own net asset value in direct MFI equity and other MIV (Fund-of-funds) investments.
h) The Fund will concentrate at least 80% of its own portfolio in the microfinance sector (and conversely no more than 20% in the SME-finance sector).

Social commitment

i) The Fund may only invest in those organizations which receive social performance scores ("SPS scores")[1] equal to or above 50 (out of a possible 100).

Leverage risk:

j) The Fund may borrow no more than 100% of its own net asset value at any one time.

[1] Based on Incofin's proprietary social performance measurement tool, known as Incofin ECHOS©

APPENDIX 2: Rural Impulse Fund Investment guidelines and restrictions on capital use

Pursuant to its *Investment Policy, Issue Document, Advisory Agreement* and *Investor and Shareholder Agreement*, the Fund is bound by the following investment guidelines and restrictions on capital use:

Concentration risk:

a) The fund will acquire no more than 49% of the voting stock of any MFI (unless it is deemed necessary to facilitate its own exit strategy).

b) The Fund will concentrate no more than 10% of its total assets in any investee.

Duration risk:

c) The Fund's equity investment time horizon, and the Fund's loan tenor, will not exceed the lifetime of the Fund.

Financial risk

d) The Fund's MFI investees must meet all eligibility requirements of the Fund's investment selection criteria for Rural MFIs.[11]

Geographical risk:

e) The Fund will concentrate no more than 20% of its total assets in any country.

f) The Fund will invest a minimum of 25% of its total assets in Latin America.

g) The Fund will endeavor to invest a minimum of 25% of its total assets in Target ACP States[12], with a minimum amount of $3,500,000.

Instrument risk:

h) The Fund's individual investment transactions will range in size from $500,000 to $2,000,000; the Fund may make multiple transactions in the same MFI at the same time (pursuant to restriction "a" above).

i) The Fund will invest no more than 50% of the proceeds from its issuance of shares into MFI equity investments. (This may be increased up to 100% in exceptional circumstances).

j) The Fund will invest no more than 50% of the proceeds from its issuance of shares into MFI quasi-equity investments.

k) The Fund's combined equity and quasi-equity investments are limited to a maximum 23.7% of total assets.

l) The Fund will concentrate no more than an amount equivalent to the sum of the mezzanine and senior debt (of its liabilities) in direct loans to MFIs.

m) The Fund will extend guarantees to MFIs for no more than $6 million in total.

Leverage risk:

n) The Fund may borrow no more than 90% of its own MFI investment at any time so long as the Loan Loss Reserve is under 2.5%; no more than 100% when the Loan Loss Reserve exceeds 2.5%.

o) The Fund's maximum total capitalization is limited to $38 million: $19 million in Senior Debt, $10 million in Mezzanine Notes and $9 million in Shares.

Liquidity risk

p) The Fund will maintain a separate reserve into which it will debit an overall provision of 0.5% of its Portfolio each year, until a balance equal to 2.5% of the Portfolio, is reached.

Foreign currency risk

q) The Fund may structure its equity and quasi-equity investments in local currency. In such instances, the Fund agrees not to expose the MFI to any foreign currency risk. Instead, the Fund accepts the full foreign currency risk exposure itself.

r) The Fund will not disburse senior loan facilities with local currency exposure and seeks to mitigate the FX risk for the MFIs by using several FX hedging techniques and instruments.

[11] See the Fund's *Investment Policy* for further details.
[12] See the Fund's *Investment Policy* for further details.

Abbreviations

AGM	Annual General Meeting (of members/shareholders)
CGAP	Consultative Group to Assist the Poor (division of the World Bank, focusing on microfinance)
CPP	Client Protection Principles
CVSO	MIV managed by Incofin IM
EAP	East Asia and the Pacific
DFI	Development Finance Institution
EECA	Eastern Europe and Central Asia
EIR	Effective Interest Rate
FSU	Former Soviet Union
HDI	Human Development Index
HR	Human resources
IIM	Incofin Investment Management (the management company formed in 2009)
CVSO	Cooperative with social objectives (since 2009 an MIV managed by IIM)
IRS	Interest Rate Swap
LAC	Latin America and Caribbean region
LIBOR	London InterBank Offered Rate
LUX GAAP	Generally Accepted Accounting Principles of Luxembourg
MENA	Middle East and North Africa
MFI	Microfinance Institution
MIV	Microfinance Investment Vehicle
MiX	Microfinance Information Exchange (global platform for microfinance reporting)
NAV	Net Asset Value
NPL	Non-Performing Loans
OECD	Organisation for Economic Cooperation and Development
OER	Operating Expense Ratio
OSS	Operating self-sufficiency
PAR	Portfolio at Risk
RIF	Rural Impulse Fund (MIV managed by Incofin IM)
SA	South Asia
SPS	Social Performance Standards (reporting to the MIX)
TA	Technical Assistance

Brief Glossary

NAV	Net Asset Value: Total value of assets of the fund minus liabilities divided by the number of shares
OER	Operating Expense Ratio: Cost of conducting operations as a proportion of the average portfolio managed during the year – it excludes financial and loan loss provision expenses
PAR	Amount of portfolio outstanding in all loans that are delinquent (at any point in time) as a proportion of the total outstanding portfolio on that date – usually measured (in microfinance) by classifying loans more than 30 days overdue as delinquent
Yield	(or portfolio yield) Income earned on the loan portfolio as a proportion of the average portfolio outstanding during the year – includes interest earned on loans, fees and commissions charged for servicing the loan.