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REVIEW OF DCA CREDIT GUARANTEE FOR MFI ACCESS TO COMMERCIAL CREDIT IN MEXICO: THE UNIÓN PROGRESO CASE

microREPORT #82

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This publication was produced for review by the United States Agency for International Development. It was prepared by Barbara Magnoni of Banyan Global, with input from John Jepsen, Andrew Iappini, and Nathanael Bourns of DAI.

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FOREWORD

This review was funded by USAID's Office of Microenterprise Development under the DAI/AMAP Financial Services Knowledge Generation (FSKG) Task Order. Its purpose was to (i) assess the usefulness of USAID's Development Credit Authority (DCA) credit guarantee mechanism as a programming tool to help a microfinance institution (MFI), Unión Progreso, formally integrate into Mexico's financial systems, and (ii) document observations that will help USAID missions improve future wholesale DCA guarantees for MFIs. This review was conducted in cooperation with a review of DCA loan portfolio guarantees by the USAID Office of Development Credit, as well as a concurrent research effort led by the Consultative Group to Assist the Poor, which is analyzing credit guarantee schemes for wholesale loans to MFIs. A desk review formed the basis of this report.

The Office of Microenterprise Development is planning two additional site-visit reviews of DCA guarantees to complement this review. All reports will ultimately serve as inputs into a "best practices" guide for USAID missions. The objective of the guide is to inform and assist missions in designing and managing DCA guarantees for MFIs seeking access to commercial funding and capital markets.

The Accelerated Microenterprise Advancement Project (AMAP) is a four-year contracting facility that USAID/Washington and missions can use to acquire technical services to design, implement, or evaluate microenterprise development, which is an important tool for economic growth and poverty alleviation.

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ABBREVIATIONS

AFIRMA	Acceso a las Finanzas Rurales para la Microempresa
CACP	Cajas de Ahorro y Crédito Popular
CNBV	Comisión Nacional Bancaria y de Valores
DCA	Development Credit Authority
FOBAPROA	Fondo Bancario de Protección al Ahorro
FIRA	Fideicomisos Instituidos en Relación con la Agricultura
LG	loan guarantee
LPG	loan portfolio guarantee
MFI	microfinance institution
MMS	Mexico Microenterprise Strategy (USAID)
ODC	USAID Office of Development Credit
PG	portable guarantee
PRONAFIM	Programa Nacional de Financiamiento a la Microempresa (National Program for Microenterprise Finance)
SFP	Sociedad Financiera Popular (Deposit-Taking MFI)
SOFOLE	Sociedades Financieras de Objeto Limitado
SMEs	Small and Medium-Sized Enterprises
UP	Unión Progreso
USAID	United States Agency for International Development

EXECUTIVE SUMMARY

As a middle-income country, Mexico is not a traditional recipient of USAID assistance. However, because it is the world's 11th largest economy and the United States' second-largest trading partner, Mexico holds great significance for U.S. interests. Despite its economic, cultural, and geographic ties to the United States, not all Mexicans are reaping the benefits of extensive trade and international visibility. The growing inequality in the distribution of benefits has prompted USAID support for pro-poor economic interventions, including support to Mexico's microfinance industry. The evolution of microfinance in Mexico has been shaped by USAID institutional and industry-wide technical programming, including two Development Credit Authority (DCA) partial credit guarantees to catalyze wholesale lending to microfinance institutions (MFIs) structured in 2001. One USAID DCA deal was made directly with an MFI, FinComún, to partially guarantee loans to microentrepreneurs. The other, and the subject of this review, was a portable credit guarantee enabling *the union de crédito* (credit union) arm of the Unión Progreso (UP) to access wholesale finance from commercial sources for on-lending. Such access to commercial finance was intended to create a source of funding enabling UP to grow sustainably.

Simultaneously with both DCA deals, the Government of Mexico initiated efforts to regulate an extremely fractured and unsupervised network of over 680 institutions providing credit, and often savings services as well, to microentrepreneurs. This move was oriented towards regulating deposit-taking activities of the various MFIs and credit unions in the country. In this context, microfinance in Mexico is slowly formalizing. However, it is unclear to what extent USAID DCA guarantees helped contribute to overall microfinance development.

This review finds that while the UP guarantee facilitated access to limited formal finance, the effects of the guarantee on the credit union's sustained transition to private funding are indiscernible. However, the experience provides lessons to USAID missions considering similar DCA guarantees. One primary take-away is that DCA works best when the goals of the guarantee complement the goals of the partner financial institutions. Conclusions and recommendations for improving similar DCA guarantees in support of MFIs are presented at the end of this report.

1. OVERVIEW OF MFI CAPITAL MARKET DYNAMICS IN MEXICO

In 2001, USAID/Mexico approved a $1 million DCA portable guarantee (PG) for wholesale commercial credit to Unión Progreso (UP), a credit union in the state of Chiuahua. The PG was later converted into a loan guarantee (LG) with the El Paso branch of Wells Fargo, a large commercial bank based in the United States. The dynamics of access to funding for microfinance institutions (MFIs) in Mexico, and the series of government interventions surrounding the implementation of DCA, were important to the subsequent outcome of the guarantee and its impact on UP as well as the MFI sector. This review sketches the conditions and dynamics that shaped the UP guarantee in Mexico.

In the aftermath of Mexico's financial crisis in 1994, 27 million unemployed workers, representing 57 percent of all nonfarm labor, looked to the informal sector for their livelihoods. It is estimated that over 680 MFIs, including nongovernmental organizations (NGOs), credit unions, cooperatives, and others, provide credit and savings services to many of these informal enterprises. By the end of 2006, MFI partners of the USAID-funded *Acceso a las Finanzas Rurales para la Microempresa*, or AFIRMA (Access to Rural Finance for Microenterprise) project implemented by DAI[1] were serving 1,195,747 active credit clients, a 28 percent growth rate over the previous year. Nonetheless, despite rapid growth of some of the market leaders over the previous two years, MFIs still serve only a small portion of the estimated 12 to 20 million Mexican microenterprises. With a large underserved population remaining, market demand for microfinance in Mexico is expected to remain strong.

1.1 MFI TRANSITION FROM DONOR FUNDING TO COMMERCIAL CREDIT

A number of donors, including USAID, the World Bank, and the Inter-American Development Bank, have been active in Mexican microfinance. However, their involvement is easily eclipsed by that of the Government of Mexico, which has more than 40 government programs dealing with "popular finance" (as microfinance is known in Mexico) at the federal level alone. Generally speaking, subsidies have been widely available to provide wholesale funding for MFIs.

After 1994, the Mexican government supplied significant levels of soft credit to MFIs from multiple large-scale wholesale lending programs. One of these, *Fideicomisos Instituidos en Relación con la Agricultura*, or FIRA (Agriculture Trust Funds), which has operated for 50 years, was established as a second-tier wholesale bank to lend to the agricultural sector. FIRA lends to MFIs through local commercial banks. Another, the Programa Nacional de Financiamiento a la Microempresa (National Program for Microenterprise Finance), or PRONAFIM—a countrywide second-tier initiative started by President Fox—is more focused on lending to various MFIs. To qualify for these programs, many MFIs have needed to improve their documentation and systems related to providing credit, human resources, and so forth, and to provide operations manuals to the agencies. The wide availability of guarantee schemes from multiple government agencies means that they are often layered one on top of the other, frequently totaling nearly 100 percent

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[1] AFIRMA's partner MFIs are AlSol, AMUCSS, CADEMI, Caja Libertad, CAME, Compartamos, Despeno, F5M, FIMEDER, FINCA, FinComún, ProMujer, and ProNegocio.

To date, there are few examples of linkages between commercial banks and MFIs in Mexico that suggest that domestic capital is playing a material role in MFI financing. One exception has been Compartamos, which converted into a bank in June 2006 and has issued two peso-denominated bonds (the first of which was supported by the International Finance Corporation) in the local markets, with the advisory and marketing support of Banamex (owned by Citigroup). Mexico's largest domestically owned bank, Banorte, is downscaling into the microfinance sector. The significant government participation in the sector appears to have discouraged MFIs from seeking commercial capital more extensively, and has acted as a disincentive to broader mobilization of savings. It may also have hindered development of the formal credit relationships that the DCA guarantee might otherwise have supported between commercial banks and MFIs.

Until it received a DCA guarantee, UP had mostly been funding its loan portfolio using member savings and soft loans from various state-owned programs. This strategy led to gradual increases in the UP loan portfolio. Excessive collateral requirements for commercial credit discouraged the UP board from long-term interest in commercial funding.

1.2 MFI TRANSITION TO SAVINGS

Financial institutions also suffered a loss of public confidence as a result of the crisis of 1994; unregulated credit unions were particularly affected. Most credit unions in the country had to be bailed out through the Mexican government's guarantee program, *Fondo Bancario de Protección al Ahorro*, or FOBAPROA (Fund for the Protection of Bank Savings), and in most cases they were unable to regain the confidence of depositors for some time. In 2000, the Government of Mexico approved a new Savings and Credit Law to regulate "popular finance." The policy's focus on savings was important for the formalization of MFI deposit services. The law particularly focused on regulating deposit-taking activities of the various MFIs, credit unions, and other legal microfinance forms in Mexico. Institutions that intended to provide deposit services to their clients were given four years to transform into regulated "popular financial institutions"—*sociedades financieras populares* (SFPs)—or "popular savings and loans institutions"—*cajas de ahorro y crédito popular* (CACPs)—which would be supervised by the Comisión Nacional Bancaria y de Valores (CNBV), or the National Banking and Securities Commission. Recent changes in banking regulation that became effective December 31, 2005, also facilitated the provision of various services by regulated financial institutions.

Though UP also received support from FOBAPROA, it managed to maintain its reputation and the trust of its members throughout the crisis. Past-due loans increased substantially, but by remaining very liquid and placing depositors' funds in a variety of Mexican and U.S. financial institutions, UP emerged from the Mexican financial crisis relatively unscathed. UP's stability was the result of a very strong and active governing board representing the credit union's shareholders. The board prided itself on conservative liquidity management and a cautious approach to risk: in 2000, UP's liquid deposits and securities amounted to nearly 170 percent of the UP loan portfolio. UP is in the process of consolidating its 14 companies into approximately four or five companies, including a regulated SFP to be named ACALA, which will be able to both take deposits and lend to its clients. UP intends to maintain its credit union status (most likely for the tax benefits to its members) and will take loans from higher-income shareholders through its credit union arm to finance its lending operations, as this entity will no longer be allowed to take deposits.

When conditions allow MFIs to mobilize greater amounts of savings, the utility and desirability of commercial credit as well as the impact of wholesale DCA deals may decrease. While the overall cost of mobilizing savings is often difficult to calculate, the low interest paid on savings creates incentives for MFIs in Mexico to strengthen balance sheets with as much savings as possible. UP funds much of its loan portfolio through member savings and, now, through term savings. As explained earlier, the strategy of maintaining substantial liquidity led to only a gradual increase in UP's loan portfolio. While effective during the hardest times, this approach has kept the credit union from undergoing significant expansion.

2. USAID SUPPORT OF MICROFINANCE

In 1999, USAID/Mexico recognized that it could play an important role in the development of Mexico's nascent microfinance industry by providing technical assistance to help institutionalize global best practices in microfinance. At the time, USAID/Mexico did not have an economic growth strategic objective (SO) that would directly support these activities. Thus, technical assistance and DCA guarantees to support MFIs were temporarily linked to USAID/Mexico's existing environmental SOs: (1) conservation of critical ecosystems and biological resources and (2) reduction of carbon dioxide emissions and pollution. In September 2000, USAID/Mexico added a new SO to its portfolio: "to strengthen the institutional base for sustainable microenterprise growth by supporting Mexican initiatives."

To implement its Mexico Microenterprise Strategy (MMS) project, USAID/Mexico contracted with Chemonics International Inc., which was given a mandate to support four promising MFIs—FinComún, Compartamos, Unión Progreso, and ADMIC—that could serve as examples of successful practices industrywide. Additionally, USAID's MMS collaborated with the Mexican government on regulatory reform for microfinance. In response to the presidential initiatives and the Savings and Credit Act of 2000, USAID shifted MMS's focus toward supporting the new environment for microfinance, attempting to prepare MFIs and NGOs to transition into regulated, deposit-taking institutions as well as preparing them for the Government of Mexico's lending programs.

USAID/Mexico's support of the microfinance industry in Mexico continues. In September 2004, USAID/Mexico initiated a new five-year microfinance support program, which involved two grant programs and a technical assistance project. The project, Acceso a las Finanzas Rurales para la Microempresa (AFIRMA), is managed by DAI. It promotes the expansion of financial services to underserved and rural markets by providing targeted technical assistance, training, and grants to financial institutions. The project's goal is to contribute to the development of a dynamic, effective microfinance sector in Mexico that provides sustainable financial services to underserved urban and rural market segments, helping them manage risk and contribute to economic growth.

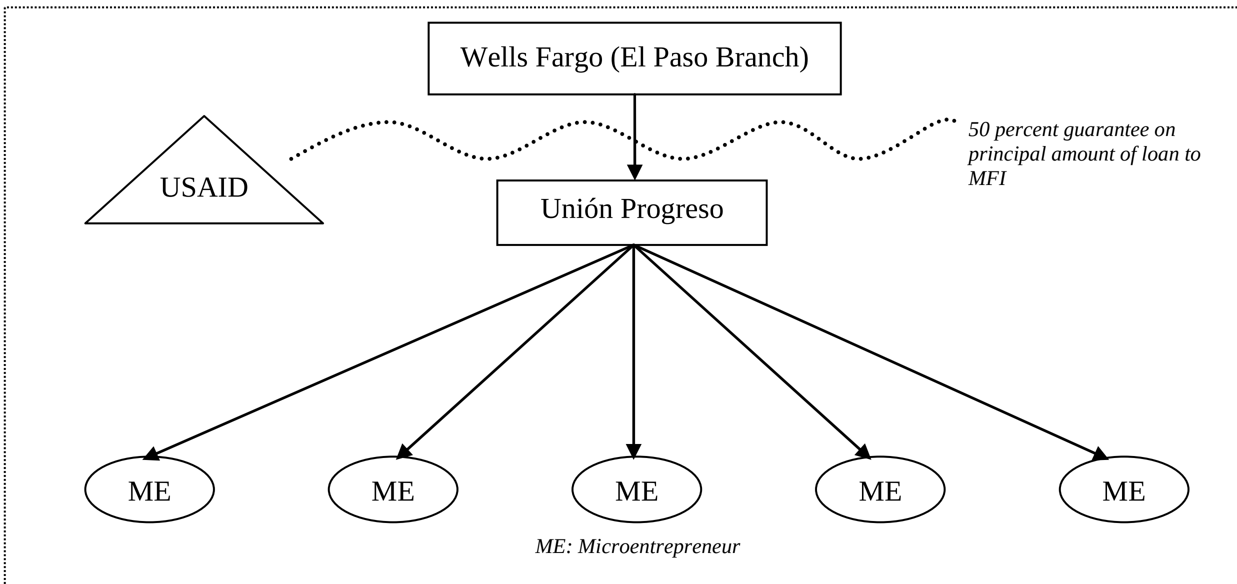
2.1 USAID/MEXICO DCA GUARANTEES

Complementing its technical assistance to MFIs, USAID/Mexico, with assistance from the USAID's Office of Development Credit (ODC), in Washington, D.C., and MMS, pursued two DCA guarantees, one with FinComún and a second with UP. USAID/Mexico selected FinComún and UP out of the four MFIs receiving technical assistance from the MMS project to receive DCA guarantees because both MFIs were lending to larger clients and were likely to have the greatest impact on unemployment. As FinComún was founded with the intention of providing financial services to microenterprises, it may have been a better candidate to use a DCA enhancement. UP had limited experience with microfinance, and further had weak management information systems (MIS) and monitoring systems, thus was not well-positioned to monitor a microcredit portfolio.

At the time (2000) these DCA guarantees were originated, ODC was interested in experimenting with various structures because the DCA guarantee program was still relatively new. As a result, UP's guarantee was structured as a Portable Guarantee (PG), which later became a Loan Guarantee (LG) when a suitable lender, Wells Fargo Bank in El Paso, Texas, was identified. While the development of these two DCA guarantees was primarily driven by USAID/Mexico, ODC was involved throughout the process and supported the Mission by providing the guidelines and information required for DCA approval. The FinComún guarantee, which was a loan portfolio guarantee (LPG) for multiple sub-loans to microenterprise borrowers, is not included in this case study because it was not designed to increase MFI access to local commercial credit. The MMS Project ended in June 2004 and the DCA guarantees for FinComún and UP expired in February and June 2004, respectively.

Following its visit to UP in 2000, the MMS project conceptualized a DCA guarantee that would complement the project's limited technical assistance. UP's management and governing board were interested in expanding the credit union's loan operations, albeit cautiously, to a lower-income segment of the population in Chihuahua. Demand for their traditional agricultural and agroindustrial lending had declined. However, loans to lower income sectors through UP's pawnshops suggested that moving down-market could prove attractive. Microenterprises in food processing, furniture production, and services were a growing economic sector and represented an interesting potential loan clientele. As the diagram below shows, USAID and MMS later designed the DCA guarantee to stimulate the availability of wholesale funds with the ultimate objective of facilitating UP's microfinance portfolio growth. The DCA enhancement was expected to advance this outcome by improving the institution's access to commercial finance and more favorable credit terms from commercial lenders.

FIGURE X: MEXICO DCA PG/LG STRUCTURE



2.2 OTHER DONORS AND GUARANTEES

The government-run Shared Risk Trust Fund, or FIRCO (*Fideicomiso de Riesgo Compartido*), which is part of the Secretariat of Agriculture (SAGARPA), provides cash-collateralized guarantees to commercial banks that lend to "credit distributors." FIRCO works primarily with local cooperatives of various types of *uniones de crédito*. Additionally, *Nacional Financiera* (NAFIM), a public bank, provides guarantees and financing to SMEs and has recently expressed an interest in expanding its lending to MFIs.

International donors have also provided MFIs with guarantees. The IFC, for instance, provided Compartamos with a guarantee for the issuance of bonds.

3. DCA IMPACT

3.1 DCA IMPACT ON UNIÓN PROGRESO

The primary objective of the USAID DCA guarantee was to expand UP's portfolio of loans to the microenterprise sector. This was stipulated clearly in guarantee documents and was supported through technical assistance provided to UP by the MMS project. In this light, an LPG would have most likely been more appropriate than a LG. However, as the DCA program was relatively new, there was an interest in "testing" various guarantee structures, and the UP guarantee was selected as a PG. While this did not hinder the objective of expanding UP's loan portfolio, it was not particularly effective in reaching the other goals most associated with a guarantee targeted to funding rather than to lending, such as changing the financial sector's behavior toward the borrower institution and expanding access to commercial sources of funding by the borrowing institution.

To measure the impact of the guarantee, USAID/Mexico monitored UP's client outreach to microentrepreneurs as well as its lending and savings portfolios, although it should be noted that no baseline was established. While the loan guarantee did not guarantee specific loans made by UP to microentrepreneurs, the loan agreement stipulated that funding from the DCA-guaranteed loan would be used to on-lend to microenterprises in Chihuahua. To monitor the impact on microfinance of the guarantee, the MMS project tracked loans by UP to end borrowers much as it tracked the LPG for FinComún, despite the differences in guarantee structures. The MMS project and USAID/Mexico reviewed these reports on a quarterly basis. The reports were sent to USAID/Mexico's Development Finance Advisor, the sole USAID/Mexico officer assigned to microfinance activities.

UP was able to use the PG structure to "shop around" for the best loan terms it could obtain. UP was interested in less costly, U.S. dollar-denominated loans, given that a significant part of its loan portfolio (28 percent) was denominated in U.S. dollars. Initially, UP considered borrowing from a number of Mexican banks, but they charged relatively high interest rates (12–13 percent in dollar terms). In mid-2000, UP negotiated a loan with Fort Davis State Bank in Texas. UP had a strong and longstanding relationship with this small Texas-based bank, primarily using its deposit services to manage its members' savings. The loan fell through, however, in part because it represented a significant portion of Fort Davis's portfolio and because the bank was not comfortable initiating the process for a DCA guarantee. As a consequence, UP approached Wells Fargo, a much larger bank with which UP had a solid and growing relationship based on its 18-year relationship with the staff of a smaller bank that Wells Fargo had acquired in the El Paso area.

UP used the Wells Fargo El Paso branch services for treasury and cash management; check clearing for U.S. dollar-denominated checks; and deposit accounts. While Wells Fargo was open to giving UP the loan, it had significant concerns about the institution as a loan client. UP had no consolidated financial statements for its 14 affiliated companies and managed its profit and loss at break-even levels for tax purposes. According to Wells Fargo, UP was not eligible for a line of credit because its risk rating would have been too high. In this regard, the DCA guarantee was crucial to the eventual approval of the loan.

The guaranteed loan was also backed by a certificate of deposit placed by UP at Wells Fargo for 50 percent of the loan amount, which Wells Fargo viewed at the time as giving 100 percent coverage when combined with the DCA guarantee. USAID did not clearly explain to Wells Fargo that the DCA guarantee would cover 50 percent of any loss on a pari passu basis net of recoverable collateral. During the interview held with Wells Fargo for this case study, the shared risk was explained and Wells Fargo's representative noted that the bank would not have permitted such low collateral, or provided the loan at such a low rate, had it been aware that the loan was not 100 percent guaranteed. This misunderstanding took place despite the fact that Wells Fargo and the ODC were in contact over a period of eight months during the origination phase and that legal representatives from both institutions reviewed and discussed the guarantee.

To the users of the guarantee (borrower and lender) as well as the technical assistance project, the origination process for the PG was excessively long. Some of these delays are likely structural: it takes time to "shop around" for the best loan terms and lender. Others were related to the desire on the part of UP to borrow in U.S. dollars rather than in local currency, which was expected at the time on all DCA deals. Delays may also have reflected the fact that portable guarantees were a relatively new tool for USAID in early 2001. Finally, some of the particularities of the lender being a US bank and the borrower being a Mexican financial institution may have made the process more complex. Necessary translations took time and effort. Once the origination process was finalized, however, the implementation of the deal was straightforward and required minimal attention.

UP has grown significantly since the DCA guarantee was implemented. At the end of 2000, UP had 11 branches in the state of Chihuahua. The institution had 320 members and a loan portfolio of MXP 54.5 million (US$5.7 million). UP did not lend to microentrepreneurs on any scale at the time. At the end of 2005, UP had 14,000 members[2] and a loan portfolio of MXP 231 million (US$ 22 million). The US$1 million from Wells Fargo was a relatively small part of funding, particularly since 50 percent of the amount was tied up in a CD pledged by UP at Wells Fargo. While the loan represented only 5 percent of UP's total liabilities at the time of origination, it had a relatively long, three-year tenor.

While not the focus of this review, two related objectives of the UP guarantee (as stated in the DCA guarantee documents) were realized to a greater extent: (i) UP effectively expanded in services to microentrepreneurs; and (ii) UP was able to attract term savings. UP viewed the loan guarantee as a means of differentiating itself in the financial sector in Chihuahua as a "USAID partner," which it hoped would instill confidence in its members and help UP capture greater and longer-term savings. Anecdotal evidence suggests that the USAID guarantee was effective in strengthening the credit union's reputation. Articles were published in local newspapers publicizing UP's participation in the DCA guarantee, suggesting that the guarantee would help protect deposits. Wells Fargo itself placed an advertisement in a local newspapers congratulating UP on its expansion.

UP was aware that the marketing approach was misleading, but it appears to have been effective. Term deposits, which were nonexistent at the time of the origination of the DCA guarantee, represented 15 percent of UP's liabilities in December 2004. UP financial statements suggest that depositor confidence improved after the signing of the guarantee. The figure below shows that annual savings grew 37 percent in December 2001, after dipping briefly in 2002; it has since remained strong at an average rate of 36 percent, with loans growing accordingly at 35 percent. UP was also able to extend the terms of its savings, introducing fixed-term deposits. At this trend's peak, UP had captured

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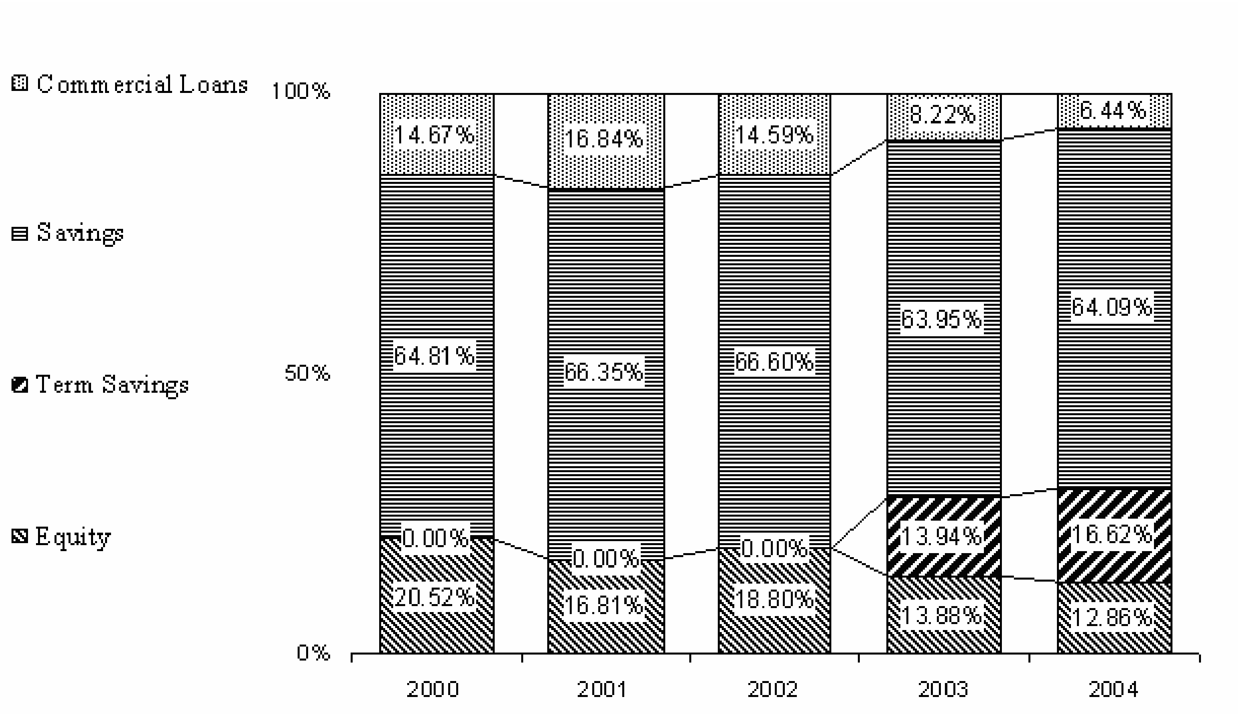
[2] However, relatively few of these members were microenterprise clients.

$8 million in fixed-term deposits. This represented over eight times the value of the guarantee and contributed to a more than twofold increase in total savings.

FIGURE X: UNION PROGRESO FUNDING STRUCTURE BREAKDOWN OF LIABILITIES AND EQUITIES



3.2 DCA IMPACT ON THE MFI SECTOR

One of the important goals of the PG/LG structure—to create linkages between borrowers and commercial financing—was not realized. Wells Fargo did not approach the loan as being part of a foray into a new sector (either microfinance lenders, or credit unions in Mexico). Instead, it saw the transaction as a risk-free loan to a regular and stable customer of the bank. Had Wells Fargo understood that some of its funds were at risk, it would not have been comfortable with the transaction. Discussions with Wells Fargo suggest that it is only willing to lend to UP in the future with 80–100 percent of the collateral on deposit. During a mid-term review of the guarantee, and again more recently, Wells Fargo explicitly stated that the loan, although successful, would not encourage the bank to build relationships with other MFIs. The flexibility that the PG structure gave the borrower may have been excessive. There is some evidence to date that local commercial banks have begun to lend directly to MFIs that have been borrowing from government programs through these banks. By allowing UP to look outside of Mexico for financing with a PG, the DCA guarantee did not create these types of commercial linkages to the sector, although it did achieve very favorable loan terms. This suggests that the guarantee structure might have had greater impact if it been limited to Mexican banks.

UP’s market share in microfinance is small. Thus, the guaranteed loan to UP represented a small fraction of available microcredit in the local region of Mexico. On the other hand, while the UP DCA guarantee did not have a large effect on stimulating formal lending to the microfinance sector, there is anecdotal evidence that DCA contributed to the improved reputation of the sector.

4. CONCLUSIONS AND RECOMMENDATIONS

The DCA guarantee enabled UP to mobilize additional funding for on-lending to the microentreprise sector in the state of Chihuahua. However, DCA may inadvertently have had a greater impact on UP's savings mobilization than on its relationship with formal credit lenders. Such use of DCA to strengthen the public's perception of the security of using UP contradicts the intention of DCA and was a misrepresentation on UP's part.

The role of regulatory and legislative changes in the microfinance industry has also played an important role in UP's strategy toward the microfinance sector. Microfinance in Mexico is formalizing, and in the future sustainable local savings may becoming a more important percentage of liabilities outside of the *cajas* (financial cooperatives), which already are important providers of savings services.[3] However, MFI access to commercial credit from banks remains limited, and the contribution of the USAID DCA guarantees to overall microfinance development also was limited. Nonetheless, it may be argued that the USAID guarantee had a positive indirect effect on recent interest from foreign sources of capital, including socially responsible investment funds, by providing some assurance of UP's institutional strength.

Based on the results of this review, a list of recommendations for future deal design follows. These are divided into (i) *environmental* considerations, and (ii) **structural** considerations.

Environmental Considerations:

1) Trends such as growth in market demand for microfinance, macroeconomic conditions, donor cooperation, government interventions and shifting MFI demand for funding such as savings, all affect the outcome and use of DCA. Deal designers should assess local market dynamics and evaluate the impact of these dynamics when developing DCA deals. While some of this analysis is already conducted as part of the economic feasibility assessment for deal preparation, designers should complete a more robust analysis of supply and demand trends affecting the utility of DCA guarantees.

2) Subsidized credit threatens the utility of credit guarantees, discourages MFIs from transitioning to commercial credit, and can act as a disincentive to mobilize savings deposits on a more massive scale. While microfinance practitioners are continuing to coordinate foreign aid programming, DCA designers should assess the level of subsidies in the MFI funding market and the effect on MFI demand for bank credit and savings deposits.

3) Overlapping guarantees threaten the effectiveness of DCA by flooding MFIs with non-sustainable cash flow. Donors should treat guarantees the same as direct lending and appreciate the distortion effects of multiple guarantee coverage. In order to minimize instances of this, donors should regularly communicate and share guarantee portfolio loan schedules, and attempt to do so with any local government actors providing guarantees as well.

[3] The largest, Caja Popular Mexicana, serves more than 1 million savings clients and is growing steadily (partly with assistance from USAID).

Structural Considerations:

PGs offer great flexibility to borrowing institutions to “shop around,” but borrowers may not select the institutions more likely to re-lend to them or to the sector when the PG expires. In the case of UP, the long-standing business relationship with Wells Fargo has helped them to secure credit lines. However, Wells Fargo has clearly stated that it does not intend to lend to other Mexican credit unions. Local lenders are more likely candidates for continued access to finance.

1) Portable and loan guarantees can play an important role in leveraging local resources to finance an underserved sector. In the case of UP, however, foreign resources were used. USAID missions should clarify early on in the DCA structuring process if local financial resources are intended to be mobilized or if the PG beneficiary may access foreign sources of capital. This should be supported by rigorous analysis of the lending practices and strategic objectives of the potential lending institutions.

2) To ensure that DCA guarantees have a sustainable impact, complementary technical assistance should be robust and long-standing. Technical assistance providers as well as ODC and the USAID mission should ensure that all parties truly understand the terms of the guarantees. Such effort should involve translations of documents as well as personal discussions with both the legal and management teams of borrowing and lending financial institutions.

3) Deal designers and subsequent technical assistance should discourage partner organizations from suggesting that DCA guarantees are a substitute for deposit insurance. UP marketed its DCA wholesale credit PG in order to increase savings mobilization, thus engaging in misleading behavior contradictory to the intent of the deal.

4) Conducting a simple baseline survey during the deal origination and including this data in the contract documentation can help to streamline ongoing data collection efforts and enhance USAID’s (particularly ODC’s) ability to measure deal impact going forward. For example, the origination process can include such information as the number of loan clients, the current market niche served, average loan size, size of loan portfolio, composition of assets and liabilities, and existing commercial loans or efforts to obtain these. This case study suggests that retroactively collecting information on an expired guarantee forces a greater reliance on anecdotal evidence, which may also be limited due to the gaps in institutional memory that result when such information is not documented or people leave.