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microNOTE 41
WWB Calí: Banco de Bogotá Loan Guarantee

In 2002, USAID guaranteed a $3 million dollar loan from Banco de Bogotá to help Women's World Banking (WWB) finance its continued portfolio growth. This operation marked WWB's second USAID loan guarantee in two years. Prior to these guarantees, WWB Cali had been financing its operations via two main sources: long-term loans from international financial institutions, and short-term loans from domestic banks. Since that time, WWB Cali has further diversified its funding base by issuing bonds in the Colombian capital markets.

December 2007

This publication was produced for review by the U.S. Agency for International Development. It was written by Brooke Jones of DAI.

BACKGROUND & PURPOSE OF CASE

In 2002, USAID guaranteed a $3 million dollar loan from Banco de Bogotá to help Women's World Banking (WWB) finance its continued portfolio growth. This operation marked WWB's second USAID loan guarantee in two years. Prior to these guarantees, WWB Cali had been financing its operations via two main sources: long-term loans from international financial institutions, and short-term loans from domestic banks. Since that time, WWB Cali has further diversified its funding base by issuing bonds in the Colombian capital markets. The purpose of this study is to explore what role, if any, the loan guarantee played in WWB Cali's evolving funding base.

THE COLOMBIAN MICROFINANCE INDUSTRY

Due to a historically unfavorable regulatory environment and financial disincentives to formalize, Colombia's microfinance industry has been dominated by informal microfinance institutions (MFIs). While some of these historical barriers to formalization have been removed, many persist, as will be discussed below in further detail. Thus, the industry continues to be served predominantly by informal MFIs. As such, up-to-date and detailed, audited information on the industry's portfolio size, composition, and financial health are not readily available. The most recent data from September 2006 listed a total of 34 institutions, regulated and unregulated, that offer microfinance products.[1] Unlike other Latin American countries, however,

[1] DAI Washington. A Study of Microfinance in Latin America and the Caribbean: Recommendations for Technical Assistance and Investment. September 2006.

the product offering is somewhat limited. Loans, specifically working capital loans, are the primary microproduct offered, followed by savings and transfer and payment system products.

While some banks, cooperatives, and commercial financing corporations (CFCs) have entered the fray, the NGO MFIs continued to enjoy 55% of market share as of 2005[2]. In fact, this figure represents an increasing market share over the previous five years. While the regulated financial institutions have started to serve the microenterprise niche, they have not grown their microfinance portfolios aggressively. With their ability to mobilize deposits, regulated FIs have a cheaper cost of capital than their NGO competitors, enabling them to potentially offer lower rates on their microfinance products and aggressively grow their microfinance portfolios. Nevertheless, they have yet to capitalize on this advantage, showing both a lack of appetite for the market niche and a sign that NGOs will continue to be the dominant players in the Colombian microfinance industry in the foreseeable future.

Fairly recent strategic acquisitions and investments in the retail banking sector, however, might signal a changing tide. Banco de Bogotá acquired Megabanco, one of the largest microfinance institutions, in November 2006.[3] BBVA, the Spanish bank, has also issued press releases announcing the BBVA Foundation's strategy to take equity positions in leading MFIs in Colombia.[4] While the acquisitions and strategic investments are certainly positive signs of change, it remains to be seen whether these initiatives will receive the internal support necessary to penetrate the niche and divert market share from the NGOs.

THE MICROFINANCE ENABLING ENVIRONMENT

Colombia's current industry composition is a direct by-product of its regulatory environment, which has played a determining role in many MFIs' strategic choice to remain unregulated. Prior to the 1990s, Colombia's financial sector was highly fragmented, thanks to laws which segmented the financial services market by "task" or product category. Colombia began to move away from this model towards the end of the 1990s. In 1997, the change was accelerated when the economic crisis forced the financial services industry to undergo a period of consolidation. Around the same time, laws that had theretofore deterred NGOs from transforming were revised to allow NGOs to become regulated financial institutions. However, despite the consolidation and regulatory reform, the Colombian financial services market is still highly segmented. As of August 2007, there were 432 regulated financial institutions reporting to the Superintendent, of which more than fifty provide retail banking services.

Vestiges of the old regulatory environment make formalization financially unattractive or infeasible for many NGOs. Specifically, the interest rate ceiling, which is currently set at an effective annual rate (EAR) of 12.7%, is cited as the primary reason many NGOs choose to remain informal. Of this EAR, 7.6% is a commission fee which only microfinance institutions are allowed to apply.[5] Even those NGOs that

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[2] Ibid.

[3] Latin Finance, Daily Briefing. Available Online http://www.latinfinance.com/newsletter/default.asp?iss=21539 17 March 2006.

[4] Press Release Available Online http://www.spainbusiness.com/icex/cda/controller/pageGen/0,3346,1549487_1561539_1596908_4069771,00.html

[5] For the specific language on the interest rate ceilings, please refer to current laws that can be found on the Superintendent's website. These

do meet formalization standards such as minimum capital requirements, WWB Cali chief among them, are not considering transformation because of the interest rate ceiling. Other constraints to formalizing include the desire to avoid income taxes, as well as the costs of regulatory reporting and compliance.

Although further regulatory reform would be necessary to induce transformation, the Colombian government has made strides to foster an increasingly microfinance-friendly regulatory structure. The timeline below provides a brief summary of the key regulatory changes that influence the current industry composition. In addition to regulatory changes, the Colombian government also established a guarantee fund which guaranteed loans to MSMEs, as well as financial institutions (regulated and unregulated) which on-lent to them.[6]

THE EVOLVING FUNDING BASE

How an individual MFI's funding base has evolved over time depends largely on whether the MFI is regulated. Because detailed industry data are unavailable, it is difficult to speak of a "typical" funding structure for NGO MFIs. However, the diagram below generally shows the pattern of funding as the MFIs grow.

Colombia's microfinance sector started with donor-funded NGOs. As the industry grew, MFIs such as WWB Cali were able to access short-term loans from Colombian banks, in addition to soft loans from multilateral lending institutions, such as the Corporación Andina de Fomento (CAF) and the IDB. The few MFIs that chose to transform into CFCs or banks were able to fund lending through capturing deposits. In contrast to other Latin American countries, investment funds such as

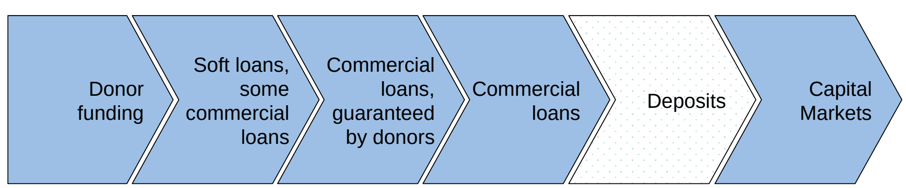
Regulatory Mile-Markers

- 1986: "Microenterprise Development Plans" are published, marking the first time the Colombian government had an articulated microfinance policy
- 2000: Banks are authorized to loan to "Commercial Financial Corporations", a intermediate regulatory form with less stringent restrictions than a commercial bank
- 2001, March: Usury laws are relaxed, allowing micro lenders to charge a one-time 7.5% commission on loans up to US$3,500, thus, covering their lending costs
- 2002: Microcredit portfolio classification was created, which relaxed steep document requirements for microcredit applicants
- 2002: Government strikes agreement w/commercial banks to disburse $131 million over two years to finance microenterprises. Most of this money was on-lent to NGOs who administered the funds, drastically increasing their lending base

Source: Compiled by DAI

Blue Orchard and Oikocredit are largely absent from the Colombian second-story investment scene. The investment funds offered loans denominated in USD, which would require MFIs to

Industry Trends: Evolution of Funding for Colombian MFIs



laws grant the executive board of the Banco de la Republica the right to impose such a ceiling. (http://www.superfinanciera.gov.co/Normativa/Conceptos2006/2006056569.pdf) The current ceiling, itself, can be found on Banco de la Republica's website: http://www.banrep.gov.co/documentos/reglamentacion/cambiaria/2006/Bol%2034%20(2006)%20ResExt8.pdf

[6] Fondo Nacional de Garantias Available Online http://www.fng.gov.co/fng/portal/apps/php/index.kwe

mitigate foreign exchange risk. These loans were also offered at rates above those associated with local loan options.[7] Thus, the investment funds were largely left out of the funding options. For the remaining NGOs which are unable to take deposits, loans continued to be the primary source of funding. Because deposit funding is not an option, the larger, more robust NGOs have had to be more resourceful in their search for capital to fuel their growth. WWB Cali is a prime example, finally looking to the capital markets to fund its growth with the issuance of an asset-backed bond in 2004. WWB's funding structure is explored in more detail in subsequent sections.

THE ROLE OF THE DONOR

Historically, the Inter-American Development Bank and the CAF have been the most active donors in the Colombian microfinance industry, providing both loans and technical assistance. Recently, USAID has played a more significant role in supporting Colombian microfinance: first, through two loan guarantees, and second, through its MIDAS program, which provides technical assistance to MFIs and the bank superintendency. Finally, the World Bank, though involved to a much lesser extent, has provided technical assistance to Banco Agrario, and has also extended credit through the IFC.

WWB CALI

Established in 1982, WWB Cali was the first microfinance institution in Colombia to disburse microloans, and WWB Cali still stands out as the oldest and largest NGO MFI in the country. Based on the 2005 industry-wide numbers, WWB Cali's 2005 portfolio of $100.2[8] million local currency equivalent represented 30% of the NGO portfolio and 9.7% of the microfinance industry's portfolio as a whole. By October 2007, WWB Cali's portfolio had grown to $211.4 million local currency equivalent.[9,10]

WWB Cali is one of five WWB affiliates operating within Colombia as an NGO. Historically, all five affiliates have maintained separate management teams and independent operations, and each institution can choose whether or not it wishes to remain autonomous. Recently however, two affiliates, WWB Bogotá and WWB Medellín, began the process of creating a new bank with the help of the BBVA foundation.[11] In contrast, WWB Popayán, WWB Bucaramanga, and WWB Cali have yet to express the intention to merge or transform into regulated entities. Regardless, the WWB institutions as a group represent the most important microfinance institutions in Colombia, in terms of both market share and service area. Currently, the greater WWB family of institutions has a presence in nine of 32 departments, with a total of 54 branches.

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[7] Plata Puentes, Nestor. "Fwd: USAID Loan Guarantee Case Study, edits." Email to Brooke Jones. 11 Feb 2008.

[8] *Estadisticas.* October 2007. WWB Colombia. 11 Sept 2007. http://www.fwwbcol.org/paginas/evolucion_cartera.html . USD calculations made using historical exchange rates on 12/31/05 and 10/31/07 from Oanda.com

[9] Ibid

[10] For 2007, industry-wide portfolio numbers, and, therefore, WWB's percentage of market share, are unavailable.

[11] De Akerman, Clara. "RV: USAID Loan Guarantee Case Study." Email to Brooke Jones. 19 Sept 2007.; & http://www.spainbusiness.com/icex/cda/controller/pageGen/0,3346,1549487_1561539_1596908_4069771,00.html

In 2001, WWB Cali's funding base was a mix of soft-loans from international finance institutions and commercial loans from Colombian banks. At 2001 year-end, loans accounted for approximately 56% of total funding, a marked increase from the 38% reported in 1998. However, according to WWB management, the loan amounts were still insufficient to support WWB's portfolio growth.[13] According to WWB management, the funding gap "…was not related to the amounts, meaning [WWB] did have access to sufficient funds to finance its growth. There were offers for financing, but with very high risk profiles or with less favorable rates, amounts, and collateral or guarantee requirements. Thus, the funding gap was associated more with higher interest rates, shorter terms, and higher guarantee requirements".[14]

Table 1: Microfinance Industry Portfolio as of December 2005[12]

	US$ Millions	Percentage
Remaining banks	196.6	19.1
Banco Agrario	323.8	31.4
CFCs	27.8	2.7
Total	548.2	53.2
Cooperatives	27	2.6
NGOs	456	44.2
Total Cooperatives and NGOs	483	46.8
Total Microcredits	1031	100.0

Source: DAI proprietary research. N.B. CFCs are "Commercial Financing Corporations"

Unfortunately, the terms of the commercial loans were not ideal. Loans from Colombian banks were short term (a year or less), local currency loans with high interest rates, and high collateral requirements. Interest rates on the local currency debt averaged around 16.5% per annum. Loans from the IFIs were more favorable: although denominated in US dollars, they had multi-year terms, lower interest rates, and no foreign exchange risk. However, the IFI loan amounts were also relatively small: $500,000 and $1,500,000 from the IADB, constituting only 2% of WWB's funding[15].

USAID LOAN GUARANTEE

In response to WWB's capital constraints, USAID supported WWB in 2001 by structuring a loan guarantee for two separate local currency loans for terms of five years each, totaling $4 million. Two Colombian banks, Banco de Occidente and Corporacion Financiera del Valle, were the lenders. The loan guarantee covered losses up to 50% of the principal, limiting USAID's maximum liability to $2 million. Without the loan guarantee, Banco de Occidente and Corporacion Financiera del Valle would have required 100% cash collateral or standby letters of credit. With the guarantee in place, these requirements were reduced to 50%. According to WWB management, the banks required cash collateral at the time because they still viewed WWB as a risky borrower, despite the guarantee being in place.[16] The cash collateral, therefore, was viewed as covering the banks' exposure to the 50% of the loan not covered by USAID's guarantee.

While the WWB management characterizes this initial guarantee deal as an unequivocal success, they found that the $4 million fell short of matching their funding needs. In 2002, USAID worked with WWB

[12] DAI Washington. A Study of Microfinance in Latin America and the Caribbean: Recommendations for Technical Assistance and Investment. September 2006.

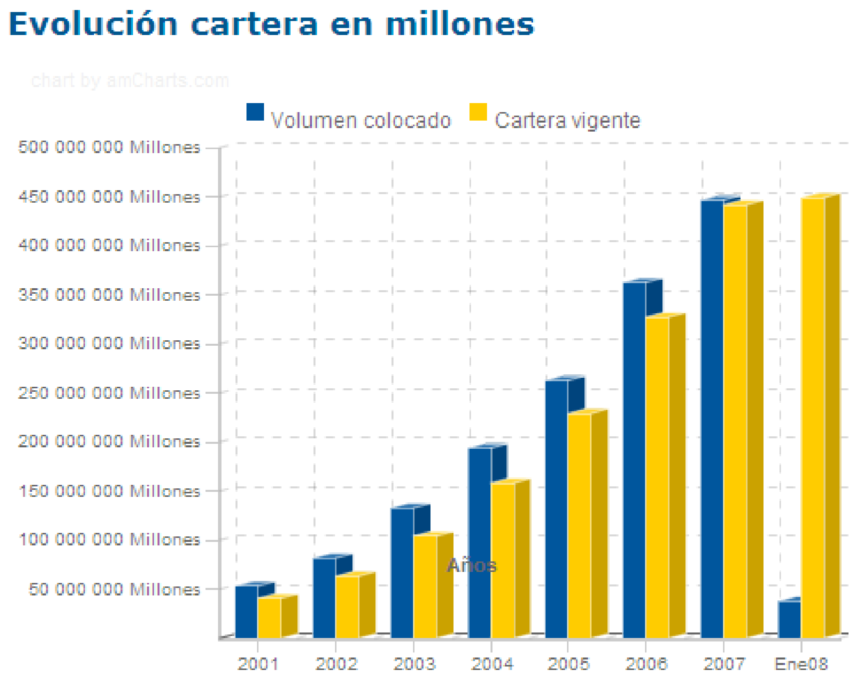
[13] Plata Puentes, Néstor Raúl. Personal interview. 25 September 2007.

[14] Plata Puentes, Nestor. "Fwd: USAID Loan Guarantee Case Study, edits." Email to Brooke Jones. 11 Feb 2008.

[15] Plata Puentes, Néstor Raúl. Personal interview. 25 September 2007.

[16] Plata Puentes, Néstor Raúl. Personal interview. 25 September 2007.

once again on a second loan guarantee. This time, Banco de Bogotá was the lender of $3 million local currency equivalent. The structure of the guarantee was similar to the prior guarantees: this credit enhancement had a five-year time horizon and offered a 50% guarantee on principal, with a guarantee ceiling of $1,500,000. At the time the guarantees were issued, WWB Cali was receiving IDB-funded technical assistance to improve its information systems, internal controls, and to fund a market study. WWB Cali management, however, does not believe that the technical assistance aided in or had any synergies with the guarantee deals. Instead, the technical assistance was valued more for its role in preparing the institution for the later bond issue.



Source: WWB Colombia, Online http://www.fwwbcol.org/paginas/evolucion_cartera.html 2/28/2008

The chart represents the evolution of WWB's outstanding loan portfolio from 2001-January 2008. The Y axis is denominated in Colombian Pesos. The exchange rate is not cited by WWB; however, Oanda.com lists an exchange rate of 1,886.74 pesos/USD as of 2/28/2008, and an outstanding loan portfolio as of 2007 year end of about $235 million. The blue bars represent the total volume of loans disbursed in the calendar year, while the yellow bars represents the total outstanding loan portfolio at the end of the year or period.

OUTCOMES & LESSONS LEARNED

WWB Cali management considers the loan guarantees to be a success, attributed to two main factors: the institution's strong credit history and operational efficiency, and the risk-mitigating influence of USAID's backing.[17] In addition to addressing WWB's capital constraints in the near term, the two loan guarantee facilities had longer lasting effects in terms of access to finance, debt profile, asset composition, and strategic planning. First, WWB Cali now accesses sizeable long-term, local currency loans directly from Colombian banks, without the need for a guarantee or burdensome collateral requirements. According to WWB management, the guarantee enabled WWB to establish a reputation and relationship with local banks that continued after the guarantees expired. Prior to the guarantee, the banks would only lend a maximum of 20,000 million Colombian pesos (approx. US$10.6 million), and required heavy collateral requirements. Currently, WWB can access loans of 150,000 million Colombian pesos (approx. US$79,5 million), with no collateral requirements.[18] Furthermore, this reputation could be leveraged beyond

[17] De Akerman, Clara. "RV: USAID Loan Guarantee Case Study." Email to Brooke Jones. 19 Sept 2007.

[18] Plata Puentes, Nestor. "Fwd: USAID Loan Guarantee Case Study, edits." Email to Brooke Jones. 11 Feb 2008.

Table 2: WWB's Funding Structure as of August 31, 2007[19]

Source	% of Funding
Bonds	37%
Commercial loans (Colombian banks)	38%
Novation of portfolio	13%
Loans (international finance institutions)	12%

Source: WWB Cali, compiled by DAI

the original lenders, to access credit from other local banks. In essence, receiving support from USAID created a strong signaling effect that improved potential lenders' confidence in WWB's ability to service its debts. Second, the loans improved WWB's debt repayment profile, meaning WWB's payment terms going forward allowed WWB to more easily service all of its term debt. Additionally, the loans helped fuel WWB's portfolio growth, while allowing it to maintain the same target microenterprise market and not be subject to mission drift. (See chart, page 6.)

WWB's management believes that if they had looked to formalization and deposits as a longer-term strategy to fuel growth, it would have been increasingly pressured to go after more affluent clients and disburse larger loans in order to make up for the increase in corporate taxes and costs of complying with more stringent reporting requirements. Access to alternative forms of funding has allowed WWB to stay true to its mission to serve the microenterprise niche. Finally, the loan guarantees also had an impact on WWB's strategic planning, prompting the management team to consider more creative sources of funding and funding structures, which eventually led to WWB's bond offering in 2005.

CONCLUSION

Today, WWB Cali is still the dominant player, as measured by market share, in the Colombian microfinance industry. The USAID loan guarantees marked a turning point in WWB's ability to access finance and fuel its impressive growth. These guarantees helped WWB evolve its relationship with local banks and its reputation in the market place, which WWB continues to leverage

in its relationships with Colombian lenders and bond investors to access increasingly favorable sources of funding. In February 2005, WWB Cali marked another first for the industry when it completed its first bond offering, issued in two tranches totaling $52 million local currency equivalent, without a guarantee from a third party. See WWB's debt structure as of August 2007 in Table 2.

WWB planned to issue its second bond offering in 2007 for a total of $200 million local currency equivalent, and recently received a loan from the IFC. Unless Colombia's regulatory framework changes significantly, WWB Cali will remain an unregulated NGO, committed to serving the microfinance niche. To that end, it will continue to fund its growth through loans and bond offerings.

[19] A novation constitutes the legal sale and transfer of an asset. As a point of contrast, an asset-backed securitization is an operation which utilizes a special purpose vehicle to legally isolate revenue streams from their underlying assets, thereby allowing the owner to parcel and sell future revenue streams without transferring the title to the underlying assets themselves. A novation, on the other hand, actually involves selling the underlying portfolio assets. In WWB Cali's case, a portion of the portfolio was sold at a discount, to account for portfolio quality and the time value of money. In Spanish, this operation is referred to as a "redescuento de letras" or, simply, a "descuento de letras"; in English, a novation.