

## First ever rated securitisation of micro loan pool

In a pathbreaking deal in the micro finance sector, IFMR Capital (earlier IFMR Trust Guarantee Company) and Equitas Micro Finance India Pvt Ltd (Equitas) have completed rated securitisation of a micro loan pool. The loan portfolio comprises priority sector urban micro loans originated by Equitas, with final maturity in October 2010. The principal amount of pass-through certificates (PTCs, or securities) equals INR 157 million. IFMR Capital structured and arranged the securitisation transaction after a comprehensive analysis of Equitas and the loan portfolio, based on its underwriting guidelines.

landmark transaction represents the first rated securitisation of micro finance loans in India. It is expected to open up new sources of debt capital, such as mutual funds, foreign banks, and NBFCs, for micro finance institutions.

The senior AA(so)-rated series A1 PTCs have evinced strong interest from domestic banks that find this security attractive from a risk return perspective. With the advent of a new capital adequacy regime in 2010, banks are expected to find more value in rated micro loan securitised PTCs.

S Bhaskar, COO, Equitas, says: "This rated securitisation transaction will

### Capital structure of securitisation

PTC	Yield terms	Principal (INR mn)	Principal %	Expected maturity	Legal final maturity (months)	Rating
Series A1	Fixed	125.4	80%	14	20	AA(so)
Series A2	Residual	31.3	20%	10	20	BBB(so)
Cash collateral		18.3	11.7% of issue size of PTCs	NA	20	Unrated

Crisil has rated the Series A1 and Series A2 pass-through certificates AA(so) and BBB(so), respectively. The PTCs will be issued by a special purpose vehicle, IFMR Trust Pioneer I (SPV), set up specifically for this securitisation. The securities are backed by micro finance loan receivables originated by Equitas.

While the AA-rated securities have been fully underwritten by a senior bank investor, IFMR Capital, the sole structurer and arranger, provides mezzanine financing in the form of an investment in 100% of the BBB(so)-rated Series A2 securities. For credit enhancement, Equitas provided a first loss facility in the form of cash collateral equal to 11.7% of the principal amount of the portfolio. This cash collateral, together with the extra interest spread being trapped in the SPV, are used to cover any shortfall in repayments on the AA(so) and BBB(so) securities. Investors in the AA(so)-rated Series A1 PTCs are further protected by the junior BBB(so)-rated Series A2 PTCs, which comprise 20% of the issue size.

The transaction is structured in such a way that the interests of all parties — the originator, Equitas; the structurer and mezzanine finance provider, IFMR Capital; and the bank investor — are aligned to ensure due diligence and performance of the underlying micro loan portfolio.

While unrated micro loan portfolio buyouts have been a common source of financing for some MFIs, this

help Equitas diversify its sources of funding and enable Equitas to offer micro credit at reduced cost to a larger section of the population."

### About IFMR Capital

IFMR Capital is a non-banking finance company based in Chennai, whose mission is to provide efficient and reliable access to capital for institutions that impact poor households. IFMR Capital acts as a bridge to mainstream capital markets for underserved sectors such as micro finance institutions, small and medium enterprises and agri-commodity-backed financing. IFMR Capital seeks to develop smooth and efficient access to capital markets by creating transparent criteria for evaluation of these new asset classes, standardising investment structures, and using financial structuring tools to generate high quality assets leading to price discovery, liquidity and growth in the new markets.

For more information on IFMR Capital, please visit:

<http://ifmrtrust.co.in/ventures/itgc.php>

### About Equitas

Equitas commenced business in December 2007 with the objective of making available finance at reasonable cost and in a transparent manner to women who are engaged in micro enterprise activities. It has 65 branches, with a portfolio outstanding of INR 1,850.7 million as on December 31, 2008, and a net worth of INR 630.2 million as on September 30, 2008.

## Conference on originate-to-distribute model

IFMR Trust Advocacy Unit (ITAU), along with IFMR Capital and Dun & Bradstreet (D&B), organised a conference on 'The Originate-to-Distribute Model of Credit Provision and Future of Financial System Design', in Mumbai on March 13, 2009. The conference brought together academicians, market participants and regulators to debate ways to strengthen the originate-to-distribute (OTD) model, particularly for rural finance. Participants also discussed ways to strengthen the process of securitisation, for scaling up Indian financial services.

Key presenters and discussants included PG Apte (IIM-Bangalore), Arvind Rangarajan (Director, Deutsche Bank), Anurag Gupta (Case Western Reserve University) and Dr Manoj Vaish (CEO, D&B India). Dr Sona Varma from ITAU made a presentation on the Indian experience with the OTD model, and Sucharita Mukherjee from IFMR Capital spoke on the application of OTD to the micro finance sector.

The panel discussion was moderated by Dr Nachiket Mor, President, ICICI Foundation for Inclusive Growth. ITAU proposes to publish the conference proceedings.



At the conference (l to r): Dr Sona Varma (Senior Advisor, IFMR Trust Advocacy Unit), Anurag Gupta (Associate Professor, Case Western Reserve University, USA), Dr Nachiket Mor (Chairman - Governing Council, IFMR Trust; President, ICICI Foundation for Inclusive Growth), Dr Manoj Vaish (CEO, Dun & Bradstreet Information Services India) and Prasad Koparkar (Head - Structured Finance Ratings, CRISIL)



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# Access

QUARTERLY NEWSLETTER OF IFMR TRUST AND ITS PARTNERS

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## Clean drinking water model makes waves in AP villages

For years the people of Vinjinampadu village in Guntur district, Andhra Pradesh, suffered serious health problems such as diarrhoea, joint pains, typhoid and frequent bouts of fever. None of the available water in the village was potable: the local pond's filter had fallen into disuse, the overhead tank that supplied water to homes was outdated, and the groundwater contained alarming levels of fluoride and chlorine.

WaterHealth India (WHI), a wholly owned subsidiary of WaterHealth International that has a presence in countries like Ghana, the Philippines and Sri Lanka, understood the situation well. WaterHealth International helps remote and underserved communities get access to safe drinking water by involving the community in setting up low-cost water purification plants. It is not a social service organisation; customers pay for the water they use. WHI's latest plant was inaugurated at Vinjinampadu on December 9, 2008. On the first day itself, 130 people registered as customers.

### Filling the supply chain gap

WaterHealth India launched its operations with support from IFMR Trust. Through its Network Enterprises Equity Fund, IFMR Trust seeks to address supply chain gaps across a variety of sectors. By incubating specialised supply chain companies, the Trust seeks to build 'networks' of enterprises in identified sectors.

Clean drinking water in remote rural India is a particular supply chain of interest to IFMR Trust and is pursued by the Drinking Water Network



The WHI plant in Vinjinampadu

Enterprise (DWNE). WHI has set up a total of 220 water purification plants, leveraging funding provided by DWNE. These plants are located in rural Andhra Pradesh (AP), between the districts of Hyderabad and Vijayawada.

Explaining the investment philosophy, Puneet Gupta, Senior Vice President, IFMR Trust, says: "While there are many people willing to supply water purification equipment, there are very few entrepreneurs who are ready to take on the challenge of distributing water to the vast rural population in the country. Hence, DWNE formed a partnership with WHI to provide clean drinking water to people, at an affordable cost. We are talking with several other potential business partners to reach different parts of the country."

### Innovative investment structure

IFMR Trust devised an innovative investment structure for WHI's plans in India, for which it required around INR 200 million (USD 5 million). The company's existing cash flows made the likelihood of getting a bank loan at reasonable rates rather slim. Financing the building of water plants purely by selling equity could have turned out to be an expensive option for WHI — if sales exceeded expectations and created a valuable enterprise. In any case, WHI's India plans involved capital-intensive projects that are usually financed by debt or project finance.

IFMR Trust worked out an arrangement with Acumen Fund, a non-profit global venture fund and one of WaterHealth International's early equity investors, whereby Acumen Fund agreed to provide a 15% first loss deficiency guarantee (FLDG) so that IFMR Trust could extend a loan of around INR 200 million to WHI. "What this meant was that if WHI could not make the interest payments, Acumen Fund would pay IFMR Trust on WHI's behalf, for a value of up to 15% of the total loan amount," explains IFMR Trust's Nayantara Kothari who was involved in the structuring of the WHI funding. IFMR Trust's loan to WHI carries a 15% coupon, in line with prevailing



WHI's patented water purification system commercial bank rates, and an eight-year term, plus a revenue share accruing to IFMR Trust, payable to IFMR Trust in the eighth year.

The arrangement benefits all parties. IFMR Trust gets a chance to earn an 'equity-like' return for taking an 'equity-like' risk. WHI did not have to sell more equity to achieve its growth targets. It got a funding instrument that allows it to reasonably match projected cash flows — from water sales with funding costs — it makes only interest payments early on until water sales increase enough to make principal repayments.

As a 'first impact' investor, Acumen Fund got the opportunity to achieve a five-fold impact with its money: its guarantee of around USD 1 million is responsible for the setting up and running of plants worth USD 5 million.

### Public-private partnership model

IFMR Trust's investment in WHI is unique in that it rests on a joint effort between the investee company and the village panchayat. After discussions with the company, the village panchayat is required to pass a resolution allotting it land and a water source to set up the plant. According to the standard agreement between WHI and the panchayat, for the first eight years WHI will maintain the plant and retain the revenue made from it. At the end of eight years, the plant will be handed over to the panchayat, after which the panchayat gets the right to revenue. If the panchayat chooses, the company will continue maintaining the plant after the eight-year period, for a service fee.

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## Clean drinking water model in AP villages

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The community is necessarily a financial stakeholder: it contributes 30-45% of the plant's cost.

WHI plants employ UV Waterworks (UVW), a patented, award-winning technology that uses an ultraviolet light source, suspended in air, to inactivate a broad range of micro-organisms. UVW delivers a high dose of ultraviolet light that inactivates micro-organisms through disruption of their DNA processes. When organisms try to replicate, they die. In addition, a multi-stage filtration process removes silt, taste and smells, converting contaminated water into clean, potable water.

### Cost of water

Water processed at WHI plants is sold at the rate of INR 2 for 12 litres, and INR 3 for 20 litres. At the time of registration, each customer is required to buy either a 12-litre can, for INR 100, or a 20-litre can for INR 150. Water is also delivered to people's homes at an additional cost of INR 4 per 12-litre can.

### Impact

WHI's system has caught on rapidly in the Guntur and Krishna districts of Andhra Pradesh where many rural people are aware of "plant water".

The biggest impact of the plants has been on health. "Previously, with the onset of winter there used to be at least 10 patients every week with fever or diarrhoea. But till now there have been none," says Dr D Hanumantharao, the village doctor at Raavipadu in Guntur district. In Lalapuram village, Lalapuram block, Guntur district, K Peddappa used to buy bottled drinking water at the rate of INR 10 for 20 litres. A customer of the plant in his village from the very first day, he says the "plant water" is not only much cheaper but also better. Another consumer in the village, Satyavani, says her family of five used to boil their water every day. Now they use up to 20 litres of "plant water" a day. Hotels in the area too have started using water from the plant.

"Universal access to clean drinking water seems like an achievable goal today because of organisations like WHI," says Bindu Ananth, President, IFMR Trust. "Ensuring adequate financing — debt and equity — for setting up and expanding drinking water utilities is a key component of the Trust's mission."

Read a more detailed story here: <http://ifmrtrust.co.in/fieldreports/water.php>

## Novel approach to low-income housing

India's rapid growth has led to a demand-supply mismatch in many areas. IFMR Trust seeks to fill such supply chain gaps in key sectors through its Network Enterprises Equity Fund. By incubating specialised supply chain companies (called network enterprises), the Trust hopes to build 'networks' of enterprises in identified sectors.

IFMR Trust's Vocational Training Network Enterprise (VTNE) has invested in the Hyderabad-based STRiVE, which is filling the gap between huge demand for entry-level jobs in the services sector and the desperate need for jobs among rural and semi-urban youth. Aarusha, a company mentored by IFMR Trust, takes this initiative one step further. It provides affordable housing solutions to people who migrate from rural and semi-urban areas to cities, to work or to study, and simply do not have the money to buy a house or even rent one.

Conceived by three experts from the housing sector, with support from IFMR Trust, Aarusha intends to be a supplier in the rental market as well as an intermediary in urban mass housing projects. The initial focus is on the first market, and the approach is simple: Aarusha has opted for a traditional solution — low-cost dormitories — and redefined it.

While low-cost dormitories in urban areas are generally crowded and dirty, with minimal amenities, Aarusha offers shared accommodation that is clean, safe, well maintained, and comes with basic furniture, a fan, and a toilet. The price tag is not steep. "Our price range is between INR 800 and INR 2,800 per month, depending on the location, room size and services attached," says V Satyanarayana (Satya), Aarusha's CEO.

Aarusha's offer has many takers. Starting operations in Chennai in August 2008, the company has, till date, around 1,500 customers in Hyderabad, Chennai and Bangalore. Most are young people from rural areas who are undergoing employment training or working in the three cities. The rest are students from villages and small towns.

### Business models

Aarusha is exploring three kinds of business models. In the first model, it buys inventory from existing hostel providers and supplies it to aggregated customers. In Hyderabad, Aarusha identified 22 existing hostel providers who could house around 900 children of self-help group members from rural areas, in the age-group 19 to 26 years,



One of the clean, well-maintained dormitories run by Aarusha

sent for training under the state government's Employment Generation and Marketing Mission (EGMM). As suggested by EGMM, Aarusha partnered with EGMM's training partner Skylark to provide the trainees accommodation.

Satya sees a lot of scope for expansion of this model. "We see scale from corporate and government sectors. In addition to the partnership with Skylark, we are working directly with EGMM and are in dialogue with other EGMM training partners."

In the second model, also initiated in Hyderabad, Aarusha set up dormitories in partnership with existing hostel providers, with shared investments and risks.

Three dorms were set up this way, with a total of 370 beds. In two cases, an existing hostel was bought; the third was built. In this model, the customer pays slightly more — around INR 2,000-2,800 per person, per month, inclusive of food. Aarusha's margins are also higher.

In the third model, tried out in Chennai, Bangalore and Sriperumbudur, Aarusha set up its own hostels — four dormitories with a total capacity of 170 beds. Accommodation is offered at INR 800-1,250 per person, per month, without food. In this model, Aarusha loses most on non-occupancy. Says Satya: "We will use this model as a last resort in situations where there are no existing hostel providers, or if partnerships with them don't work out."

IFMR Trust has offered strategic management and incubation support to Aarusha. Negotiations are on to provide debt capital for Aarusha's expansion. The company hopes to come up with shared accommodation for 5,000 people in the three cities of its current operation, by early 2010. "Our model works on volumes rather than margins," Satya explains.

Read a more detailed story here: <http://ifmrtrust.co.in/fieldreports/aarusha.php>

## Promoting rural savings through MMMFs

Megala R, a homemaker in Karambayam village, Thanjavur district (Tamil Nadu), was in a paradoxical position. She wanted to save regularly in a bank. But the nearest branch is in Pattukottai, around 10 km away. Distance apart, she found the process of opening and operating a savings account daunting — an introducer is needed to open the account, and a minimum deposit has to be maintained. Megala was a ready customer for a financial product, without a satisfactory product or provider.

The situation is repeated in millions of cases across rural India. While there are around 600,000 villages in the country, there are only about 45,000 rural branches of public sector banks and regional rural banks. The result: a huge demand-supply gap. Around 60% of India's rural population remains 'unbanked'.

In this situation, Kshetriya Gramin Financial Services (KGFS) companies, promoted by IFMR Holdings, have found a workable solution. Pudhuaaru KGFS (PKGFS), the first KGFS company launched by IFMR Holdings, in Thanjavur district, is promoting a mutual fund instrument that offers safety, ease of operation and the opportunity to earn returns comparable to, if not better than, interest earned on a bank savings account.

Since December 2008, PKGFS has been promoting among its customers ICICI Prudential Liquid Plan, a Money Market Mutual Fund (MMMF) product that offers protection of the principal amount, easy liquidity, and low entry requirements.

"An MMMF," explains Nitin Chaudhary, Senior Manager, IFMR Holdings, "is a mutual fund that invests solely in money market instruments, which are forms of debt that mature in less than one year and are very liquid. Treasury bills make up the bulk of the money market instruments." The short duration of an MMMF investment portfolio makes it less sensitive to changes in interest rates, compared to

other debt products of mutual funds, and portfolios are structured to generate optimum interest income — there have been only a few, very rare cases in India where MMMFs have given one-day negative returns.

An advantage, compared to bank savings accounts, is that MMMFs earn compound interest; the interest earned is reinvested in the principal, earning more interest. In fact, MMMFs have been offering returns that are not only higher than returns on bank savings accounts, but even bank fixed deposits (see table below, 'Annualised tax returns on MMMFs').

There is one disadvantage vis-à-vis a bank account. You can put in or get money out of a savings account immediately — by going to the branch where you have the account, or going to an ATM. In the case of a mutual fund product, there is a one-day delay: a customer who submits a redemption request today, before a specified cut-off time, will get the money only tomorrow.

PKGFS customers, however, are spared even this inconvenience. The company has devised a system whereby investments made by MMMF customers on a particular day are transferred to an 'investment parking account' and remitted to the mutual fund before the cut-off time, on the same day. Likewise, on submitting a redemption request, the customer gets money from PKGFS immediately. The amount is treated as a loan, advanced by PKGFS for the period between the time the redemption request is placed and the redemption amount is received from the mutual fund.

With such ease of operation, coupled with security of the principal and relatively attractive returns, investments in MMMFs become a good way to build capital. This is what Megala is doing. She invests INR 100-200 periodically in MMMFs, applying for redemptions only when required. Other customers like Rajkumar, who has a small cycle-repair shop next to the PKGFS branch in

Karambayam, use MMMFs more like a savings bank account, by investing and redeeming frequently.

In the three months since it introduced the product, PKGFS has over 80 MMMF customers who have invested a total of around INR 70,000.

Any for-profit or not-for-profit private, professionally run or community-based organisation can replicate this model in a remote rural location, after securing the required certification to sell mutual fund products. However, some investment in technology is necessary.

IFMR Trust Senior Vice President Anil SG explains: "Distribution of mutual fund products is a highly data-intensive process requiring a lot of computation, with inputs from Registrar and Transfer Agents (RTAs) of mutual funds. Without a robust technology platform, mutual fund distributors will have to spend a lot on paper and paper transport costs, which may make MMMF distribution unviable."

PKGFS has invested in a proprietary Customer Management System (CMS), which is used to capture the demographic profile of its customers. The CMS generates pre-populated application forms, transaction feeds for different products, and also acts as an RTA database for the MMMF product.

PKGFS got around another obstacle faced whilst offering MMMF products: customers have to have a PAN card. While a PAN card is mandatory for income tax payers, many individuals in rural locations, who have low incomes, are unaware of PAN cards and the rather cumbersome process of obtaining one. PKGFS manages this challenge by helping customers fill in PAN applications and sending the forms, in bulk, to PAN centres authorised by the income tax department. Customers have to pay a one-time application fee of INR 67. A photograph and proof of residence are required.

While these requirements would undoubtedly be barriers for the promotion of MMMFs in many rural locations, IFMR Holdings is ready to bridge a major part of the barrier.

Says Anil SG: "As part of our mission to maximise the financial wellbeing of every individual and every enterprise, by providing financial services in remote rural locations, we are willing to offer free software and training to organisations interested in offering MMMF products."

Read a detailed technical note on this subject by Anil SG and Nitin Chaudhary here:

<http://ifmrtrust.co.in/downloads/MMMF.pdf>

Annualised tax returns on MMMFs (returns over three months)

Parameters	Instruments		
	Bank savings	Bank fixed deposits	MMMFs*
Annualised interest rate (yield)	3.5%	7.5%	8.06%
Tax rate**	33.99%	33.99%	22.06%***
Annualised post-tax returns	2.31%	4.95%	6.28%

\* Quantum Liquid Fund

\*\* Highest tax for individuals

\*\*\* Effective divided tax paid from NAV

Source: 'Put "idle" cash to use', Business Line, August 31, 2008