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Nice work

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The highlight of last week's activity in the capital markets was undoubtedly the news that Brac, the Bangladeshi microfinance institution, had closed Asia's – and possibly the world's – first securitisation backed by microcredit loans.

At just US$15m equivalent, the transaction was only a tiddler but it is the first off a six-year programme that should eventually raise US$180m for Brac. All being well, the programme will not only provide certainty of financing but, judging by the first issuance, it will do so at some 200bp below Brac's current cost of funds. That is a lot of money saved – money that will go to the poor of Bangladesh.

Apart from the remarkable loss numbers in Brac's loan portfolio – just 2% for unsecured lending to the rural poor – the most impressive thing about the deal is that those who put it together attempted to do so in an entirely commercial way to ensure the deal is completely replicable for Brac, for other Bangladeshi microlenders and for microlenders elsewhere in the world.

Those involved insist that, while the presence of development finance institutions FMO of the Netherlands and KfW of Germany enabled the first issuance and set the programme rolling, Brac will be able to sell future tranches of paper without the involvement of any multilateral body. The fact that three local banks – counting Citibank Bangladesh in that category – bought a third of the deal (a portion without any external credit enhancement) seems to support that contention.

Despite what anti-capitalists argue, it is often the case that the financial industry benefits the poor, but it is usually hard to see that actually taking place. In this case, those involved were unambiguously on the side of the angels, which must have made a groundbreaking deal all the sweeter.

Not easy

While we're on the subject of tricky ABS deals, we have a word of advice for those bankers at ABN AMRO who have recently been mandated on a securitisation for Indonesia's Federal International Finance: give up, lads.

Including those involving domestic deals, this is, by our count, the third ABS mandate that FIF has handed out in the past few years – and those are just the ones we heard about. None has made it to market and it will take a bit of fancy footwork to get this one anywhere close.

Pick a number

Asia's financial markets were remarkably sanguine last week after the sabre rattling from North Korea's Dear Leader in the shape of a series of ballistic missile tests.

Admittedly there was something Heath Robinsonesque about the exercise, with the long-range missile managing just 40 seconds of flight, but should these actions from the world's weirdest nuclear power be worth just 2bp of widening in Asian CDS? That's what happened, with even South Korean spreads hardly moving.

This is one of those "pays yer money and takes yer choice" questions. On the one hand, some suggest that the regime – finally entirely cut off from the global financial system – is this time, really, definitely, on the brink of collapse with all that that means: a potential nuclear war at worst or many millions of starving North Korean's descending on the South and China at best.

Others point to surges in Seoul's Kospi stock index in the aftermath of previous North Korea-inspired selloffs to argue that any dip would be a buying opportunity.

So how to price in those risks on Asian CDS spreads? Ooh, we'd say about 15bp!

Loans overdue 1–30 days stood at 11.5% of total contracts in 2005, up from 10.1% in 2004, while those overdue 31–60 days were around 2.8% in 2005 versus 2.4% a year earlier. Loans overdue 61–90 days were at 0.8%, up from 0.5% while delinquencies ranging in the 91–150 day period stood at 0.9% in 2005 versus 0.6% in 2004.

If a deal does arrive, potential investors will be comforted by the fact that Astra is majority owned, through Singapore's Cycle & Carriage, by Jardine Matheson, a multinational company that will be careful not to burn investors needlessly.

However, Jardine's reputation with investors knowledgeable about Indonesia is not entirely unblemished. The company acquired the Astra group of companies in the aftermath of the Asian financial crisis and when Astra relapsed into a second round of defaults in 2001, Jardine wasn't afraid to impose a controversial restructuring on the group's creditors.

... head out on the highway

Another powerful argument that ABN will be able to martial if and when a deal does come to market is the remarkable performance of those Indonesian ABS deals closed before the Asian crisis struck. Unlike nearly every other debt transaction closed around that time, all the Indonesian securitisations arranged before the crisis paid down without investors losing any principal.

This is not the first time that FIF has talked about motorcycle loan-backed securitisation. In August 2004, the company mandated a potential Rp500bn (US$54m) onshore deal to Kresna Securities. A considerable amount of work was done on the deal, with Pefindo working on the rating, but it came to nothing. (*See IFR Asia 302.*)

Matthew Davies, Shankar Ramakrishnan

SECURITISATION

Bangladesh's Brac establishes template for microfinance ABS

Brac, a Bangladeshi body that claims to be the largest NGO in the world, last week closed Asia's first securitisation of microcredit loans and the first securitisation in Bangladesh.

The deal effectively launches a new asset class – one that has been talked about for many years – and therefore potentially sets up a template to provide ongoing financing for Brac and other microcredit institutions.

"The transaction provides a new way for microfinance institutions to fund their microcredit programmes while reducing dependency on volatile donor financing," a Brac official said.

Those involved acknowledged that the participants devoted time to get the deal off the ground as a development finance initiative, but insisted that the resulting programme and the first trade were structured, priced and sold entirely on a commercial basis. "The effort was to make the structure and the underlying collateral achieve the best possible rating for the issuer and the pricing is commensurate with that. That's exactly what Brac asked everyone to do," said Bob Annibale, global director of microfinance at Citigroup. "Otherwise there's little prospect for scaling up or diversifying Brac's investor base – it has to be based on more than an interest in seeing microfinance succeed."

The securitisation programme should raise Bdt12.6bn (US$180m) over a period of six years. The programme is structured so that new one-year maturity paper is issued every six months, with Bdt1.05bn to be issued each time. The first Bdt1.05bn came last week through Brac Micro Credit Securitization Series 1.

Precise pricing details were not disclosed, but Brac said that its all-in funding cost – including fees paid to bankers, lawyers, the rating agency, etc – was around 11%. While that is about 200bp inside Brac's normal cost of funds the yield is also juicy enough to encourage investors to get involved. For comparison, the Bangladesh government's six-month treasury bill, the most liquid benchmark, was trading last week at around 7%.

The assets backing the deal are microcredit loans made to the poor primarily in rural communities not reached by Bangladesh's commercial banks. The average outstanding principal of the loans is around US$95. The dynamic pool will contain about 3.3m loans for the life of the transaction. Brac's normal loss on its loan portfolio is about 2%, a level that compares very favourably to loss numbers in normal consumer loan deals in developed markets.

The simple passthrough structure sees a special-purpose trust purchase the receivables from Brac and issue certificates to investors representing beneficial interest in the receivables. All principal and interest payments are in Bangladeshi taka.

The initial issuance of certificates was divided into three tranches, each of which rank pari passu. There is no subordination, just 150% overcollateralisation of receivables.

The three tranches went to different investors. Netherlands development institution FMO purchased a third of the certificates and Citibank purchased another third, with its share backed by a guarantee from FMO and counter guarantee from Germany's KfW. The final third was divided between Citibank Bangladesh and two local banks – Tubali Bank and (unrelated) City Bank.

Those original investors are likely to continue to invest over the life of the programme, but those involved will also seek to bring in other investors. Some might suggest that the provision of guarantees on some of the certificates by FMO and KfW detracts from the truly commercial nature of the deal. But those involved insist that the involvement of the development institutions will not be necessary for future issuance of the programme and simply served to get the first transaction away in order that other potential investors can see how it works.

"This first deal was only intended to be for these five investors because we wanted to let it run for a year – go through the plumbing – so that then we can bring other investors in," said Annibale.

RSA Capital is the lead arranger, with *Citigroup*, FMO and KfW acting as co-arrangers. RSA is a financial boutique based in Dhaka and Boston.

The deal is also a significant moment in the development of Bangladesh's capital markets. It is the first securitisation and the first deal to be rated Triple A. The rating comes from the Credit Rating Agency of Bangladesh.

"We have brought the global financial markets to the doorsteps of nearly 1.2m households in Bangladesh. As one of the largest financing efforts ever dedicated to advancing poverty-focused microcredit, this is a landmark for the microfinance industry," said Fazle Hasan Abed, Brac's chairperson.

Brac employs more than 100,000 people, mostly in Bangladesh.

Matthew Davies