R-co 4Change Impact Finance, meeting the financial and ethical goals of investors

As a new fund in the Rothschild & Co range, R-co 4Change Impact Finance offers to invest in Emerging markets through microfinance, a vehicle aimed at generating a positive social impact among communities excluded from the "traditional" financial systems.

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How would you define microfinance?

Constantin Augier: Microfinance consists in providing access to financial services and support to communities excluded from the "traditional" financial systems. Its purpose is therefore financial inclusion. Beyond microcredits, the most widespread example, it covers a wide range of services, including deposits, loans, payment services, insurance etc. All these measures generally aim at enabling people to create or develop small businesses and, ultimately, improve their living conditions.

Its operation relies on microfinance institutions (MFIs), primarily non-profits, micro-banks, NGOs, or cooperatives that come in contact with the population and offer access to those services. As such, these institutions pursue a social purpose through a mission of development assistance, but also an economic goal, so as to ensure their sustainability and the continuity of this mission.

"Away from a charitable mindset, beneficiaries of MFI services become real agents of change..."

They benefit from several sources of financing, the main one often coming from investment funds such as R-co 4 Change Impact Finance.

The principle of financial inclusion is central as the role of MFIs is to provide support in the implementation of projects, and not just simply to maintain a creditor-to-borrower relationship. Away from a charitable mindset, the beneficiaries of these services become real agents of change. While it is not a magic solution to poverty, microfinance can, however, be a solution to reducing it.

How would you describe R-co 4Change Impact Finance?

C. A.: R-co 4Change Impact Finance is a microfinance investment vehicle. This type of investment product is similar to a private debt fund and thus operates outside of the listed markets. It can therefore be seen as an interesting diversification solution as part of a global allocation due to its decorrelation with the main asset classes and its low volatility target. The portfolio is invested in a number of mid-sized MFIs selected by our partner Symbiotics, through loans with a maturity of 12 to 36 months. These amounts lent to institutions will enable them to provide the financial services they offer.

Where does the willingness to develop this investment solution come from?

C. A.: This initiative is the result of a convergence between our wish to offer solutions with a high social impact and the wish expressed by our clients to give meaning to their investments. In addition, microfinance is relatively unexplored by asset management companies, so the supply of funds to finance this sector is very limited. As a result of this low awareness, there is a very large financing gap to meet the needs of MFIs.

Historically, microfinance was mainly an area for philanthropists, International organisations or large institutions, such as the World Bank or the IMF, but more and more private capital is entering the circuit. Indeed, if the smallest organisations are financed with subsidized rates by International institutions and the largest by banks at very low rates, between these two categories, the remaining 80% of institutions have to rely on private funding. It therefore seemed particularly relevant to us to develop a product that could address this threefold issue.

Why did you choose Symbiotics to create this fund?

C. A.: Symbiotics is one of the leading microfinance companies in Europe. We entered this partnership because it gave us the opportunity to develop a fully tailor-made product. Symbiotics was for us the wise and logical choice, as they are able to ensure the management of the portfolio, the technical assistance, and all required services. This partner provides support throughout the entire process including due diligence, credit origination, structuring and issuance of loans granted to MFIs etc.

Apart from ensuring its distribution, what is the role played by Rothschild & Co in managing this fund?

C. A.: We have an advisory role and are in charge of defining the main guidelines for the fund's management. Every month, we organise an advisory committee with Symbiotics to discuss various investment opportunities. We carry out a macroeconomic analysis and determine the structure of the portfolio in terms of allocations and desired levels of diversification and loan maturities. We also define the exclusion criteria we wish to apply to the portfolio and, of course, impose our Group policy in this area.

Symbiotics, *a leader* in microfinance

Symbiotics is a Geneva-based company that was set up about fifteen years ago and that specialises in sustainable and inclusive finance in emerging countries.

Its founders come from the microfinance asset management and computer software development sectors and have acquired specific knowledge of microfinance with the determination to involve as many stakeholders as possible on this topic.

Their main expertise is in research, origination and ranges from advisory to portfolio management. They also have the capacity to provide technical assistance to MFIs and to advise them in order to help them grow and structure themselves.

Since its creation, Symbiotics has recorded nearly 5,000 loans for an amount exceeding USD 5 billion, of which more than 2 billion are currently under supervision or under management, through 72 countries.

We also have the opportunity to specifically target certain sustainable development goals defined by the United Nations by directing our investments towards MFIs involved in specific initiatives, such as the development of green energy or the reduction of gender inequalities. We are also involved with liquidity management and hedging the portfolio against currency risk: we sometimes adjust it in order to optimise returns.

What makes this fund different from a "traditional" fixed income fund?

C. A.: The main difference comes from the portfolio's risk/return profile. This type of fund is intended to have a very low volatility and is not correlated to key interest rates and "traditional" asset classes. Apart from credit events, this investment solution ensures stable returns. The second important point here concerns liquidity. A "traditional" fixed income fund can offer daily liquidity thanks to its market that allows it, but in our case, liquidity is only available quarterly, to the extent that to remove a loan from the portfolio, we must wait for it to reach maturity.

Are there any specific risks associated with this particular asset class?

C. A.: Investing in Emerging countries *via* microfinance does indeed involve certain risks, in particular country risk on the economic, political and macroeconomic fronts. However, Symbiotics

carries out a macroeconomic analysis before any investment is made. The beneficiaries assessed must offer guarantees and a certain stability in terms of these three aspects. Regarding the currency issue, we have chosen to fully hedge the currency risk within the portfolio. Finally, it is important to note that the risk of default by MFIs is quite low, due in particular to the size and maturity of the loans granted. Nevertheless, to limit this risk, we position ourselves on fairly short maturities, not exceeding three years, in order to not expose ourselves excessively to the lack of visibility to which some institutions may be subject.

Nevertheless, this risk of default exists, what measures do you implement in such situations?

C. A.: A valuation committee is organised every month. If most of the time there is no incident to report, in case of a credit event, Symbiotics will contact the institution concerned, seeking to identify the reason and see if the problem is related to the country, the institution itself, the currency, or an exogenous shock. Following this investigation, Symbiotics will present us with the MFI's valuation assessment and implement solutions to deal with the default. This may include the set-up of a new payment schedule, a debt restructuring etc. Symbiotics will therefore reflect on the solutions to be implemented and even possibly join forces with other creditors. Symbiotics has long expertise in the management of such cases and has set up a particularly well-established process with a high recovery rate.

How does Symbiotics identify the MFIs in which they invest?

C. A.: Symbiotics has three major regional analysis offices in Latin America, Africa, and Asia, as Central Europe and Middle East are cover from Geneva. Each of them has some ten analysts in charge of about fifteen MFIs in two or three different countries. These analysts regularly visit the areas they are responsible for, to meet with the MFIs in which they have invested in or to identify new ones. The time spent on site allows them to have a thorough knowledge of the territory in which they operate and of the local institutions.

“Among the indicators used to measure the positive impact of the MFIs, the number of regular borrowers is particularly revealing...”

Each MFI identified is the subject of a social impact study based on 98 objective, transparent and mostly quantifiable criteria, structured around major themes such as social governance, working climate, financial inclusion, client protection etc. The resulting assessment is in the form of a scale including both the positive and negative impacts of the institution studied. The issue of over-indebtedness of communities and how the institution will monitor and manage this type of situation is a key issue in these assessments.

What indicators do you use to assess the social impact of your investments?

C. A.: We have access to a monthly report through which we know the number of end clients who have benefited from our investments andthe gender distribution, but also the average amount of financing, whether such financing has benefited rural or urban communities and the nature of the activities concerned. However, among the indicators used to measure the positive impact of the MFIs, the number of regular borrowers is particularly revealing. Indeed, this reflects the relation of trust between the two parties. In addition, the fact that a person renews a loan implies that they were able to repay the first loan, but this can mainly be interpreted as a sign of growth.

Symbiotics also publishes a detailed annual report incorporating feedback from MFIs and micro-borrowers who have benefited from financing from the portfolio. This report focuses on certain sustainable development goals to determine the results achieved regarding these specific issues. This makes it possible to illustrate with concrete cases the positive effects, the number of people directly or indirectly impacted and, in particular, those who, due to these measures, managed to overcome a situation of extreme poverty. ■

Recommended investement period: 3-5 years

The Sub-Fund is ranked 2 on the synthetic risk and reward indicator scale, which is based on historical data. Due to its exposure to fixed income markets, the Sub-Fund may experience medium volatility, as expressed by its rank on the above scale. Historical data may not be a reliable indication for the future. The risk category shown is not guaranteed and may shift over time. There is no capital guarantee or protection on the value of the Sub-Fund. The lowest category does not mean “risk free”. Special Risk Considerations: risks linked to transactions with FI, credit risk, counterparty risk, emerging and frontier economies risk, liquidity risk, leverage risk, changing interest rates risk, foreign exchange/currency risks. Please refer to the full Prospectus for additional details on risks.

Disclaimer

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About the Asset Management's division of Rothschild & Co

As the Asset Management's division of Rothschild & Co, we deliver bespoke investment solutions to institutional clients, financial intermediaries and third-party distributors. We aim to develop complementary expertise in active high-conviction management and open architecture investment solutions. Based in Paris with offices in 10 European countries, Asset Management's division of Rothschild & Co has around 170 employees and over 21 billion euros under management. For more information: www.am.eu.rothschildandco.com