

## RESEARCH

## Preliminary Ratings Assigned In Groundbreaking Microfinance CDO BlueOrchard

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NEW YORK (Standard & Poor's) May 3, 2007—Standard & Poor's Ratings Services said today that it assigned its preliminary credit ratings to the \$58 million (equivalent) floating- and fixed-rate notes series 2007-1 to be issued in a groundbreaking microfinance collateralized debt obligation (CDO) transaction, BlueOrchard Loans for Development S.A. (Compartment 1) (Compartment 1) (BOLD), a Luxembourg-regulated SPE.

At the same time, an unrated portion of \$50 million will be issued as part of the credit support (see list below).

This is the first time that a microfinance CDO has been rated publicly, creating a milestone in the development of the microfinance market.

The notes will be collateralized by a portfolio of unsecured loans to 21 microfinance institutions (MFIs) based in 13 developing countries (Azerbaijan, Bosnia, Cambodia, Colombia, Georgia, Ghana, Kenya, Mongolia, Montenegro, Nicaragua, Peru, Russia, and Serbia). The unsecured loan proceeds will be on-lent by the MFIs to approximately 100,000 of economically deprived obligors who are typically unserved by the traditional banking system.

The transaction has been arranged by Morgan Stanley & Co. International PLC in a repeat of the unrated 2006 BOLD deal. It has again involved Geneva-based BlueOrchard Finance S.A., which selected the MFI loan portfolio and will act as manager/servicer for the loans. Standard & Poor's will soon release a CDO Manager Magnifier report on BlueOrchard Finance.

At closing, BOLD will use the note proceeds to fund the loans to the MFIs. All but two loans (which must fund within 15 and 30 days) will fund at closing. All but one of the loans will be fixed rate, the majority will be five-year bullet, and they may potentially be denominated in U.S. dollars, euros, Peruvian nuevo soles, Colombian pesos, Ghanaian cedis, and Russian roubles.

The preliminary ratings reflect:

- The credit enhancement provided through the subordination of cash flows to the respective classes;
- The credit estimates performed on each of the MFIs;
- The transaction's cash flow structure, which was subjected to various stresses requested by Standard & Poor's;
- The collateral manager's experience in the microfinance industry;
- The currency swaps are expected to be provided by Morgan Stanley (AA-/Positive/A-1+) as well as Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (FMO) (AAA/Stable/A-1+) and interest rate swaps from Morgan Stanley;

- The reserve account, whose initial balance will be funded over time through excess spread and drawn upon as required to cover shortfalls in the priority of payments; and
- The issuer's expected bankruptcy remoteness at closing.

Assigning a rating for the first time to a microfinance CDO is significant in this market's emergence into the mainstream.

Very few of the world's estimated 10,000 MFIs have directly accessed the capital markets, with most historically relying on donations and subsidies to fund the loans and other financial services they offer. There are various reasons for this, centered principally on the reluctance or inability of institutional investors to expose themselves to unrated firms with varying legal structures—from regulated to unregulated, from corporate entities to non-government organizations (NGOs).

Standard & Poor's ability to analyze and rate microfinance CDOs gives MFIs greater access to the capital markets through securitization. Institutional investors require consistent, transparent metrics to assess the credit quality of MFIs and means of evaluating their performance on a global basis. Assigning ratings to the notes imparts credibility to this asset class, allowing this transaction and future ones to be assessed by investors in a way not possible before.

In rating this transaction, Standard & Poor's relied on the analytical skills of its financial institutions and structured finance practices. The financial institutions team performed credit estimates on all the MFIs and the structured finance analysts adapted standard CDO credit analysis with other factors specific to microfinance and emerging markets. This was coupled with supporting legal analysis.

Overcoming these analytical hurdles and assigning ratings is likely to stimulate demand for securitization notes with exposure to MFI loans, although our growth expectations for this sector are for a steady—but not meteoric—flow of transactions in the medium term.

Standard & Poor's expects a further two or three of these types of CDO transactions in 2007, backed by unsecured loans made to MFIs across a wide range of countries, including the ones in BOLD 2007.

While the size of the world's microfinance market is set to grow phenomenally in the next decade—with a predicted rise to at least \$250 billion from today's \$17 billion—growth in microfinance securitizations will certainly not match this. The reason is clearly not a lack of collateral but rather that the market must first overcome the obstacles that currently hinder the MFIs' access to international capital: a lack of transparent and reliable data, unhedged foreign exchange risk, and institutionalizing best practices, to name a few.

The scope of this challenge is encapsulated in the fact that a mere maximum 1%-2% of MFIs are currently considered large and sophisticated enough to potentially engage in a securitization. While these 100-200 institutions will undoubtedly benefit from the diversity of funding that securitization represents, they alone will not set the securitization market alight in the near term. For truly impressive growth, the MFI sector as a whole will need to implement best practices, minimum reporting standards, as well as focusing funding efforts on the second and third tier MFIs, among many other things.

The cost of doing this currently prohibits most from attaining the minimum size and level of sophistication required to access international capital, but a worldwide initiative (perhaps from a concerted effort by multilateral institutions and capital market institutions, coupled with philanthropic foundations and socially responsible investors) may vastly increase the number of MFIs accessing the capital markets.

Without an initiative of this sort the vast majority of MFIs will still rely on historical sources of funding, perhaps aided by savings deposits in some

cases. But however limited the number who can engage in a securitization, the microfinance market has taken a significant step in the right direction with the launch of the rated BlueOrchard transaction.

The full presale report for this transaction was published today. This article, and a related media release "Microfinance Securitization Is Still In Its Infancy, But A Rating Methodology Is In The Works" published on March 22, 2007, are available to subscribers of RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at [www.ratingsdirect.com](http://www.ratingsdirect.com). The presale report can also be found on Standard & Poor's Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Select Ratings, Structured Finance, then choose the asset class. The presale is under the Reports tab. Alternatively, call Client Support Europe on (44) 20-7176-7176.

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#### RATINGS LIST

BlueOrchard Loans for Development S.A. (Compartment 1)  
\$108 Million (Equivalent) Floating- And Fixed-Rate Notes Series 2007-1

Class	Prelim. rating	Prelim. amount (Mil. \$)
A	AA	42
B	BBB	16
C	NR	42
X	NR	8

NR-Not rated.

This press release is based on information as of May 3, 2007. The ratings shown are preliminary. This report does not constitute a recommendation to buy, hold, or sell securities. Subsequent information may result in the assignment of final ratings that differ from the preliminary ratings.

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