

1. Introduction and purpose of Oikocredit and the Foundation

Oikocredit

Oikocredit (the Society) was established in 1975 in Rotterdam, the Netherlands, and possesses corporate status according to the laws of the Kingdom of the Netherlands. The Society is owned by its members throughout the world; churches, subdivisions of churches, councils of churches, church-related organizations, partner members and support associations established by individuals and local parishes. The Society has an undefined ending date.

The main objective of Oikocredit is to mobilize financial resources (not being grants) from members as well as third parties, mainly in developed countries, and to channel the proceeds thereof as loans or investments to partner organizations in order to raise standards of living and support small entrepreneurs in the developing countries.

By continuously issuing shares to its members, numbering 598 members at 31 December 2012, Oikocredit mobilises the capital needed to carry out its mission of development financing through partner funding.

Mission: Oikocredit, as a worldwide cooperative society, promotes global justice by challenging people, churches and others to share their resources through socially responsible investments and by empowering disadvantaged people with credit.

Vision: Oikocredit will be a highly respected and leading provider of opportunities for socially responsible investments and credit for development.

Support Foundation

The main purpose of this Support Foundation is to mobilize grant funds to assist Oikocredit in the various activities it deploys in developing countries and also assist Oikocredit partners in developing countries.

A. Covering non-banking costs of Oikocredit and its partners

Non-banking costs can be defined as support to our partners and our network beyond regular financial services. Examples of these costs are:

- capacity building activities for Oikocredit partners
- strengthening of social performance management skills for both Oikocredit partners as well as Oikocredit staff
- support for Oikocredit members based in developing countries to participate in the decision making processes of Oikocredit

B. Covering excessive risks related to lending by Oikocredit to its partners

The Foundation also covers excessive risks related to Oikocredit's lending to partners through:

- establishment of a grant based Local Currency Risk Funds to cover excessive risks of local currency lending to Oikocredit's partners in developing countries
- establishment of grant based Guarantee Funds to extend guarantees for high risk partners in developing countries

C. Accepting donated member capital from Oikocredit members

2. Activities of the Foundation

A) COVERING NON BANKING COSTS

ACTIVITIES

1. Capacity building and social performance management (SPM) activities¹

In addition to providing financial services to partners, Oikocredit offers capacity building to strengthen and support partners. The Foundation offers capacity building as it has been proven that providing financial services to partners alone is not enough. Weaker or start-up partners have to be “accompanied out of poverty” by more than just credit. The needs of partners and potential partners are very diverse and requested initiatives can be costly and time consuming. Oikocredit must therefore make choices. One important choice is to obtain funding through the Foundation for capacity building and to strengthen social performance management of Oikocredit and its partners at various different levels.

Experience has shown that capacity building is also needed for other reasons. At times partners need short-term assistance to overcome specific difficulties such as conducting market research, developing management information systems, training staff in product development, etc. At times a feasibility study is needed to check whether a potential partner has the capacity to take on a loan and repay over time. In quite a number of cases, capacity building is needed to mitigate risks and assist partners to remain viable.

At times substantial assistance and long-term assistance is needed which goes beyond the services Oikocredit can offer. For example, Oikocredit partner, Terrafina, offers support to emerging microfinance institutions in a number of African countries. This support is extensive and includes consultancy, often combined with some financial support to start-up activities.

To address these different needs, various levels of capacity building support have been identified.

- Social performance related capacity building

This is the foundation of the capacity building program which strengthens the social performance management of Oikocredit’s partners. In practical terms, this ensures that partners have the capacity to effectively and efficiently deliver the assured value or benefit to clients or target groups in a sustainable way. This entails two services; analysis (social audit) and follow-up.

Analysis:

Support to improve social performance management is an important service that is offered to partners. It begins with the due diligence process where a potential partner is assessed on its social, financial, environmental and technical merits. The due diligence process is a very important starting point and assists both the partner and Oikocredit in analyzing the strengths and weaknesses of the organization in its delivery of services to improve the lives of those it aims to support. Strengths and weaknesses can be identified in systems, qualifications of staff and products and services. In a number of cases, partners choose to conduct a social audit with external assistance to broaden their knowledge about social performance management. Social audits can be costly and time consuming. The Foundation is therefore willing to cover part of these costs.

Follow-up:

Social audits only make sense when there is an intention for a follow-up to work on improvements based on the outcome of the analysis. An integrated part of the capacity building service is to therefore assist partners in follow-up activities related to the outcome of the audit. The Foundation, in cooperation with its donor partners, will try to secure funding to enable the implementation of follow-up activities needed to enhance social performance.

¹ Includes technical assistance and feasibility studies

- Other specific types of support

In addition to SPM related support, Oikocredit and its field staff have identified a number of strategic areas where many partners require additional support. These areas include risk management and governance and product and market development. As partners scale-up their operations over time, they need to also develop in the areas of risk management and governance. These areas are often overlooked and it is presumed that providing credit or working capital is sufficient to ensure success. Oikocredit's many years of working in the field shows that support is needed to scale-up management and related capacities as well. Organizational systems and processes need upgrading and updating and new systems often need to be introduced. Agriculture continues to be the source of income for millions of the world's rural poor. Providing support to the various stages of the agricultural value chain is important for Oikocredit, as it is actively seeking to increase its development portfolio in this sector. Oikocredit is currently developing programs and specific capacity building initiatives to support partners in these areas.

- General capacity building

Not all capacity building support is directly linked to SPM or the issues mentioned above. At times partners or potential partners require other types of support such as feasibility studies or extensive reorientation in the market. The Foundation aims to facilitate these requests if the proposed intervention clearly strengthens the partner in fulfilling its mission and the request also fulfils the donor's conditions to support the program.

- Referral

Oikocredit field staff, SPM managers and Oikocredit International staff will use networks, relations and expertise to refer partners to institutes, consultants and networks that can offer requested capacity building support by partners.

2. Other non-banking activities

Oikocredit is an international organization which focuses on development finance. It values the contribution of its members in decision making processes in developing countries. Not all members in developing countries have the means to attend meetings. Therefore, support is sometimes provided through the funding of travel costs to attend Oikocredit's annual general meetings.

CONCRETE PLANS FOR NON-BANKING COSTS FOR THE NEXT FIVE YEARS

To further fulfil Oikocredit's mission, a dedicated department named Social Performance and Financial Analysis was established in July 2009. The department's basic objective is to position Oikocredit as an organization that ensures its financial support leads to improvement of the lives of the poor. Initially, the department was devoted to better understanding partner's needs, particularly their social objectives and goals, conduct and outcomes. With these systems now fully in place to support this, the department has shifted its attention to focusing on what is happening at a client level.

Important plans for the next five years include:

- coordination with partners, universities and other engaged institutions in identifying change at client levels
- revisiting partners who have benefitted from capacity building support and identifying changes which have been sustained
- continuing the alignment of Oikocredit's tools within the sector
- continuing to support the improvement of various areas of partners' operations to ensure sustainable, effective and efficient delivery of benefits and value to poor people
- strengthening small agriculture enterprises directly to benefit the rural poor (this will have priority)
- developing a stronger environmental lens in due diligence and raising partners' awareness about potential or possible environmental impacts
- promoting the focus on social performance on an international level by participating in key networks related to SPM such as MF Transparency, the SMART campaign and the Social Performance Task Force
- collecting and disseminating important lessons learned in the area of social performance for internal and external purposes

FUNDING OF NON BANKING COSTS

Part of the funding is offered through services and other non-financial assistance. Over the years, Oikocredit has built-up relations with organizations such as PUM (a Dutch semi-government program where experienced, retired experts give technical assistance for short periods of time), DED (German development agency which sends out personnel), ING employees and many others that provide support in-kind to enhance the capacities of partners. Grants and subsidies from Oikocredit's own members and donors such as the Church of Sweden, ICCO and Rabobank Foundation will be raised through the Foundation and will be used to implement the various activities of the Support Fund.

B) COVERING EXCESSIVE RISKS RELATED TO LOCAL CURRENCY LENDING THROUGH THE ESTABLISHMENT OF A LOCAL CURRENCY RISK FUND WITHIN THE FOUNDATION

ACTIVITIES

1. Local Currency Risk funds

Oikocredit has had local currency exposure for many years. Its liabilities (the available member's capital and long term loans) are predominantly in euro, while a significant part of its assets (especially in development financing) are denominated in local currencies.

The board of Oikocredit decided that Oikocredit's exposure (the mismatch between euro and local currency assets less liabilities) should be hedged or covered in another way. Oikocredit and its investors should not be faced with unexpected realized and unrealized exchange losses. Oikocredit wants to be able to repay its investors (long-term loans as well as member capital) on the due date or on request, without having to face exchange losses. It is especially important to protect the investors of Oikocredit as they already accept a low dividend to enable Oikocredit to finance partners that many other funders will not. To expose an investor's money in addition to exchange risks is not reasonable.

The exchange rate losses on local currency losses are hedged or covered in one of the following ways:

a) Hedging local currencies through hedging contracts with financial institutions

Whenever possible, local currencies are hedged by entering into hedging contracts with banks and financial institutions.

However, for a large part of the portfolio, there are no real possibilities for hedging, as banks are not prepared to take-up these risky activities. Volumes are low and related risks are considered too high.

b) Establishing a Local Currency Risk Fund

As there are only limited possibilities to hedge local currencies with banks, Oikocredit decided to implement its own system which is described below and will be managed by the Foundation.

- Spread risks over several countries

The exchange rate risk on local currencies is mitigated, if lending in local currencies is extended to a large group of borrowers in many different countries (diversification of risks). In principle, loans in local currencies are therefore offered to all partners in all countries where Oikocredit is active. However, in practice, local currency loans will only be offered to partners in relatively stable countries (the criteria is spelled out for acceptable inflation and devaluation and it is reviewed whether the country can freely exchange local currency for hard currency.) Countries with a severe devaluation of currency are excluded up until the moment the economy becomes more stable and has an acceptable economic outlook.

- Country limits

Country limits are based on Moody's ratings (as well as others). Special measures have been taken for a few countries where Oikocredit found good reason to not rely on Moody's rating (the Oikocredit board has to approve this), or where special funding allowed for a larger exposure.

- Higher local currency interest rates

The exchange rate risk on local currencies is further mitigated through the usually higher interest Oikocredit calculates for local currency loans. Local interest rates within developing countries have an interest rate differential compared to hard currency loans. This differential reflects the expected re/devaluation (often as a result from inflation) of currencies in these developing countries.

If loans in local currencies are granted to Oikocredit partners, then the interest rate to be charged to the partner is base rates (e.g. Inter bank offered rates) plus a surcharge for costs and risks. The base rate is thereby expected to cover both costs of capital of Oikocredit and normal currency devaluation risks. The mark-up covers operational costs plus the credit risk incurred with the financing of the project. Therefore, in general, loans in local currencies have a higher interest rate than loans in hard currencies.

- The Local Currency Risk Fund (LCRF) within the Foundation

To cover exchange rate risks as a result of excessive devaluations of certain local currencies, it is necessary to build-up a special fund with grants. A good example of excessive devaluation of local currencies was the effects of the Asia crisis in 1998, when Oikocredit partners could not repay their loans due to currency devaluations of local currencies versus USD and European currencies.

Following this, Oikocredit established a fund within the Foundation based on donations from organizations and members. This fund covers the currency losses and therefore enables Oikocredit to grant loans in local currencies. This fund is set-up in such a way that it works as an insurance instrument: Exchange losses will be charged to the fund and exchange rate gains will be added.

The LCRF only needs to cover the exchange risk, not the credit risk. This implies that a much larger amount in local currency loans can be extended than is available in the Local Currency Risk Fund as all the other risks are borne by Oikocredit itself. In order to cover the risks, an amount should be available in the fund that has to be at least 20% of the total currency exposure of Oikocredit. The 20% is based on studies made by a like-minded organisation. This means that loans can be offered in local currency up to five times the amount available within the LCRF².

This fund is essential as hedging facilities on several local currency loans cannot be offered by banks.

CONCRETE PLANS AND FUNDING FOR THE NEXT FIVE YEARS FOR THE LCRF

The foundation aims to raise funds to continuously cover 20% of the expected local currency exposure of Oikocredit during the period under review.

2. Guarantees

Specific criteria for the use of guarantees from the Foundation's Guarantee Fund

² How does Oikocredit calculate the exchange rate differences to be charged or added to this fund, in order for the fund to fulfil its role as an insurance instrument?

- Oikocredit and the loan partner agree on entering into a local currency loan with a relevant local currency interest rate. The loan (plus interest) is administered and repaid in local currency.
- From the moment of disbursement, the loan is administered within Oikocredit in a separate administration model (in euro as well). A reference interest rate in euro is determined for the particular loan as exchanged in euro at the moment of disbursement. The reference interest rate for the euro loan is determined as if the loan would have been granted in euro.
- On an annual basis, the interest earned on the loan granted in local currency and instalments received, as exchanged in euro (a), are compared to the interest and instalments received, as if the loan was granted in euro (b), the difference in interest between (a) and (b) is 'saved' for possible exchange rate differences (as a result of devaluations) in later years.
- When a local currency loan is repaid, the total outcome of loan (a) (a local currency loan plus local currency interest received, as exchanged in euro) and loan (b) (the same loan, but exchanged to a euro loan at the moment of disbursement, plus a relevant euro interest earned on this loan) are compared. If the outcome is negative, the amounts are charged to the local currency risk fund established within the Foundation. Excessive exchange rate risks in crisis years will be automatically charged to the Local Currency Risk Fund within the Foundation. If the outcome is positive the amounts are added to the local currency risk fund.

The Guarantee Fund was established (grant based) to facilitate access to credit for partners to be financed by Oikocredit that would otherwise have no or limited chance in meeting the financing conditions or a high chance of not meeting Oikocredit's regular approval conditions.

Assessment will point out how the partner fits in one or more of the following five categories:

- start-up operations
- scaling-up to reach profitability
- new unproven ventures for established organisations
- partners categorised as moderate/high risk
- partners with collateral deficiency

Social performance

In addition to the above criteria, partners proposed for the guarantee arrangement must have high social performance indicators. Oikocredit has established a system of quantitative social performance indicators, together with benchmarks derived from portfolio data. This system revolves around the environmental, social and governance (ESG) scorecards developed in 2010 for microfinance institutions and developed in 2011 for production and services partners.

Sustainability

The status of ownership and (financial) sustainability of a potential partner must be explicit. It should also be clear how positive developments are made through conditions and/or monitoring.

Guarantee cover

Oikocredit is expected to select an appropriate guarantee cover for each partner, based on a balance of desirable risk exposure and minimization of guarantee fees involved. The guarantee given will be a maximum of 50% of the amount to be financed. Any losses under this guarantee scheme will be charged to the guarantee fund within the foundation. In order to cover the above mentioned credit risks, the amount of guarantee funds that has to be available to cover possible losses is set as at least 20% of the total exposure for high risk loans of Oikocredit guaranteed by this fund.

CONCRETE PLANS AND FUNDING FOR THE NEXT FIVE YEARS FOR GUARANTEE FUNDS

The foundation aims to raise funds to continuously cover 20% of the expected high risk loan exposure of Oikocredit during the period under review.

C) ACCEPTING DONATIONS FROM MEMBERS

ACTIVITIES

The Foundation will manage donations from Oikocredit members who wish to donate their member capital to support Oikocredit's activities. The members who donate the capital to the Foundation or the Foundation's board can decide how the donated capital is invested.

CONCRETE PLANS AND FUNDING

This will be dealt with on an ad hoc basis. The possibility of granting member capital will be promoted.

3. Managing reserves of the Foundation

- All of the grants will not necessarily be utilized immediately and might be available for some time at the disposal of the Foundation's board. The grants not utilized in the short term (less than 1 year) and reserves available for the long term, shall be invested in a solid bond portfolio. The bonds should be at least investment grade and the portfolio should be ethically sound. Returns on these investments will be added to the funds.
- Grants that are expected to be used in the short term (less than 1 year) will be kept in cash or in an Oikocredit account earning relevant interest rates which will be added to the funds.