Scaling up Microfinance in India:
A Case Study of Community Reinvestment Fund

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10 May 2006

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Executive Summary

The Indian subcontinent champions some of the world's brightest minds that—when faced with the challenge of improving the lives of tens of millions—view the challenge as an opportunity. Microfinance, lending to the poorest of the poor, is an untapped market that demands a viable, proven economic model for scaling up its operations. Grameen Capital India (GCI) asked this capstone group to research Community Reinvestment Fund (CRF), a similar established enterprise in the United States, in order to capture specific recommendations in how to develop, cultivate, and capture the latent MFI market in India.

CRF opened its doors and its books to our research team, sharing valuable insight. The MFI loans that GCI is inheriting from Grameen Foundation USA's India Initiative is primed to generate a viable securitization product while considering the following lessons and recommendations derived from the case study of CRF:

1. CRF offers four capital channels, designed to fit the specific needs of each separate customer. This flexibility in their product line coupled with ever expanding knowledge of the regulations precludes waste and inefficiency. CRF consults with experts in investment banking and tax lawyers because the Community Developed Financial Institution (CDFI) market is still relatively new. CRF then uses that knowledge to educate potential investors and loan originators on recent developments in U.S. laws that govern community investment development.

2. When CRF purchases a loan, they automatically retain the servicing of the loan. In most cases, however, they contract the servicing back to the loan originator for a fee.

3. There are some inherent limitations to the applicability of CRF's experience to GCI's planning. CDFIs in the U.S. provide fixed collateral for loans. We assume this currently is not the case in India. The securitization laws in the U.S. also have a longer history than those in India; an exclusive study of the evolution of U.S. laws may benefit strategists in anticipation of India's future. Finally, the relationships between CRF and the credit rating agencies are different than those in India. CRF hires investment bankers like Piper Jaffray which bring an insider's perspective because the rating agencies closely guard their methodologies for determining ratings. These firms often use a computer based model to predict how the credit rating agencies will classify future bonds.

4. CRF aims to shorten the 'warehousing' process for each security. The most recent bond, CRF Series 17, required an abnormally long 18 months to be formulated. CRF receives the credit rating based on a 70%-30% split between private and social investors. By over-collateralizing, CRF intends to move to an 80%-20% split with a much quicker turnaround on the next security.

5. CRF's path to a rated securitization was not a straight and smooth one. CRF began in 1989 with a $2.5 million portfolio. Although the U.S. financial market is quite viable, it took sixteen securitizations before Standard & Poor's (S&P) rendered a AAA rating on CRF Series 17 security. Prior to the Series 17 security, CRF's customer base had a greater concentration of investors who wanted to take on more risk and, therefore, demanded higher payouts. CRF Series 17 was CRF's first to meet the minimum $50 million threshold for securitization rating by S&P.

Introduction

Although the United States does not operate a microfinance market, a similar model that targets community development in poor sectors provided obvious parallels. By examining the non profit organization Community Reinvestment Fund (CRF), we were able to identify key initiatives and successful strategies for the U.S. market with the expectation that some would translate into recommendations for Grameen Capital India Pvt. Ltd. (GCI) as they prepare to create the conditions for growth in the world's largest democracy.

The microfinance industry in India has enormous potential: 75 million households live below the poverty line. The current demand for microfinance far outpaces all sources of capital in the country, virtually rendering the market untapped. GCI's objective is to increase the number of poor clients reached by microfinance institutions (MFIs) in India by integrating them into the formal financial markets. GCI can substantially impact the microfinance market in India specifically by increasing the availability of funds while simultaneously decreasing the cost. GCI, through its partnership with ICICI Bank, is working with the Centre for Micro Finance Research (CMFR) to research proven cost efficient methods to develop, cultivate, and capture the latent MFI market in India. CRF is an ideal organization to observe as it is a trailblazer that creates and develops niche markets for social purposes in the U.S.

CRF began operating in 1989 solely focused on the local market in Minneapolis, Minnesota. Seventeen years later, through modest growth and expansion, CRF now operates in over twenty U.S. states with plans to reach even further. CRF has held consistently to its clear social vision in order to achieve the scale and scope of their position today. The methods, techniques, and lessons learned along the way may dovetail into GCI's effort to develop strategic objectives within the emerging MFI sector.

Two members of our research group visited CRF headquarters in Minneapolis and interviewed several executives including the CEO and CFO in order to obtain an insider's perspective on the U.S. process, obstacles faced, and recommendations for GCI and the Indian market. CRF employs a detailed four-step process of securitization that encompassing every step from acquiring debt through managing the assets held. Section II of this report outlines each step followed by strategic recommendations for GCI.

This report is divided into four parts and will serve as an analytical case study that compares the general parameters of CRF's existing practices and proposes recommendations and future research areas for GCI. It begins with an inside look at CRF, including background information on the history, current operations and clientele. Section II, as mentioned previously, outlines CRF's securitization process and concludes with recommendations for GCI. The third section addresses overarching conceptual lessons for GCI, answers specific questions that were posed by GCI and outlines areas for future research. Section IV contains three appendices that cover definitions and acronyms, rating systems in India, and U.S. laws.

Community Reinvestment Fund

History of CRF

CRF is a non-profit, non-governmental organization that helps community development leaders meet their goals by bringing in capital through the secondary market for loans. Founded in 1989 by Frank Altman, CRF has assisted in development throughout many economically disadvantaged communities by stimulating job creation and economic development, funding housing projects, and building community facilities. CRF is primarily funded by its own activities: loan purchasing, loan servicing, and training and technical assistance. In addition, CRF receives support from foundations, corporations, and individuals that want their social investments to be maximized. These contributions have given CRF a capital base that is used to procure loans and protect against losses.

Headquartered in Minneapolis, CRF began its development work throughout Minnesota, but now operates nationally. CRF has worked in development on all levels – from single-person nonprofits to state organizations. Using four different programs called "capital channels," CRF has multiple methods of helping various types of lenders. It has helped establish small businesses, create affordable housing for families, and fund community projects and facilities. CRF has a close relationship with its client community development lenders and offers minimal administration, quick turnaround, fair pricing, and flexibility.

Demand for CRF Services

Mr. Altman served Minnesota's Governor Rudy Perpich as an advisor on energy and economic development issues during the mid-1980s. Mr. Altman was in charge of approximately $10 million worth of state-funded loans made for energy improvements and multi-family rental properties. He asked why these loans could not be sold for cash which could, in turn, be lent again. The existing government gridlock was inhibiting resources from flowing smoothly and organizational inertia proved a stumbling block to reform.

While Minnesota was facing budget cuts, Mr. Altman determined that many community economic development agencies in the state already had originated a number of loans. They had assets on their books and if they could sell those loans, they would not have to come back to the state for an appropriation. These agencies instead could utilize the assets they already had.

Mr. Altman also discovered that many of these loan funds had assets that were under-utilized. The funds might have been available, but because of the perceptions that the funds (or pool of funds) were not large enough, they sat idle. Two factors were at play: the agencies could not request another appropriation, and the assets they had on their books could not be utilized at that time.

Mr. Altman continued to consult with a number of people and organizations. The Northwest Area Foundation learned of Mr. Altman's initiative and offered to fund it, with the condition that he leave state government. He accepted and lobbied the state legislature to make

it clear that public sector agencies, such as economic development agencies, did have the power to sell loans.

CRF's Early Growth

CRF's pilot deal, arranged in 1989, was a $2.5 million securitization of loans from five different communities. Having proved successful, the next step was to try to grow the organization so that it could survive and become more meaningful. During a recession in 1990, CRF faced two problems: (a) finding loans that were not overly risky, and (b) a lack of sufficient capital. As a result, only $600,000 of loans were purchased that year.

As the economy improved the following year, the Northwest Area Foundation—an established foundation in St. Paul, Minnesota—introduced CRF to U S WEST, Inc. (which has since merged with Qwest Communications International, Inc.). U S WEST was concerned about rural economic development in its geographic market—fourteen western states. U S WEST made a substantial grant to CRF over a period of several years. This grant funded CRF's growth in the western states and paved the way for CRF to become a regional player in the community development financing market.

CRF has grown substantially and steadily ever since. The McKnight Foundation eventually became involved and more major corporations also provided support. Every year CRF has been able to buy more loans, raise more capital, and develop a proven track record. Mr. Altman and his team have devoted much time to educating the market on the concept of selling loans, as this notion was foreign to most economic development agencies.

Today, CRF has approximately 500 loans in the repayment period, meaning that there is still a balance to be paid by the borrower. Each securitization is comprised of a different mix of purchased loans. CRF's largest deal to date is a $50 million securitization that is its first to be rated. This securitization started with 150 loans, but now is down to approximately 135 loans due to the elimination of loans because of their complete repayment.

CRF's Structure as a Non-Profit

The concept of CRF was to reduce the role of government and to support non-profits. CRF conducted research that indicated that a for-profit would not be successful because the initial transaction costs vis-à-vis payoffs were too high. The idea of a for-profit resource having this mission did not seem viable.

Foundations' charitable resources were scarce during CRF's early years, as they were also experiencing significant cutbacks in their funding. In response, CRF devised a plan—use a small amount of contributed dollars, leverage that with social investments and try to attract large amounts of private capital. CRF did not want to become dependent on public appropriations, as that was the very problem it was trying to combat. With virtually no public funding, CRF is now a market-driven concept with money raised from investors.

CRF's Products and Services

CRF provides three services: loan purchasing, loan servicing, and training and technical assistance. These services are CRF's primary source of revenue.

Loan Purchasing

CRF purchases community development loans and then sells them to institutional investors, thus providing community development lenders immediate cash on hand. This service allows small nonprofits access to the secondary loan market. The loans CRF buys are from organizations that finance community development; CRF does not buy loans from individuals. These community development lenders must provide assistance to low-income communities.

Loan Servicing

Loan servicing is critical to the securitization because it identifies the process by which the original borrower's loan repayments are collected and transmitted to the investors. CRF has a variety of options for loan servicing. CRF may opt to service the loan itself, or the original lending organization may service the loan as an intermediary between the borrower and CRF. Should the CDFI retain the loan servicing, it does so as part of the loan sale contract and is paid for its efforts. In addition, CRF can service loans on a contract basis for lenders who retain their loans, but would like to avoid servicing responsibilities.

Training and Technical Assistance

CRF offers training and technical assistance both for large groups and on an individual basis. This assistance covers a variety of topics, including: policy and procedure audits, risk management, loan documentation and servicing, and capitalization strategies.

How does CRF provide capital?

CRF employs tested for-profit techniques and applies them towards community-development purposes. CRF "leverages" funds and takes advantage of U.S. tax laws through the New Market Tax Credit in order to generate capital.[1] Specifically, CRF purchases several existing community development loans in order to generate a substantial financial instrument. Once these loans generate sufficient capital, CRF then packages them and sells them to institutional investors. The product itself works like a bond. It technically is called an "asset-backed debt security" and relies on a steady flow of repayments to remain viable.

CRF funds community development lenders through private capital in four basic ways: advanced commitment, existing loan purchase, structured finance, and loan to lender. CRF terms each of these models "capital channels." The lender receives cash immediately with each of the products. A description of each capital channel is below, followed by an example of its implementation.

[1] The New Market Tax Credit program is aimed at stimulating private investment in low-income communities. It is a first of its kind tax credit to investors who make qualified equity investments in privately managed investment vehicles. Investors take advantage of tax credits worth more than 30% of the amount they invested when they invest in "community development entity" (CDE).

Advance Commitment

The advance commitment product entails CRF's purchase of a lender's loan or loans before the loans are closed. CRF and the lender agree to underwriting and documentation criteria to cover a specific dollar amount of lending. With advance commitment, CRF removes its normal requirement of having the lender mature the loan for at least twelve months. CRF, therefore, requires sellers to retain a risk position in each loan because it is unseasoned. CRF targets a minimum transaction of $250,000 for advance commitment loans. This option is most beneficial for lenders whose funding needs surpass their current program's capacity.

Example: Lender A has a program for helping businesses expand, but cannot meet the needs without additional resources. CRF and Lender A agree to the underwriting standards for loans that CRF will buy. Lender A will fund 20% of each loan and CRF will fund the remaining 80% of the loan. CRF agrees to buy up to $2 million of these loans over the next year. In the first six months, Lender A originates 8 loans worth a total of $1 million, $800,000 of which is provided by CRF. The seller thereby retains a certain amount of risk while the preponderance of capital and risk reside with CRF.

Structured Finance

With this option, CRF evaluates a portfolio and advances cash based on the portfolio's market value. Using the structured finance method, transaction costs are minimized and the advance amount is maximized. This capital channel often is used when an organization has a large number of loans available to sell and wants to avoid the evaluation of each individual loan.

Example: Lender C has made 100 loans of similar size, term and interest rate totaling $5 million. To save time and effort, CRF evaluates the loans as a portfolio to determine its value, say at $4 million. CRF buys the right to the cash flow of the entire portfolio and Lender C receives the $4 million immediately, plus residual cash that is paid once CRF is paid in full.

Loan to Lender

Through this option, CRF is able to give some community development organizations liquidity by making a loan to the lender, using the lender's existing portfolio as collateral. This method works best when the lender has a large number of assets that can be used as collateral for an advance from CRF and needs the funding for an ongoing program. The amount of the advance and the repayment schedule are determined by the lender's loan pool and cash flow, meaning this option is based on the lender's (not the borrower's) financial strengths.

Example: Lender D, a municipality, has a $1 million loan fund that provides significantly-below-market rates for home rehabilitation. Lender D prefers not to sell the loans because their value to the marketplace is not as high as if they were close to market rates. Because as a city Lender D has other sources of cash flow in addition to the rehabilitation loan fund, CRF provides a loan of $750,000 based primarily on the loan fund but also secured by other revenue sources.

Existing Loan Purchase

This option enables CRF to buy loans previously originated by the lender, the values of which are determined by the loans' terms and interest rates. The existing loan purchase option is helpful for lenders with limited options for recapitalizing. During our site visit, CRF personnel revealed that existing loan purchase is overwhelmingly the most used of the capital channels. The bulk of this paper, therefore, will delve into the creation of a securitization based on existing loan purchase.

Example: Lender B would like to replenish its loan fund quickly to meet anticipated needs. Lender B has five loans worth a total of $150,000; all have been in effect for twelve months and have been paid on time and as required. The interest rates of the loans are close to the market rate. CRF values the loans at $146,000, a price satisfactory to Lender B. The parties sign an agreement and Lender B receives a check. Lender B prefers that the borrowers be unaffected by the sale. CRF pays Lender B an additional fee to continue to service the loans. Lender B receives cash for their existing loans, which in turn generates immediate capital to finance existing opportunities.

CRF's Future Outlook

The CDFI market still does not have enough potential for scalability to draw attention from typical market investors without the help of an intermediary such as CRF. CRF's task at hand now is to take advantage of favorable tax treatment, forecast near- to mid-term market changes relative to their unique product, and leverage that information to maximize the capital available to the non-profit organizations from which it purchases the loans. The loan securitizations CRF provides are relatively novel products for Wall Street. The U.S. market still needs to develop a greater degree of comfort with the sector. CRF's history provides a solid foundation on which this relationship may be built. All of CRF's securities have performed to expectation, with a loss ratio of 0.5% and a current delinquency rate of 0.29%. As CRF improves its efficiency, it will be able to compile and offer securitizations more quickly, thereby further increasing the market's exposure to this product.

CRF's intent is to securitize $1 billion in loans over the next five years using $50 million securitizations to expedite their rating and sale. New market activity is expected to account for approximately $400 million of the total. $100 million will come from securitizing affordable housing construction. The remaining $500 million will be divided evenly over the course of the five years and will target business loans to organizations with which CRF has existing relationships.

CRF's Securitization Process

Of the four capital channels, purchasing existing loans comprises the bulk of CRF's operations and the base of all its securitizations. Securitization is a valuable tool for CRF to leverage other forms of capital in order to make more money available for CDFI economic development loans. This is accomplished by pooling assets (loans) together and using a special purpose vehicle (SPV) to market a security to investors. CRF uses a four-step securitization process: 1) acquiring loans, 2) warehousing, 3) securitization, and 4) servicing.

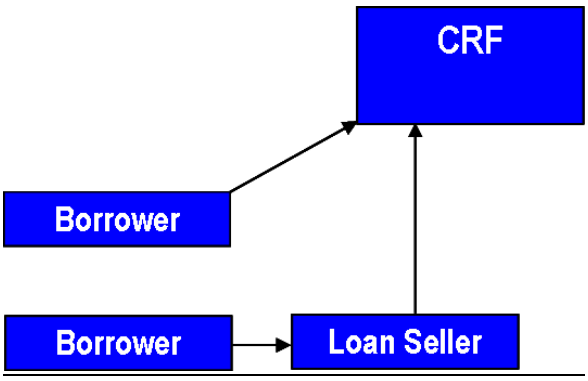
The theory behind securitization is that an organization can increase its operational flexibility because its access to capital is broader. Instead of the CDFI borrowing from a bank or foundation 100 percent of what it requires to fund an economic development loan, the CDFI can structure those cash flows. In market-based financial systems, such as the U.S., securities markets allow firms and organizations to gain access to wider market capital.[2] Rated notes can fund from 70% – 90% of the security and the remaining percentage can be funded the through foundations or other forms of capital. CDFIs cannot affect this outcome individually, but CRF can aggregate the loans and achieve an effective securitization.

In a simplified form, when the CDFI provides loans to borrowers and has utilized all available funds, it cannot make any other loans. CRF's role is to provide the CDFI with cash assets so that they can reinvest it in the community by offering more loans. CRF buys a number of these financial assets (loans), structures them into a form acceptable to a wider market, and commissions a rating for the securitization. CRF acquires market capital covering a minimum of seventy percent of the securitization total and, through an investment banker, packages the loans in a bond and sells to investors.

Step 1: Acquisition of Debts and Loans

CRF's market managers work in the field to identify prospective loans for purchase and CDFIs that have loans potentially for sale matching CRF's criteria. Those loans are submitted to CRF, which re-underwrites them. CRF committees evaluate the loans for their acceptability, and the loan purchase is closed after their approval. Control of the loans is then transferred to CRF's servicing department. The loans stay on CRF's books in what CRF calls its "warehouse". CRF must have enough total capital—including liquid assets and line(s) of credit—to hold the loans until enough are amassed to create a securitization. This interim stage will be covered in greater depth in Step 2.

[2] The World Bank. "Financial Structure." < http://www.worldbank.org/research/projects/finstructure/index.htm>.



Source: CRF

Pooling

The first process, called pooling, occurs while CRF is aggregating loans using its warehouse line of credit. As the pool grows, the Closing and Pooling Manager runs summary statistics to analyze the pool's characteristics, such as average loan size, outstanding balance, and months remaining to maturity. Usually included in the statistics are both loans that are in the warehouse and loans to which CRF has made a commitment that are expected to close by the time the security is issued. The aim is to determine whether the securitization is going to have certain aggregate characteristics that will give a well balanced pool.

Statistics

As an example of the statistics used in the pooling process, we will refer to Appendix E (entitled "The Initial Development Loan Pool") of CRF's most recent securitization, Series 17; this appendix is provided as Appendix II of this paper for convenient reference. "The Initial Development Loan Pool" provides tables that are descriptive of the loan pool based on certain risk characteristics that investors evaluate. The table *Distribution by Class of Outstanding Principle Balance*, for instance, provides a rundown of the size of the loans by loan count. In CRF Series 17, there are a great number of small loans and not very many big loans. By dollar amount, however, a high percentage of the total value is concentrated in the top three loan classes (loans above $1.75 million). These parameters offer perspective from which investors evaluate the security.

The two types of amortization that CRF purchases are regular loans and balloon loans. The inclusion of too many balloon loans in one securitization concerns investors because the borrower is not making interim payments. This creates uncertainty about whether the borrower will be able to pay off their loan when it matures.

Other descriptive statistics provided as tables in "The Initial Development Loan Pool" are:

- **Months since origination,** showing how seasoned the pool is. Typically a seasoned pool, with an average of at least one year, will perform better than an unseasoned pool because it is more predictable;
- **Remaining months to maturity,** which is a mirror image of seasoning. Current loan-to-value ratio (LTV) is the loan amount versus the value of the collateral. The higher the LTV, the better because this spreads out risk;
- **Interest rates,** summarizing the range of interest rates on the notes;

- **Debt service coverage,** as based on projections of how much money the company will make in income that will be necessary to service the debt. If it is expressed in a ratio of 2:1, the company is going to make twice as much money as will be needed to service the debt;
- **Collateral type,** describing the security. The vast majority of CRF's collateralized assets are real estate (84% in CRF Series 17), and only a few of them are equipment;
- **Geographic distribution,** which describes how well distributed the loans are by state around the country. The greater the number of states involved, the greater the opportunity for diversification and the lower the risk default in the case of a localized depression;
- **Lien position on the collateral,** meaning the priority of a lien that has been recorded onto the property. In most loans, CRF is in the second position;
- **Loan purpose,** which highlight—similarly to geographic distribution—the diversification of the loans as a gauge of dependence on any one sector and, therefore, the related level of risk;
- **Year of origination,** which provides another look at how seasoned the loans are; and
- **The North American Industry Classification System (NAICS) code,** a critical component of the CRF underwriting process. It is based on this data, collected by the Risk Management Association, that CRF evaluates how a potential partner company compares to its sector peers. For example, CRF would examine the debt-to-worth of the gas station it is underwriting as compared to all other gas stations. In addition to evaluating loans when market managers submit them to CRF, this is used to ensure there is not too much industry concentration. This would increase the risk of the pool.

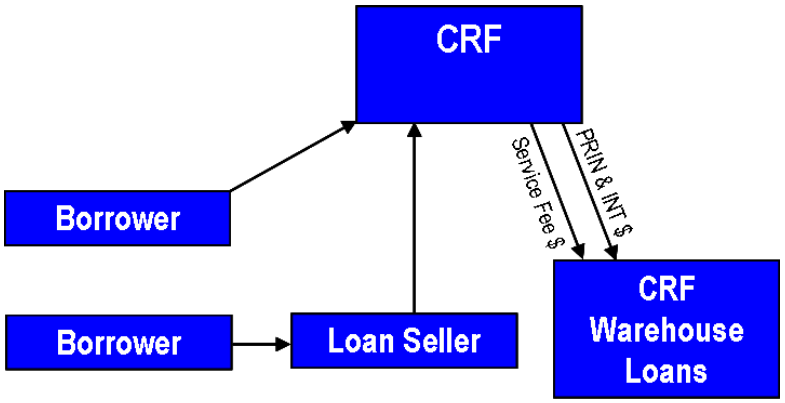
CRF assesses these different data on an iterative basis. If there is a loan that will skew one of these categories, CRF may decide to hold that loan for another pool. CRF makes a few "representations and warranties" to ensure there is not a certain percentage of loans that are particularly risky. These representations and warranties are legal promises that CRF makes to investors and are clearly set out beginning on page 16 of the Series 17 security.

The perfect pool would have all loans about the same size and no one loan larger than 1% of the pool. So with a $50 million pool, an average loan size of $500,000 would be ideal. The preferred loan size will also depend on how the loans are securitized. For example, if credit card receivables are being securitized, average loan size should be much smaller than $500,000 and the amount of loans should be much more numerous. The preferred loan size greatly depends on what particular assets being securitized. Since in CRF's case the collateralized assets are commercial real estate, the average loan size is approximately $250,000.

Step 2: Warehousing (Special Purpose Vehicle)

As CRF is pooling various loans, they are assigned to a special purpose vehicle (SPV), which is CRF's warehouse.[3] This is a subsidiary, limited liability company (LLC) that CRF establishes. U.S. Bank provides CRF with a $40 million line of credit to help finance the warehouse. The amount of time loans stay in the warehouse varies depending on a number of factors, including when the last securitization was issued, how many other loans are in the warehouse, how quickly CRF can aggregate loans that meet their criteria, and how large CRF wants the next securitization to be. While the loans sit in CRF's warehouse, CRF is de facto the investor. Once loans are structured into a securitization, the investor group becomes an entirely different group of parties.

Warehousing allows CRF to aggregate loans as economic development agencies are willing to sell them. Warehousing makes it possible for CRF to create a market because, just like stocks, liquidity is necessary.



Source: CRF

Credit Enhancement

In order to issue a security, CRF must use credit enhancement, which reduces the risk. In CRF Series 17, there are two forms of first loss debt guarantee that CRF holds: 1) over-collateralization, and 2) holding the bottom tranche (and often the bottom two tranches) in multi-tranche securities. Credit enhancement helps attract market rate investors; they feel there is less risk to their investment because there is a significant cushion in case of a loan default.

Over-collateralization occurs when a security is issued for less than the face value of the loans; the over-collateralization amount represents the difference in value between the notes that were issued and the size of the loan pool. In CRF Series 17, the amounts were $46.1 million and approximately $50 million, respectively, resulting in approximately $4 million of excess collateral (loans against which CRF did not issue notes). This excess collateral is CRF's retained interest in the deal. It serves to protect the investors, and it is CRF's investment in the deal. Piper Jaffray, CRF's investment banker, utilizes a complex financial model to determine the

[3] SPV is the commonly used term for securitization but CRF prefers the term warehouse, therefore both terms are used in this paper.

amount of over-collateralization necessary. CRF is not privy to the specifics of Piper Jaffray's models.

Issuing a multi-tranche security is another credit enhancement tool. It allows the security to be tailored to the market and seek a more diverse set of investors—from those who seek shorter term, less risky bonds to those who seek riskier bonds with higher returns. Different tranches have different risks and different returns associated with them. CRF issues a series of hierarchical tranches; CRF maintains ownership of at least the lowest, and often the lowest two, tranches. All the cash flow starts by paying the market-rate investors who purchased the highest (A) tranche. These investors, which are typically larger banks, will accept a somewhat lower return because they receive Community Reinvestment Act (CRA) credit. Interest is then paid to the B tranche and all subsequent tranches in order. Payments on the principle are issued after all the interest costs are covered, and they are released in the same segmented manner as the interest. Eventually, when all tranches owned by outside investors have been repaid completely CRF will recoup its investment. This requires CRF to have a substantial amount of subordinate capital in order to cover its expenses.

In the case of a rated security, there are very specific sizing requirements for each of the rating levels. The bottom, E, class of notes is an unrated class that is most subordinate. It earns interest while the other classes are outstanding and receives no principal until all the other classes are paid in full. For AAA-rated notes, it must be demonstrated that a certain percentage is subordinate. In CRF Series 17, this percentage was approximately 13% (Class D and E notes).

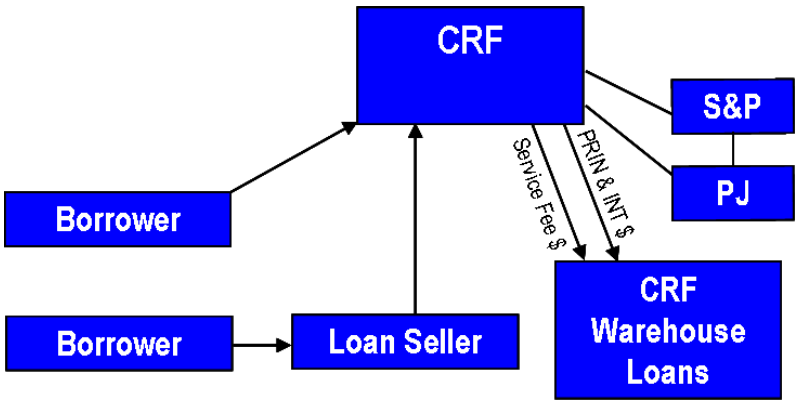
The rating agency also requires the proposed securitization be submitted to a very rigid series of stress tests. The investment banks must assume losses on a certain schedule and recoveries on a certain schedule so it can be proven that those subordination levels actually support the AAA notes without any interruption in cash flow.

When the aggregate dollar amount of loans in the warehouse nears the goal, CRF begins to prepare for the securitization. They provide a collateral tape (record of financial calculations) to Piper Jaffray. CRF works with Piper Jaffray—and subsequently Standard and Poor's (S&P)—to determine security components such as interest rates, the amortization of each tranche by evaluating the LTV, and the collateral types.

There is usually a positive spread between the rate on the loans that are in the warehouse and what CRF is paying on them. If CRF were a for-profit corporation, they would likely be operating at a loss when holding loans, but with Community Reinvestment Act credit (discussed below), the warehouse's line of credit is with U.S. Bank's community banking group. This is a group U.S. Bank put together exclusively to do community banking for CRA activities.

Step 3: Securitization – Issuing Security to Investors

The next step in the process is the actual issuing of a security. CRF works with their investment banker, Piper Jaffray, and the rating agency, S&P, to determine the structuring of the security.



Source: CRF

Piper Jaffray

Once Piper Jaffray receives the data (collateral tape) from CRF, they begin running various models. This phase is focused on gathering the data and sizing the bonds. Piper Jaffray and CRF have some insight into how S&P models, and together they try to predict the results of S&P's analysis. Piper Jaffray models the deal on a system called Intex, through which it can evaluate various scenarios.

S&P

CRF will then prepare a presentation for the rating agency to discuss the company, the loan pool and other factors that S&P will consider. The appendices of CRF Series 17 provide examples of what S&P looks for, including: descriptions of some of the larger individual loans, backup data about a comparable program CRF used as a database, previous offerings, and corporate financial statements.

CRF sends the presentation to the rating agency, which then will probe particular questions, usually over conference calls. The raters will look at the analysis that Piper Jaffray has provided. S&P may have some points on which it disagrees, for example on how little subordination CRF has put behind second lien loans. The ratings agency may then require that CRF increases the subordination and run the stress scenario models again. It is a cyclical process of revision between CRF and the ratings agency.

The structure efficiency is dependent on the mix of loans. The ideal loan pool would have 100 loans that all have exactly the same start and end dates and exactly the same coupon. The more disparate the loan pool, generally the less efficient. Just running the calculations may show that a 15% subordination level is needed. If the pool is fairly inefficient with lumpy cash flows, however, that number might rise to 17% because of how the cash flows are shaped.

Pricing

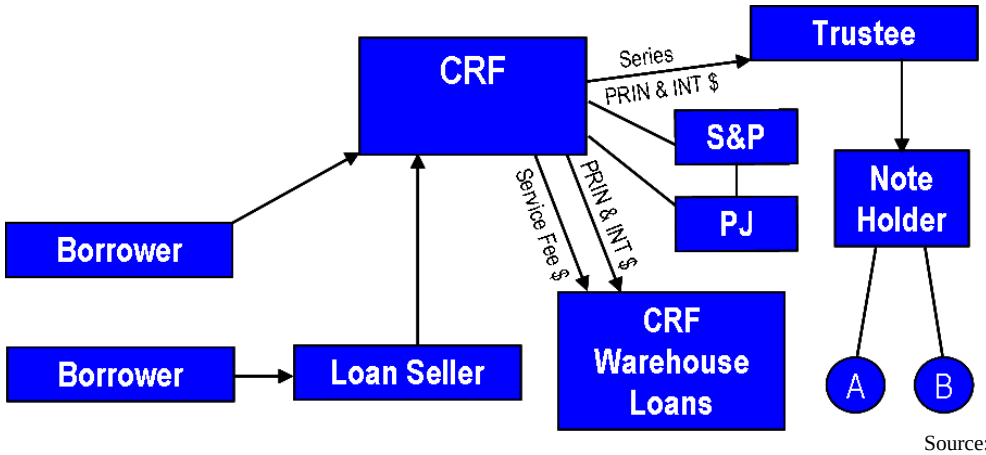
The ratings agency dictates everything in terms of how the market rate/social investment split works. CRF strives to convince the rating agencies through historic performance, analysis, underwriting criteria, and guidance that S&P's decision models are too conservative. Rather than the more conservative split of 70% of the securitization shares being sold on the market and the remaining 30% covered by social capital, CRF would prefer the ratio to be a higher (e.g. a split of 80%-20%).

To determine the 70%-30% split, S&P determines how much can be rated AAA, how much can be rated A, and how much can be rated BB. CRF tries to establish what level of defaults—or Armageddon-type scenarios—the rating agencies are willing to accept to get 40% of the security rated AAA. They use a set of assumptions, defaults, and severities (expected losses) to model the security. These models determine what percentage of the pool, at least hypothetically, would never incur a loss. When model scenarios are run, the percentage that never incurs a loss will be rated AAA. Next, they will take less conservative assumptions and determine the AA notes, A notes, and so on.

Notes Class	S&P Rating	Percentage of Security	Basis Points Over the Treasury (Cost of Capital)
A-1, A-2, A-3	AAA	40	70
B	A	20	125
C	BB	10	225
D, E	Unrated	30	800 (0)
Weighted Average	N/A	--	315.5 (75.5)

The number of basis points (100 basis points = 1%) over the Treasury Bill rate dictates the cost of capital across the pool. The unrated piece of the securitization might require 800 basis points to sell in the marketplace. Foundations and other social interest groups, however, will buy this at or near zero points over the Treasury Bill rate. The cost of capital will be a weighted average and will dictate the pricing on the loans. The margin must then be determined. In the example above, all the basis points over the Treasury would go to the investor, and the 315.5 basis points would be a break-even scenario. The margin will dictate how much over the break-even point CRF will need to cover costs and expenses.

CRF seeks investors for the tranches with 70, 125, and 225 basis points over the Treasury Bill rate, but does not have to go to the market for the unrated piece. CRF's overall cost of capital, what would have been 315.5, will be 75.5 with social investors' involvement. If with a profit margin the weighted average cost of capital (WACC) is increased to 125 basis points, the challenge then is to determine how much of those points is given back to the customer or reinvested back into the organization to create more capital.



Source: CRF

Customers (Investors)

CRF spends considerable time and effort trying to secure the remaining thirty percent of the securitization that will not be funded by the market. This higher risk tranche usually requires much more expensive capital; a higher interest rate would need to be offered to entice investors to purchase it. In CRF's structure, however, the capital is subsidized not by any government entity, but by charitable foundations. CRF demonstrates to these social investors the social benefit of the securitization to the community, and in response they are willing to accept less than market rates on their investment.

Piper Jaffray is ultimately responsible for placing the rated pieces. Piper Jaffray's sales desk finds investors from its list of customers who, in the past, have invested in fixed income securities and determines what they will pay and the spread they are willing to take. Piper Jaffray may supply the potential investors with some of the Intex model results it obtained or some predicted outcomes at various prepayment speeds. Investors may also use their own models.

CRF also has developed relationships with buyers, such as insurance companies, that fundamentally like what CRF does. Additionally, since the security has a AAA rating, risk of default is low. Supporting the social need is also attractive to some investors. An investment banker needs to be engaged to sell the bonds and help size the bond and work with the ratings agencies.

The goal is to have the ratings at the time Piper Jaffray begins to market the security to investors. CRF typically will create a preliminary offering statement. This statement is similar to a full issuing, except that the ratings and rates will not be included. CRF generally will work with Piper Jaffray to market the security.

When Piper Jaffray identifies an interested investor (or "hot lead") that has several questions because it has never before heard of CRF, a conference call will be arranged with either with a senior vice president or the CFO of CRF to answer any questions the potential investor may have. The questions may cover any number of issues, including: the loans, the loan originators, or CRF's financials.

Piper Jaffray will accept orders from investors for an established period of time. It contacts potential investors with a strike price set of interest rates. Piper Jaffray may offer, for example, the class A1 notes at forty basis points over the one-year Treasury note ("T-note"). If the investor is buying other AAA-rated securities at thirty-five basis points over the one-year T-note, it receives a premium of five basis points for investing in a CRF security, which is not as well known. Some investors like this premium, while others may think it is too risky. The investor will then place an order with Piper Jaffray for a particular class of notes in denominations of millions of dollars.

When the deadline is reached, if there are more orders than there are notes to sell, Piper Jaffray will determine for which tranche the demand is highest. CRF received the highest demand for its class B notes—which received an A rating—and was oversubscribed for these notes because investors liked the weighted average life and the spreads.

This oversubscription will not necessarily change the structure of the next series issued. Good investment bankers generally follow the market and its periodic changes closely. CRF and Piper Jaffray go to the market with what think the demand is, but occasionally the market will shift or a big player, like a mutual fund, will come into the market that is actively seeking notes of a particular length. CRF was actually able to decrease the spreads on the class B notes by about 20 basis points because oversubscription resulted from the high demand.

Reducing spreads will cause some investors to step back. If not enough investors withdraw their orders when the price is lowered, some allocations must be arranged. The investors will be offered a lower amount, say $2.5 million instead of $3 million.

Finally, a point is reached where the deal is done and Piper Jaffray verifies the orders with all the buyers. A closing date is then established, followed by two weeks separating the closing of bids and the issuing of securities. During that time, all remaining required actions such as the following are completed: lawyers finalize all the documents and all the subscription agreements, and CRF registers all the notes with the electronic clearinghouse, and other required actions are completed.

On closing date, cash is exchanged for electronic certificates and the deal is considered complete.

Community Reinvestment Act (CRA) Credit

CRF's securities are particularly attractive to banks because they, as investors, can receive CRA credit for the geographical area from which loans were bought, even though the bank conducts no direct business there. Banks are required by law to invest in communities in which it conducts business. Investment can include building a local branch or indirectly funding development in the community through loans. This enticement is invaluable for many investors because many are always looking for CRA opportunities and investing in CRF is a very low-cost way of doing so. When CRF prepares an offering, CRF shows the geography of the offering. Interested investors often parse out that geography amongst themselves. There is a "no double toning" rule, meaning that multiple groups cannot obtain CRA credit for one loan in a particular

geographic area. So the investors literally divvy it up and express to CRF which loans they desire in terms of CRA.

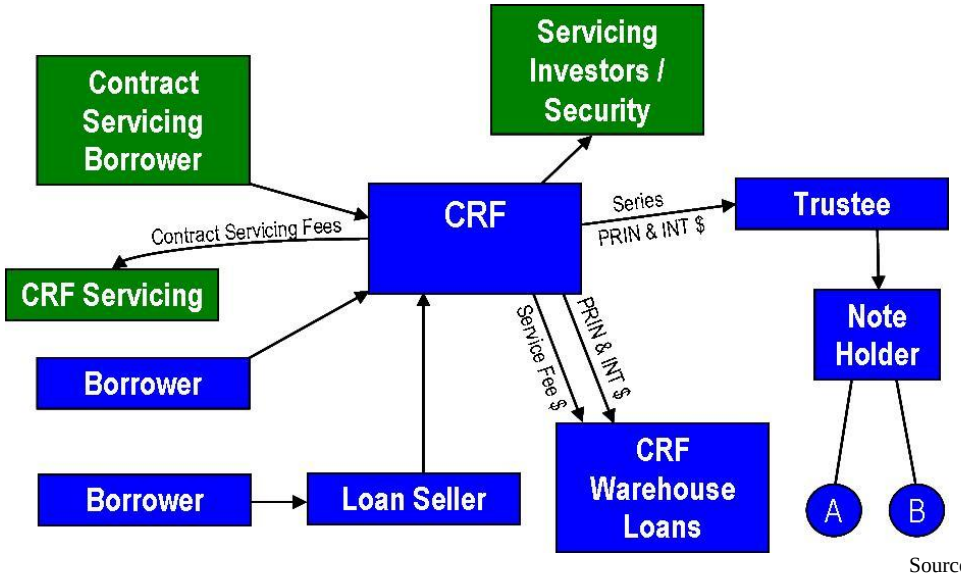
A bank investor in the A class can receive CRA credit with geographic split. U.S. Bank also receives CRA credit for the warehouse line of credit they supply to CRF, whether CRF uses it or not. For example, if CRF is using only $10 million of the $40 million line of credit U.S. Bank provides, U.S. Bank still receives a $40 million credit.

Securitization is a costly process, especially on small deals. The fixed costs could be as high as $200,000 just to complete the deal. Spreading $200,000 over a $50 million deal is still considered quite a high percentage. CRF's goal is to continue to make its deals larger so as to offset the impact of those fixed costs.

Amount	Interest rate	Class	Payoff date
$8,871,000	2.77%	Class A-1 Notes	July 2010
$8,610,000	3.59%	Class A-2 Notes	May 2013
$8,610,000	4.21%	Class A-3 Notes	September 2019
$7,674,000	5.72%	Class B Notes	July 2024
$6,523,000	8.45%	Class C Notes	May 2025
$3,000,000	6.50%	Class D Notes	May 2029
$2,814,000	6.25%	Class E Notes	May 2029

Source: CRF

Step 4: Servicing – Managing and Servicing Assets



Source: CRF

Once the security is issued, CRF Servicing Division is in the middle between the CDFIs and the trustee. CRF Servicing ensures the borrower fulfills its obligations in accordance with the signed agreement. These responsibilities include, but are not limited to: monitoring payments for delinquency, making sure the CDFIs are up to date on any financial statements that are supposed to be submitted on an ongoing basis, and verifying taxes are paid on the loan for real estate. CRF Servicing keeps all parties notified. The goal is to retain the value of each asset.

When CRF buys loans from a lender, the CDFI may transfer to CRF the loan servicing as well. The lender may have been receiving payments on (or "servicing") a loan for several years and want to remove itself from the relationship completely. In that case, CRF will engage the borrower directly, and the borrower makes their payments directly to CRF. In a majority of the loans CRF buys, however, the seller retains the servicing duties. Because the lender is local to the borrower, the servicer can more easily meet with the borrower. An additional benefit is that the borrower experiences no change in its business relationships.

The funds will flow from the borrower to the lender. Then in a manner proscribed by a servicing agreement, the CDFI forwards those funds to CRF monthly or as received and informs CRF how they need be applied. CRF maintains a shadow system for that as well. So these are two aspects that CRF may be servicing loans have already been securitized, or may be in the future.

Ratings agencies are concerned with the stability of the servicer of these assets and the quality of the servicing. If the performance of an asset does not adhere to the repayment schedule, the rating agency must be absolutely confident that the servicing will be done correctly. Those responsible for collecting cash and distributing it must be designated by the servicing agreement. The ability to communicate and convince the rating agency of the quality of a servicing operation must be demonstrated, else the servicing may have to be placed with another organization. CRF feels it has been able to communicate to S&P that it is proficient at servicing small business loans, so S&P agrees to CRF servicing them. The trustee, who has fiduciary responsibility, keeps checks on the servicer. To the extent that the servicer does not carry accomplish its commitments satisfactorily, the trustee withdraws the servicing responsibility and assigns it to another entity.

In contrast, CRF issued an affordable housing security and tried securitizing it in a rated deal. CRF is not as robust in the affordable housing arena. While the loans were in the warehouse, CRF serviced them. In order for the security to be rated, however, CRF had to contract out that servicing to another servicer in order to issue a rated security.

Reporting begins with the servicer receiving the cash in from all these different loans. The servicer has monthly reporting responsibility to the trustee and delivers the cash to the trustee along with reports explaining what they received on which loans and how it distributed. The trustee then divvies it up amongst the various bonds. Each year the servicer must go through compliance audits mandated by the servicer agreement which is dictated by both the trustee and S&P. The trustee is taking on fiduciary responsibility, so they want checks and balances to ensure that the servicer is fulfilling its obligations, including monthly cash reporting to the

trustee and monthly cash transfers to the trustee. The trustee then distributes the cash to the bond holders.

The role of the (third party) trustee, usually Wells Fargo, is to protect the rights of investors in the deal. Once the security is finalized, CRF Servicing takes the loans in their servicing system that had been allocated to the warehouse (as an investor) and transfers them to a security, in this case Series 17. Before CRF Servicing transfers the loans and payments are received, the cash would have been channeled to this group (warehouse) through the system similar to a remittance. Once CRF Servicing changes the system, it handles the issue as a Series 17 loan, causing the cash to flow to the trustee.

Customers

The smallest investment in CRF's Series 17 by one purchaser was $500,000. Although CRF has worked with a few regional banks as investors, most business is done with larger banks. CRF expects many of the same investors who purchased CRF Series 17 to also purchase its upcoming Series 18. When CRF went from issuing an unrated security to a rated one, CRF had a number of investors who bought its unrated notes in the past, but chose not to buy the rated notes because there was less yield. Unrated paper (note) is inefficient and, therefore, more return is necessary. If an investor is not obligated by internal investment rules to buy rated notes, they can make more yield off unrated notes. Some investors made the switch from unrated to rated notes, but many backed away.

CRF has never been able to approach the largest groups of investors who, by their investment rules, have very little capacity to buy unrated notes. This group includes insurance companies and pension funds. Insurance companies and pension funds are often required to mark their portfolios to the market daily, which banks do not necessarily need to do. The former need some sort of index for comparison. They must be able to compare it to other AAA rated notes that have a one-year weighed average life by picking a comparable index (e.g. Bloomberg) and then measure or mark their holdings to the market. Access to this division of investors is yet another reason why ratings are important. There is no index with which to compare unrated notes.

Length of Pay-off Period

In oversimplified terms, CRF's average pay off period is approximately five years. The structure is called "turbo." When CRF issues a security, different parties agree on what amount they will invest in total notes. For example, if the investor purchases $8 million of A notes and $4 million of B notes, CRF will put $16 million worth of loans into that deal (because of over-collateralization, as discussed above). CRF distributes a payoff schedule which shows what the security would look like if every loan makes its payment every month. CRF applies a default factor to the schedule, and revises the schedule to show what the investors can expect the cash stream to be.

If any loans pay early, the cash goes first to the A-note investor to pay down the A class investment. A-note investors are paid off first before B-note investors start receiving any money above the interest. All note holders receive interest from inception, but the A class principal is paid first. That pool of $16 million of loans generates cash flows to A, B and C. Any additional

funds collected over the term of the security pay down the A class principal first. The repayment period for A-notes is approximately five years.

A-notes are paid off early by design. The cash flow has prepayment assumptions built into it. They are very low prepayment assumptions, although it is common for these loans to prepay over these assumptions. This is where the turbo concept comes in. The pay down will be "turboed": A first, then B.

Once A is paid off and a fair amount of B is paid off, CRF has the right to ask the B investors if they would like to get out of the deal now. Since B holders are typically social investors, they will want to renew as well. They will usually agree to get out of the current deal and have the remaining cash rolled over to the next security.

An example of possible rollover situation:

Total amount of loan balance remaining	$7 million
– B-note principal remaining	– $1 million
– C-note principal remaining	– $4 million
= Amount of over-collateralization remaining	**= $2 million**

The B-note holders have $1 million still owed to them, so they may agree to get out of that $1 million. Since CRF is C and the only investor left, they will then take what remains. CRF will "de-fees" (divest or dissolve) and just close down that security. CRF will take those loans and roll them into the next security. CRF has loans in its Series 13 from what was left when Series 9 was paid off. It has loans in Series 17 that were left when Series 12 paid off. CRF is looking at Series 13 and 14, and they will probably be de-feesed going to Series 18. These loans rollover quickly; that is the turbo effect.

<u>System of Checks and Balances</u>

Investors get a monthly set of reports that are not comprehensive. These reports provide information on how much of the principle has paid down and basic delinquency statistics. The statistics are compiled by a combination of CRF Servicing and the trustee. CRF Servicing remits to the trustee and the trustee then follows the rules of the indenture (the legal document of the security) and pays according to a waterfall of priority of payments.

When a security is issued and the payments have been structured on these notes on a monthly basis, two parallel cash flows are run. With all the underlying loans according to their terms, one overall amortization schedule is made which adds together all the loans. This schedule results in a cash flow schedule that will demonstrate how much the trustee will receive each month. The trustee will then take all that cash and figure out how to divvy it up among all the note holders.

The Flow of Funds—which may be found on page 9 in CRF Series 17—sets out the rules. On the first of each month the trustee will start out with cash that had been remitted to its account the day before by CRF. "The Flow of Funds" dictates the order in which payments are made. If all the cash has been distributed before the last class is paid, then they do not receive

any money. This is how the subordination effectively works. Class A note holders are not concerned with a particular loan being delinquent, because they will get paid regardless.

There is a fee if loan sellers are doing the servicing. For example, on a twenty-year fixed rate loan, CRF prices off the expected weighted average life, which is about ten years. CRF will quote their pricing as being the ten-year T-note plus roughly 350 basis points. This amount is how much of the yield CRF must receive. If the ten-year T-note is at 450, then CRF's minimum note rate will be 800 basis points, or 8%. The servicing fee must be layered on top of the loan. If the servicer wants to earn 50 basis points, it must make that loan at 8.5%.

The 25- to 50-basis point range encompasses the majority of the servicing fees. CRF typically imposes set a rule on loans under $500,000 that the servicer (CDFI) must take a servicing fee of at least 0.25%, so that the CDFI receives enough revenue to actually cover the cost of servicing. If the loan is over $500,000, CRF may allow this rate drop to 0.125%. CRF allows the loan seller determine other aspects, such as what its market will bear and how much its costs are. If the CDFI tries to take 100 basis points, which makes its loans not competitive, then it will not make any loans.

Applicability to GCI

Given the example set by CRF, it appears that GCI is primed to successfully begin the securitization process. As compared to CRF's initial securitization of loans from five organizations totaling $2.5 million, GCI's five initial partners transferring from the Grameen Foundation USA India Initiative had an outstanding loan portfolio of $14-24 million as of 31 December 2005 from which to draw its securitization. These loans serve 1.2 million active clients. With that quantity and variety of loans, GCI should have the flexibility necessary to implement effectively the pooling technique as employed by CRF. The key questions that GCI must address to ensure a loan pool's viability are: (1) is the rating system in place for CRISIL or Fitch to rate different tranches within the same securitization, and, if so, would GCI prefer this CRF-style model; and (2) given the government-imposed priority lending requirements, is the ratio of tranche division used by CRF appropriate in the Indian market. A marked difference between the processes of CRF and GCI is the need for partnership with an external investment banker such as Piper Jaffray. GCI's relationship with ICICI Bank and Citigroup and the purportedly intimately cooperation with the rating agencies throughout the rating process may benefit GCI by removing a layer of uncertainty experienced by CRF.

GCI's long-term growth goals—twenty to thirty MFI partners and funds of $350 million in five years—appear roughly comparable to the growth of CRF in its early years. It is important, however, to recall that it took CRF over fifteen years and seventeen securitizations to achieve a rated security. CRF could not have accomplished a securitization of sufficient size without the warehousing capacity to amass the $50 millions in loans necessary. To improve upon this timeline, GCI should not only focus on achieving a AAA rating for its securitization, but should also intensely study its target audience so that the division of the securitization's ratings suits its investors' interests. These interests may not be obvious; for example, CRF found

many more investors attracted to its B rated tranche than expected, and the lower rates of return inherent with the AAA tranche turned off some investors.

Discussion

Indian Priority Sector Lending Scenesetter

In terms of the immense size and enormous penetration in rural areas in developing countries, the Indian banking sector has been remarkably successful. With a solid reputation for stability among depositors, the Indian banking sector contributes to the reduction of poverty and a diversification of agriculture. In recent years, however, complaints have often been that the Indian banking sector has become more expensive and inept. Many people attribute the setbacks to the overstaffed banks and their large fraction of non-performing assets and under-lending. As a result, many firms seem to be starved of credit and banks seem remarkably reluctant to lend.

This section will outline how the Indian rural banking policy have changed in the three phases (1969 to late 1970, late 1970s to late 1980s, and early 1990s to present) and, in particular, will probe into the priority lending regulations and the securitization policy in India. Comparison between the Indian and the U.S. securitization regulations is drawn to uncover the major differences in terms of policy and regulations.

Development of Regulations

In 1969, fourteen major Indian commercial banks nationalized and the Green Revolution was initiated. A new policy, known as "social and development banking" was declared to "provide banking services in previously un-banked or under-banked rural areas, provide substantial credit to specific activities including agriculture and cottage industries, and provide credit to certain disadvantaged groups".[4] The Government of India and the Reserve Bank of India (RBI) gave specific directives including imposing ceilings on interest rates and setting guidelines for the sectoral allocation of credit. It set a target of 40% for priority sector lending—namely agriculture and allied activities and small-scale and cottage industries. After the priority lending policy was announced, the these sectors rose in the total advances of scheduled commercial banks from 14% in 1969 to 21% in 1972 and hit 33% in 1980.

During the second phase beginning in the late 1970s, the Indian governments focused on anti-poverty program and issued two schemes, namely the developed loans-cum-subsidy schemes and the rural poor and state-sponsored rural employment schemes. It also approved directed credit policy, during which credit was directed towards the so-called weaker sectors.[5] More than 40% of total advances lending went to priority sectors during this period.

The Indian government approached free-market philosophy in the third phase starting in 1991. From that time forward, the banks have not been wholly nationalized. In the "Report of the Committee on the Financial System" submitted by the Narasimham Committee, high priority has been given to phase out the directed credit policy, deregulate interest rates, revoke branch-licensing policy, create market and profitability driven institutional structure, etc. From 1990-91

[4] S. Wiggins & S. Rajendran. 1987. *Rural Banking in Southern Tamil Nadu: Performance and Management (Department of Agricultural Economics and Management),* (University of Reading), Final Research Report.
[5] V. K. Ramachandran & Madhura Swaminathan, 2001. *Does Informal Credit Provide Security?* Rural Banking Policy in India. International Labour Office, Geneva

to 1996-97, the number of loan accounts to agriculture fell by 5 million.[6] By 1998, only 38% of bank credit in rural areas went to agriculture.

Priority Sector Lending Regulations

As mentioned above, the priority sector lending was to expand the flow of credit to agriculture and small industries. The targets and sub-targets set under priority sector lending for domestic and foreign banks operating in India are:

	Domestic banks (both public sector and private sector banks)	**Foreign banks operating in India**
Total Priority Sector advances	40% of Net Bank Credit (NBC)	32% of NBC
Total agricultural advances	18% of NBC	No target
SSI advances	No target	10% of NBC
Export credit	Export credit does not form part of priority sector	12% of NBC
Advances to weaker sections	10% of NBC	No target

Source: http://www.rbi.org.in/scripts/FAQView.aspx?Id=8

The priority sector encompasses: agriculture, small scale industries, small road and water transport, small business, retail trade, professional and self-employed persons, state-sponsored organizations for scheduled castes/scheduled tribes, education, housing, consumption loans, micro-credit provided by banks either directly or through any intermediary, loans to self-help groups (SHGs) and NGOs, loans to the software industry, loans to specified industries in the food and agro-processing sector having investment in plant and machinery up to Rs 5 crore, and investment by banks in venture capital.

Specific standards are applied to qualify these priority sectors and investments made by the banks in special bonds issued by the specified institutions could be reckoned as part of priority sector advances subject to certain conditions. In the case of non-achievement of priority sector lending target, domestic scheduled commercial banks are allocated amounts for contribution to the Rural Infrastructure Development Fund (RIDF) established in National Bank for Agricultural and Rural Development (NABARD). Foreign banks are required to deposit with the Small Industries Development Bank of India (SIDBI) an amount equivalent to the shortfall for one year at the interest rate of 8% per annum.

[6] Narayana, D. 2000. *Banking Sector Reforms and the Emerging Inequalities in Commercial Credit Deployment in India* (Thiruvanthapuram, Centre for Development Studies), Working Paper No 300, March.

There is a time limit for disposal of loan applications (fortnight for the applications up to Rs 25,000 and 8-9 weeks for those over Rs 25,000). The interest rate in the case of loans up to Rs 2 lakh should not exceed the prime lending rate (PLR) of the bank. Banks are free to determine the interest rate in the case of loans above Rs 2 lakh.

Priority sector lending by commercial banks is monitored by RBI through periodical returns received from the banks. Performance of banks is also reviewed at the state, district, and block levels for compliance with the Lead Bank Scheme.

Future of Priority Sector Regulations

There are many signs that the regulations regarding priority sector lending will remain a part of the Indian banking system for the foreseeable future. It has become an ingrained aspect of lending over the course of its existence and is unlikely to disappear soon. In those sectors it serves, the demand for credit is far from being met and the issues causing market failure have yet to be resolved. Microfinance organizations hold the promise of rectifying some of those problems and bringing credit to those outside of the formal financial sector. The work of an institution like GCI could assist the microfinance institutions in scaling up their work.

Ranjula Bali Swain tested the claims by some like Kochar (1997) and Bell (1990) that there is simply low demand for credit among certain sectors of Indian society and published her results in the *Journal of Economic Development*. After analyzing the results of three different models, Swain concluded that in India, "a considerable number of households are credit rationed by the formal sector."[7] She attributes the difference between her test results and the results of contending academics to the latter's reliance on old and skewed data. (They used data from productive areas in the 1980s.) One of the important findings from the third—and most realistic—model was the significant effect landownership had on determining credit access. Swain concludes by pointing to the inroads made by self-help groups in neutralizing this affect. Her work illustrates the continued need for government intervention in dealing with the markets failure to provide credit to the priority sector.

Swain's work also identifies the positive role that microfinance can play in extending credit to the poor, a fact that has not gone unnoticed by the Indian government. The increase in legislative support for microfinance organizations and the resultant successes point toward continued government backing of MFIs. The government has assisted the microfinance industry in a variety of ways. One example is its inclusion on the list of priority lending targets. This inclusion allows banks to meet their loan targets by funding institutions that were already experienced and successful at lending to the priority sector. Another form of government support was seen in the circular that the RBI sent to all banks opening the door for self-help groups to open joint accounts. The government also showed its interest in promoting microfinance when its National Bank for Agriculture and Rural Finance decided to dedicate itself to a program that would increase and strengthen links between self-help groups and the formal sector on a permanent basis. This swell in formal support for the increased functioning of

[7] Swain, Ranjula. 2002. *Credit Rationing in Rural India,* Journal of Economic Development. 27(2). http://scholar.google.com/scholar?hl=en&lr=&q=cache:-DNwVGQleKcJ:jed.econ.cau.ac.kr/full-text/27-2/swain.PDF+India,+priority+sector, p. 18.

microfinance organizations in India bodes well for the future relationship between the government and this sector.[8]

In the MIT working paper "Banking Reform in India", the authors suggest one relevant reform that would increase available credit to socially profitable areas by lowering the risk and costs associated with lending to certain priority sectors. Their suggestion is the formation of businesses that could essentially serve as finance companies for microfinance organizations. These for-profit organizations would use their specialized knowledge of the industry to link the formal banking sector to successful MFIs. The potential for banks to profit from these transactions has been illustrated by recent bilateral transactions between the banks and MFIs. MFIs would also stand to gain by their increased capacity. The suggestion of these well-respected academics falls closely in line with the purpose of GCI, and the likely continuation of priority sector lending targets would assist such an organization is establishing its reputation at a lower than normal cost of capital.

Indian Securities Regulations

Development

The securitization market in India holds great promise. Asset-Backed Securitization (ABS) issuances grew by a strong 176% to 223 billion rupees during 2005, accounting for 72% of the structured finance market. The average deal size also increased and entry of newer loan asset categories diversified. The Mortgage-Backed Securitization (MBS) market reported a growth of 13% in 2005.

We, however, do see some obstacles and deficiencies in the Indian securitization market that hinder the activities in this area. By 2002, there are no laws specially governing securitization tractions in India. The Working Group on Asset Securitization, which was set up in July 2000, has been working on the draft and hoped to address several missing points from the legislation in the new regulations. The important points are: true sale (isolation from bankruptcy of the originator), tax neutral bankruptcy remote SPE, stamp duties, taxation and accounting, and eligibility.

Additionally, by 2002, Indian does not have a sophisticated debt market, therefore it lacks a benchmark yield curve for pricing. The appetite for long-term exposures (above ten years) is quite low. Investors have a relatively insufficient understanding of securitization, which should prompt more targeted education to corporate investors.

Situation in 2006

On February 1, 2006, the RBI issued *Guidelines on Securitization of Standard Assets*. The new guidelines were a result of the adaptation of the recommendations that the R. H. Patil committee made in April 2005 and they immediately applied to all banks, financial institutions, and non-banking finance companies. These regulations require that securitization involve a true sale and they set the criteria for the SPVs that will be used in the process. They additionally lay

[8] Sharma, Manohar. "Community-Driven Development and Scaling-Up of Micro-Finance Services: Case Studies from Nepal and India". International Food Policy Research Institute, FCND Discussion Paper 178. http://www.ifpri.org/divs/fcnd/dp/papers/fcndp178.pdf

out the policy regarding credit enhancement, liquidity, underwriting, and services. Furthermore, the guidelines spell out the investment norms for SPV securities and delineate the accounting practices for securitization. Lastly, the regulations describe the disclosures that must be made in the process.

Although it is a positive sign that the government of India is focusing on the subject of securitization, Vinod Kothari, a member of the government of India's consulting group on reforms for secured lending law, raises some serious questions about the effectiveness that these regulations will have on the securities market in India. One aspect about which he complains is the murkiness of the regulations. One example is the confusion over who receives any residual SPV profits. Kothari also complains that the RBI oversteps its bounds. This is especially true with the subject of how banks account for their securitization transactions, where "amortization of gains on sale…[is]…a position taken neither by the International Accounting standard nor by the U.S. accounting standard". In addition, there is the threat that these regulations, including the requirement for 100% capital for first loss facilities, could be applied retrospectively. Muddying the waters even more is that RBI has set out these regulations despite the Indian assertion of its intention to align with Basel II, a fairly different set of regulations, by next year. Kothari predicts that the weight of these regulations will bring banks' plans for securitization projects to a halt. The only alternatives would be a circumvention of the law by creating two-tier structures where one SPV sells to another SPV and no longer falls under the regulations, or the development of a mezzanine market.

General Lessons from CRF Case Study

Efficiency

The largest issue for CRF—and an area in which it is constantly trying to improve—is operating at a scale where there is efficiency. The high fixed costs involved in securitization in the U.S., which can total $200,000 just to issue the security, requires a large base over which to spread these costs. The securitization's efficiency is dependent on the mix of loans. The more disparate the loan pool, the less efficient the securitization. With a more diverse set of targeted investors, CRF is able to more accurately assign risk to different investors.

In CRF's early days, only two unrated tranches were issued: an A tranche owned by investors and a B tranche held by CRF. This dual tranche system was highly inefficient. CRF now is able to issue a number of tranches, increasing the efficiency of the securitization and allowing for better utilization of funds. CRF, therefore, can conduct larger deals and utilize less capital. CRF's quest is to reach a scale at which point it will be completing $100+ million transactions. A security of this size is still small in comparison to Wall Street averages, but enormous for the community lending sector.

Flexibility

CRF approaches each potential client [referred to in this paper as "CDFIs" or "lenders"] with the same customer-centric mentality: "how can we tailor our services and products to best serve our client's needs?" Flexibility has been CRF's watchword since 1989. Each client is

treated individually, and together CRF and the client develop a plan by asking the following questions:

- What's your [the lender's] funding source?
- What are your immediate and long-term cash needs?
- Who are your lending partners, if any? And what do they need?
- What kind of loans are you making?
- What kind of loans would you like to make?

The responsibility for servicing the loans is also established through this discussion. CRF has a track record of servicing loan portfolios that might not fit the operational parameters of other servicers. In addition to the standard features you would expect of any servicer, CRF offers the "high-touch" servicing that is in keeping with their mission of helping bring capital to communities. Beyond providing options for loan servicing, the financial products are designed to meet the needs of the lender. Providing several options in terms of payment, servicing, terms, and the scope of the loans all reflect CRF's standard of flexibility.

Proactive Approach

CRF has demonstrated a very proactive approach to development. In its early stages, CRF sought out clients avidly; staff members traveled from town to town, seeking organizations that would consider selling loans. If GCI were to adopt a similar approach now while its project is still in development, it could build a larger base of cooperating MFIs and perhaps identify investors within the community. It will take a lot of work for GCI to convince potential clients that the unique securitization products are right for them. By starting now, GCI may be able to move at an accelerated pace down the same path that CRF followed to securitization.

Responses to Questions Posed by GCI

Usage of Alternate Servicers

CRF only utilizes a third-party alternate servicer beyond itself and the original lending organizations as a last resort. When needed, Wells Fargo Bank acts as an alternative servicer. While collecting payments itself would eliminate the middleman, GCI and CRF face similar obstacles to doing so. These obstacles include a geographically wide-spread distribution and high volume of borrowers. The primary benefit of leaving the servicing of loans to the CDFIs/MFIs is that they have an infinitely more detailed knowledge of the borrowers than CRF/GCI could gain without undue expense. An important secondary benefit is that—by keeping the CDFIs/MFIs involved in the collection process—the CDFI/MFI continues to have a stake in the accountability of the borrowers, which may bolster the rating agency's opinion of the loans' viability.

Issue of Commingling Funds at MFI Level

CRF's experience offers little insight on the issue of funds commingling while in the possession of the MFIs. CRF does not face this problem because it pays its trustees monthly the day before it receives payments from the borrowers. CRF is able to do this because the banking technology allows for immediate transfer of funds between the servicers' and CRF's bank

accounts once the servicers deposit the funds, which is also easily accomplished in almost any location in the U.S.

MFI Collateral

CRF's leaves 30% of the securitization unrated, covering this segment with capital raised outside of market investors. Following this lead, GCI can pass a percentage of this lowest tranche back to the MFI as an exhibition of the MFI's continued interest. GCI may also bolster the MFI's stake in the loan repayment by hiring the MFI back as the servicer of the loan.

Areas of Future Research

This study provides a stepping stone from which additional areas can be analyzed. Though over-arching, this report relied on case study analysis. It could be further enriched if complemented with a finance viewpoint. A financial analysis would provide concrete numbers for a sample portfolio of loans and explain explicitly how CRF or potentially GCI would securitize such a portfolio. The benefit of numbers would provide an accurate method to measure the diversification achieved and the actual amount of collateralization required to achieve a certain rating. Rates of returns, average revenue yield, and costs for all parties could be precisely calculated as well. Though some of the risks of securitization have been mentioned in this study, others need to be more precisely determined, including interest rate risk, payment timing risk, and prepayment risks. Since CRF's portfolios of loans are longer term, some of the short-term risks associated with long-term lending such as payment timing risk were not applicable. The credit card industry may provide a model and would be more relevant for GCI's potential payment timing risks since payments for credit cards are made at different periods, yet investors are paid monthly. From a financial architecture viewpoint, many of the pros and cons of different structures can be analyzed in more detail. GCI will begin with simple pass-throughs but in the future, they may benefit from more sophisticated structures.

Another independent but equally important focus for future studies would be the limitations of scaling up MFIs in India. An immediate concern is the concentration of MFIs in India within a few states. If geographical diversification is not possible, portfolio diversification would be limited and wholly dependent on the occupational diversity of the borrowers of the MFIs. Secondly, if more geographical areas are not included, a question of concern is how long before the market is saturated? Competition from various products on the investor side of the equation need to be explored and anticipated. As an example, should another priority sector lending paper be available and rated AAA, how would the GCI bond rate fare in comparison and are there any other possible entrants in the market?

Appendix I: Acronyms & Definitions

Balloon loan	"A long-term loan, often a mortgage, that has one large payment (the balloon payment) due upon maturity. A balloon loan will often have the advantage of very low interest payments, thus requiring very little capital outlay during the life of the loan." (From: www.InvestorWords.com)
CDFI	Community Developed Financial Institution
CMFR	Centre for Microfinance Research ; academic wing of ICICI located in Nungambakkam, India
CRA	Community Reinvestment Act
CRF	Community Reinvestment Fund; headquartered in Minneapolis, Minnesota
CRISIL	Credit Rating Information Services India, Ltd.
Crore	Stands for 10 million; for example: 4 crore = 40,000,000
CUSIP	Identifier for bonds
CYM	Constant Yield to Maturity
ETM	Escrowed To Maturity
FLDG	First loss default guarantee
GCI	Grameen Capital India; headquartered in Mumbai, India
GFUSA	Grameen Foundation USA
ICICI	ICICI Bank
Lakh	Stands for 100,00; for example: 6 lakh = 600,000
LLC	Limited Liability Company
LTV	Loan-to-value ratio; "The ratio of the fair market value of an asset to the value of the loan that will finance the purchase. Loan-to-value tells the lender if potential losses due to nonpayment may be recouped by selling the asset." (From: www.InvestorWords.com)
MCRIL	Micro-Credit Ratings International Ltd.
MOAP	Microfinance Open Architecture Project
MFI	Microfinance institution
NABARD	National Bank for Agricultural and Rural Development
NAICS	North American Industry Classification System
NBC	Net Bank Credit
OID	Original Issue Discount
P/L	Profit/Loss Statement
RIDF	Rural Infrastructure Development Fund
ROI	Return on Investment
Rs	Indian rupees
S&P	Standard and Poor's
SHG	Self-Help Group
SIDBI	Small Industries Development Bank of India
SPV	Special Purpose Vehicle
TEY	Taxable Equivalent Yield
UNDP	United Nations Development Program
WACC	Weighted Average Cost of Capital
YTD	Year to Date T-Bills – Treasury Bills

Appendix II: CRF Series 17 Appendix E

APPENDIX E

THE INITIAL DEVELOPMENT LOAN POOL

Unless otherwise noted, all statistical percentages in this Private Placement Memorandum are approximates and are measured by the aggregate principal balances of the Initial Development Loans on the Cut-Off Date, after application of principal payments received by the Sponsor and the Loan Originators before such date, and all dollar amounts are based on the principal balances thereof on the Cut-Off Date. The statistical distribution of the characteristics of the actual pool of Initial Development Loans delivered on the Closing Date will vary somewhat from the statistical distribution of such characteristics for the pool presented in this Private Placement Memorandum. The Sponsor, however, does not believe that the characteristics of the pool delivered on the Closing Date will differ materially from such statistical distribution. Prior to the Closing Date certain Development Loans may be removed and additional Development Loans substituted therefor.

None of the Initial Development Loans are insured or guaranteed by the United States Small Business Administration (the "SBA").

All of the Initial Development Loans were, and all of the Subsequent Development Loans will be, originated and underwritten by the Sponsor or were purchased and reunderwritten by the Sponsor in accordance with its underwriting criteria contained in Appendix B to the Sale and Servicing Agreement. As of the close of business on the Cut-Off Date, the aggregate principal amount of the Initial Development Loans expected to be delivered to the Trustee on the Closing Date equaled approximately $48,979,517 (the "Original Pool Principal Balance").

Payments on the Initial Development Loans

The Initial Development Loans have payments of principal and interest due throughout the month with interest payable in arrears. Interest due on the Initial Development Loans is based on a fixed rate, plus the appropriate margin. The monthly payment received is apportioned between interest and principal based upon a "simple interest" basis, which means that payments are applied as they are received first to accrued interest, then to principal, with interest calculated on the number of days between the current and previous payments. If a monthly payment is received prior to its due date, less of such payment will be allocated to interest than would be the case if such payment were received on its due date. Conversely, if a monthly payment is received after its due date, more of such payment will be allocated to interest than would be the case if such payment were received on its due date. The monthly payments are re-calculated periodically to reflect changes in interest rates, the then-current principal balance and the then-remaining term to maturity.

Certain Characteristics of the Development Loan Pool

Set forth below is a description of certain characteristics of the Initial Development Loans as of the Cut-Off Date. Certain of the percentage columns may not sum to 100.00% due to rounding.

The Outstanding Principal Balances of the Initial Development Loans as of the Cut-Off Date was as follows:

Outstanding Principal Balance

Lower Bound		*Upper Bound*	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
0.00	*to*	250,000.00	76	59.38%	7,027,118.44	14.35%
250,000.00	*to*	500,000.00	22	17.19%	7,617,232.75	15.55%
500,000.00	*to*	750,000.00	11	8.59%	6,718,346.39	13.72%
750,000.00	*to*	1,000,000.00	8	6.25%	7,464,919.70	15.24%
1,000,000.00	*to*	1,250,000.00	1	0.78%	1,032,142.58	2.11%
1,250,000.00	*to*	1,500,000.00	1	0.78%	1,485,555.35	3.03%
1,500,000.00	*to*	1,750,000.00	1	0.78%	1,580,243.90	3.23%
1,750,000.00	*to*	2,000,000.00	5	3.91%	9,228,663.27	18.84%
2,000,000.00	*to*	2,250,000.00	1	0.78%	2,080,245.15	4.25%
2,250,000.00	*to*	2,500,000.00	2	1.56%	4,745,049.49	9.69%
			128	*100.00%*	*48,979,517.02*	*100.00%*

The distribution of Balloon Loan Outstanding Balances by months to maturity as of the Cut-Off Date was as follows:

Balloon Outstanding Balance by Term

Lower Bound		*Upper Bound*	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
0	*to*	30	5	9.09%	272,233.80	1.96%
30	*to*	60	24	43.64%	3,342,910.40	24.02%
60	*to*	90	11	20.00%	3,282,669.93	23.59%
90	*to*	120	10	18.18%	4,268,042.71	30.67%
120	*to*	150	2	3.64%	405,217.97	2.91%
150	*to*	180	1	1.82%	298,562.93	2.15%
210	*to*	240	2	3.64%	2,045,085.60	14.70%
			55	*100.00%*	*13,914,723.34*	*100.00%*

The distribution of the number of months since origination as of the Cut-Off Date was as follows:

Months Since Origination (Seasoning)

Lower Bound		*Upper Bound*	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
0	*to*	12	52	40.63%	27,158,899.87	55.45%
12	*to*	24	25	19.53%	12,211,985.11	24.93%
24	*to*	36	6	4.69%	421,086.06	0.86%
36	*to*	48	4	3.13%	1,085,724.29	2.22%
48	*to*	60	14	10.94%	2,441,130.80	4.98%
60	*to*	72	6	4.69%	842,077.64	1.72%
72	*to*	360	21	16.41%	4,818,613.25	9.84%
			128	*100.00%*	*48,979,517.02*	*100.00%*

The distribution of the number of remaining months to maturity of the Development Loans as of the Cut-Off Date was as follows:

Remaining Months to Maturity

Lower Bound		*Upper Bound*	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
0	*to*	30	10	7.81%	430,452.40	0.88%
30	*to*	60	35	27.34%	5,881,862.03	12.01%
60	*to*	90	17	13.28%	3,887,516.82	7.94%
90	*to*	120	16	12.50%	6,607,773.91	13.49%
120	*to*	150	6	4.69%	1,874,164.98	3.83%
150	*to*	180	12	9.38%	4,745,797.51	9.69%
180	*to*	210	5	3.91%	1,224,640.83	2.50%
210	*to*	240	24	18.75%	22,668,008.73	46.28%
240	*to*	270	2	1.56%	1,528,500.00	3.12%
270	*to*	300	1	0.78%	132,799.81	0.27%
			128	*100.00%*	*48,979,517.02*	*100.00%*

The distribution of the current undiscounted Loan-to-Value Ratios* of the Initial Development Loans was as of the Cut-Off Date as follows:

Current Undiscounted LTV Ratio

Lower Bound		*Upper Bound*	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
0.000%	*to*	30.000%	8	6.25%	575,716.97	1.18%
30.000%	*to*	40.000%	2	1.56%	454,406.64	0.93%
40.000%	*to*	50.000%	6	4.69%	1,682,728.56	3.44%
50.000%	*to*	60.000%	15	11.72%	7,010,911.77	14.31%
60.000%	*to*	70.000%	23	17.97%	8,194,612.87	16.73%
70.000%	*to*	80.000%	22	17.19%	10,563,408.24	21.57%
80.000%	*to*	90.000%	42	32.81%	19,474,138.94	39.76%
90.000%	*to*	100.000%	10	7.81%	1,023,593.03	2.09%
			128	*100.00%*	*48,979,517.02*	*100.00%*

* For each Development Loan, the "Loan-to-Value Ratio" or "LTV Ratio" as presented in this table is defined as the percentage obtained by dividing (i) the sum of (a) the current principal amount of such Development Loan as of the Cut-Off Date, plus (b) the principal balance of any Prior Lien as of the date of origination of the related Development Loan by (ii) the total collateral value of the primary and secondary collateral securing such Development Loan at the time of origination.

The interest rates borne by the Initial Development Loans (the "Note Rates") were distributed as follows as of the Cut-Off Date:

Interest Rate (Note Rate)

Lower Bound		*Upper Bound*	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
2.000%	*to*	3.000%	2	1.56%	32,376.35	0.07%
4.000%	*to*	5.000%	3	2.34%	1,128,290.29	2.30%
5.000%	*to*	6.000%	10	7.81%	1,765,146.41	3.60%
6.000%	*to*	7.000%	30	23.44%	10,195,010.49	20.81%
7.000%	*to*	8.000%	50	39.06%	29,478,306.76	60.18%
8.000%	*to*	9.000%	21	16.41%	5,610,210.44	11.45%
9.000%	*to*	10.000%	9	7.03%	686,194.90	1.40%
10.000%	*to*	11.000%	3	2.34%	83,979.38	0.17%
			128	*100.00%*	*48,979,517.02*	*100.00%*

The distribution of Debt Service Coverage Ratios of Initial Development Loans aged less than 24 months as of the Cut-Off Date was as follows:

Debt Service Coverage
(Loans Aged <= 24 mos.)

Lower Bound		*Upper Bound*	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
0.500	*to*	1.000	1	1.33%	88,196.55	0.22%
1.000	*to*	1.500	19	25.33%	8,623,216.83	21.91%
1.500	*to*	2.000	23	30.67%	14,900,654.52	37.87%
2.000	*to*	2.500	12	16.00%	6,706,129.78	17.04%
2.500	*to*	3.000	6	8.00%	3,877,458.07	9.85%
3.000	*to*	15.000	14	18.67%	5,155,099.64	13.10%
			75	*100.00%*	*39,350,755.39*	*100.00%*

The distribution of amortization types (i.e., regular vs. balloon) of the Initial Development Loans as of the Cut-Off Date was as follows:

Amoritization Type

Item	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
Balloon	55	42.97%	13,914,723.34	28.41%
Regular	73	57.03%	35,064,793.68	71.59%
	128	*100.00%*	*48,979,517.02*	*100.00%*

The distribution of Initial Development Loans by Collateral Type as of the Cut-Off Date was as follows:

Collateral Type

Item	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
Business Assets	1	0.78%	107,716.86	0.22%
Cash	1	0.78%	92,841.95	0.19%
Equipment	3	2.34%	902,685.46	1.84%
Marketable Securities	1	0.78%	984,307.25	2.01%
Real Estate	107	83.59%	43,971,938.16	89.78%
Real Estate & Business Assets	6	4.69%	514,669.01	1.05%
Real Estate & Equipment	4	3.13%	1,636,911.14	3.34%
Real Estate & Furniture, Fixtures & Equipment	4	3.13%	750,482.58	1.53%
Real Estate, Furniture, Fixtures and Equipment & Accounts Receivable	1	0.78%	17,964.61	0.04%
	128	*100.00%*	*48,979,517.02*	*100.00%*

The distribution of Initial Development Loans by state as of the Cut-Off Date was as follows:

			Geographic Distribution (State)	
Item	***Count***	***Count (% Of)***	***Curr. Bal.***	***Curr. Bal. (% Of)***
Alabama	2	1.56%	66,654.58	0.14%
Arizona	3	2.34%	349,366.79	0.71%
California	27	21.09%	20,364,075.24	41.58%
Colorado	5	3.91%	5,189,665.84	10.60%
Florida	8	6.25%	405,754.51	0.83%
Idaho	1	0.78%	113,900.92	0.23%
Illinois	1	0.78%	2,080,245.15	4.25%
Indiana	1	0.78%	2,266,007.97	4.63%
Massachusettes	6	4.69%	1,917,479.20	3.91%
Minnesota	48	37.50%	6,616,754.03	13.51%
Montana	7	5.47%	1,536,623.60	3.14%
Ohio	1	0.78%	83,620.41	0.17%
Oregon	2	1.56%	1,573,683.44	3.21%
Pennsylvania	4	3.13%	273,936.70	0.56%
South Carolina	2	1.56%	1,083,952.83	2.21%
South Dakota	1	0.78%	679,653.66	1.39%
Texas	1	0.78%	288,158.74	0.59%
Utah	7	5.47%	3,997,141.46	8.16%
Washington	1	0.78%	92,841.95	0.19%
	128	*100.00%*	*48,979,517.02*	*100.00%*

The distribution of Initial Development Loans by lien position as of the Cut-Off Date was as follows:

Lien Position

Item	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
1st	44	34.38%	18,283,150.31	37.33%
2nd	79	61.72%	29,726,528.97	60.69%
3rd	5	3.91%	969,837.74	1.98%
	128	*100.00%*	*48,979,517.02*	*100.00%*

The distribution of the Initial Development Loans by loan purpose as of the Cut-Off Date was as follows:

Loan Purpose Type

Item	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
Loan to Lender	4	3.13%	4,590,311.22	9.37%
Purchase	98	76.56%	32,799,990.88	66.97%
Refinance	19	14.84%	11,346,268.95	23.17%
Rehab	7	5.47%	242,945.97	0.50%
	128	*100.00%*	*48,979,517.02*	*100.00%*

The distribution of Initial Development Loans by year of origination as of the Cut-Off Date was as follows:

Year of Loan Origination

Year	*Count*	*Count (% Of)*	*Curr. Bal.*	*Curr. Bal. (% Of)*
1988	1	0.78%	298,562.93	0.61%
1989	1	0.78%	8,451.52	0.02%
1991	2	1.56%	28,621.19	0.06%
1992	4	3.13%	136,638.83	0.28%
1994	4	3.13%	870,815.91	1.78%
1995	3	2.34%	858,902.44	1.75%
1997	4	3.13%	303,846.35	0.62%
1998	2	1.56%	2,310,774.08	4.72%
1999	9	7.03%	1,109,511.37	2.27%
2000	11	8.59%	2,173,697.07	4.44%
2001	5	3.91%	1,156,578.22	2.36%
2002	9	7.03%	524,940.45	1.07%
2003	34	26.56%	15,756,678.78	32.17%
2004	39	30.47%	23,439,497.88	47.86%
	128	*100.00%*	*48,979,517.02*	*100.00%*

The distribution of Initial Development Loans by NAICS as of the Cut-Off Date was as follows:

	North American Industry Classification System (NAICS)			
Item	***Count***	***Count (% Of)***	***Curr. Bal.***	***Curr. Bal. (% Of)***
Administration of Urban Planning and Community and Rural Development	2	1.63%	2,682,372.70	5.85%
All Other SICs (51 different SICs)	60	48.78%	6,055,681.34	13.20%
Broadwoven Fabric Mills, Cotton	2	1.63%	1,083,952.83	2.36%
Carwashes	2	1.63%	828,683.44	1.81%
Colleges, Universities, and Professional Schools	1	0.81%	709,861.52	1.55%
Commercial Printing, NEC	1	0.81%	300,000.00	0.65%
Construction and Mining (Except Petroleum) Machinery and Equipment	1	0.81%	1,972,844.50	4.30%
Eating and Drinking Places	6	4.88%	723,068.63	1.58%
Food Preparations, NEC	1	0.81%	995,000.00	2.17%
Fresh Fruits and Vegetables	1	0.81%	1,777,339.76	3.87%
Gasoline Service Stations	8	6.50%	3,635,654.13	7.92%
Hotels and Motels	3	2.44%	3,446,571.14	7.51%
Lumber and Other Building Materials Dealers	1	0.81%	1,485,555.35	3.24%
Lumber, Plywood, Millwork, and Wood Panels	1	0.81%	973,049.49	2.12%
Motor Vehicle Dealers (New and Used)	2	1.63%	2,763,464.41	6.02%
Natural, Processed, and Imitation Cheese	1	0.81%	679,653.66	1.48%
Offices and Clinics of Dentists	2	1.63%	45,141.01	0.10%
Offices and Clinics of Doctors of Medicine	2	1.63%	1,967,290.73	4.29%
Offices and Clinics of Health Practitioners, NEC	1	0.81%	580,922.24	1.27%
Operators of Apartment Buildings	11	8.94%	3,558,155.69	7.75%
Operators of Non-Residential Buildings	4	3.25%	2,382,399.36	5.19%
Plumbing, Heating, and Air-Conditioning	2	1.63%	547,924.37	1.19%
Residential Care	2	1.63%	822,936.89	1.79%
Social Services, NEC	2	1.63%	1,437,991.72	3.13%
Specialty Outpatient Facilities, NEC	1	0.81%	2,080,245.15	4.53%
Tires and Tubes	1	0.81%	644,572.08	1.40%
Water, Sewer, Pipeline and Communications, and Power Line	1	0.81%	673,681.81	1.47%
Wrecking and Demolition Work	1	0.81%	1,032,142.58	2.25%
	123	*100.00%*	*45,886,156.53*	*100.00%*

IMPORTANT NOTICE

The information contained in this **APPENDIX E** should only be reviewed in conjunction with the information contained elsewhere in the Private Placement Memorandum concerning the Notes and any investor should review the entire Private Placement Memorandum prior to making any investment decision. For an explanation of certain assumptions, including the "Base Assumptions," relevant to these materials and the risks associated with any investment in the Notes, see "**NOTEHOLDERS RISKS AND OTHER CONSIDERATIONS**" in the Private Placement Memorandum.

Appendix III: Relevant U.S. Laws

United States regulation of the type of asset-securitization used by CRF is governed by several areas of law—including, but not limited to, securities law, contract law, and corporation law.

Securities Laws

Stocks, bonds, and investment contracts in the U.S. are governed by securities law. CRF's Series 17 falls within this category of a bond, even though the asset-backed nature of Series 17 makes it somewhat unusual. All securities including CRF Series 17 are governed primarily by two laws: The United States Securities Act of 1933 and The Securities Exchange Act of 1934. The primary purpose of boththese laws is to increase transparency and ensure public access to information about the investment. These laws also are designed to prevent and punish misrepresentations and fraud on the public or on investors.

CRF Series 17 was issued pursuant to these laws, but Series 17 and other securities issued by CRF are special cases because they are not offered to the public. They are offered as "private placements."[9] The rules for private placements allow an entity like CRF to approach large institutions or other "qualified buyers" privately to negotiate the sale of the security. This process was designed to ease—among other things—the disclosure requirements placed upon issuers of the security, such as CRF. Private placements work well for CRF because it obtains most of its capital from a limited number of investors who invest large sums of money. If CRF, however, were not able to obtain all of its financing from large institutions or qualified buyers, CRF would have to go to the public market where disclosure requirements would become more cumbersome. Additionally, if one of the purchasers of Series 17 or any other privately placed security sold its rights to the security to a third party, the entire security would then lose its special status as a private placement. To minimize these requirements, CRF restricts the resale of its securities.

Since CRF sells largely to institutional investors and GCI plans to do the same, Rule 144A is the most relevant to both organizations. In addition to Rule 144A's requirements that investors be institutions or "qualified institutional buyers," there are two other requirements placed upon the issuer. The issuer initially must make the buyer aware that it is offering a private placement. CRF, for example, explicitly states the private placement status of Series 17 on the top of the securitization's front page. This statement serves as notice to the investors that they may not have the same protections as they would under a publicly traded bond. Rule 144A also requires, however, that the issuer keep the investors aware of "reasonably current information" about the security. Customer service is a priority for CRF, and current information—including CRF's financial statements—are readily available upon request from CRF.

Contract Law

[9] Private placements are available under Section 4(2), Regulation D, and Rule 144A.

U.S. law historically required that banks seek the approval of borrowers before selling loans to a third party. This would mean that the CDFIs would have to seek the permission of borrowers before selling the loans to CRF. This provision would take time and money, and the borrower may not consent. The U.S. Uniform Commercial Code changed this requirement. Article 9 of the code allows the bank to sell the loan without the consent of the borrower. If India does not have measures similar to Article 9, creating securitizations could be significantly more cumbersome.

Corporation Law / Limited-Liability Companies

Limiting liability is an important consideration for securitization. Essentially, CRF does not want to be financially liable if a security goes bankrupt. As a result, CRF's warehouse is a structured as limited liability company (LLC) under the state of Delaware's law. This LLC is a "legal fiction" that establishes a special purpose vehicle (SPV). Since the security is warehoused in an SPV, investors have recourse against the SPV without the recourse extending to the greater CRF organization. If India's laws do not allow for limited liability, GCI may be exposed to financial loss.

Appendix IV: References

Websites

CRF: http://www.crfusa.com
GCI: http://www.tech.gfusa.org/programs/india_initiative/grameen_capital_india/ *and* http://www.tech.gfusa.org/programs/india_initiative/india_initiative_updates/
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