

## EVOLUTION OF PRODUCT INNOVATION

### The Luxembourg Fund Labelling Agency (LuxFLAG) and Microfinance

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The Luxembourg Fund Labelling Agency a.s.b.l. (LuxFLAG) is an independent organization based in Luxembourg that aims to promote the raising of capital for Microfinance by awarding a distinctive Label to eligible Microfinance Investment Vehicles (MIVs). LuxFLAG represents another step in helping make Luxembourg attractive as an innovative centre for MIVs and its Label ensures investors that the investment vehicles to which they commit their money are indeed investing in Microfinance.

#### Background

Thanks to the 2005 International Year of Microcredit, the award of the 2006 Nobel Peace Prize to a Microfinance practitioner and strong media coverage, awareness of Microfinance and access to financial services as tools that can alleviate poverty have taken a massive leap forward.

LuxFLAG is a fitting illustration of the synergy present in the Luxembourg financial centre. In October 2005, as part of the United Nations' Year of Microcredit, Luxembourg promoted a Round Table on Microfinance at which a number of studies were presented and at which the idea as to how Luxembourg could establish itself as a key centre for Microfinance was debated. Through the Round Table, the Luxembourg Government gave its support to two studies on MIVs commissioned by ATTF (Financial Technology Transfer Agency). The first study called for a label for MIVs. The second study confirmed the attractiveness of Luxembourg structures and suggested initiatives, including a label. One of the projects resulting from the Round Table was therefore the launch of a MIV Label (later to become LuxFLAG), a niche product in the fast growing universe of ethical investment vehicles.

The label project was subsequently taken forward by the ALFI Socially Responsible Investment Funds Working Group. In Spring of 2006, a concrete proposal was then prepared by a task force of potential partners. On 20 July 2006 LuxFLAG was formally launched in the presence of Her Royal Highness the Grand Duchess Maria Teresa, who accepted Honorary Presidency of the Agency. Both Mr. Luc Frieden, Minister of the Treasury and the Budget, and Mr. Jean-Louis Schiltz, Minister of Development and Cooperation, were present to sign the Statutes of LuxFLAG.

#### Charter Members

The Agency is an example of successful cooperation between the private sector, the NGO sector and the State, and benefits from the full support of both the Ministry of Finance and of the Ministry of Foreign Affairs. LuxFLAG's founding partners (Charter Members) reflect the broad interest that Microfinance has elicited in the Luxembourg financial centre. These are:

Appui au Développement Autonome (ADA)  
Association of the Luxembourg Fund Industry (ALFI)  
European Investment Fund (EIF)  
Financial Technology Transfer Agency (ATTF)  
Luxembourg Bankers' Association (ABBL)  
Luxembourg Stock Exchange  
State of the Grand Duchy of Luxembourg  
LuxFLAG is managed by a Board of Directors that represents its founding members.



#### Why a Label?

The primary objective of the LuxFLAG Microfinance Label is to reassure investors that the MIV actually invests, directly or indirectly, in the Microfinance sector. Investing indirectly means that the MIV can, rather than giving direct loans to Microfinance Institutions (MFIs), invest into other MIVs themselves investing more than 50% in Microfinance. The label, which is available to eligible MIVs domiciled in any jurisdiction where regulation is equivalent to that available in EU member states, facilitates distribution and therefore fund raising, and contributes

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to the visibility of the relatively young MIV sector. The label also enhances the image of the MIV, by proving that it is regularly scrutinized by an expert panel and meets internationally recognized standards in the Microfinance sector. Although the main objective is to confirm that the MIV actually invests in Microfinance, it is also intended that funds receiving the label should comply with minimum requirements in terms of transparency and investor protection. However, the LuxFLAG Microfinance Label is not a guarantee of performance, nor does it constitute a recommendation to invest.

A label for MIVs is particularly important because MFIs are increasingly turning to international markets to raise capital to increase their reach into the poor urban and rural areas, and a growing number of MIVs are being created to serve this need. Moreover, institutional and retail investor demand for socially responsible investment opportunities is also growing at a dramatic pace and as the number of funds expands, there is a need to assist investors in their choice of investment, especially since the complexity of different structures available and similarity of investment policies make it difficult for potential investors to choose their investment in Microfinance.

#### Other benefits for labelled funds

Labelled funds that have received the label benefit from increased visibility. Indeed, LuxFLAG markets itself actively and is widely promoted by its Members via its website, promotional brochures, press conferences, articles, conferences, seminars, industry related media opportunities, as well as via regular press releases, thereby adding value to the brand and providing a platform from which to attract investors. Not only does the labelled fund appear on the LuxFLAG website ([www.luxflag.org](http://www.luxflag.org)), but it is also identified with a specific label in a dedicated list on the database of CCLux (a subsidiary

of the Luxembourg Stock Exchange, [www.cclux.lu](http://www.cclux.lu)) which is made available to major international data vendor companies. LuxFLAG also publishes statements relative to labelled MIVs on its website. Moreover, a fund that has been granted the LuxFLAG Microfinance Label may also use the distinctive LuxFLAG Logo in its marketing and promotional activities.

#### Criteria

The purpose of LuxFLAG is to grant a label to MIVs on the basis of agreed and published criteria (available on [www.luxflag.org](http://www.luxflag.org)). Indeed, in order to obtain a LuxFLAG Microfinance Label, a fund must comply with a number of criteria set by LuxFLAG. The principle conditions are that the MIV must:

- be subject to supervision equivalent to that in EU Member States;
- have a Microfinance portfolio corresponding to at least 50% of the MIV's total assets;
- have at least 25% of its Microfinance portfolio invested in MFIs rated by a Microfinance rating agency recognized by LuxFLAG;
- have a commercial objective (the label will not be granted to donor organizations, such as state donor entities or charitable trusts).

#### Procedure

The MIV must complete and sign an application form (which is available on the [www.luxflag.org](http://www.luxflag.org)) and return it to LuxFLAG together with a series of addenda in hardcopy or electronic format. These documents are:

- the prospectus of the investment vehicle;
- the Statutes or Articles of Incorporation;
- the latest audited financial statements;
- the unaudited semi-annual financial statements, if more recent;

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LUXFLAG – Chairman of Board of Directors



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- a full list of assets in the portfolio (if not included in the financial statements) together with evidence that at least 50% of the portfolio is invested in Microfinance and that at least 25% of the Microfinance portfolio is invested in MFIs rated by a rating agency recognized by LuxFLAG.

#### Process

Analysis of the candidate funds is delegated to an Eligibility Committee, composed of Board Members and external Microfinance experts. This panel makes recommendations to the Board, which takes the final decision.

Successful applicants will be required to pay an annual fee and to sign a set of Terms and Conditions relating to the use of the LuxFLAG Label. The label will be granted for a period of one year, and renewable subject to review for continued fulfilment of the eligibility criteria.

#### Labels

The first LuxFLAG Labels were granted on Wednesday, 31 January 2007 (and renewed on 7 April 2008) in the presence of Mr Jean-Louis Schlitz, Minister of Development Cooperation and Humanitarian Action to three Microfinance funds domiciled in Luxembourg and managed and distributed by internationally renowned institutions.

Three further funds have obtained the LuxFLAG Label in 2008.

Details of the labelled funds, which are all promoted by major European financial institutions, are available on LuxFLAG's website: [www.luxflag.org](http://www.luxflag.org).

#### Associate Members

LuxFLAG also welcomes Associate Members. Many renowned organizations have joined LuxFLAG as Associate Members, and numerous others are in the process of doing so.

#### Website

LuxFLAG's website, [www.luxflag.org](http://www.luxflag.org), contains information about the Agency and Microfinance, criteria and procedures to obtain a label, as well as details of labelled funds.



**Thomas Seale,**  
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Vice Chairman, International Affairs  
Member of the ALFI Board of Directors  
European Fund Administration S.A.  
Chief Executive Officer

#### Information about Microfinance

Microfinance is defined as the supply of loans, savings, insurance, transfer services and other financial products to poor and low-income clients excluded from the traditional banking system. Typically, Microfinance includes providing financial services to micro-entrepreneurs to set up a business. Microfinance Investment Vehicles (MIVs) are investment vehicles raising funds from social, commercial, private or institutional investors in order to invest them in Microfinance assets. In general, Microfinance Institutions (MFIs) in which MIVs invest will have an average loan size of less than EUR 5,000 (or EUR 10,000 within Europe). Microfinance Institutions (MFIs) refer to all types of formal and semi-formal institutions that offer Microfinance services and devote a major part of their resources to provide Microfinance services and/or whose client base consists 50% or more of poor and low-income people and the micro-enterprises owned by them.

The MIV market increased significantly in size during the first half year of 2008 to reach EUR 5.5 billion and is projected also to grow strongly this year. Over 93 MIVs exist, using widely varying legal structures (source: CGAP, February 2008) out of which more than 50% are regulated investment vehicles. Over half of the regulated and supervised MIVs are domiciled in Luxembourg with a total Microfinance portfolio of USD 1.32 billion. At 30 June 2008, MIVs with the LuxFLAG Label hold assets under management of USD 1.3 billion, whereof the Microfinance portfolio amounts to more than USD 1 billion.