

## Refugee Integration Fund (RIF)

*"It is an opportunity. You have to invest in the integration of refugees and you get a return on that investment down the road."*

- H el ene Rey at the World Economic Forum in Davos

### Challenge

- ❖ **Europe faces large inflow of refugees:** According to UNHCR, there are c.3 million refugees in Europe, with c.1.1m seeking asylum in 2015 (c.70% increase compared to 2014). The current situations of refugee represent the largest European refugee inflow since the former Yugoslavia conflict in 1996.
- ❖ **Inflow of refugees will continue:** Given the ongoing geopolitical conflicts in countries including Syria, Iraq, Afghanistan and Eritrea, the large inflow of asylum seekers into the EU is expected to persist for the foreseeable future.
- ❖ **European humanitarian challenge:** The refugee crisis poses key challenges to the EU-28 including labour market integration of refugees. Poor refugee integration leads to negative social and economic impact on host countries (i.e. reliance on benefits and radicalisation).
- ❖ **Socioeconomic integration of refugees is now a necessity:** once refugees settle (gain asylum status, language and certain skills), they need to be integrated to the society, which is often difficult due to labour market's discriminations. Entrepreneurship can offer solution to non-employment, giving chance to refugees to contribute to the society and socially integrate to the community.
- ❖ **Lack of adequate financial supports:** Currently, both the EU governments and private sectors are not delivering adequate financial services or funding to settled refugees with skills to start a business. Therefore, there is a significant market gap and investment opportunity to provide funding to refugees, enabling them to pursue entrepreneurship activities.

**Investment thesis [solution]:** refugees' access to funding to start a business is crucial for their entrepreneurship activity, which would lead to potential solution to refugee unemployment and poverty. Refugee Integration Fund ('RIF') seeks to support refugees through indirectly providing microfinancing to refugee entrepreneurs using Collateralized Loan Obligation ('CLO') structure. Microfinance is an established funding channel in developing countries, where entrepreneurs are unable to fully access financial services. RIF will create a SPV, which will act as a lender to Microfinance Institutions ('MFIs') [MFIs will provide loans to refugees] in Europe as well as an issuer of notes to investors. The idea and investment structure have been validated by scholars, social finance consultants, EIF structuring and guarantee professional, and securitization professional. CLO assists investors in mainly two ways; information and coordination. It reduces due diligence costs for the investors and creates investment opportunities for institutional investors within the MFI space.

### Investment Overview

#### Target Geography:

- ❖ Germany, France and Sweden (Pilot and Phase 1)
- ❖ + Italy, Austria & the rest of EU (Phase 2)

#### Asset Class and Capital Structure:

- a) **CLO:** notes issued by SPV in tranches; guaranteed senior v tranche
- b) **SPV's Assets:** a pool of loans to MFIs and cash reserve from equity tranche

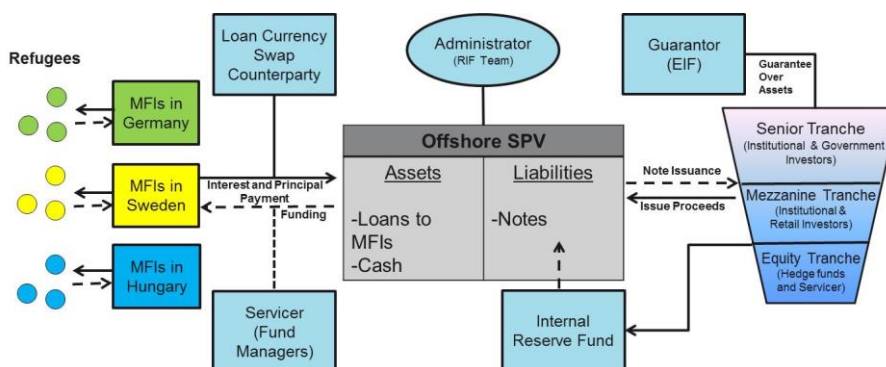
**Target investors:** Philanthropic Investors (esp. pilot); Institutional & Government Investors (senior tranche); Hedge funds or Servicer (Equity Tranche)

**Target pilot scheme:** €10m

**Target Fund Size:** €30m in Phase 1, €35m in Phase 2

**Term:** 4 years

**Minimum Investment Size:** €1m



### Investment Structure Explained

- ❖ **Target Investors:** Philanthropic investors, Institutional investors (i.e. banks, pension funds, mutual funds), Impact Investors, Development Finance Institutions (i.e. IFC, CDC, DEG), host nation governments, foundations focused on microfinance (MasterCard Foundation) invest through purchase of senior notes guaranteed by the European Investment Fund. First-loss notes and equity tranches are sold to hedge funds and servicers as incentive.

- ❖ **Microfinance Institutions ('MFI'):** MFIs universe will include the top-tier microfinance institutions and the second tier microfinance institutions. Securitization can help non-deposit taking MFIs to reduce their cost of funding and to manage their capital base more effectively. Total Addressable Market in the EU for pilot scheme is estimated to be c. €70m based on c.7000 refugee entrepreneurs in 2016 & average loan size of €10,000. TAM for Phase 1 is €1.04bn based on 3.2m refugees, with 2.4% pursuing entrepreneurial activities and average loan size of €10,000.

- ❖ **Servicer:** International investment bank(s) will act as a servicer of the loans. Asset managers specialised in microfinance select the MFIs and act as servicer

for the loan pool, carrying out due diligence, fund allocation and payment collection services for the SPV.

*MFI Peer Groups and Loan Terms*

- ❖ **CLO structure:** Unsecured loans to MFIs will be pooled as collateral for the notes by the RIF management (administrator). The pool consists of 10 to 30 loans. The capital structure of the CLOs has 3 main tranches: senior tranche, mezzanine tranche and equity (junior) tranche. The SPV issues debt/equity notes varying in yield and subordinate levels. Internal credit enhancement is available in the form of (i) subordination mezzanine and junior tranches as well as (ii) a reserve account funded from proceeds of junior note holders.

- ❖ **External Credit Enhancement and rating:** External credit enhancement for the senior notes in the form of a guarantee can be provided by multilateral financial institutions (e.g. EaSI Guarantee Financial Instrument provided by EIF) with the objective of guaranteeing full and timely payment of interest and principal on the senior notes.

- ❖ **Currency Swaps:** Permits local currency funding to MFIs, reducing currency risk exposure and also mitigating SPV's exposure to currency mismatches.

Peer Groups	Top-tier MFIs	Second Tier
<i>Years of operating</i>	> 5 Years	>3 years
<i>Credit Rating</i>	International Agencies (Planet Rating SAS, Microfinanza etc.)	Local Agencies
<i>Estimated Peer Group Size</i>	100-150	300
<i>Base Interest</i>	15%	20%
<i>Terms</i>	3-4 Years	4 Years
<i>Grace Period</i>	1 Years	2 Years

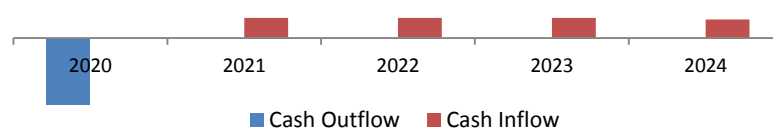
## Risks and Mitigations

Risks	Mitigation
<b>Default risks of refugees:</b> potential risks of refugees not meeting repayment or interest of loan schedules.	In the MFI's loan agreement put a term that requires stringent refugee payment obligation that MFIs have to implement. E.g. Collective Community Joint Liability Programme – a group formed based on geography, industry and ethnicity. All members within a group are jointly and severally liable for the repayment of group loan and its interests. Failure of scheduled repayment or interest payments bars all the group members a future access to the loan. Failure to implement stringent requirement by MFIs in their loans to refugees – set a high penalty rate to MFI in case of breach.
<b>MFIs' default risks</b>	Term loans' requirements: e.g. set required debt-to-equity ratio, restriction on subordinated debt on MFIs' assets – check compliance to those requirements before each scheduled payment of loan to MFIs.
<b>Quality of the loans:</b> no collateral	Guarantee from EIF for the senior tranche for credit enhancement. Cash from equity tranche reserved in SPV in the case of default – to pay senior tranche
<b>Lack of available information on refugee integration</b> - Guarantors would ideally want to analyse data on the creditworthiness of the individual borrowers.	Can base the data from previous non-EU asylum seekers in the EU. Cooperate with agencies that provide language and career educations within the EU to gather more information.
<b>Securitization regulation</b> – through the periods, more EU countries will be encompassed in CLO model. The regulations of these countries may differ in securitization and this could be an additional risk.	Legal due diligence to be carried out on those countries and hire local legal experts to minimise potential regulation damage and higher costs (e.g. through tweaking the existing model in that particular country).

## Finance Structure: MFI loans 9% yield

Cost	Target IRR
Service cost: 2%	Senior tranche (40%): 6% yield
Guarantee cost: 2%	Mezzanine tranche (35%): 8% yield
Management fee: 1%	Equity tranche (25%): residual cash flow

## Cash Flow Projections



**Assumption:** Cash flow projections demonstrate transactions between SPV and MFIs. The cash inflow represents interest and principal payments on loans with an average duration of four years

## Expansion Strategy

RIF aims to expand within EU through three phases. First, a pilot scheme with a fund size of €10-15m and geographic focus on Germany, France and Sweden will be launched. For the pilot scheme, there will be no securitization. It will run for up to four years and will establish track-record to attract investors. Second, the actual fund will be raised targeting institutional and private investors. Third, the fund will be extended to other EU countries. The target countries are selected on the basis of the fastest increase in the refugee destinations, the most popular refugee destinations, and the national governments' policies toward refugees. Germany, France and Sweden account for 75% of asylum applicants in EU-28 (Eurostat). The project is highly scalable as costs and risk typically decrease with economies of scale & learning.

Pilot (0-4 years) – Germany, France and Sweden	Phase 1 (4-8 years) – Germany, France and Sweden	Phase 2 (8-12 years) – Italy, Austria & RoEU
<ul style="list-style-type: none"> <li>Pilot test using grant funding</li> <li>Develop standardized microfinancing scheme for refugees and data collection method, improve feasibility</li> <li>Proof of a sustainable track record to attract institutional investors</li> </ul>	<ul style="list-style-type: none"> <li>Introduce securitization model to institutions</li> <li>Sweden is playing an active role and has taken 45,000 refugees (highest number of refugees per capita)</li> <li>France has over 600,000 refugees with valid permit between 2010-2014</li> </ul>	<ul style="list-style-type: none"> <li>Replicate CLO model across EU countries</li> <li>Austria is one of the top destinations with second highest number of refugees per capita in 2015</li> </ul>

## Entrepreneurial Empowerment

RIF assists refugee entrepreneurs by providing loans to those with skills and talents to spot opportunities. Such investment/financial support can run concurrently with other entrepreneurial supports, i.e. information provision, networking, mentoring/counselling, training and partnership [World Migration Report 2015]. Refugees would bring new idea, skill and innovation to the cities and their diversity in background would be of additional value.

## Social inclusion

Entrepreneurship encourages social inclusion of refugees within the community. Providing familiar food or wedding dresses not only brings employment, but also ways to unite communities, preserve traditions and a sense of normality. Overall, refugee entrepreneurship improves the psychological well-being of individuals and the overall atmosphere in communities.

## Economic Benefit

Research suggests that whether refugees are a benefit or a burden to the host nation depends not just on who the refugees are, but also how they are involved in financial activities. RIF would provide a stepping stone for refugees with skills who are willing to start the business. In Australia, humanitarian migrants make twice of the money from their businesses than people on skilled and family visas. In Germany and the US, immigrant entrepreneurs have higher incomes than employed migrants, and they contribute to the cities' economic performance.

## Social Impact Measurement

- **Social impact:** Number of entrepreneurial support; based on conservative estimates, RIF reaches c.10,000-15,000 entrepreneurs within EU-28; psychological wellbeing of refugee communities; financial inclusion status of refugees
- **Economic impact:** The level of GDP of EU can be up to 0.25% higher through successful refugee integration (IMF); Labour force growth; Venture Capital activity