Terence Ward

 15 Gramercy Park

New York 10003

 USA

 9 November 2009

***RE: formal complaint about the Calvert Foundation and/or MicroPlace***

Dear Mrs Berenbach and Mr Davis,

*I was unaware who best to direct this letter to. The broad topic is a customer service complaint, so Mr Davis appeared to be the right contact. The gravity of the situation suggests that the CEO should be aware of this, whose email I assume follows the same format.*

I wish to make a formal complaint relating to the investment I recently made on MicroPlace (transaction ID FBDGSL, invested through LAPO via Calvert CI Note). Under the reassuring words on the Microplace website[[1]](#footnote-2) under the title “Can I trust Microplace”, it is stated:

“Yes you can. We're a registered broker with the Securities and Exchange Commission, and subject to a whole host of rules and regulations. We're also a business unit of eBay with the charter to use its assets to do good in the world.”

So with this in mind, considering my protection under the SEC regulations, and considering the fact that the specific investment I did was actually executed by Calvert Foundation, I would like a thorough response to my complaint or I shall be forced to take this matter further.

On 4/11/2009 I invested $25 in LAPO, a Nigerian MFI that you invested in, via the MicroPlace platform. I shall commonly refer to your own prospectus as provided on your website[[2]](#footnote-3), dated April 30th 2009. I shall also refer to two MicroRate reports of LAPO for the years 2005 and 2007. The former is publicly available[[3]](#footnote-4). Only a summary of the latter is publicly available[[4]](#footnote-5), otherwise the full report is available by subscription to MicroRate, which I assume you have. You may wish to have these documents at hand to understand the gravity of this complaint. I shall begin with a summary of the elements of your own prospectus I find contradictory to this investment.

**The Calvert Community Investment Note Prospectus**

On page 2 you refer to the types of borrowers who will receive funding from the Community Investment Notes as “predominantly non-profit borrowers”. LAPO is one of the most profitable microfinance institutions in all of Africa. There are 13 separate references to the high profitability of LAPO in the 2007 MicroRate report alone, 5 of which appear on the front page.

To quote some particularly interesting references, consider the following: “LAPO consistently displays excellent operating margins, good liquidity levels, and high profitability” (page 1); “LAPO is highly profitable, due to generous operating margins...” (page 2); “LAPO shows good liquidity and high profitability; such factors can be partially explained by very high operating margins” (page 4); “Nonetheless, they [operating margins] remain extraordinarily high” (page 4). “The effective interest rate for their main product is comprised between 70% and 80%” (page 10).

What you may notice is that these make specific references not only to overall profit, but also to the operating margins, which, in an MFI are predominantly the interest and fees charged. I will refer to these items later.

On the same page in the prospectus (2), under the sub-title “Repayment”, you state:

*“Although the Foundation has established rigorous due diligence and payment monitoring procedures....”*

I found this unusual, as the evidence suggests you carried out very little due diligence in the case of LAPO given the abundance of publicly available information that seems to suggest it is a deeply flawed institution. But you elaborate on this a little later (page 8, under “Investment Criteria”):

*“Potential investments are first screened for financial soundness and then evaluated according to the criteria established by the Investment Committee”.*

As will be demonstrated shortly, the financial soundness of LAPO is questionable: half of its balance sheet consists of savings illegally captured without a banking license, as stated on the front page of both rating reports. The institution is financially insolvent: current assets are less than current liabilities when these illegally captured savings are considered, all of which are short-term (31 weeks is the maximum loan term, thus the savings are all repayable within one year, and therefore are considered *current* liabilities). The net profit margin has decreased during the period between the ratings when the portfolio over doubled. To consider this financial soundness is unusual. But your prospectus goes on to discuss in detail the due diligence process you apparently perform, also on page 8:

*“Due Diligence - Specialists produce due diligence reports prior to the Investment Committee’s review of applications. All applicants are expected to provide three years of financial information. Due diligence also includes analysis of the organization’s operational and management track record, capital structure, loan portfolio quality, and compatibility with the Foundation’s goals.”*

Would it be possible to obtain a copy of the due diligence report you carried out? Which specialists performed this analysis that was so rigorously checked by your Investment Committee? Did this analysis include a discussion of the lack of a banking license? Did it discuss the actual cost of capital to LAPO clients? Presumably this passed your own tests of financial soundness, am I to conclude? And does LAPO comply with Calvert Foundation’s own goals, as suggested? Did anyone from Calvert actually visit LAPO on-site?

On the MicroPlace website under the Nigeria section there is a charming description of a lender, Martina Okhuelegbe, who is apparently in the business of soap production. Her photo appears under the title “Some of the borrowers we serve”.

Perhaps you could explain why this same photograph appeared on the NOTS Foundation website[[5]](#footnote-6) until recently and was featured in the monthly magazine to ASN-Novib investors in Holland, *Op Koers* number 23 of February 2008. I am sure ASN Bank will be able to confirm this and perhaps send you a copy, the head of institutional relations is Mrs Dorine Putman-Devilee. If not, you can find this on the ASN Bank website[[6]](#footnote-7).

The last reference I wish to make regarding your prospectus is to remind you of a comment on page 4. Under the heading “What is Community Investing?”:

*“Community Investment directly finances socially or economically beneficial projects in disadvantaged communities that generally cannot attract financing through traditional market mechanisms. The mission is to invigorate local communities and provide the poor with avenues to economic self-sufficiency”*

The next part of this complaint will demonstrate that you are failing in your stated goal.

**Interest Rates at LAPO**

Firstly, as alluded to earlier, the high profitability at LAPO is presumably accounted for by the high interest rates charged to the clients. High gross operating margins, as stated in the MicroRate report, confirmed in the financial statements, can come from few other sources in a mono-product microfinance bank. Presumably you are aware of the actual cost of capital that is charged by the institutions you invest in? I assume this forms part of any due diligence. It appears that when the actual full cost is considered, including fees and the illegal capturing of savings, the actual cost of capital is slightly over 100% per year.

Do you find such interest rates compatible with your social focus? Do you believe that poverty reduction is possible at these rates? The rates were openly discussed in the ASN-Bank AGM held in Holland earlier this year, and yet no action appears to have been taken. Again, I urge you to contact ASN Bank who will provide you with a transcript of the meeting where the question is clearly asked, in English. The question was addressed to the guest speaker, the CEO of LAPO, flown in especially for the meeting. No credible answer was provided and all questions were stopped immediately thereafter.

Do you accept these interest rates? The reference in the MicroRate document on page 10 mentioned earlier suggests rates of 70% to 80%. These do not actually fully consider the effect of savings. If in doubt, do contact Perrine Pouget directly, the author of the MicroRate report. Her contact details are on the report.

If the interest rates are suspected to be a little on the high side, a possible arbiter in this case could be Microfinance Transparency. Mrs Berenbach endorsed this movement[[7]](#footnote-8), explicitly approving of transparent pricing for microfinance loan products. Presumably you would therefore be happy for this institution to verify the interest rates at LAPO? The precise statement endorsed by Calvert was: “Facilitate the collection and dissemination of transparent microcredit product pricing information. Educate stakeholders and enhance their understanding of microcredit product pricing”.

**Capturing Savings Without a Banking License at LAPO**

Moving on to the illegal capturing of savings, I have a number of questions on this issue:

1. Could you confirm that MicroPlace, as regulated by the SEC, is permitted to invest via Calvert in institutions that operate illegally, particularly when evidence of such illegality was so clearly detectable at the time of making the investment?
2. Could you confirm whether or not you were aware of the illegality of capturing savings at the time of making the investment decision, or did this fact, printed on the front page of both rating reports evade your due diligence team? Are MicroPlace aware of this yet?
3. Particularly in light of the current financial crisis, does Calvert Foundation find it appropriate to on-lend client savings without the necessary safeguards in place to protect the interests not simply of the clients, but often the life savings of some of the poorest women in Nigeria? The MicroRate 2007 report specifically discusses this: “Client savings intermediation without a license and *without an appropriate structure*” (page1, emphasis added); “Approximately one third of funding is provided by client deposits even though as a NGO, LAPO is not licensed to mobilize savings” (page 2). As you are no doubt aware as a US-based institution, there are strict rules on capturing savings from the public in order to safeguard not only the wealth of the citizens of a country, but to protect the integrity of the financial sector of that country. These rules are in place to protect the citizens, and in this case, to protect the very poor, almost exclusively female clients of a poor African country, and yet an institution that entirely ignores these rules is deemed an acceptable investment target by your company. Could you explain this please?
4. You may be tempted to suggest that LAPO is merely safeguarding funds, not on-lending them, as some MFIs do. But the MicroRate report suggests otherwise:

*“With a cost of only 4-5%, savings deposits are a much cheaper source of funding than commercial credit. Recognising this, LAPO has strongly pushed savings mobilization. In MicroRate’s opinion, this policy bears a serious risk since as a NGO, LAPO is neither authorized nor adequately equipped to mobilize savings from the public”* (page 5)

*“..forced savings are a key component of LAPO’s lending methodology... LAPO also mobilizes voluntary savings... Best practice would call for a MFI that is not authorised to mobilize savings, to set up an arrangement that allows its clients to deposit their savings in a licensed financial institution. LAPO’s present policy of using savings deposits to fund its operations – besides being illegal – exposes its clients to risks of which they are unaware.... intermediating savings on a large scale without the proper authorization must be considered an unacceptable practice that LAPO should address urgently”* (page 6).

If there is any doubt about whether full-blown illegal financial intermediation is taking place at LAPO, do consult the balance sheet. Apparently you have these for the preceding three years at the time of an investment, as stated in your due diligence description. Do note that MicroRate specifically use the term “illegal” in this quote, and specifically discuss the risk to the clients, factors you presumably either failed to notice in your analysis, disagreed with, or ignored.

1. In your rigorous due diligence assessing the financial soundness of the institution, did you consider the fact that LAPO is unable to repay these savings were it to attempt to legitimize its operations and return savings? Perhaps your analysis did not stretch to the financial statements?
2. Perhaps you also consider the Nigerian financial sector to be sub-standard, or corrupt, and therefore such regulations are not worth obeying? As it happens, Nigeria is fast becoming one of the leading financial centres in Africa, and the Central Bank of Nigeria is surprisingly rigorous. You may have noticed the recent warning from the Central Bank entitled “CBN to Sanction Erring Directors of Microfinance, Mortgage Banks”. If not, do read this fascinating report published on the Syminvest website under the July news section. But on the subject of the apparently cavalier approach Calvert Foundation seems to take in respecting local regulations, you may find it interesting to consult the Central bank of Nigeria website directly, where the legality of NGO MFIs capturing savings is discussed in some detail[[8]](#footnote-9):

*"9.3 Non-Governmental Organization - Micro Finance Institutions (NGO-MFIs): This policy recognizes the existence of credit-only, membership-based microfinance institutions which shall not be required to come under the supervisory purview of the Central Bank of Nigeria. Such institutions shall engage in the provision of micro credits to their targeted population and not to mobilize deposits from the general public.”*

To conclude this section, there appears little doubt as to whether LAPO has been capturing savings illegally. What is less clear is whether Calvert Foundation knew about this, and deemed it acceptable; or did not know about it, in which case the integrity of your due diligence process is questionable given the availability of the information. However, the most pressing issue for Calvert Foundation, and MicroPlace, is whether such an investment actually breaches SEC regulations.

**Calvert Foundation’s Impact on the Nigerian Poor via the LAPO Investment**

The next area of this complaint relates to the impact upon the poor. The underlying purpose of any investment in Calvert Foundation is to benefit the poor. Is this taking place?

It is often claimed that high interest rates in microfinance institutions are somehow permitted, or justified, on account of the high operating costs; hyper-inflation of the country; the need for MFIs to urgently reach break-even (operational sustainability); and the high returns earned by micro-entrepreneurs. The high operating costs at LAPO are beyond dispute – the company displays an almost allergic inclination towards any economies of scale with size. Cost per borrower increased from $31 to $39 over the last year of the 2007 MicroRate report while the gross portfolio increased from $7.7m to $16.5m (over doubling). Nigeria is not a hyper-inflating country. LAPO is very large by African standards and extremely profitable, well beyond break-even. However, the evidence of the supposed opportunities available to clients initially appears limited, or hard to obtain.

The evidence for this is remarkably simple: why are the clients leaving LAPO at such a rate if the institution is helping them so much? Is this because they are no longer poor nor in need of credit? Again, quoting from the MicroRate report of 2007 on the specific topic of client retention at LAPO:

* “the client desertion rate remains high” (page 1)
* “Despite LAPO’s efforts to better meet their client needs, the borrower attrition rate has increased to a very high 51%” (page 7)
* “Not surprisingly, those branches with the highest client attrition rate also show higher portfolio at risk ratios” (page 7)
* “Retaining their clients remains however a big challenge” (page 10)
* “However, client desertion remains high at 27% as at end 2007” (page 11)

Why are the clients leaving so rapidly if LAPO is helping them out of poverty? Why is the average loan size of the entire institution and the average FIRST loan size of clients so similar? Does this not suggest that the vast majority of clients never proceed beyond the first loan? And what do we make of the quote on the MicroPlace page for LAPO:

*“We enjoy strong bonds of loyalty with our clients as clients easily identify with the institution [LAPO]. Client loyalty is reinforced by our participatory approach, which consists of group and Branch Council structures and meetings, and supplementary social development programs”.*

Does this seem consistent with the chronic client drop-out rates mentioned five times in the MicroRate rating of 2007? Client loyalty seems to contradict high client desertion, would you agree? Indeed, if there is so much loyalty amongst LAPO clients, why has the average number of clients per branch barely changed over the last few years?

**Conclusion**

When you put all these factors together, does a picture form of an institution that meets the core goals of Calvert Foundation? Do you honestly believe you are being frank with your investors, such as myself, in your description of the Calvert Community Investment Note? Subject to you verifying the claims in this letter, would you proudly place this same letter on your website for your investors to learn more of where their funds are being invested? I suspect not. And are you sure you are complying with SEC regulations?

I notice in your prospectus that DOEN are a lender to Calvert (page 31). DOEN are also an investor in the recently formed Microfinance Transparency initiative, which aims to publicise interest rates charged by MFIs by region[[9]](#footnote-10). Are DOEN aware of the lending practices of LAPO? Or the investments Calvert Foundation deem acceptable? It seems somewhat contradictory for DOEN to support an initiative aimed at exposing precisely the sorts of investments you apparently find acceptable, while investing in Calvert Foundation, would you not agree? I will contact DOEN shortly.

So, it will perhaps come as no surprise to you that LAPO has just received possibly the first ever downgrading of a microfinance institution by a rating agency – this very same institution you so thoroughly verified in your due diligence under SEC scrutiny. Thus it appears that this is now fully in the public domain:

http://microrate.com/wp-content/uploads/2008/03/MicroRate\_Press-Release\_LAPO\_Aug\_2009.pdf

I believe that microfinance is a valuable tool in the battle against poverty. However, it is not a panacea, and it has to be used responsibly, ethically, transparently and with a developmental goal specifically borne in mind. I am disturbed to see what I consider sloppy, unprofessional, lazy behaviour from an institution such as Calvert Foundation. You are a gatekeeper – you channel funds from individuals and institutions, such as myself, to the MFIs that act as distributors of this funding to the poor. If faith in the gatekeeper vanishes, the entire funding structure of the sector collapses, and this is what you are apparently jeopardizing.

I therefore would like a formal, written response to each and every question in this document, or a valid explanation of why such a response is not possible. At that point I will decide whether to forward this letter, with the references entirely from the public domain, to one of the various newspapers and journals currently investigating the validity of the claims made by the microfinance sector ever since the revelation of Compartamos, of which I assume you are aware. I will also determine, on the basis of your reply, whether this letter is worth referring to the SEC and to MicroPlace.

I am sure you are aware that with co-investors such as Grameen Foundation (now a household name after the Nobel Prize); commercial banks such as Citi, Deutsche and ASN Bank facing scrutiny currently under the broad financial crisis of imprudent investment; and various microfinance funds implicated – this is a newsworthy story.

Indeed, I recently met Mohammed Yunus at a conference in Florence last week and publicly asked a question about the relationship between Grameen USA and LAPO, as he had specifically discussed his dislike of MFIs charging such interest rates. He emphatically declared to the audience “*Microfinance is being invaded by corruption and we must have a completely break; a total separation from these loan sharks! No more beating around the bush. We must call them what they are—loan-sharks! And there must be set limits on interest rates charged to the poor.*”

He then spoke passionately about the need for creating a new model -- Social Business enterprises – to break the cycle of speculation in MFIs. He explained that Social Business are new kind of businesses introduced in the market place with the objective of making a difference in the world. Investors in the social business get back their investment, but do not take any dividend from the company. Profit is ploughed back into the company to expand its outreach and improve the quality of its product or service. A social business is a non-loss, non-dividend company. And the shareholders’ wishes are fulfilled (as they have invested in the social business with this intention). He cited Danone’s recent investment in yoghurt production in Bangladesh as an shining example.

After the talk he specifically asked me to elaborate, and Grameen are now also investigating this institution. Do consider that Grameen Bank and Grameen Foundation USA are legally separate entities, but regardless, the reputation risk to Grameen Bank is sufficient to warrant them distancing themselves from any activity resembling traditional money-lenders, or in Mr. Yunus words, “loan-sharks.” And you should expect such actions in the future.

Were you to actually wish to resolve this problem, this will require the immediate reduction of the genuine cost of capital charged to LAPO clients and the return of all savings to these clients, with interest, in order to comply with the regulatory structure of Nigeria. Otherwise I can see no means by which an investment in LAPO can be considered consistent with your core mission, and the only course of action may be to withdraw the Calvert Foundation investment in LAPO or to publicly expose this to your investors for them to decide whether they wish to have their funds invested in such an institution, and ask for the opinion of your own regulator, the SEC.

Regards from New York,

Terence Ward

1. www.microplace.com/learn\_more/howitworks?panel=4 [↑](#footnote-ref-2)
2. www.calvertfoundation.org/downloads/prospectus/Prospectus.pdf [↑](#footnote-ref-3)
3. www.ratingfund.org/ratings\_completed.aspx [↑](#footnote-ref-4)
4. www.microrate.com/home/microrate-public-ratings [↑](#footnote-ref-5)
5. www.nots.nl/microcredit.php?page=1&item=NOTS%20Microcredit%20bonds%20for%20private%20persons

This has subsequently been removed by NOTS, but contact them directly to confirm this: I can provide a screenshot if in doubt [↑](#footnote-ref-6)
6. http://www.asnbank.nl/index.asp?nid=9492 (scroll down to page 19) [↑](#footnote-ref-7)
7. www.mftransparency.org/endorsements/ [↑](#footnote-ref-8)
8. www.cenbank.org/out/publications/guidelines/dfd/2006/MICROFINANCE%20POLICY.PDF [↑](#footnote-ref-9)
9. www.mftransparency.org/news/pr/doen-foundation-donation/ [↑](#footnote-ref-10)