

TFET- Funded

Grant No. 8186-TIM (TF)

**Microfinance Development
Project**

Microfinance Development Project Grant 8186-TIM

A. Summary

The Project has established a sustainable rural microfinance institution in Timor Leste, the Instituicao de Microfincas de Timor-Leste (IMTL), responsive to the needs of the rural poor, particularly women, to support job creation and help reduce poverty. The IMTL is now owned by a Foundation, and managed and operated by a Board. Its future strategic directions including lending policies are the responsibility of the Foundation and the Board. The IMTL is now a wholly regulated finance institution and is under the direct supervision of the Banking and Payments Authority (BPA).

To date, within 12 months, the IMTL has established 3 branches and a head office. Another branch in Oecussi will be in operation by the end of 2003. As of 15 May 2003, about 2,400 borrowers have availed themselves of microcredit loans totaling around \$440,000, while 3,100 depositors have deposited around \$830,000. Repayments are close to 98%. Performance of microfinance operations is expected to improve further over the next 12 months. The rehabilitation of credit unions (CUs) is less successful than expected due to the Credit Union Federation's (CUF's) inability to work effectively with CUs, which come under its direct supervision. Despite continuous strengthening support from the Project, the CUF management remains weak. The Project's main focus now is on local capacity building of the IMTL and directly with staff of CUs for future expansion of microfinance in Timor-Leste.

The Project has been successful in establishing the needed policy and legal framework, basic financial infrastructure such as the IT system, and training necessary for microfinance development in Timor-Leste. It is essential to appreciate the complex challenges faced by the Project in the initial stages of establishing the IMTL. Establishing and operating a viable microfinance institution in a new nation like Timor-Leste takes time. The microfinance activities through the IMTL and CUs will make further progress in the next 12 months.

B. Background

The main objective of the Project is to help reduce poverty. Its immediate purpose is to create an environment that will facilitate community-based opportunities for income generation and sustainable employment.

The three major components of the Project are (i) institutional building and strengthening, (ii) rural finance for micro-enterprise, and (iii) project management.

ADB provided an associated advisory technical assistance (TA) for \$250,000 to help the United Nations Transitional Authority in East Timor (UNTAET) develop a policy and legal framework for microfinance operations. The TA was approved on 6 December 2000 and is now completed. In addition, ADB also approved another TA in October 2001 for \$150,000 to support the installation and adoption of the UN/FAO-GTZ microbanking system (MBWin) as the core banking software for IMTL operations. This TA is still ongoing and will be completed by end-2003. The TAs provided support in reviewing existing microfinance policies and in preparing new policies/regulations on the IMTL's financial management and in installing the microbanking system.

The TA consultants for the development of policy and legal framework prepared (i) policies for the establishment of a microfinance bank including bylaws for incorporation, ownership, licensing, minimum capital requirements, etc.; (ii) the creation of a foundation (to act as the initial owner of the microfinance bank or institution¹); (iii) broad policy and regulations for effective microfinance operations; and (iv) draft regulations for CUs operations.

As a result of the TA, the Foundation for Poverty Reduction (the Foundation) and the Microfinance Institution of Timor-Leste (IMTL)² were approved with the promulgation of two executive orders³ in December 2001. The Foundation's Board of Trustees was established and the Board of Directors of the IMTL was organized in early 2002. The BPA issued a preliminary operating license on 22 May 2002. The TAs have been instrumental for the successful establishment of a microfinance operational system and necessary policy and legal framework in Timor-Leste.

The IMTL established a head office on 13 May 2002, and now has three branches. The Dili branch started in May 2002, Gleno in September 2002, and Maliana in November 2002. Due to the December 2002 riots, the Dili branch was badly damaged and as a result, its operations have been shifted to a temporary office. A new office building is being renovated and will be ready by end of June 2003. Generally, there was no serious damage to its operations as it had an adequate computerized back-up system. The operation was resumed within a week after the riots, and there was no bank run.

As per the final license issued by the BPA, the IMTL is now authorized to

- (i) receive deposits in the form of demand, time, and other types of deposits in US dollars;
- (ii) extend credits with a minimum of 65% of portfolio for microcredits;
- (iii) provide payment and collection services;
- (iv) issue and administer current account services/checks; and
- (v) provide safekeeping services for valuables.

With the authority to engage in demand deposit accounts, the IMTL has created a settlement account with the BPA and is a member of the Timor-Leste interbank clearing system.

1 UNTAET/ East Timor Public Administration (ETPA) (then the Government of East Timor prior to independence) or any recipient of the Grant could not own a bank or finance institution due to prohibitions under the UN Charter.

² This is the official name of the microfinance institution to be established under the Grant in accordance with the objectives of the Project (para. 2 of the Aide Memoire).

³ Executive Orders Nos. 2001/7 and 2001/8 were issued on 1 December 2001 by the Office of the UN Special Representative of the Secretary General (OSRSG).

C. Implementation Performance

Table 1: Implementation Progress and Projections
(all figures are cumulative, unless otherwise stated)

		30 Jun 2002	30 Sep 2002	31 Dec 2002	15 May 2003	31 Dec 2003
No. of MF Institution offices opened	Planned	3	3	3	3	5
	Actual	2 ⁴	3	5 ⁵	5	
No. of MF staff hired	Planned	20	30	35	40	70
	Actual	14	20	26	28	
Amount of savings/deposits generated (\$)	Planned	100,000	200,000	300,000	400,000	700,000
	Actual	58,600	230,000	455,000	850,000	
No. of savers/depositors	Planned	300	600	1,000	1,500	3,800
	Actual	167	756	1,190	3,400	
Amount of loans disbursed (\$)	Planned	50,000	100,000	150,000	300,000	1.20 M
	Actual	12,200 ⁶	51,200	236,800	440,000	
No. of wholesale borrowers	Planned	1	2	3	3	8
	Actual	0	0	0	0	
No. of CU borrowing	Planned	2	4	6	8	14
	Actual	0	0	0	0 ⁷	
No. of individual borrowers	Planned	250	500	750	1,500	6,000
	Actual	0	212	1,550	2,340	
Overall repayment rate	Planned	100%	98%	97%	96%	94%
	Actual	100%	100%	97.4%	98%	
No. of CU/CU-related training conducted	Planned	12	16	20	24	40
	Actual	9	12	16	20	
No. of MFI/ IMFTL training conducted	Planned	7	10	12	16	30
	Actual	8	10	14	18	
Training/Operating manuals prepared	Planned	7	8	8	10	12
	Actual	10	10	10 ⁸	12	

⁴ Included here is the Dili IMTL branch, and the Head Office operation.

⁵ Included here is the setting-up of the temporary Dili branch and Head Office after the ransacking and destruction of the Dili branch, Head Office, and PMU office in Comoro, Dili.

⁶ IMTL started operations only in May 2002.

⁷ Closer evaluation of the internal system and financial capacities of the CUs showed their unpreparedness to go into credit transaction even with a wholesale institution.

⁸ Most of the hard files and backup copies of the manuals were destroyed during the 4 December riots and all have to be rewritten. The task is still ongoing.

ADB's Microfinance Strategy in Timor-Leste

The objective of ADB's microfinance strategy in Timor-Leste is to ensure access institutional financial services for the poor in the rural areas to support their economic activities. The strategic focus is on:

- Creating a policy environment that will enable viable delivery of a wide range of services to the poor;
- Fostering a sustainable microfinance infrastructure for the establishment of a microfinance bank and credit unions;
- Intensive capacity building to enable the people of Timor-Leste to manage the operations; and
- Promoting and adopting best practices in microfinance development including customized replication of the Grameen model and universal best practices of credit unions and other microfinance institutions.

Proposed Lending Packages of the MDP-MFI

The proposed Microdevelopment Project-microfinance institution (MDP-MFI) will develop several lending products to increase its outreach beyond its organic structure.

MFI Group/Retail Lending Approach

The MDP-MFI will be a retail lender and savings mobilizer using the "Group Approach" similar to the Grameen Bank concept in areas where no other MFI is operating. Eventually, if MFIs would want to operate in the area, the MDP-MFI formed groups will be enjoined to link up with that MFI.

Wholesale Lending – MFI Account Management Approach

The MDP-MFI will do wholesale lending to accredited MFIs (e.g., financial NGOs) through "MFI Account Officers". These officers will be assigned to handle a fixed number of accredited MFIs in various districts that will be funded by the MDP-MFI to allow them to service end users adopting proven microfinance best practices espoused by the MDP-MFI. The account officers will be responsible for assessing the capability of all MFIs under them for accreditation by the MDP-MFI. They will also help develop MFI training programs as needed. Lastly, the account officers will monitor the MFI-borrower operations to ensure consistency in approach, client focus, and proper loan supervision, and provide technical assistance, as and when needed.

Direct Cooperative Lending Scheme

There are emerging farmers' cooperatives, consumers' cooperatives, and other self-help groups and their numbers are expected to increase as other Trust Fund for East Timor (TFET) and bilateral projects (e.g., agricultural development projects) are implemented. These cooperatives and self-help groups are likely to require financial assistance to start-up or expand operations, acquire fixed assets or adopt new technology. The MDP-MFI will develop financial packages to cater to the cooperative and self-help group clientele.

Key Constraints of Microfinance Development

Among the key constraints in microfinance development in Timor-Leste are:

- Limited financial services, almost 70% surveyed indicated that they have no access to any form of financial services, and almost all have no access to formal financial institutions;
- Poor infrastructure and lack of access to markets, poor roads, lack of power and water supply, and communications result in low quality and uncompetitive products for sale;
- Heavy reliance on grants from donors discourages savings mobilization and hinders the formation of desired values of thrift and self-reliance;
- Lack of local expertise, as very few Timor-Leste people with financial expertise are available; and
- Lack of an enabling microfinance policy.

D. Capacity Building of IMTL Staff

A total of 28 staff has been recruited to run the IMTL. Since its inception, the IMTL has been focusing on staff training to undertake efficient microfinance operations. As part of the capacity building, training activities are undertaken regularly on microfinance planning, loan products, financial concepts, accounting and banking procedures, and also outreach target setting and microfinance principles. Selected staff are also provided with on-the-job training in the computer system and financial software (MBWin) for day-to-day operations. Formal MBWin training was conducted by the UN-FAO technical team.⁹ Specific training for field staff is being undertaken in microfinance technologies. On-site training has been provided for (a) promoting microcredit products; (b) forming small groups of 5–8 members; (c) evaluating loan applications; and (d) loan disbursements and collections. So far, most microfinance centers have completed the first cycle with a repayment rate close to 100%. The dropout rate is insignificant. Each field staff is handling about 100 clients, with an outstanding loan portfolio of about \$4,000. Based on this trend, in a year's time, each staff will handle about 300 clients, which is comparable with other countries.

The Project has established networks with other microfinance institutions as well as banking associations in the region to keep updated with developments in microbanking, practices, trends, techniques, and technologies. The key institutions will include, among others, the Rural Bankers' Association of the Philippines (RBAP), Asian Institute of Management (AIM), Development Finance Institute (DFI), and the Asia-Pacific Regional Agricultural Credit Association (APRACA).

As of 16 May 2003, total loans disbursed totaled about \$440,000 for about 2,400 borrowers and outstanding loans have reached \$284,857 for 1,502 active borrowers with past due loans of \$4,227. The past due loans are mainly from market vendors in Dili. The other branches so far has no delinquency yet, though some coffee farmers groups in Gleno may miss their payments due to heavy rains. The average of size of loans to microfinance clients is \$65, and for market vendors it is \$100. These loan amounts are expected to increase gradually in subsequent cycles (Table 2).

**Table 2: Active Borrowers and Loans Outstanding
(as of 16 May 2003)**

Branch	No. of Active Borrowers	Loans Outstanding	Past Due Loans	Portfolio at Risk (%)
Dili Main	412	38,098.55	4,226.77	11.09
Gleno	717	153,232.78	None	0
Maliana	373	93,525.55	None	0
Total	1,502	284,856.88	4,226.77	1.48

⁹ Services are financed under TA No. 3743-ETM: Microfinance Information Technology Systems Development, approved in October 2001.

Deposits have continued to increase despite severe damage caused to the main IMTL office in Dili due to riots in December 2002. Savings from 3,392 depositors have reached \$830,051 as of 15 May 2003 (Table 3). Between January and May 2003, the deposit increases are as follows: Dili 70%, Gleno 26%, and Maliana 265%. The lack of banking facility outside Dili is the main reason why people use the IMTL for safekeeping. Although the loans and deposits have been increasing, IMTL is still incurring operational losses (with very small loans, and much lesser volumes and margin in comparison with other countries), though much lower than projected in the IMTL's Business Development Plan. By industry standards, the figures are very encouraging, considering that the Dili branch has been in operation for 9 months, Gleno, 5 months, and Maliana just 3 months.

**Table 3: Status of Deposits
(as of 16 May 2003)**

Branch	Total Deposits (31 Jan 03)	Total Depositors (Jan/03)	Ave. Deposit (Jan/03)	Total Deposits (16 May 03)	Total Depositors (16 May 03)	Ave. Deposit (May/03)	Increase/Change (%)
Dili Main	407,816	991	410	693,735	2,049	338	70
Gleno	24,050	482	50	39,915	920	43	66
Maliana	26,420	166	160	96,401	423	227	265
Total	458,286	1,639	280	830,051	3,392	244	

Actual operational results have shown more positive results than projected. Currently IMTL assets have increased to almost \$3.0 million, or 50.0% more than projections, mainly due to larger than expected deposits. Actual deposits received amount to 624%, more than what was earlier projected in the Business Development Plan and financial projections. The actual loss is 60% less than the projections. The net worth stood at \$1,955,833.39 as of 16 May 2003. To date, operational results are commendable (Table 4).

Table 4: Comparison between Actual Results of Operations and Financial Projections

	Financial Condition, after the 1st year according to Business Devt. Plan	After one year, actual FS as of 16 May 2003	Performance Over Targets (%)
Total Assets	1,999,132.00	2,992,763.56	49.7
Liquid Assets:			
Cash in vault/ on hand	51,428.00	93,810.56	82.4
Due from BPA	1,205,751.00	2,214,013.30	83.6
Due from commercial bank	17,351.00	141,689.76	716.6
Loans and Discounts:	611,370.00	289,084.31	-52.7
Loans and Discounts – Current		284,857.54	
Loans and Discounts – Past due		4,226.77	
Provisions for loan losses	(12,227.00)	(4,227.43)	-65.4
Fixed Assets:	125,460.00	48,961.77	-60.9
Offices/ Leasehold improvements		2,877.79	
FFE including vehicles		53,117.79	
Reserve for depreciation		(7,033.81)	
Due from other branches:		195,492.83	
Other Assets:		9,301.94	
Total Liabilities and Capital Accounts	1,999,132.00	2,992,763.56	
Liabilities:			
Deposit liabilities	114,632.00	830,051.34	624.1
Other liabilities		9,970.00	
Due to Head Office/ Dili Main branch		195,492.83	
Capital Accounts:	1,884,500.00	1,955,833.39	3.8
Paid-up capital	2,000,000.00	2,000,000.00	
Profit and Loss:			
(Undivided Profits) Previous year			
P/L: Current year	(115,500.00)	(44,166.61)	-61.7

BPA – Banking and Payments Authority; FFE = Furniture and Equipment; HO = head office; P/L = Profit and Loss.

Based on the financial ratios proposed by the Consultative Group to Assist the Poorest (CGAP) on financial institutions, the IMTL's overall financial position as of 16 May 2003 is satisfactory (Table 5). Table 6 provides information on regulatory thresholds of activity by type of microfinance institution. Table 7 gives information on microfinance policy and institutional responsibility and Table 8 provides information on the responsibilities of microfinance key players. Tables 9 and 10 provide the Consolidated Income and Expenses and Consolidated Statement of Condition, respectively. (Tables 6–10 are at the end of this section)

**Table 5: IMTL's Operating and Financial Ratios
(as of 16 May 2003)**

Equity to asset Ratio (EAR)	<u>Total equity</u> Total Assets	<u>1,955,833.39</u> 2,992,763.56	= 65.35%	A minimum of 15-25% capital position versus total assets is deemed desirable per CGAP standards. IMTL's almost 75% EAR support further expansion of the loan portfolio and much leeway for leveraging.
Outreach	No. Of accounts < 500.00 Total no. of loan accounts	<u>1,481</u> 1,502	= 98.6 %	Outreach to the "target poor sector" is almost 100% using surrogate standards of measure, e.g. loan size. Acceptable standard is at least 65% of accounts borrow \$500 and below. All IMTL loans are small.
Current ratio	<u>Current assets</u> Current liabilities	<u>2,449,513.62</u> 830,051.34	3.0 : 1.0	The ratio of 4:1 is high and very safe. The Business Plan submitted to BPA pegs liquidity at 50% of total deposit liabilities. 1.5-2.0 : 1.0, however, are the microfinance industry standards.
Portfolio at risk (PAR)	<u>Past due accts.</u> Loans outstanding	<u>4,226.77</u> 289,084.31	= 1.46%	The PAR or the past-due ratio is still low at 2.3%. But this does not mean relaxing the guard and vigilance. 10% is the acceptable maximum level set by Microfinance standards.
Operating self-sufficiency	Operating income Total operating expense	<u>38,663.32</u> 48,562.23	= 79.6%	The IMTL still has a long way to go until it attains operational self-sufficiency. 120% \geq is optimum level. This is understandable since the IMTL has just started operations and expects to lose within 2 years.

The major concern of IMTL operations is to keep loan delinquencies low, and collection efficiency high, yet strive for larger outreach. The main problem would be the risk of nonpayment of loans. The IMTL Board of Directors has approved and adopted a very prudential system of loan loss provisioning. Uncontrolled deterioration of loan quality will definitely impact on the net capital accounts, and the level of regulatory capital may gradually diminish. Focus and emphasis are therefore being given to controlling and containing this particular risk. Several corrective measures to minimize the problems were discussed with IMTL staff.

The branches' loan staff have yet to fully comprehend the loan designs and documentation requirements. Due to the distance from the Dili Head Office, more time is needed to provide intensive and direct assistance and support to the branches, particularly Maliana. This is particularly more urgent since the BPA and the Government are contemplating on appointing the Maliana branch as the agent for revenues collection in Bobonaro border district. The district administrator has also submitted a proposal to the Maliana branch to be the payroll-service provider for the district, similar to the arrangement in the Gleno branch. There are several potential areas where the IMTL could play a vital role in the local communities.

E. IMTL's Operational Progress

Among the key achievements of the IMTL to date are:

- (i) During its first year of operation, May 2002-May 2003, total assets grew from \$2.0 million to \$3.0 million, or an equivalent of 50% growth in total resources within 1 year;
- (ii) Total loans disbursed reached \$440,000 with an outstanding loan receivable of \$290,000 servicing more than 2,000 borrowers;
- (iii) Repayment rate of not less than 98% was maintained during the first year despite the extreme poverty and restricted financial and economic opportunities characterizing and generally affecting the economy of Timor-Lese;
- (iv) IMTL has attracted deposits amounting to \$830,000 from small savers and customers in only one year of operation;
- (v) One branch in Gleno, Ermera District, has already achieved breakeven point; and
- (vi) The total number of customers, both borrowers and savers, has reached the 6,000 mark in a year's time.

F. Rehabilitation, Strengthening, and Expansion of Credit Unions

The Project provides support for rehabilitation CUs through the CUF. Of the 27 initially identified CUs, only 4 were considered to be operational. As such, support to rehabilitate 4 CU offices in Same, Atsabe, Bobonaro, and Ailieu has been provided. Each CU was provided about \$9,000 worth of office furniture and equipment. The assistance provided to the CUs was aimed at accelerating their rehabilitation and operations and enabling the CUF to revive the CU movement in the country. In practice, most old CUs are beyond rehabilitation due nonresolution of past fund accountability problems.

Based on an independent verification of the 15 CUs currently listed by the CUF, only 5 are old CUs, and the rest are new, and out of 12, only 3 are considered to have the potential to be viable in the short term. The rest have less than 50 members and not even worth registering. Sustainable CUs should have at least 250 members to be able to have the synergy to benefit members. The Project will seek the Government's views regarding the future of the CUs. The existing CUs and the CUF itself have very low-absorptive capacities for even small amounts of external credits and assistance. A major issue for providing additional funds is good governance. As a result, the Project Management Unit (PMU) will seek the Government's support to supervise CUs and the CUF to ensure CU development. Overall economic growth and employment generation is crucial to CU progress.

G. Strengthening of the Credit Union Federation

The Project supported the CUF in establishing new CUs and also provided assistance in capacity building through training, workshops, etc. The Project also supported field-level training conducted in various districts. CUF directors were also funded to attend a CU executive training program and workshops/conferences overseas. Recently two officials were sponsored to attend the Asian Center for Credit Union conference in September 2002 in Bangkok and a training/tour

in Australia. As part of capacity building, a short-term consultant experienced in business operations of credit unions and cooperatives was also fielded in July 2002 for 5 personmonths to set up of the CUF's financial system; assist in streamlining financial activities of the CUs and the CUF; and intensify assistance at the CU level.

The CUF has received sizeable operating assistance and technical and logistical support in the form of transport, computers and other office equipment, furniture, and supplies, apart from various training support. So far, the achievements of the CUF are less than satisfactory.

H. Project Cost, Status of Financing, and Disbursements

The Project cost was originally estimated at \$7.72 million for financing from TFET, but so far only \$4 million has been made available. Based on discussions with the Trustees, the remaining \$3.72 million may no longer be available for the Project.

Of the \$4 million made available to the Project, the project expenditure has reached \$3.32 million (inclusive of \$2.0 million as equity). Disbursements are on schedule, even though the project records were destroyed during the December 2002 riots. Based on current evaluation, the Project will be completed by end-2003.

I. Implementation Arrangements

1. Project Organization and Management

With the establishment of the IMTL, the PMU has been supporting the overall operations. The Project Coordination Committee (PCC) was established from the start of the Project to provide policy guidance to the PMU on administrative and financial matters and helps establish linkages with appropriate microfinance institutes and agencies. The Government actively coordinated the Project through the Ministry of Development and Environment. There is full ownership of the Project from the Government.

2. Procurement of Goods and Services

All major procurement of goods and services for the Project has now been completed and is in accordance with the ADB's regulations and practices. Procurement delays in the year earlier are no longer being experienced at present.¹⁰

3. Monitoring and Evaluation

Project activities are being monitored regularly by the PMU. The IMTL has an internal reporting system that generates up-to-date reports on its financial conditions and status. The UN-FAO team under the ADB-funded TA has developed and integrated the MBWin financial software for IMTL operations. In the field, an internal system of monitoring the performance of loan field staff is in operation. Each staff supervises and collects from 10 centers that have 4–8 groups each, and each group has 4–8 members. Microfinance groups' loans range from the first cycle of \$80, then \$120, \$150, and \$200, up to \$250. The operations are closely monitored. The PMU prepares regular reports on IMTL's operations and the overall implementation progress of the Project. Separate accounts and financial statements for the microfinance institution and the Project are being maintained. The first audit of the Project accounts was recently completed by

¹⁰ In the past, goods had to be procured via the Government's central procurement policy for all TFET-funded projects and government needs.

Ernst & Young, Darwin, Australia. The external auditors have confirmed that the project accounting and records fully meet the requirements and the grants of the TFET have been utilized efficiently as stated in the grant agreement.

4. Consulting Services and Training

To date, six international and five domestic consulting services have assisted in the areas of project management, training, human resources development, and management information systems. In addition, training consultancy for microfinance promotions, organizing, procedures and monitoring were provided through ADB technical assistance. The Project is committed to instilling prudent banking practices among local officers/staff and training them to undertake full management and operation of the IMTL as early as possible.

J. Project Impacts

1. Socioeconomic impact

The Project's overall goal is poverty reduction through increased rural employment and income opportunities by providing appropriate microfinance services for microenterprises. Microfinance operations in the rural areas are well appreciated by the poor. Some 3,392 deposit accounts had been opened by 16 May 2003, of which 1,174 were less than \$200, averaging around \$46. The microfinance group's first cycle of loans are mostly small and averaging a mere \$45. The IMTL now serves the needs of the poorer households in selected districts for savings and as a source of small, short-term loans. If these services are continuously provided efficiently and properly sustained over long periods, then the poor will benefit both from access to credit (such as for production and from assistance during lean months), as well as to saving facilities (building-up own capital for enterprise and livelihood projects). Efforts are being made to expand microfinance operations to more districts. Rural employment through small and micro enterprise development has a positive socioeconomic impact.

2. Impacts on Capacity Building and Policy

The Project has been successful in building local capacity. Since its inception, the Project has been focusing on training IMTL staff to undertake efficient microfinance operations. For sustainability, capacity building through training on microfinance operations has been the main focus. Each IMTL staff is targeted to handle about 300 clients in a year's time.

K. Overall Contribution to the Economy

Poor and low-income households have a large demand for safe and convenient deposit and microcredit services. Microfinance operations under the Project started to provide the poor an opportunity to save and access microcredits to improve their livelihoods through microbanking.

1. Lessons Learned

However, there is a great deal that remains to be done to improve microfinance operations in Timor-Leste.

- (i) The major concern of the IMTL operations is to keep loan delinquencies low, and collection efficiency high, for larger outreach. The main problem would be the risk of nonpayment of loans. Uncontrolled deterioration of the quality of the loans will definitely impact on the net capital accounts, and gradually diminish the level of regulatory capital. Focus and emphasis is therefore being given to controlling and containing this particular risk.
- (ii) Further legal and regulatory framework has to be developed.
- (iii) More ongoing local training in skills upgrading to increase competency levels is needed before embarking on further expansion of operations.
- (iv) Changing the mindset, especially instilling a sense of positive attitude toward development of microfinance within the country, is important for poverty reduction.

2. Continuing Needs

- (i) There is a need for continuing support to extend microfinance operations in more branches to provide seasonal saving and loan facilities to rural microenterprises.
- (ii) There is also a continuing need for technical assistance support for capacity-building. The regulatory and legal framework for CUs is not yet complete. Further support to monitor performance is also necessary.

Table 6: Regulatory Thresholds of Activity by Type of Microfinance Institution

MFI Type	Activity that Determines Regulatory Status	Proposed Form of External Regulation, If Required	Regulatory Agency
CATEGORY A MFIs Type 1 Basic Nonprofit NGO	Making microfinance loans not in excess of grants and donated/concessional funds	None – Voluntary registration with self-regulatory Organization	None, or self-regulatory organization
Type 2 Nonprofit NGO with limited deposit-taking	Taking minor deposits, e.g., forced savings or mandatory deposit schemes, from microfinance clients in community	None – Exemption or exclusions provisions of provision of banking law; compulsory registration with self-regulatory organization	Self-regulatory organization
Type 3 NGO transformed into Incorporated MFI	Issuing instruments to generate funds through wholesale deposit substitutes (commercial paper, large value certificates of deposit, investment placement notes)	Registration as a corporate legal entity; authorization from securities and exchange agency, with limitations on size, term, and tradability of commercial paper instruments	Companies' registry agency; securities and exchange agency
CATEGORY B MFIs Type 4 Credit Union, Savings and Credit Cooperative Society	Operating as closed- or open-common bond credit union or savings and credit cooperative society; deposit-taking from member clients in the community, workplace, or trade	Notification to and registration with cooperatives authority or bank supervisory authority; or certification and rating by a private independent credit rating agency	Cooperatives authority, or bank supervisory agency or credit rating entity Category C MFIs
Type 5 Specialized Bank, Deposit-taking Institution, or Finance Company	Taking limited deposits (e.g. savings and fixed deposits) from general public beyond minor deposits exemption in banking law. Microfinance activities more extensive than NGOs but operations not on scale of licensed banks	Registration and licensing by bank supervisory authority, with limitation provisions (e.g., savings and fixed deposits/capital multiple, higher liquidity reserves, limits on asset activities and uses)	Bank supervisory authority
Type 6 Licensed Mutual Ownership Bank	Nonrestricted deposit-taking activities, including generating funds through commercial paper and large-value deposit substitutes, from the general public, investors and other banks	Registration and full licensing by bank supervisory authority as a mutual-ownership or equity bank; compliance with capitalization /capital adequacy requirements, loan loss provisioning and full prudential regulations	Bank supervisory authority

**Table 7 : Policy and Institutional Responsibility
of Various Stakeholders**

Institution	Policy	Objective	Measurement
MFI	Accessible and sustainable financial services; equitable intermediation	Outreach expansion; Financial strength; Organizational soundness.	Market share; Standard financial ratios; Service quality = zero complaints
Government	Enabling policy environment conducive to an efficient microfinancial market	Support for market Oriented policies; Favorable resource allocation for microfinance; Private sector participation incentives	Market-based rates/ policies adopted; Investments in infrastructure, research, extension; Insurance and guarantees
Private Banks	Recognition of microenterprise market potential; Building Bank-MFI interaction	Suitable financial services; Liquidity support to retailing MFIs	Microfinancial products promoted; Correspondent banking tie-ups introduced
NGOs (nonfinancial)	Capability building support; Microentrepreneurs, community organizations and MFIs linkage	Appropriate training programs, performance standards advocacy; Market matching and intertrading	Trainings held, performance standards and systems installed; Market linkages achieved
Donors	Policy dialogues and technology development; Project impact assessment and logistics support to critical program advocacies	Policy improvement and technology upgrade; Seed-funding of pioneering microfinance programs	Policies adopted and/or technology introduced; Programs launched, or on pilot runs; projects reviewed and assessments done

Table 8: Responsibility Among Key Players

Key Player	Accountability
1. Shareholders	Responsible for appointing good and competent directors
2. Board of Directors	Set policy and appoint good and competent management
3. Management	Carry out the business in accordance with established policies
4. Audit committee/ internal audit	Test compliance with policies
5. External auditors	Express opinion and evaluate risk management policies
6. Outside stakeholders: The Public Donors and creditors Investors/Depositors/Clients Analysts Credit rating agencies Media	Understand responsibility and insist on proper disclosure Assess financial standing, operating results, quality of loans Responsible for own decisions Analyze MFI and advise investors, creditors and donors Carry out fair and impartial rating and point out downside risks Inform the public
7. Regulators	Create regulatory framework to optimize risk management

Table 9: INSTITUIÇÃO DE MICROFINANÇAS DE TIMOR LESTE
Dili, Timor Leste
CONSOLIDATED STATEMENT OF INCOME & EXPENSE
As of 16 May 2003

Code	Account Title	Consolidated Amount (\$)
4.0	INCOME :	
4.01	INTEREST INCOME	38,114.22
4.01.1	Interest on Due from Banks	5,069.62
4.01.4	Interest & Fees on Loans & Discounts	33,044.60
4.01.4.1	Interest Income on Loans	13,580.60
4.01.4.1.3.10	Market Vendor Daily Loans	3,615.92
4.01.4.1.3.20	Seasonal Crop Loans	1,657.63
4.01.4.1.3.30	Other Business Loan	429.86
4.01.4.1.4.10	Microfinance Group Loans	3,463.55
4.01.4.1.4.20	Payroll Loans	4,102.75
4.01.4.1.4.30	Employee and Staff Loans	310.89
4.01.4.2	Loan Fees	19,464.00
4.02	NON-INTEREST INCOME	548.10
4.02.5	Commission Income & Transaction Fees	548.10
4.02.6	Other Non-Interest Income	-
4.03	EXTRAORDINARY INCOME	1.00
4.03.3.3	Miscellaneous Income / Loss	1.00
	TOTAL OPERATING INCOME :	38,663.32

5.0	EXPENSE :	
5.01	INTEREST EXPENSE	1,089.28
5.01.2	Interest by Individual Deposits	1,073.14
5.01.2.1	Saving Deposits	1,073.14
5.01.2.2	Time Deposits	-
5.01.3	Interest on Legal Entities Deposits	16.14
5.01.3.1	Saving Deposits	16.14
5.02	NON-INTEREST EXPENSE	27.50
5.02.4	Commission Expense & Transaction Fees	27.50
5.03	OPERATING EXPENSE	47,445.55
5.03.1.1	Salaries and Wages	27,640.00
5.03.1.3	Fringe Benefits - Employees	600.00
5.03.3	Advertising and Public Relation	45.00
5.03.4	Audit, Legal & Professional Fees	-
5.03.5	Rents Paid	160.00
5.03.6	Expense on Premises and Fixed Assets	-
5.03.7	Depreciation and Amortization	5,384.01
5.03.7.3	Depr.Machinery & Equipment	1,370.48
5.03.7.4	Depr.Furniture & Fixture	2,079.95
5.03.7.5	Depr.Vehicles	1,358.68
5.03.7.7	Amort.Leasehold Right & Improvement	238.67
5.03.7.9	Amort. Deffered Charges	336.23

5.03.8	Provision	1,850.39
5.03.8.1	Provision for loans losses	1,850.39
5.03.9	Other Operating Expense	11,766.15
5.03.9.1.1.05	Security, Janitorial & Messengerial Services	5,600.00
5.03.9.1.1.10	Information Tech./Automation Expense	246.00
5.03.9.1.1.15	Communication Expense	372.94
5.03.9.1.1.20	Power,Light and Water	659.59
5.03.9.1.1.25	Fuel and Lubricants	2,379.99
5.03.9.1.1.30	Traveling Expenses	276.00
5.03.9.1.1.35	Stationery and Office Supplies	516.52
5.03.9.1.1.40	Representation and Entertainment	260.30
5.03.9.1.1.50	Repairs and Maintenance	827.50
5.03.9.1.1.55	Freight and Handling Expenses	80.00
5.03.9.1.1.60	Taxes and Licenses	5.00
5.03.9.1.1.70	Miscellaneous Expenses	542.31
5.04	EXTRAORDINARY EXPENSE	-
5.04.3	Other Extraordinary Expenses	-
	TOTAL OPERATING EXPENSES :	48,562.33
	NET INCOME (LOSS) BEFORE TAX :	(9,899.01)
	PROVISION FOR INCOME TAX :	-
	NET INCOME (LOSS) AFTER TAX :	-

Table 10: INSTITUIÇÃO DE MICROFINANÇAS DE TIMOR LESTE

Dili, Timor Leste

CONSOLIDATED STATEMENT OF CONDITION

(As of 16 May, 2003)

Code	Account Titles	Consolidated	
		No.of Accts	Amounts(\$)
1.0	A S S E T S :		
1.01	LIQUID FUNDS		2,449,513.62
1.01.1.1	Cash in Vault/ on hand		93,810.56
1.01.2	Due from BPA		2,214,013.30
1.01.3	Items in course of collection		-
1.01.4	Due from Commercial Banks		141,689.76
1.02	INVESTMENT		-
1.04	LOAN, ADVANCES & DISCOUNTS	1502	284,856.88
1.04.1	CURRENT LOAN		284,857.54
1.04.1.1.3.10	Market Vendor Daily Loans	303	34,453.71
1.04.1.1.3.20	Seasonal Crop Loans	231	61,357.42
1.04.1.1.3.30	Other Businees Loans	51	11,282.09
1.04.1.1.4.10	Microfinance Group Loans (Direct)	618	17,822.34
1.04.1.1.4.20	Payroll Loans	278	149,733.53
1.04.1.1.4.30	Loans to Employee and Staff	21	10,208.45
1.04.2	PAST DUE LOANS		4,226.77
1.04.2.1.3.10	Past Due Market Vendor Daily Loans		3,536.10
1.04.2.1.4.10	Past Due Microfinance Group Loans		690.67
1.04.3	PROVISION FOR LOAN LOSSES		(4,227.43)
1.05	ACCOUNTS RECEIVABLE		4,636.52
1.05.1	Interest Accrued		1,136.52
1.05.3	Other Receivable		3,500.00
1.06	FIXED ASSETS		48,961.77
1.06.2.1	Offices		-
1.06.2.3	Leasehold Improvements		2,877.79
1.06.3	Furniture and Fixtures		4,940.05
1.06.4	Machinery and Equipment		34,807.74
1.06.5	Vehicles		13,370.00
1.06.9	RESERVE FOR DEPRECIATION		(7,033.81)
1.06.9.3	Accum.Depr.Furniture & Fixture		(1,181.51)
1.06.9.4	Accum.Depr.Machinery & Equipment		(3,367.30)
1.06.9.5	Accum.Depr.Vehicles		(2,485.00)
1.09	OTHER ASSETS		204,794.77
1.09.1	Prepaid Expenses		-
1.09.2.1.0.00	Due from Gleno Branch		145,690.06
1.09.2.1.0.01	Due from Maliana Branch		49,802.77
1.09.3	Office Accounts		5,038.15
1.09.3.1	Petty Cash Fund		600.00
1.09.3.3	Stationery and Office Supplies		4,438.15
1.09.6	Miscellaneous Assets		4,263.79
1.09.6.9.7	Deffered Charges		4,263.10
1.09.6.9.9	Sundry Debits		0.69
	Total Assets :		2,992,763.56

Code	Account Titles	Consolidated	
		No.of Accts	Amounts
2.0	LIABILITIES :		
2.04	DEPOSITS	3392	830,051.34
2.04.1.1	Demand Deposit	4	17,151.00
2.04.1.3	Other (Passbook Saving)	3,388	812,900.34
2.06	Other Sundry Current Liabilities		1,416.00
2.08	Other Liabilities/Due To Dili Branch		205,462.83
3.0	CAPITAL ACCOUNTS :		1,955,833.39
3.02	Capital Paid-Up & Assigned		2,000,000.00
3.06	Profits / Losses		(44,166.61)
3.06.1	Previeous Financial Year		(34,267.60)
3.06.2	Current Financial Year		(9,899.01)
	Total Liabilities & Capital Accounts :		2,992,763.56