

TFET- FUNDED

GRANT NO. 8186-ETM

MICROFINANCE DEVELOPMENT PROJECT

Implementation Status

Grant No. 8186-ETM(TF): Microfinance Development Project (TFET-Funded)

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A. Primary Objectives

The Project aims to help reduce poverty in East Timor by facilitating community-based opportunities for income-generation and the creation of sustainable farm and nonfarm employment. Specifically, the Project will

- (i) help the poor to engage in income-generating activities;
- (ii) provide MFI capacity-building and administrative support to rehabilitate and strengthen the operations of credit unions and set up a sustainable microfinance bank to provide financial services to poor and low-income households;
- (iii) provide financial assistance through credit line and equity to these MFIs; and
- (iv) provide project management.

The Project will address poverty by providing financial services to about 20,000 beneficiaries by the end of 3 years, of which about 8,000 will be served through the credit unions and 12,000 through the microfinance bank. This is in the assumption that the full Project funding of \$7.72 will be made available by the TFET. Details of the Project are in Appendixes 3.1–3.4.

B. Physical and Financial Progress

1. Overall progress

The Project was signed in late December. Project implementation began in February 2001 and is progressing satisfactorily. An imprest (special) account has been established in Dili and an initial advance of \$0.77 million was received only in May 2001. The initial expenditures were mainly for setting up the Project Management Unit (PMU), including the hiring of 5 international consultants and their local counterparts, as well as the procurement of 3 vehicles, 6 computers, other office equipment and initial office supplies for the PMU.

2. Establishing the Project Management Unit (PMU)

In mid-January, a microfinance specialist was hired and funded by ADB who was subsequently appointed by UNTAET/ETTA as the Interim Project Manager, prior to the recruitment of international consultants for the PMU. Among the pre-implementation highlights are:

- (i) The Project Coordinating Committee (PCC) was convened, chaired by the Cabinet Member for Economic Affairs and composed of the Head,
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Commerce, Industry, and Tourism Division (CITD, the Executing Agency), the acting Project Manager, and the Executive Director of the local credit union federation (CUF) as members. The PCC meets monthly to review project progress and problems.

- (ii) A 5-person selection panel, including 3 East Timorese ETTA officers, was formed for the selection of PMU international consultants, from over 65 applicants responding to ADB-ETTA job announcements. The panel used a rating system largely based on "hands-on" experience in MFI operations and core competence and experience in the position applied for. The other criteria considered were educational attainment in relevant fields, working experience in developing or postconflict countries, and languages and information technology skills.
- (iii) Subsequently, 5 local consultants and 3 local staff were selected and fielded by end of May 2001. The PMU moved from the ADB premises to its permanent office along with the CITD at the Fomento Building, Dili. In the meantime, procurement of 3 utility vehicles, office equipment, and initial office supplies has been completed.
- (iv) The PMU consultants were briefed and grounded on the Project, had an interface with the TA Advisory Team, and were introduced to the Executing Agency and other strategic partners. The Project detailed schedules, capacity-building targets, performance indicators, and project disbursement budgets previously prepared were further refined by the PMU (see attached tables).

3. Capacity building of MFIs

It was decided that the strengthening of the CUF and rehabilitation of credit unions will take slight precedence over the setting up of the microfinance bank, due to policy and operational measures that need to be resolved in establishing the latter. Thus, while the detailed planning of activities, training preparation, and target setting will be for both the credit unions and the bank, it is anticipated that the execution of these plans will initially focus more on the credit unions until the policy and legal issues for setting up the microfinance bank are resolved.

- (i) **Rehabilitation of CUF and credit unions.** The PMU has drawn up the detailed plans and budget for the strengthening of the CUF and at least 10 credit unions over the last half of 2001. A series of workshops with key officers of existing and dormant credit unions in close coordination with the CUF volunteer staff were conducted to facilitate the planning process and tailor fit the capacity-building approach to the local context. The initial training activities will be the training of at least 25 credit union trainers to cover all facets of credit union operations and structure. The training modules and budgets have been prepared and training activities started in June.

In the meantime, the following documents and operational guidelines were finalized: (a) CUF and credit union bylaws; (b) operating policies and guidelines for the Central Fund to be managed by the CUF that will provide financial intermediation among credit unions; (c) operating policy, systems and procedures for all credit union operations; and (d) audit and management performance procedures.

- (ii) ***Setting up the Microfinance Bank.*** The PMU in coordination with the TA Advisory Team prepared the legal and documentation requirements for incorporation and licensing of the bank, to include the respective bylaws for the CUF (the proposed initial and sole owner of the bank) and the business plans required by the CPO. The PMU will also proceed with site selection for the head office and first two branches; preparation of staffing pattern and training modules; and design of forms, systems, and procedures. However, it will hold in abeyance the recruitment of personnel and actual implementation of setting up the bank until the policy and legal issues are fully resolved.

4. *Strengthening microfinance policy and legal framework*

- (i) ADB provided a piggybacked advisory TA of \$0.25 million to assist UNTAET in developing a policy and legal framework supportive of the establishment and growth of viable MFIs.
- (ii) The TA is aimed at helping create an environment conducive to the development and growth of MFIs following proven best practices. Two policy experts have completed initial fieldwork from mid-February to early April, and are expected to finish their work by July 2001.
- (iii) A Steering Committee was formed to provide overall guidance to the TA Advisory Team, composed of representatives from key UNTAET/ETTA Departments (Central Fiscal Authority, CITD, National Planning and Development Agency, and Office of the Principal Legal Advisor) with the CPO as observer/advisor.
- (iv) The TA consultants have drafted and circulated the following among ETTA and ADB offices concerned:
 - (a) Draft Credit Union Law;
 - (b) Concept Paper on establishing a Foundation and a Microfinance Fund to address the ownership and control issue of the proposed microfinance bank and to sustain capacity-building of local MFIs (also circulated to major donors);
 - (c) monitoring and supervisory guidelines/standards for credit unions;
 - (d) operating policy and guidelines for the credit union Central Fund; and
 - (e) draft bylaws of the microfinance bank, the CUF, and the legal or registration documents for setting up the MFIs.

ISSUES AND MEASURES

Microfinance Bank

Planned activity and situation: The MFB will provide a broad range of financial services through a head office and branch network. It will undoubtedly in the future be the major provider of micro- and rural-financial services in East Timor. It will have a capital of \$2 million and register as a bank under the existing banking law passed by UNTAET on 25 February 2000. The minimum required capital of \$2 million is provided under the Project.

Requirements: The Central Payments Office (CPO) requires that a bank must be registered under a Companies Act prior to its licensing under the Banking Regulations. To qualify for registration, the MFB must be a limited liability company. Registration documents must be prepared, including an Establishment Document and Articles of Association (bylaws). There is now a general consensus among the Steering Committee, Cabinet members, and ADB that an independent foundation should be formed to initially be the sole shareholder of the MFB. The foundation will have a board of trustees composed of representatives from major donors, government, and civil society (e.g., the Church, credit unions, and NGOs). This resolves the issue of UNTAET/ETTA being legally unable to own a bank. It will also insulate the MFB from political interference or similar problems inherent to a state-owned bank. Over time, the foundation will divest its shares so that the MFB's clients, credit unions, NGOs or any citizen of East Timor will ultimately own the MFB.

Constraints: Thus far, there is no Companies Act or Foundation Law passed in East Timor. Invoking the applicable Indonesian Law is legally possible, but there are no implementing mechanisms under this option. The Companies Act has been drafted and may be passed before mid-July 2001 (the target date for the dissolution of the ETTA Cabinet and the National Council, after which UNTAET may opt to pass only emergency laws). However, there is no similar initiative at present for passing a Foundation Law, and invoking Indonesian laws may not be the solution since the legal status of foundations in Indonesia remains unclear.

Actions. The PMU and the TA Advisory Team will continually advocate for the passage of the Companies Act until this is enacted, preferably before 15 July 2001. The TA Advisory Team has also drafted an appropriate Foundation Law and will advise the ETTA authorities concerned to enact it before mid-July 2001. The Project will assist the authorities in procuring precedents for such a law. The TA Advisory Team has drafted incorporation documents for a company, and will draft incorporation documents for a foundation. The PMU will be responsible for registration of the company and in obtaining a bank license for the MFB.

ISSUES AND MEASURES *(cont'd.)*

Credit Unions

Planned activity and situation: Some 21 credit unions will be rehabilitated and will provide microfinance services in most districts of East Timor. Although there is an Indonesian law on cooperatives (Law of 1992) that covers the operation of credit cooperatives, the law is inadequate, is presently being redrafted, and likewise suffers from lack of implementation mechanism in East Timor.

Requirements: It is vital for credit unions to be formed and registered under an appropriate credit union law that complies with international best practices. Such law should cater to the unique requirements of credit unions as self-help, self-policing, member-based financial intermediaries that need to be differentiated from other financial institutions dealing with the general public. Moreover, there should be a prudential framework for supervising credit unions, and there should be a registrar of credit unions. Lastly, there should be a legal framework for a credit union federation.

Constraints: There is no credit union law, and no machinery to administer the law.

Actions. The TA Advisory Team has drafted a credit union law and bylaws, and prepared incorporation documents for a credit union. A supervisory framework for credit unions has been designed. The project will advise the authorities in enacting an appropriate credit union law before mid-July 2001. The PMU and the TA Advisory Team will help draft bylaws for the credit union federation.

Overall MFI Policies and Legal Framework

Planned activity, situation, and requirement: The emerging importance of the microfinance market has made monetary authorities in some developing countries realize the need for separate laws governing MFIs. Traditional banking laws, on which the existing Regulation 2000/8 is modeled, are geared for regular commercial banking entities. An appropriate MFI law, which could be embodied in or be separate from the Banking Law, would clearly delineate microfinance as a major subsector altogether, especially in the East Timor, which is mainly a microfinance market considering the pervasive poverty. This would also avoid the complexities of piecemeal exemptions now and then for MFIs.

An alternative to a quicker setup of MFIs is to submit to the provisions of UNTAET Regulation 2000/8 and invoke its special provisions (under Section 2.6) that allows the CPO to issue instructions applicable to nonbank financial institutions and MFIs.

WORK PROGRAM FOR THE NEXT 6 MONTHS

Institutional Strengthening of CUF and Credit Unions

- (i) Passage of the Credit Union Law or Regulation by July 2001
- (ii) By the third quarter, the credit union federation (CUF) training would be completed and at least 25 credit union trainers would have been trained.
- (iii) By fourth quarter 2001, at least 16 credit union training modules would have been completed for the 10 target credit unions. This would involve at least 255 persons separately undergoing training as credit union board or working committee members, management or staff, and a select group of members (see attached tables).
- (iv) Within the same period, these 10 credit unions would be operational and reaching out to over 1,000 prospective members.

Setting up the Microfinance Bank

- (i) Passage of Companies Act and Foundation Law or Regulations by July 2001
- (ii) Completion of institutional arrangements among major stakeholders
- (iii) Convening of the CUF board of trustees and appointing the MFB Board
- (iv) Registration and licensing to operate by August 2001
- (v) Within 3-4 months from registration and licensing of the MFB, the PMU would do the following pre-operational activities, among others:
 - site selection and improvement of the head office and two district branches;
 - setting up operating policies and procedures, forms, and control reporting systems;
 - selection, recruitment, and training of head office and branch staff;
 - procurement of office equipment, vehicles, and initial office supplies;
 - dryrun and debugging of systems and procedures prior to bank opening; and
 - promotion campaign for the bank.

The MFB should be operational by the fourth quarter of 2001 with about 500–700 clients.

Appendix 3.3

Program Activities and Budget Matrix (TFET-Funding only)

Microfinance Development Project for East Timor (8186 ET-TF)
Table 3. Program Activities and Budget Matrix (TFET Funding only)

Overall Goal: Set up a responsive, equitable, and sustainable microfinance system to provide financial services to low-income groups	2001						Phase			Total
	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	2001	2002	2003			
Program Activity										
A. Project Management Unit Operations										
1. Procurement of equipment and initial supplies		0.11			0.11				0.11	
2. Consulting services		0.12	0.19	0.19	0.49	0.21	0.10		0.80	
3. Operating overheads		0.01	0.01	0.01	0.04	0.06	0.06		0.16	
Sub-total	0.00	0.25	0.20	0.20	0.64	0.27	0.16		1.067	
B. Capacity Building and Institutional Strengthening										
1. Capacity Bldg & Institutional Development of credit unions & Credit Union Federation (CUF)										
1.1 In-country training activities (trainers, credit unions & CUF)		0.02	0.02	0.02	0.05	0.08			0.13	
1.2 Overseas training & study tours			0.03	0.03	0.05				0.05	
1.3 Procurement of basic office equipment & supplies		0.03	0.03	0.04	0.10	0.04			0.14	
1.4 Staff salary & operating subsidy			0.02	0.03	0.05	0.03	0.03		0.11	
2. Capacity Building for Microfinance Bank										
2.1 In-country training			0.03	0.03	0.05	0.05			0.10	
2.1 Overseas training program			0.03	0.03	0.05				0.05	
Sub-total	0.00	0.05	0.14	0.16	0.35	0.20	0.03		0.57	
C. Financial Support										
1. Financial Support for credit unions and CU Federation										
1.1 Credit Union Liquidity Fund (interfunding scheme)			0.15	0.25	0.40	0.60	1.50		2.50	
2. Financial Support for Microfinance Bank										
2.1 Equity infusion to set up Microfinance Bank			2.00		2.00				2.00	
2.2 Liquidity Credit or additional equity infusion										
Sub-total	0.00	0.00	2.15	0.25	2.40	0.60	3.00		6.00	
D. Contingency										
Grand Total	0.00	0.29	2.49	0.65	3.43	1.10	3.19		7.72	
Cumulative Total	0.00	0.29	2.78	3.43	3.43	4.53	7.72			

Appendix 3.4
Performance Targets, July–December 2001
 (amounts in US\$)

	Number of CUs	Members per CU	Total Members	Average Loans	Average Savings	Total Loans	Total Savings
Credit Unions	10	100	1,000	100	50	100,000	50,000
	Number of Loan Officers	Members per Officer	Total Members	Average Loans	Average Savings	Total Loans	Total Savings
Microfinance Bank	12	40	480	80	25	38,400	12,000
Total			1,480			138,400	62,000