

Joint Programme
INFUSE – Inclusive Finance for the Under-Served Economy (2008 - 2012)

Country:

Timor-Leste

UNDAF Outcome(s):

- (1) To halt and begin to reverse the proportion of people whose income is less than USD 0.55 a day
- (2) To halt and begin to reverse the proportion of people who suffer from hunger
- (3) To slow down and begin to flatten rural and urban unemployment trends, particularly youth.

Prog/project Title: INFUSE: Inclusive Finance for the Under-Served economy

Programme/project Duration: January 2008 to December 2012

Fund Management Option(s): Combination (parallel/pass-through)

Administrative Agent: UNDP

Total estimated prog/project budget: \$ 5,000,000
Out of which:

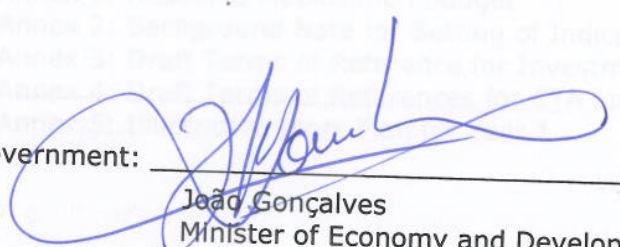
1. Planned resources:

- Government
- Regular/Other Resources
- NGO or private
- UNCDF \$ 1,050,000
- UNDP \$ 500,000
- Donor ...
- Donor ...

2. Unfunded budget: \$ 3,450,000

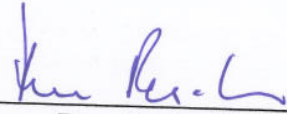
Approved on behalf of:

Government:


João Gonçalves
Minister of Economy and Development

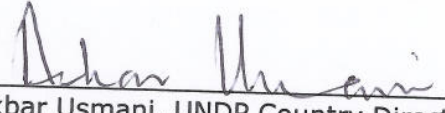
18/04/08
Date

UNDP:


Finn Reske-Nielsen
Resident Representative

18/04/08
Date

UNCDF:


Akbar Usmani, UNDP Country Director
On behalf of
Henriette Keijzers
Executive Secretary, a.i.

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Table of Contents

Executive Summary.....	2
List of Acronyms	3
Part I. Situation Analysis	4
1. Country Context	4
2. Financial Sector Development in Timor-Leste.....	4
3. Programme Justification	8
Part II. Strategy.....	11
1. Programme Strategy	11
2. Stakeholders, Target groups, and Ultimate beneficiaries.....	12
3. Programme Components.....	14
4. Expected End of Programme Situation	16
5. Strategic Alliances	17
Part III. Result Framework	18
Part IV. Management Arrangements	21
Part V. Legal Context	24
Part VI. Annual Work Plan Budget Sheet.....	25

Annexes:

- Annex 1: Resource Mobilisation budget
- Annex 2: Background Note for Setting of Indicators and Targets for INFUSE
- Annex 3: Draft Terms of Reference for Investment Committee for FIF Fund
- Annex 4: Draft Terms of References for CTA for the INFUSE Programme
- Annex 5: Illustrative Work Plan for Year 1

Government of Timor-Leste

United Nations Capital Development Fund United Nations Development Programme

INFUSE – Inclusive Finance for the Under-Served Economy (2008 – 2012)

Executive Summary

The poor and low-income earners ("Bottom of Pyramid" (BOP)) in Timor-Leste are largely excluded from access to financial services, and thus form the core target group for the development of an inclusive financial sector, serving the majority of the people. While their number will decrease as employment generation efforts take effect, the high population growth partially offsets this trend. Assuming a modest 5% decrease in the BOP over the next seven years, a total of 112,800 households representing 570,000 people should have access to financial services by the end of 2012, for the goal of a fully inclusive financial sector to have been reached.

The financial sector in general is expanding, and the microfinance industry, which serves the BOP, has progressed beyond the start-up phase to launch Inclusive Finance in Timor-Leste. A range of institutions, including commercial banks, offer a relatively wide array of financial services, and AMFITIL, the association of microfinance institutions, has been formed with a focus on sustainable operations. However, the outreach of the financial service providers (FSPs: Commercial Banks, NBFIs, Credit Unions, NGO-MFIs, Credit Cooperatives) is limited. With coherent and focused support, the financial sector should be able to increase its outreach, especially to BOP, by 20-25% per year, reaching a total of 78,100 BOP borrowers (70% of projected BOP households) and mobilizing savings in 187,100 voluntary deposit accounts (70% of projected total households) at the end of the project.

The overarching goal of the INFUSE Programme is to contribute to the achievement of the Millennium Development Goals (MDGs), in particular the Goal 1 of cutting absolute poverty in Timor-Leste by one third by 2015, by increasing sustainable access to financial services for the poor and low-income people, both male and female. INFUSE will focus on increasing access by poor and low-income people to sustainable financial services while taking a sector approach in addressing these issues. Three mutually reinforcing programme outputs include:

- Policy development and strategic coordination to enhance the enabling environment;
- Facilitating the growth and long-term sustainability of the retail financial service providers, so that they can reach an increasing number of the poor and low-income people; and
- Establishment of a financial business support infrastructure in Timor-Leste

INFUSE is implemented jointly by UNDP and UNCDF; the Programme also invites interested donors and partners for the financial contribution in order to fill the gap of funding resources.

List of Acronyms

ADB	Asian Development Bank
AMFITIL	Association of Microfinance Institutions in Timor-Leste
BDS	Business Development Services
BNU	Banco Nacional Ultramarino (formerly CGD)
BOP	"Bottom of the Pyramid", the poor and low-income population
BPA	Banking and Payments Authority
BRI	Bank Rakyat Indonesia
CCF	Christian Children's Fund
CGAP	Consultative Group for Assistance to the Poorest
CGD	Caixa Geral de Depósitos (currently BNU)
CRS	Catholic Relief Services
CTA	Chief Technical Adviser
CUF	Credit Union Federation – also referred to as FHM
DAI	Development Associates Inc.
FHM	Federacaun Hanai Malu (Union of Savings and Credit Cooperatives)
FIF	Fund for Inclusive Finance
FPRET	Foundation for Poverty Reduction in East Timor (owner of IMFTL)
FSPs	Financial Services Providers
FSS	Financial Self-sufficiency ratio
GDP	Gross Domestic Product
GoTL	Government of Timor-Leste
GTZ	Gesellschaft für Technische Zusammenarbeit (Germany)
IC	Investment Committee (for the Fund for Inclusive Finance)
IFC	International Finance Corporation
IMFTL	Instituicao de Microfinancas de Timor-Leste
INFUSE	Inclusive Finance for the Under-Served Economy (working title)
INGO	International Non-Governmental Organization
MBB MIX	Micro Banking Bulletin Market Information Exchange
MDG(s)	Millennium Development Goal(s)
MFIs	Microfinance Institutions
MIS	Management Information System
MoED	Ministry of Economy and Development
MSMEs	Micro, Small, and Medium-scale Enterprises
NDP	National Development Plan
NGO	Non-Government Organization
PaR	Portfolio at Risk
RFA	Request for Applications
SEP	Small Enterprises Project
SHGs	Self Help Groups
SME	Small and Medium-scale Enterprise
TA	Technical Assistance/Assistant
TFET	Trust Fund for East Timor
TL	Timor-Leste
TRM	Tuba Rai Metin (microfinance institution)
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
UNMISSET	United Nations Mission of Support in East Timor
UNOPS	United Nations Office for Project Services
UNTAET	United Nations Transitional Administration in East Timor
USAID	United States Agency for International Development
WB	World Bank

Part I. Situation Analysis

1. Country Context

Timor-Leste ranks 150 of 177 in the UN Human Development Index (2007)¹ as one of the poorest countries in South East Asia. Among the total population of over 1 million in the country, about 40% (42% in rural area) lives below the national poverty line of USD 0.55 per capita a day. GDP growth rate is volatile, ranging from (-) 35% in 1999 to (estimated) 8% in 2007. Oil-and-gas revenue accounts for roughly half of the GDP, and are estimated at around USD 100 million per year which leads to the current oil fund at USD 2 billion. The real non-oil GDP was estimated at USD 320 million in 2007, which is higher than the 2005 level.

Prior to the security disturbance in 2006, Timor-Leste made progress on the macroeconomic stability. The adoption by the Government of Timor-Leste (GoTL) of the US Dollar as legal tender has contributed to the higher price level, which impedes competitiveness in the lower-cost environment of South Asia. The trade deficit has narrowed to an estimated USD 171 million in 2005 (excludes petroleum revenue), amounting to about 49% of non-petroleum GDP.² Non-oil activity began to recover in 2005 as stable macroeconomic conditions and improved policies offset a scaling down of donor activity. The acceleration of oil-and-gas production after its start in 2004 resulted in rapid GNI growth. Inflation was low through early 2006, including relative to competitors, as demand fell with the downsizing of the previous UN mission while production of basic food staples increased.

However, the civil unrest in 2006 had seriously hindered the country's growth momentum.³ The economy contracted by 5.8% in real terms, with real non-oil declining to USD 296 million. Coupled with the population growth, GDP per capita dropped from USD 450 in 2001 to USD 370 in 2006⁴. Real non-oil GDP growth was estimated to be negative, despite an end-year boost from public spending and international aid.⁵ Private sector activity was also disrupted. Although the situation is largely quelled and calm so far, the peace and stability are still fragile as seen in 2007 and most recently in February 2008. There are challenges ahead for the achievement of economic growth.

2. Financial Sector Development in Timor-Leste

Financial Services Providers (FSPs)

The formal banking sector in Timor-Leste includes three foreign owned commercial banks: i.e. ANZ, Banco Nacional Ultramarino (BNU)⁶ and Bank Mandiri, as well as the Instituicao de Microfinancas de Timor-Leste (IMFTL), which is regulated by the Banking and Payments Authority (BPA) under a special decree law. The non-bank Financial Services Providers (FSPs) include two

¹ UNDP, *Human Development Index, 2007*

² World Bank, *Background paper for Timor-Leste and Development Partners Meeting, April 2006*

³ International Monetary and Financial Committee Fifteenth Meeting-April 14, 2007

⁴ UNDP, *Human Development Report, 2006*

⁵ International Monetary and Financial Committee Fifteenth Meeting-April 14, 2007

⁶ Formerly Caixa Gelal de Depósitos (CGD)

specialized NGO microfinance institutions (MFIs)⁷; three savings and credit cooperatives with a membership of more than 250 people, and 8-9 non-financially specialized NGOs, of which four are members of the Association of Microfinance Institutions in Timor-Leste, AMFITIL.

While ANZ and Bank Mandiri primarily serve the corporate and expatriate market in the capital Dili, BNU has embarked on a rapid expansion of its branch network aiming to reach all 13 districts by 2008. As the undisputed market leader, BNU holds about 62% of deposit accounts at a value of 48% of total deposits, not least due to the banking of government contracts and staff. BNU provides low threshold savings accounts and smaller, collateralized business loans, albeit with a very long processing time lag.

As of June 2007, three of AMFITIL members – Moris Rasik, IMFTL and Tuba Rai Metin – significantly increased the size and also improved the quality of their credit portfolio. However, the average portfolio at risk from AMFITIL members remains high at 15.8%, indicating that most NGO-MFIs are still struggling with the aftermath of 2006. Moris Rasik, the largest NGO-MFI with 9,336 loan clients, reached operational sustainability for the first time, covering all of its operational costs from its interest income. Medi-CCF and IMFTL have achieved operational sustainability for some time.⁸ IMFTL was created in 2001 under the ADB-managed Microfinance Development Project (MDP) with a USD 4 million grant as a company limited. But shares in effect are owned by a government fund and replenished by donor agencies. The current ownership structure prevents IMFTL from acquiring a banking license, and limits IMFTL deposit mobilization to a USD 1 million ceiling. This is stunting the growth potential and ambitious branch network expansion plans of the institution. Therefore as a first step in its transformation and licensing as a category C (small) bank, the ownership structure needs to change.

The FSPs each serve their core segment of the market, and especially the NGO-MFIs are reaching deep into the segments of very poor clients. As at June 2007, the five AMFITIL member institutions together served a total of 23,392 savers (5.5% of the poor and low-income population) and 18,988 borrowers (4.6%). While the geographic coverage of financial service providers spans 11 of the 13 districts in Timor-Leste, the client coverage in each district, with the exception of Dili, is still thin at 1-20%. The range of products and services on offer is well developed and varied for the young industry and the small market, but the limited supply of credit for agricultural production and equipment corresponds poorly to the agrarian economy of Timor-Leste.

Current and Projected Demand for Financial Services

There is substantial unsatisfied demand for financial services in Timor-Leste, and the perception has stimulated attempts to estimate the size of the market.

The total potential market for financial services in Timor-Leste is small by international standards, at around 472,000 people in the economically active age range (between 15-64 years of age)⁹. This market includes 87% or 410,000 self-employed people¹⁰, used here as a proxy for the poor and lower income segment (“bottom of pyramid” (BOP)) in 87,290 households¹¹ (see Figure 1). This majority of the population is at present largely excluded from access to financial services. While the BOP percentage will decrease as employment generation efforts take effect,

⁷ The national NGO Moris Rasik; and Tuba Rai Metin (TRM), supported by CRS.

⁸ AMFITIL Quarterly Report, April – June 2007.

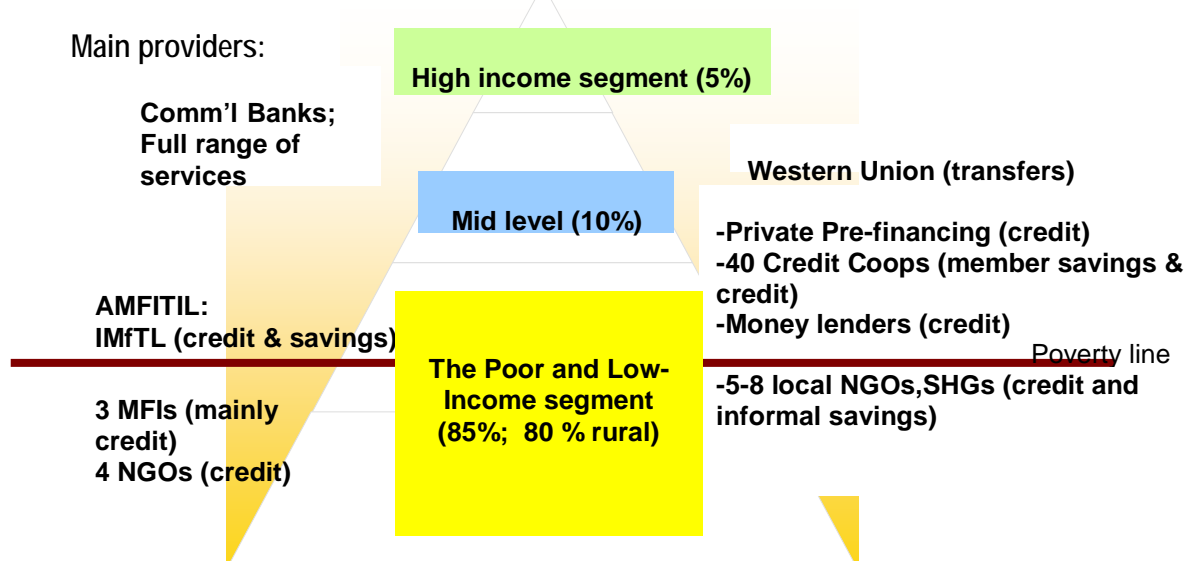
⁹ UNDP, *Timor-Leste Human Development Report: Paths out of Poverty*, 2006

¹⁰ UNDP, *Timor-Leste Human Development Report: Paths out of Poverty*, 2006

¹¹ Population data and average size of households from 2004 *Census of Population and Housing Timor-Leste*

the high population growth partially offsets this trend. Assuming a modest 7% decrease in the BOP over the next five years, a total of 112,300 households representing 527,000 people should have access to financial services by the end of 2012, for the goal of a fully inclusive financial sector to have been achieved (see Annex 2 for the calculation).

Figure 1: The Bottom of the Pyramid (BOP) in Timor-Leste



The outreach of savings services by financial services providers (banks, microfinance institutions, credit cooperatives and NGOs) comprised 56,896 savers or 12% of the economically active people in Timor-Leste¹². A total of USD 88.09 million was mobilized from these savers, 97.6% deposited with the commercial banks. Safe and sound savings services are crucial to BOP customers as means of paying for major life events (weddings, funerals), taking advantage of a business opportunity, and as a cushion against sudden shocks, such as illness or a bad harvest.

Supply of credit increased to around 34,100 borrowers (7% of the economically active population) in 2005 from 27,816 borrowers (6%) in 2004, with an outstanding loan portfolio of USD 75.6 million from 67.82 million, respectively. But the market is segmented and commercial banks are reluctant to lend to BOP. Most of the overall value of loans outstanding represents a relatively small number of very large enterprise loans from the commercial banks, typically for public construction projects. As the non-regulated NGO-MFIs cannot mobilize savings from the public, and as the current ownership structure of IMfTL prohibits its transformation into a fully licensed bank, it is not surprising that credit is more widely available to BOP than savings. To guard against poor families over-indebting themselves, credit services to BOP are often limited to one loan per household. MFIs are currently reaching 25% of BOP households, and only one of the 5 MFIs in AMFITIL is delivering services to BOP on a fully financially sustainable basis. The average quality of the MFI portfolio measured by Portfolio at Risk (PaR) at 30 days is higher than desirable at 15.8%.

Legal Environment

¹² As of September 2004

Since its creation in November 2001, the Banking and Payments Authority (BPA) has taken on most of the normal functions of an autonomous central bank under a Banking Regulation instituted by UNTAET in 2000. The BPA issues licenses, regulates and supervises the commercial banks and IMfTL, and manages the Dili Interbank Clearing House. As 'proto'-central bank of Timor-Leste, the BPA has a legislative mandate for its operations. Its primary objective is macroeconomic, that of achieving and maintaining domestic price stability. It is also responsible for managing the monetary and exchange rate regime. Yet the second of these responsibilities is redundant so long as the dollarized currency regime is in place, while responsibility for control of inflation rests primarily with fiscal policy. Pending any decision to adopt a national currency, BPA's macroeconomic responsibilities are more prospective than actual.¹³

The legislation also gives BPA financial system-building responsibilities, and these are of primary importance under present circumstances. They are related to promoting the stability, liquidity and solvency of a market-based banking and financial system, together with a safe, sound and efficient system of payments.¹⁴ BPA has prepared a corporate plan for its further institutional development over the period to 2007.¹⁵

The 2002 National Development Plan¹⁶ calls for the BPA to become 'a catalyst for significant growth of savings and credit', and to 'promote more competition and increasing numbers and types of private banks and financial institutions (including widening rural presence by private banks). Specifically, BPA has been charged to 'support donors and NGOs to develop micro savings and credit schemes especially in rural areas' and to 'develop regulations and capacities to promote private superannuation and other savings schemes'. Thus the BPA's responsibility to nurture the development of microfinance is explicit. The BPA has so far taken the stand that specific regulation of the microfinance sub-sector is inappropriate at this stage. This position seems very sound, based on the current level of maturity of the microfinance industry, and leaves MFIs more free to innovate and experiment, but it does elevate the significance of the performance standard-setting developed by AMFITIL.

Past and Ongoing Assistance to the Financial Sector

Donor agencies and international organizations have been assisting Timor-Leste in all sectors of the economy since 2000. Over the past seven years, the total GoTL-registered spending on private sector development programs amounted to USD 22.6 million, with donors funding totalling more than 90%. Almost 80% of these funds have been provided for microfinance programs and support to SMEs.

From 2000-2003, the World Bank managed two projects¹⁷ that included the provision of subsidized credit. The USD 1 million CEP credit component was a revolving fund as an add-on to the broader-scope project, and the USD 4 million SEPI credit component provided a wider range of individual loans (USD 500–50,000) for private business, disbursed without risk sharing through BNU. Neither project fared well, however, with repayment rates across districts ranging from 28-31% for CEP¹⁸ and around 60% for SEPI.

¹³ WB-John Conroy, *Timor-Leste Access to Finance for Investment and Working Capital*, 2006

¹⁴ WB-John Conroy, *Timor-Leste Access to Finance for Investment and Working Capital*, 2006

¹⁵ BPA (2004) Corporate Plan 2004-2007.

¹⁶ Planning Commission (2002): *Timor-Leste National Development Plan*, pp 65 ff.

¹⁷ Community Empowerment and Local Governance Project (CEP I, II, III), and Small Enterprise Project (SEP I and II)

¹⁸ See Craig Wilson: *Final Evaluation and ICR Report for the WB Small Enterprises Project (SEP I)*, Economic Analysis, March 2003.

ADB has contributed USD 4 million to the financial services sector, supporting the establishment of and technical assistance to IMFTL. Earlier support to the revival of the credit cooperative sector was discontinued. GTZ is implementing an agricultural productivity improvement (food security) project in Baucau and Viqueque in collaboration with the Ministry of Agriculture, Forestry and Fisheries (currently the Ministry of Agriculture and Fisheries; MAF), and has been providing investment and working capital as interest-free loans to traders and farmers. USAID has funded a 'Small Grants Program' contributing a total of USD 1.04 million through 17 grants to the microfinance industry for loan capital, operational costs and training, benefiting 6 NGO members of AMFITIL as well as 5 credit cooperatives. In 2005, USAID launched a new 3-year Private Sector Development Project (DSP) which has a financial services component aiming to support the establishment of a Banker's Association; facilitate access by SMEs to commercial credit; assist AMFITIL in developing a longer-term business plan; and promote donor coordination. The present program has consulted with the DSP on opportunities for collaboration, including in the area of DSP's support to value chains and several opportunities for synergy have been identified.

In partnership with ILO, UNDP is implementing the EC-funded "Skills Training for Gainful Employment Programme" (STAGE) in four districts, providing much needed business development training to currently unemployed, potential entrepreneurs in collaboration with the District Employment Centres under the Ministry of Social Solidarity. This training could provide an element of the financial literacy (for businesses) that the INFUSE programme could support through a partnership with the STAGE programme. An Employment and Vocational Training Fund (EVFT) was established under this project, chiefly to provide grants and loans to business training providers. As trainees are also demanding micro-credit, and as the current supply of funding to the sector is inadequate, a part of the EVFT funds have been allocated to 3-year interest-free loans to MFIs operating in the target districts. Three loans have been signed; two with MFIs (Moris Rasik and TRM) and one with a non-specialized NGO and former member of AMFITIL. From consultations with project staff, it was understood that the EVFT would reallocate these funds to its core training activities if alternative funding could ensure access to microfinance by target beneficiaries in the STAGE areas of operation.

UNDP/UNOPS is implementing an agricultural development project in Ainaro and Manatuto (AMCAP¹⁹) in cooperation with MAF. As part of this effort, UNOPS has supported the formation of 28 Self Help Groups (SHGs). The SHG strategy is being replicated in the district of Oecussi under the OCAP²⁰. As part of the programme's exit strategy, linkages between the SHGs and the stronger FSPs are being explored.

The IFC planned a mission in November 2007 to review IFC support to the sector. Depending on the areas identified by the IFC to support, the INFUSE programme will form a partnership with the IFC programme to benefit from synergies. Potential areas likely to be supported by the IFC include (1) Policy Level: support to public-private sector dialogue on policy constraints; (2) Meso: developing the financial infrastructure, including credit registry; and (3) Retail: equity investments in FSPs.

3. Programme Justification

Poverty Reduction and Inclusive Finance

¹⁹ Ainaro Manatuto Community Activation Project

²⁰ Oecussi-Ambeno Community Activation Project

World leaders have pledged to achieve the Millennium Development Goals (MDGs), including the overarching goal of cutting absolute poverty by half by 2015. UNDP coordinates global and national efforts to reach these Goals.²¹ The Government of Timor-Leste is committed to attaining the MDGs as they apply for the new country, aiming to cut poverty by one third by 2015.

Access to financial services underpins the ability of the poor and low-income people at the “Bottom of the Pyramid” (BOP) to achieve the MDGs on their own terms in a sustainable way. Financial services enable the poor to increase and diversify incomes, build human, social and economic assets, and to move from everyday survival to planning for the future: they invest in better nutrition, housing, health, and education.

Microcredit is most appropriate where local economic activity is ongoing to generate sufficient household cash flow and borrowers use loans to grow rather than establish a business. Market development in Timor-Leste continues to be a necessary ingredient in the fight against poverty – credit cannot alone lift the BOP out of poverty. For these reasons, it would be inappropriate to establish only a fixed outreach target for credit services; demand for credit will increase with economic opportunities. In order for an inclusive financial sector to contribute to the overall goal of poverty reduction, it is much more important to invest in the FSPs serving the BOP to ensure that their technical skills and systems of delivery are sound, safe and strong enough to meet the demand for credit and other financial services, as it increases over time. This means maintaining a high portfolio quality (PaR of less than 5%), and attaining financial self-sufficiency (being able to cover all real and indirect costs of operations by income earned from the operations). To do so, financial services providers need to expand their customer base to a sustainable scale, while strengthening their systems. Financial self-sufficiency ratio (FSS) in Timor-Leste is estimated to be 3,000 customers for savings-led institutions (credit cooperatives, deposit-mobilizing banks); and 12,000 customers for credit-led institutions (NGOs). Equally, it is estimated that a feasible growth rate is 20-25% per year. More recently, the term Inclusive Financial Sectors is in use to describe this emerging vision. The vision of inclusive finance²² can be characterized by:

- (a) Access by all bankable households and enterprises to a full range of financial services at a reasonable cost, including savings, short and long-term credit, mortgages, insurance, pensions, payments, local money transfers, international remittances, leasing and factoring;
- (b) Soundness of institutions, which is maintained through performance monitoring by stakeholders and, where required, sound prudential regulation;
- (c) Financial and institutional sustainability as a means of providing access to financial services over time;
- (d) Multiple providers of financial services, wherever feasible, to bring cost-effective alternatives to customers, including sound private, non-profit and public providers.

To realize the vision of financial inclusion, financial services for poor and low-income population and micro and small enterprises should be seen as an important and integral component of the financial sector. This sector should include a continuum of financial institutions, each with its own comparative advantages, and each presenting the market with an emerging business opportunity.

Fragmented policy and investment (funding) framework

²¹ While the baseline for the MDGs globally is 1990, year 2001 when Timor-Leste gained independence would be a more appropriate baseline against which to measure progress in Timor-Leste, and the poverty reduction target should thus be revised accordingly to one third.

²² See the “Blue Book” on Building Inclusive Financial Sectors (UNCDF and UNDESA) 2006.

At present, there is no specific vision statement for the financial sector indicating the role microfinance could play in contributing to national development, or how it might be developed as an integral part of the financial sector. Microfinance is specifically mentioned as a tool to combat poverty in the National Development Plans and in several of the previous Sector Investment Programmes (SIPs). The policy framework within which the sector operates could benefit from clarification, streamlining and coordination.

Stemming from the lack of a coherent national policy/vision statement, the level of effective coordination of microfinance development efforts in the small country remains low. Overall consensus among all stakeholders and adherence to performance-based, results-oriented good practices in a sector approach to the development of an inclusive financial sector has yet to be attained.

While not directly counter-productive to microfinance provision immediately, the legal and regulatory environment needs to be developed for financial services to expand in the medium term:

- a) There is no legislation for non-bank financial institutions, which would enable growing NGO-MFIs to graduate and be licensed to intermediate deposits in future;
- b) The administration of legislation pertaining to contract enforcement, fraud prevention, and resolution of business disputes is often inefficient, and weaknesses in the judiciary creates uncertainty, especially for commercial bank expansion;
- c) An insurance law (which will reduce risk for lenders) has recently been approved but awaits implementing regulations and the issuance of licenses to insurers;
- d) The enactment of legislation for bankruptcy to secure creditor rights is urgent, due to the recent rapid increases in bank lending²³; and
- e) Land legislation and land titling, facilitating the use of land as collateral, is delayed. There is not yet a law for equipment leasing, which would assist in overcoming collateral problems, though legislation for private leasing of property has been enacted.

Low FSPs' capacity

Financial institutions suffer from the human resource deficiencies that affect all areas of national life. All of the FSPs are by international standards small and display weaknesses in financial, managerial and strategic management capabilities. The key to attaining sustainability for the FSPs is growth and retention of customers and asset quality. In the process, some consolidation through mergers and divestiture of less successful portfolios to stronger institutions should be encouraged.

To reach substantial scale and attain sustainability, retail financial service providers (e.g. commercial banks, non-bank financial institutions, NGO-MFIs, credit unions, credit cooperatives) need appropriate packages of funding including grants, loans and Technical Assistance (TA) to improve their capacity to manage growth, risk and product development while expanding their customer base at a feasible rate. A 'one-stop' funding facility (i.e. FIF), which combines the available funding resources for the sector under joint management by funders would ensure equitable access, enhance coherence and coordination, and save valuable time for funders and FSPs alike, by:

- a) Setting uniform and transparent standards and criteria for eligibility, selection, contracting, performance monitoring and reporting;

²³ The 2005 IMF Country Report notes that 'recent rapid increase in bank credit to the private sector, including small businesses, strengthen[s] the case for faster progress in establishing a legal framework that defines the rights of different categories of creditors in the case of insolvency'.

- b) Jointly issuing calls for applications based on the FSPs' own business plans, projections and needs assessments to establish a more demand-driven and performance-based development of potential market leaders within the financial services sector;
- c) Ensuring uniform and technically competent appraisal, monitoring, and review of performance;
- d) Providing a joint decision-making forum for all funders;
- e) Enabling multiple funders to jointly meet the needs of FSPs for different funding modalities (grants, loans, TA), and larger amounts over longer periods of time.

Lack of Ancillary (support) services necessary for financial institutions

FSPs are essentially private sector businesses, whose commodity is money. Successful microfinance institutions maintain a social mission by targeting the low-income segment of the market while providing their services based on sound business approaches – the so-called 'double bottom line'. FSPs need the same range of business support services as other services enterprises, but at present, this service infrastructure (e.g. financial literacy for clients, auditors, rating agencies, credit reference bureaus, cash-in-transit service providers, insurance agencies, IT support, trainers, consultants, FSPs networks etc.) is absent, except a few with low capacity.

The few existing business support infrastructure for the financial sector, namely AMFITIL, the Credit Union Federation (CUF), and others, need to be strengthened through support to the networks. In addition, it will be important to attract potential private or public sector business service providers to the emerging market, so that required business services will be available to the FSPs in a commercially viable manner in future.

Part II. Strategy

1. Programme Strategy

Overall Objective and Target

The overarching goal of the INFUSE Programme is to contribute to the achievement of the MDGs, in particular the Goal 1 of cutting absolute poverty in Timor-Leste by one third by 2015, by increasing sustainable access to financial services for the poor and low-income population, both male and female.

INFUSE will focus on increasing access by poor and low-income population to sustainable financial services while taking a sector approach in addressing these issues. Three mutually reinforcing programme outputs include (see Figure 2 below):

- 1) Policy development and strategic coordination to enhance the enabling environment;
- 2) Facilitating the growth and long-term sustainability of the retail financial service providers, so that they can reach an increasing number of the poor and low-income people; and
- 3) Establishment of a financial business support infrastructure in Timor-Leste.

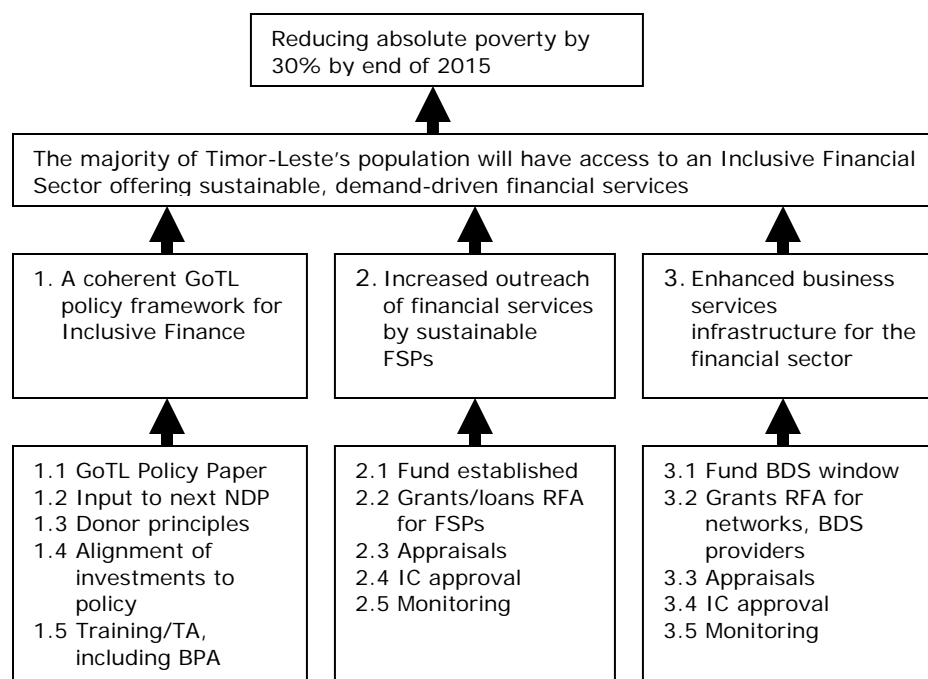
Figure 2: Programme Overview

Aim: The Programme will contribute to...

Objective: By the end of the Programme...

Outputs:

Activities:



Overall programme success will be measured against a general outreach indicator of number of borrowers and number of voluntary savings accounts established. To avoid mistaking a general demand for cash in the stagnant economy with a demand for (repayable) credit²⁴, INFUSE will target an outreach growth rate for credit services to the poor and low-income population of 20% per year, reaching 78,100 borrowers by end 2012 (70% of projected number of BOP households), of which 50% are women. Promoting at least one savings account per household²⁵, INFUSE will target a scale of 187,100 voluntary savings accounts (70% of projected total households) by the end of 2012 (Please see annex 2). When measuring this indicator at output (results) level, the credit outreach target will be coupled with qualitative indicators of portfolio integrity (Portfolio at Risk at 30 days) and sustainability (financial self-sufficiency and return on assets).

2. Stakeholders, Target groups, and Ultimate beneficiaries

Stakeholders

The main stakeholders of INFUSE are:

- The Ministry of Economy and Development (MoED) as the proposed Chair of the Working Group to lead the process of developing a Vision/Policy Statement on Inclusive Finance;

²⁴ For a more detailed account, please refer to the paragraph 15 and 16,

²⁵ See also the discussion of demand in World Bank: "Timor-Leste Private and Financial Sector Review" (draft) November 2005.

- Other key governmental agencies participating in the sector policy development process include the Ministry of Finance, the Ministry of Agriculture and Fisheries, the Secretary of State for Vocational Training and Employment, and other departments overseeing the delivery of rural, urban, micro- or commercial financial services in Timor-Leste;
- The Banking and Payments Authority (BPA) will serve as an observer to the Investment Committee (IC; see Annex 3) for the Fund for Inclusive Finance (FIF)²⁶ established jointly by development partners to coordinate and synergize funding of financial services providers, facilitating the integration of microfinance into the formal financial sector. The BPA's primary role is to ensure that investments are within Government's policy;
- The group of development partners (donor agencies) supporting the development of the financial sector at large, and/or funding provision of financial services either directly or through international or national NGOs, projects or programmes. Donors will be invited to join the IC for the FIF to align and coordinate investments. The key donor agencies include but are not limited to USAID, ADB, World Bank, EC, IFC, GTZ, UNDP, and UNCDF;
- The financial services providers (FSPs) in Timor-Leste, including commercial banks (BNU, Bank Mandiri, ANZ Bank); non-bank institutions such as IMFTL; NGO-MFIs such as Moris Rasik, Tuba Rai Metin and their international NGO partners; other NGO members of AMFITIL (CCF MEDI and Timor Aid); credit cooperatives (Fini Sorumutu, Fitun Naroman, Naroman); and other NGOs, Self-Help Group promoters and projects delivering or supporting the provision of financial services;
- The existing and future professional networks and associations of the financial sector, including the Association of Microfinance Institutions in Timor-Leste (AMFITIL), the Federation of Credit Unions (Federacaun Hanai Malu), and a future Banker's Association; and
- The providers of business support services to the financial sector: adult literacy, credit reference bureaus, training and consulting companies and institutes, chartered accountants, auditors, MIS, IT and ICT/cel-telcom service providers etc.

Target groups

The core target groups of INFUSE are:

- The MoED will be supported with technical assistance as needed to facilitate the accomplishment of a national Policy/Vision Statement on Inclusive Finance.
- The BPA as well as the MoED will be supported with flexible funding/technical assistance to study emerging trends such as the needed regulatory framework for m-banking²⁷, source short-term technical assistance, and draft, review and consult new legislation for the sector as needed;
- The wide range of FSPs in Timor-Leste will have equitable access to a broad range of funding through the FIF. Applications will be selected competitively, based on sound business plans and agreed performance targets; and

²⁶ To be confirmed by the BPA.

²⁷ See for example the regulatory regime in the Philippines to facilitate the use of cell phones (G-cash) to lower the cost of financial transactions.

- The existing (and future) professional networks and associations, as well as providers of business support services to the financial sector will have equitable access to temporary and declining funding through a special window of the FIF. Applications will be selected competitively, based on sound business plans and agreed performance targets.

Ultimate beneficiaries

The ultimate beneficiaries will be the Timorese in general, and in particular the poor and low-income population, whose access to a broader range of appropriate and sustainable financial services will increase.

3. Programme Components

Output 1: A coherent GoTL policy framework for Inclusive Finance

A national policy/vision statement for inclusive finance is developed, consulted and adopted by GoTL, and enabling legislation is in place to support the expansion and consolidation of the financial sector. Coherent, effective and synergetic donor funding based on the national policy framework has been provided.

Main Activities

1.1 At the policy level, the MoED will spearhead the process of developing the vision statement in consultation with Ministry of Agriculture and Fisheries, Secretary of State for Vocational Training and Employment, Ministry of Finance, Ministry of State Administration and Territorial Management, and the BPA. In addition, the FSPs (e.g. commercial banks, NBFIs, NGO-MFIs, credit unions, credit cooperatives) serving the sector will be consulted. Training opportunities²⁸ will also be provided to main stakeholders involved in the Sub-SIP process. With an agreed vision for the sector, the MoED will facilitate its inclusion as an input to the next National Development Plan. The Chief Technical Advisor (CTA) will provide technical assistance in the process.

1.2 The INFUSE Programme will provide training opportunities and technical assistance as necessary to the MoED and the BPA to study emerging trends, review, revise or draft new legislation to enable the agreed development strategy for the sub-sector and ensure that identified constraints are addressed. Legislation for review could include:

- NGO Law and Association/Foundation registration;
- Banking and Non-bank financial institution legislation and regulations;
- Other business legislation relevant to the Financial Sector;
- Legislation and regulation for credit unions and cooperatives.

1.3 Based on the National Policy Statement on Inclusive Finance, the programme will work with development partners to facilitate harmonization and alignment of current investments to the new policy, and to provide recommendations for strategic or operational adjustments. As donor agencies have played a large role as investors in the currently subsidized microfinance industry, INFUSE in close collaboration with other donor-funded projects, will also provide technical assistance to the donor community, including UN Agencies, to coalesce and harmonize their support to the sector under a set of Principles for Good Practice Funding of Inclusive Finance, which will enhance coherence and alignment of investments to national policies. UNDP and

²⁸ Scholarships will be provided for Government policy makers and legislators to the CGAP Microfinance Course in Turin, Italy (Boulder course).

UNCDF will promote the alignment of the UNDAF with these principles and the Government's policy statement.

Output 2: Increased Outreach of Financial Services by Sustainable FSPs

Good practice-based Financial Services Providers (FSPs) serving primarily the poor and low-income market make progress towards sustainability and increase their outreach, while maintaining a high portfolio quality.

Main Activities

2.1 The FIF will be established, combining the available funding resources for FSPs from UNDP, UNCDF and any other interested funding agencies. The purpose of the Fund is to assist promising FSPs with appropriate grant and loan funds to address key institutional weaknesses, resulting in increased outreach and improved sustainability within a competitive environment.

2.2 The FIF will be directed by the IC comprising all interested current and future funders of FSPs and financial sub-sector development (see draft TOR for the IC in Annex 3). The FIF-IC takes joint investment decisions based on agreed criteria, in response to applications received and appraised by a Secretariat led by the CTA (see draft TOR for the CTA in Annex 5). To ensure that funding is driven by demand, the business plans and proposals from the applicant FSPs will form the basis for the appraisals.

2.3 Applicants to the FIF will be selected in an open and transparent process, and upon approval of an investment or a funding package (grants, loans and/or technical assistance), the IC will sign performance-based agreements for grant or loan funds with the FSP, defining amount, nature and timing of support as well as monitoring indicators, targets and reporting requirements. The Secretariat will monitor performance over time, and report to the IC. Key selection and performance indicators will include positive trends in outreach (scale); portfolio quality and financial self-sufficiency (commercial viability).

2.4 In addition to the support through the FIF, short-term technical assistance, training, and exposure visits will be provided directly to FSPs, not through the FIF, when urgent needs arise. This support is opportunity-based and therefore typically not foreseen in the larger, longer-term the agreements signed between the Investment Committee and FSPs. This increases the flexibility of the INFUSE Programme to quickly respond to and support such opportunities.

Output 3: Enhanced business services infrastructure for the financial sector

Private and public business service providers offering high-quality and market-responsive services to the financial sector are available in Timor-Leste, and a professional microfinance association (AMFITIL) is effectively representing the industry in policy dialogues.

Main Activities

3.1 Through a special window of the FIF as supervised by the IC, grant funds will be made available to support the establishment (start-up phase) of a business support infrastructure for the financial sector. The criteria for eligibility, appraisal, and selection, monitoring and reporting will be adopted by the IC, and the process of application, contracting, monitoring and reporting will mirror that set for FSPs. The target applicants for support from this window of the Fund will include professional associations of FSPs, such as AMFITIL and CUF, and providers of business services to FSPs (e.g. adult literacy, training, audit, ratings, credit reference bureaus, Cash-In-Transit service providers, MIS and Internet Communications Technology (ICT/cell phone -

telecoms), etc.), including private companies, private, public and professional institutes, universities, and consultants.

3.2 Applicants to the FIF will be selected in an open and transparent process, and upon approval of an a funding package (grants and/or technical assistance), the IC will sign agreements for grant with Business Support Service (BSS) providers, defining amount, nature and timing of support as well as monitoring indicators, targets and reporting requirements. The Secretariat will monitor performance over time, and report to the IC. As the group of potential grantees will not directly work with individual customers, but contribute to the strengthening of the FSPs as institutions. Therefore, priority will be given to proposals that contribute to financial transparency (accurate performance monitoring, public reporting to customers and commercial investors); product diversity and innovation (market research, testing of new products, services and technologies to reduce transaction costs); and competitiveness (increasing the range of providers to ensure that services offered are competitively priced, and client responsive).

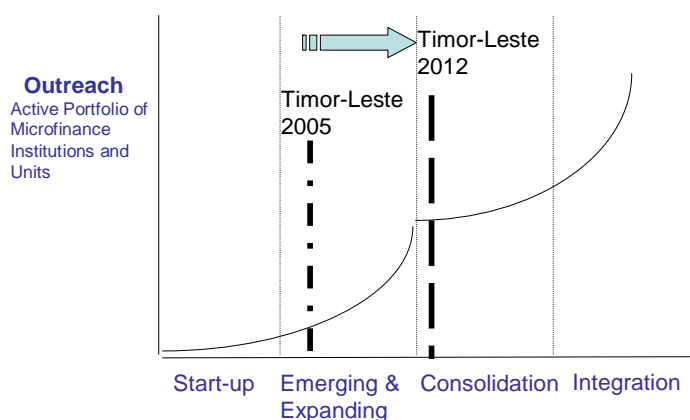
3.3 As BSS providers are almost absent in Timor-Leste, the CTA will liaise with regional BSS providers and industry networks to attract interests for the market. Exposure visits to Timor-Leste will be provided directly to BSS providers when needs arise.

4. Expected End of Programme Situation

The INFUSE Programme has a planned lifespan of five years, ending in 2012. It will concurrently support retail FSPs to strengthen their capacity to serve more customers in a better and more sustainable way; promote the establishment of a business infrastructure to provide viable and market-responsive support services (training, technical assistance etc.) in future; and strengthen the enabling environment for the sub-sector through the development of a clear and comprehensive policy framework, better legislation, and enhanced donor coordination based on good practices.

Successful achievement of these three outcomes will ensure that the financial sub-sector of Timor-Leste is inclusively serving the majority of the population including the BOP, and enhance the capacities and linkages to commercial funding to enable sustainable continuation of service provision, without a continued need for donor funds. It is thus expected that INFUSE can close out at the end of 2012, leaving a well-coordinated, consolidated and self-sufficient sub-sector supported by private sector service providers within a truly enabling policy and legislative environment, in which national stakeholders continue to consult and identify solutions to arising constraints.

Figure 3: Expected Development with Programme



Development phases for financial services to the Base of the Pyramid

5. Strategic Alliances

Given the low level of economic activity and diversification in rural areas, strategic partnerships will be developed with other programmes and actors that are strengthening the economic base, and diversifying the rural economy. In addition, international expertise will be called upon for the development of the inclusive finance sector.

The USAID Private Sector Development program, and in particular its financial services component would be a key collaborating partner in the development of the financial sector. Moreover, the USAID/DAI support to developing value chains for products will be critical in private sector development and stimulating economic opportunity and demand for financial services. IFC has established an office to manage an initial TA-based private sector support program in Timor-Leste, representing another opportunity for collaboration. The IFC could play a lead role in credit registry and other areas of financial sector development. The ILO's programme in support of the Ministry of Social Solidarity will be an important strategic partner for this clientele. The UNDP/UNCDF Local Governance Support Programme (LGSP) will stimulate the local private sector at district and sub-district level by building procurement capacity of local governments to contract of private contractors to build local infrastructure. The World Bank Household Data Survey has proposed Timor-Leste (see monitoring and evaluation section) as one of the initial global pilots, and will improve the quality of data on household uses of financial services.

International financial services resources will be called upon to assist FSPs and the general sector development process as relevant. For commercial banks, technical assistance will be sought e.g. from CGAP's Commercial Banking Retail Advisory Service (RAS), and for MFIs, the newly established MicroSave Asia as well as the Micro-Credit Ratings International Ltd (MCRIL), rating service from India, may offer relevant services. Policy makers, legislators and donor staff could benefit from the CGAP trainings offered regionally and in Turin, Italy in July-August each year.²⁹

²⁹ See www.cgap.org/direct

Part III. Result Framework

Intended Outputs	Output Targets	Main Activities	Inputs
<p><u>Output 1</u></p> <p>A coherent GoTL policy framework for Inclusive Finance:</p> <p>A national policy statement for inclusive finance is developed, consulted and adopted by GoTL, and enabling legislation is in place to support the expansion and consolidation of the financial sector. Coherent, effective and synergetic donor funding based on the national policy framework has been provided.</p>	<ul style="list-style-type: none"> - A Policy Statement on goals, strategies and priorities for Financial sub-sector development is adopted by GoTL (Y1) - A consolidated Financial Sub-sector Activity Plan for 2007-2012 is developed as part of the NDP 2007-12 (Y2) - Principles for Support to the Financial Sub-Sector have been adopted by key donors (Y2) - UNDAF aligned with policy (Y2) - Current and future investments in the sub-sector are reviewed for compliance with national policy framework (Y3-5) 	1.1 Assist MOED in drafting and consulting a national Policy statement on Inclusive Finance for GoTL adoption as input to NDP2007-12.	<p>Advisory Service : CTA</p> <p>Fellowship: CGAP Microfinance Course in Turin</p> <p>Translation/Publications</p> <p>Information dissemination</p>
		1.2 Assist MOED and BPA in drafting, reviewing and consulting on enabling legislation for financial sub-sector development	<p>Advisory Service: short-term experts</p> <p>Training and Exposure visit</p>
		1.3 Draft good practice principles for sub-sector support adoption by development partners and assist in review of baseline investment matrix to align investments to the national policy. Align UNDAF with a national policy framework.	<p>Advisory Service: CTA</p> <p>Advise to UNCT: UNDP Resident Representative</p>
		1.4 Introduce microfinance best practices	<p>Advisory Service: UNCDF</p> <p>Workshop and stakeholder events</p>
<p><u>Output 2</u></p> <p>Increased Outreach of financial services by sustainable FSPs</p> <p>Good practice-based Financial Services</p>	<ul style="list-style-type: none"> -Baseline for borrowers and savers to be confirmed at inception. - at least 20% increase in loans outstanding to poor and low-income (BOP) borrowers per year (compounded), totalling 78,100 loans outstanding by end year 5 	2.1 Mobilize additional investors for a Fund for Inclusive Finance (FIF) and form joint Investment Committee (IC).	Resource Mobilization: UNDP/UNCDF
		2.2 Recruit CTA in consultation with the PSC and IC, establish Secretariat for the Investment Committee (IC), and draft an Operations Manual with eligibility, selection, monitoring and reporting criteria and formats for adoption by IC.	Advisory Service: Short-term expert

Intended Outputs	Output Targets	Main Activities	Inputs
Providers (FSPs) serving primarily the poor and low-income market make progress towards sustainability and increase their outreach, while maintaining a high portfolio quality.	<ul style="list-style-type: none"> - at least 20% increase in number of voluntary savings accounts per year (compounded), totalling 187,100 accounts by end year 5 - At least 5 FSPs have reached break-even (FSS >= 100%) - Financially sustainable FSPs maintain an average PaR (30 days) of max. 5% 	2.3 Issue Request for Proposals to FSPs, receive and appraise proposals based on business plans for presentation to IC with recommendations and standard agreements for signature by the IC upon approval.	Advisory Service: CTA
		2.4 Ensure disbursements to investees as per agreements, and monitor performance against targets set.	Micro Capital Grant – loan Micro Capital Grant - Grant Operational PIU: 4 National Staff, office equipment, 2 vehicles, rent, communication equipments, office consumable, Travel (DSA)
		2.5 Liaise with industry networks to compare progress in performance, monitor financial sector developments, and report semi-annually to IC and Programme Steering Committee with recommendations for follow-up.	Advisory Service: CTA Advisory Service: UNCDF
		2.6 Provide short-term technical assistance, training, and exposure visit directly to FSPs when urgent needs arise.	Advisory Support: short-term experts Training and Exposure Visit
Output 3 Enhanced business service infrastructures for the financial sector Private and public business service	<ul style="list-style-type: none"> - AMFITIL is formalized as a professional association (Y1) - AMFITIL functions as advocate for the NGO-MFIs serving poor and low-income customers (Y2) - AMFITIL membership has increased, and members meet minimum standards of 	3.1 Draft eligibility, selection, monitoring and reporting criteria and formats for the business support services (BSS) window of the FIF for adoption by the IC.	Advisory Service: Short-term expert
		3.2 Issue Request for Proposals to networks and BSS providers, receive and appraise proposals based on business plans for presentation to IC with recommendations and standard agreements for signature by the IC upon approval.	Advisory Service: CTA

Intended Outputs	Output Targets	Main Activities	Inputs
providers offering high-quality and market-responsive services to the financial sector are available in Timor-Leste, and a professional microfinance association (AMFITIL) is effectively representing the industry in policy dialogues, serving as an information hub for members and the public.	<p>portfolio quality and sustainability (Y3)</p> <p>- At least 3 private or public sector providers of high-quality business services to FSPs have established outlets in Timor-Leste (Y5). Priorities include Financial Literacy, credit reference, audit, and exploring potential for m-banking (cell phone transactions).</p>	3.3 Ensure disbursements to investees as per agreements, and monitor performance against targets set.	<p>Micro-Capital Grant - Grant</p> <p>Operational PIU: 4 National Staff, office equipment, 2 vehicles, rent, communication equipments, office consumable, Travel (DSA)</p>
		3.4 Liaise with regional BSS providers and industry networks to attract interest for the market.	<p>Strategic linkages and PR to regional BSS providers and network</p> <p>Exposure visit to TL</p>

Part IV. Management Arrangements

1. Management and Coordination Arrangements

Harmonization of UN funding will be achieved through Joint Programme Arrangements: This is a “Joint Programme”, as defined by the UN Development Group (UNDG), and associates UNDP and UNCDF as follows:

- For Donor and other third party co-financing, UNDP will act as Administrative Agent on behalf of both agencies, according to UNDG rules, and this will be reflected in (a) an inter-agency Memorandum of Understanding to be signed by both UNDP and UNCDF, and by other UN agencies which opt later to support this programme and (b) the Letter of Agreement signed between the Administrative Agent and Donor and other co-financing partners;
- In the course of implementation of this programme, and in monitoring and reporting on progress, UNDP, UNCDF and other future associated UN agencies will collaborate according to the regulations for Joint Programmes as these are issued by UNDG.

The administration of this Programme shall be governed by UNDP rules and regulations, which UNCDF also adopts, as defined in the Resource Management Guide within the policy context defined by the Executive Board.

UNCDF and UNDP will appoint a backstopping Programme Officer (PO) who will have responsibility for managing UNCDF, UNDP and pooled funds for the programme. The Programme Officer will, under the supervision of an Assistant Resident Representative of the Poverty Reduction and Environment Unit, oversee the quality of programme delivery.

The MoED is the Government counter-part of the INFUSE programme and chairs the IC of the FIF (See the annex 4 for the Term of Reference of the IC). In particular, it will lead the first programme component, “Output 1: A coherent policy framework for Inclusive Finance”, managing the consultative process on a vision for the sector.

Proposed Initial Membership: Investment Committee	
<i>Chair:</i>	Ministry of Economy and Development
<i>Members:</i>	<i>Representatives of:</i> Ministry of Agriculture and Fisheries Ministry of Finance Banking and Payment Authority (BPA) - Observer UNDP UNCDF ADB IFC USAID
<i>Secretariat</i>	Programme Implementation Unit

The BPA will serve as an observer to the IC to ensure that investments at the retail level are within the Government’s policy and regulatory framework.

The programme will establish the IC which will lead the FIF to coordinate funding to FSPs serving the lower-segments of the financial sector, networks, and business service providers in order to

make efficient use of public resources, avoiding duplication and over-subscription. Donors and private investors supporting financial retail or business service providers will be encouraged to join the IC. The IC will establish joint eligibility, selection, performance monitoring and reporting standards and criteria, and will receive business plans and funding proposals from FSPs and business services providers (See Annex 3 for TOR of the IC). The Programme Implementation Unit (PIU) will serve as a secretariat to the IC, carry out appraisals of proposals to facilitate review by the Committee, as well as monitor and report progress of investees to the Committee.

In addition, the IC and investees supported under the programme will meet at least once a year to review progress achieved; and actively discuss constraints and opportunities to support the development of an inclusive financial sector. These Annual Meetings shall be co-hosted by the chair of the IC (i.e. MoED). Recommendations emerging from these discussions will be referred to the respective bodies with the mandate to review and implement, where possible.

The PIU will be established and headed by the Chief Technical Adviser (see draft TOR for the CTA in Annex 4). In addition, three national staff will initially be recruited on time-bound service contracts for the Secretariat: a technical officer acting as Deputy CTA; a finance/administration officer; and a driver cum clerk. The CTA will prepare annual work plans and budgets and semi-annual progress reports for a) programme Management and Operations and b) Technical programme components respectively. To ensure equitable access, the Secretariat will be housed separate from any stakeholder.

2. Fund Management Arrangements

Fund management will be a combination of “parallel funding” (whereby UNDP and UNCDF manage their respective core funds through their separate business units) and “pass-through” (whereby Donor and other third party co-financing funds will be transferred to each of the two agencies according to their budget management responsibilities as detailed in the budget, through the intermediary of an Administrative Agent);

3. Risk Analysis and Mitigation Measures

The following table indicates summaries of risks and mitigation measures associated with INFUSE implementation.

Risks	Likelihood	Potential impact	Mitigation measures
Shortfall in reaching resource mobilisation target of USD 2,900,000	High	High	Donors will be invited to participate in the IC so that they can oversee programme performance. They can participate directly in financial decision-making by reviewing and approving grants to FSPs. The Programme will also seek the financial contribution from the Government (e.g. Ministry of Finance, Ministry of Economy and Development, etc.) to fill in the resource gap.
Lack of favourable institutional and policy environment for growth of the sector	High	High	One of the components in INFUSE is the policy-related activities; to support the government in drafting, reviewing and consulting related policies and legislations on Inclusive Finance. The Programme will engage the government and related authorities to achieve enabling environment for microfinance sector. In this process, it is important to ensure that a shared common vision is developed and shared among all stakeholders so that it could be fed into

			the other two components.
Insufficient demand from MFIs/FSPs for capacity building	Low	High	Consultation with MFIs/FSPs during formulation process showed strong interest in their capacity building. However, in order to ensure their commitment, the Programme will encourage MFIs/FSPs the importance of the capacity development through the implementation.
Sustainability of human resource in MFIs/FSPs (staff with appropriate skills do not stay for longer term.)	High	High	INFUSE aims at the sustainability of the MFIs/FSPs through its implementation, including their capacity development. In addition to the support through the FIF, short-term technical assistance, training and exposure visits will be provided (not through FIF) when urgent needs arise (opportunity-based). By doing so, staff are expected to stay at their existing organizations for longer-term.

4. Monitoring, Evaluation and Reporting

The programme will conduct regular monitoring of the Programme through the framework of the IC. The monitoring and evaluation activities will be participatory and all stakeholders are encouraged to be involved in the process.

The FSPs and business service providers receiving assistance under the FIF will submit quarterly progress reports to the IC Secretariat on performance against standard indicators and targets as set in the Grant or Loan Agreements as adopted by the IC. In addition, FSPs will post their data on the MIX Market³⁰ facilitating international exposure, and FSPs will consent to the MIX Market forwarding their data to the Micro Banking Bulletin (MBB) for global and regional benchmarking.

The CTA will prepare and submit a mid-year and annual progress reports (APRs), narrative as well as financial, to the IC. Specifically, the reports will include information on progress toward intended programme outputs: 1) the development of policy statement: 2) investments made by the IC: 3) results achieved by FSPs based on standard performance and financial indicators. In addition, the annual progress report will also cover issues of 4) constraints and opportunities for further development of the sector, 5) policy changes needed to remove the constraints or seize opportunities, and 6) lessons learnt.

The IC will approve the reports. The approved reports will be posted on UNCDF Microfinance Unit's website with links to other programme partners upon request.

The programme is subject to an independent evaluations (mid-term and final), managed by the UNCDF Evaluation Unit, to assess its overall performance, the outputs and outcomes produced against its initial targets, the impact it has brought or would likely to bring about with a focus on the progress toward sustainability of the FSPs, its relevance to the national context, and management efficiency. The evaluation will provide lessons learned and recommendations to improve programme performance or national policy for the next phase of the project. The mid-term evaluation should be completed and available before the end of the first phase of the project to provide input to management of the phase II.

The World Bank-initiated Financial Inclusion household data survey is proposed as a complement to this evaluation, feeding into the MDGs larger poverty reduction agenda, and helping the private sector identify opportunities for expanding access to financial services. The initial survey will serve as the baseline against which project performance takes place, with the follow-up

³⁰ <http://www.themix.org/en/index.html>. UNCDF will establish a UNCDF/UNDP dash-board under the MIX market to facilitate the entry of new and less experienced FSPs to the MIX.

survey measuring progress. By measuring financial exclusion and better understanding the reasons and nature of exclusion, policymakers will be better able to take appropriate policy actions. Programme funding will be available to support these surveys.

5. Cross-cutting Issues: Gender Mainstreaming

Numerous impact studies document that the ability to borrow, save, and earn income enhances poor women's confidence, enabling them to better confront systemic gender inequities.³¹ The INFUSE will ensure equal participation of both female and male in programme activities. Gender disaggregated data will be collected to monitor the programme progress.

While the FIF criteria for the selection of application and the performance monitoring will be agreed among IC participants, the UNDP and UNCDF will promote to include gender disaggregated data into procedures and guidelines that will ensure women participation in training programmes, workshops and seminars and consultation activities. Special consideration will be given to training techniques and schedules to ensure women participation in every stage of the process.

Part V. Legal Context

This document shall be the instrument referred to as such in Article 1 of the Standard Basic Assistance Agreement (SBAA) between the Government of the Democratic Republic of East Timor and the United Nations Development Programme, signed on 20 May 2002. The host country implementing agency shall, for the purposes of the Standard Basic Assistance Agreement, refer to the government co-operating agency described in the agreement. The following types of revisions may be made to this document with the signature of the UNDP Resident Representative only, provided he/she is assured that the other signatories of the document have no objectives to the proposed changes:

- Revision in, or addition to, any of the annexes of the document;
- Revisions which do not involve significant changes in the immediate objectives, outputs, or activities of the Programme, but are caused by the rearrangement of inputs already agreed to, or by cost increases due to inflation, and
- Mandatory annual revision, which re-phase the delivery of agreed inputs or increased expert or other costs due to inflation or take into account agency expenditure flexibility.

³¹ G8 and CGAP endorsed 11 key principles of microfinance: Key principle 2. www.cgap.org/keyprinciples.html. See also CGAP Donor Brief No.9, December 2002: Microfinance and the Millennium Development Goals. Several Impact studies by MFIs in Timor-Leste confirm these global findings.

Part VI. Annual Work Plan Budget Sheet

Work Plan for: (INFUSE – Inclusive Finance for the Under-Served Economy)

Period: Year 2008

Expected Output	Activities	TIME FRAME				RESPON -SIBLE PARTY	PLANNED BUDGET		
		Q 1	Q 2	Q 3	Q 4		Source of Funds	Budget Description	Amount
Achieving a policy/vision statement	Draft and consult on a national policy statement of Inclusive Finance for GoTL adoption as input to NDP2007-2012			x	x	UNCDF		63100 CTA	30,000
						UNCDF		71200 International Consultant	8,000
						UNCDF		71600 Travel	5,000
						UNDP		74200 Printing and Publication	5,000
						UNDP		Trainings and Workshops	5,000
						UNDP		74700 M&E	5,000
						UNDP		Facilities & Admin, etc.	16,200
Increased outreach of sustainable financial services	Mobilize additional investors for a FIF and IC			x	x	UNCDF		63100 CTA	30,000
	Establish and operationalise the FIF					UNCDF		71200 International Consultant	7,000
						UNCDF		71600 Travel	5,000
	Provide short-term technical assistance					UNCDF		72600 Grant and Loans	100,000
						UNDP		74700 M&E	5,000
						UNDP		Facilities & Admin, etc.	16,200
Promoting a business services infrastructure	Set-up and operationalise the business support services (BSS) window of FIF			x	x	UNCDF		63100 CTA	15,000
						UNCDF		71600 Travel	3,000
						UNCDF		72600 Grant and Loans	100,000
						UNDP		74700 M&E	2,200
						UNDP		Facilities & Admin., etc.	16,200

Work Plan for: (INFUSE – Inclusive Finance for the Under-Served Economy)
Period: Year 2009

Expected Output	Activities	TIME FRAME				RESPON -SIBLE PARTY	PLANNED BUDGET		
		Q 1	Q 2	Q 3	Q 4		Source of Funds	Budget Description	Amount
Achieving a policy/vision statement	Draft, review and consult on enabling Inclusive Finance	x	x	x	x	UNCDF		63100 CTA	40,000
	Draft good practice principles for sub-sector support by development partners					UNCDF UNCDF UNDP UNDP UNDP UNDP UNDP		71200 International Consultant 71600 Travel 74200 Printing and Publication Fellowships Workshops for stakeholders 74700 M&E Facilities & Admin., etc.	40,000 20,000 10,000 50,000 10,000 15,000 33,500
Increased outreach of sustainable financial services	Operationalise and monitor the FIF	x	x	x	x	UNCDF		63100 CTA	40,000
	Provide technical assistance to FSPs					UNCDF UNDP UNDP		72600 Grants and Loans 74700 M&E Facilities & Admin., etc.	700,000 15,000 33,550
Promoting a business services infrastructure	Operationalise and monitor the business support services (BSS) window of FIF	x	x	x	x	UNCDF UNCDF UNCDF UNDP UNDP		63100 CTA 71600 Travel 72600 Grants and Loans 74700 M&E Facilities & Admin., etc.	50,000 20,000 100,000 15,000 33,550

Work Plan for: (INFUSE – Inclusive Finance for the Under-Served Economy)
Period: Year 2010

Expected Output	Activities	TIME FRAME				RESPON -SIBLE PARTY	PLANNED BUDGET		
		Q 1	Q 2	Q 3	Q 4		Source of Funds	Budget Description	Amount
Achieving a policy/vision statement	Introduce microfinance best practices	x	x	x	x	UNCDF UNCDF UNDP UNDP UNDP UNDP UNDP UNDP		63100 CTA 71200 International Consultant 71600 Travel 74200 Printing and Publication Fellowships Workshops for stakeholders 74700 M&E Facilities & Admin., etc.	40,000 25,000 15,000 10,000 40,000 10,000 30,000 34,000
Increased outreach of sustainable financial services	Operationalise and monitor the FIF	x	x	x	x	UNCDF		63100 CTA	40,000
	Provide technical assistance to FSPs					UNCDF UNCDF UNDP UNDP		71200 International Consultant 72600 Grants and Loans 74700 M&E Facilities & Admin., etc.	20,000 600,000 30,000 34,000
Promoting a business services infrastructure	Operationalise and monitor the business support services (BSS) window of FIF	x	x	x	x	UNCDF UNCDF UNCDF UNDP UNDP		63100 CTA 71600 Travel 72600 Grants and Loans 74700 M&E Facilities & Admin., etc.	40,000 15,000 90,000 30,000 34,000

Work Plan for: (INFUSE – Inclusive Finance for the Under-Served Economy)
Period: Year 2011

Expected Output	Activities	TIME FRAME				RESPON -SIBLE PARTY	PLANNED BUDGET		
		Q 1	Q 2	Q 3	Q 4		Source of Funds	Budget Description	Amount
Achieving a policy/vision statement	Introduce microfinance best practices	x	x	x	x	UNCDF		63100 CTA	40,000
						UNCDF		71200 International Consultant	25,000
						UNCDF		71600 Travel	15,000
						UNDP		74200 Printing and Publication	10,000
						UNDP		Fellowships	40,000
						UNDP		Workshops for stakeholders	10,000
						UNDP		74700 M&E	15,000
						UNDP		Facilities & Admin., etc.	37,000
Increased outreach of sustainable financial services	Operationalise and monitor the FIF	x	x	x	x	UNCDF		63100 CTA	40,000
	Provide technical assistance to FSPs					UNCDF		72600 Grants and Loans	550,000
						UNDP		74700 M&E	15,000
						UNDP		Facilities & Admin., etc.	37,000
Promoting a business services infrastructure	Operationalise and monitor the business support services (BSS) window of FIF	x	x	x	x	UNCDF		63100 CTA	40,000
						UNCDF		71600 Travel	15,000
						UNCDF		72600 Grants and Loans	85,000
						UNDP		74700 M&E	15,000
						UNDP		Facilities & Admin., etc.	37,000

Work Plan for: (INFUSE – Inclusive Finance for the Under-Served Economy)
Period: Year 2012

Expected Output	Activities	TIME FRAME				RESPON -SIBLE PARTY	PLANNED BUDGET		
		Q 1	Q 2	Q 3	Q 4		Source of Funds	Budget Description	Amount
Achieving a policy/vision statement	Introduce microfinance best practices	x	x	x	x	UNCDF		63100 CTA	40,000
						UNCDF		71200 International Consultant	25,000
						UNCDF		71600 Travel	15,000
						UNDP		74200 Printing and Publication	10,000
						UNDP		Workshops for stakeholders	10,000
						UNDP		74700 M&E	30,000
						UNDP		Facilities & Admin., etc.	33,500
Increased outreach of sustainable financial services	Operationalise and monitor the FIF	x	x	x	x	UNCDF		63100 CTA	40,000
	Provide technical assistance to FSPs					UNCDF		72600 Grants and Loans	450,000
						UNDP		74700 M&E	30,000
						UNDP		Facilities & Admin., etc.	33,500
Promoting a business services infrastructure	Operationalise and monitor the business support services (BSS) window of FIF	x	x	x	x	UNCDF		63100 CTA	40,000
						UNCDF		71600 Travel	15,000
						UNDP		72600 Grants and Loans	75,000
						UNDP		74700 M&E	30,000
						UNDP		Facilities & Admin., etc.	33,500

Annex 1 Resource Mobilisation Budget and Detailed Component Budgets

Results	Year: 2008-2012 Award Title: INFUSE	Phase I		Phase II			Target Total
		2008	2009	2010	2011	2012	
Expected Output	Planned Budget	Year 1	Year 2	Year 3	Year 4	Year 5	
1. Achieving a Consolidated Policy Framework	CTA	30,000	40,000	40,000	40,000	40,000	190,000
	International Consultant	8,000	40,000	25,000	25,000	25,000	123,000
	Travel	5,000	20,000	15,000	15,000	15,000	70,000
	Printing and Publication	5,000	10,000	10,000	10,000	10,000	45,000
	Fellowships	0	50,000	40,000	40,000	0	130,000
	Workshops, stakeholder	5,000	10,000	10,000	10,000	10,000	45,000
	Monitoring & Evaluation	5,000	15,000	30,000	15,000	30,000	95,000
	Facilities & Admin	16,200	33,500	34,000	37,000	33,500	154,200
	Subtotal	74,200	218,500	204,000	192,000	163,500	852,200
2. Increased Outreach of Sustainable Financial Services	CTA	30,000	40,000	40,000	40,000	40,000	190,000
	International Consultant	7,000	0	20,000	0	0	27,000
	Travel	5,000	0	0	0	0	5,000
	Grants and Loans	100,000	700,000	600,000	550,000	450,000	2,400,000
	Monitoring & Evaluation	5,000	15,000	30,000	15,000	30,000	95,000
	Facilities & Admin	16,200	33,550	34,000	37,000	33,500	154,250
	Subtotal	163,200	788,550	724,000	642,000	553,500	2,871,250
3. Promoting a business services infrastructure	CTA	15,000	50,000	40,000	40,000	40,000	185,000
	Travel	3,000	20,000	15,000	15,000	15,000	68,000
	Grants and Loans	100,000	100,000	90,000	85,000	75,000	450,000
	Monitoring & Evaluation	2,200	15,000	30,000	15,000	30,000	92,200
	Facilities & Admin	16,200	33,550	34,000	37,000	33,500	154,250
	Subtotal	136,400	218,550	209,000	192,000	193,500	949,450
	AOS (7%, rounded)	26,200	85,800	79,600	71,800	63,700	327,100
	Subtotal by Phase I & II	1,711,400		3,288,600			
	TOTALS	400,000	1,311,400	1,216,600	1,097,800	974,200	5,000,000
	UNDP	200,000	0	100,000	100,000	100,000	500,000
	UNCDF	200,000	525,000	325,000	0	0	1,050,000
	Subtotal	400,000	525,000	425,000	100,000	100,000	1,550,000
	To be mobilized (Year)	0	786,400	791,600	997,800	874,200	3,450,000
	To be mobilized (Phase I & II)	786,400		2,663,600			3,450,000

Annex 2

Background note for setting of Outcome targets for INFUSE

1 Projections of market/demand based on current data										
		2004	2005	2006	2007	2008	2009	2010	2011	2012
A. Total population										
(census + 3.2% p.a.)	3.20%	924,642	954,231	984,766	1,016,278	1,048,799	1,082,361	1,116,996	1,152,740	1,189,628
HHs @ 4.7/HH		194,943	203,028	209,525	216,229	223,149	230,290	237,659	245,264	253,112
B. Econ active (51%)		471,567	486,658	502,231	518,302	534,888	552,004	569,668	587,898	606,710
C. Self-employed/BOP (87% of B)		410,264	423,392	436,941	450,923	465,352	480,244	495,611	511,471	527,838
C1. BOP HHs @ 4.7		87,290	90,083	92,966	95,941	99,011	102,179	105,449	108,824	112,306
C2. BOP HH decrease 7%						98,021	99,114	101,231	103,382	104,445
D. Poor (40% of A)		369,857	381,692	393,906	406,511	419,520	432,944	446,799	461,096	475,851
Poor HHs @ 4.7		78,693	81,211	83,810	86,492	89,260	92,116	95,064	98,106	101,245
Poor HHs decrease 5%						88,367	89,352	91,261	93,200	94,158
2 Current Supply data										
A. Total Savings Accounts		56,900	68,150							
A1. Total voluntary savings acc. (est)		40,500	59,875							
A2. Voluntary BOP savings acc.		17,000	35,000							
B. Total loans		27,816	34,100							
B1. Loans to BOP		18,750	21,800							
3 Projected targets for INFUSE financial services outreach										
A. Voluntary savings accounts			35,000	42,000	50,400	65,520	85,176	110,729	143,947	187,132 = 70% of tot HH
B. Loans to BOP			21,800	26,160	31,392	37,670	45,204	54,245	65,094	78,113 =70% of BOP HH

- Assumptions:
- 1) Non-Bank Financial Institution legislation in effect latest by 2008, and 2 MFIs transforming
 - 2) Growth rate for savings: 20% from 2006-2007, then 30% 2008-2012 per year compounded
 - 3) Growth rate for credit: 20% per year from 2006-2012 per year compounded

Annex 3

DRAFT TERMS OF REFERENCE

INVESTMENT COMMITTEE OF THE FUND FOR INCLUSIVE FINANCE

1. Rationale for the Fund for Inclusive Finance

The Fund for Inclusive Finance (FIF) is a Fund initiated by the Government, UNCDF and UNDP and supported by key donors and other stakeholders in the financial sector of Timor-Leste. The overall aim of FIF is to provide financial access to the poor and low-income population and to promote the development of an inclusive financial sector, characterized by:

- i) Access by all bankable households including the poor and low-income households and micro/small enterprises to a full range of financial services at a reasonable cost, including savings, short and long-term credit, mortgages, insurance, pensions, payments, local money transfers, international remittances, leasing and factoring;
- ii) Soundness of institutions, which is maintained through self-regulation and standard setting, performance monitoring by stakeholders and, where required, sound prudential regulation;
- iii) Financial and institutional sustainability ensuring the ability of FSPs to continue to provide access by customers to financial services over time;
- iv) Multiple providers of financial services, wherever feasible, to bring cost-effective alternatives to customers, including sound private, non-profit and public providers.

The FIF provides a coordinated donor-funding mechanism for grants and loan capital to financial service providers (FSPs), based on agreed Good Practice principles, in ways that would increase outreach, market responsiveness and sustainability.

In order to coordinate funding of FSPs serving in particular the lower-income segments of the financial sector, funders will be encouraged to join the IC of the Fund. The premise of pooling resources is to create efficiencies and better adherence to good practices, resulting in greater return in terms of outreach and institutional development impact per dollar invested.

2. Management Structure of the Investment Committee (IC)

Funders participating in the IC may do so through pooled funding arrangements through the UNDP/UNCDF joint programme account, or for parallel funding (coordinated arrangements). The goal will be to have funding decisions for the sector taking place within a coordinated framework in accordance with microfinance best practices³². To expedite programme payments, donors wishing to channel contributions to the Fund through the UNDP/UNCDF programme account, would be able to do so.

³² Best-practices in microfinance are reflected in the "Donor Guidelines on Good Practice in Microfinance, Building Inclusive Financial Systems" (www.cgap.org/docs/donorguidelines.pdf), and CGAP Focus Notes, Technical Papers, Consensus Guidelines and other publications www.cgap.org.

The Banking and Payments Authority of Timor Leste (BPA) will serve as non-voting observer to the IC. The role of the BPA will be to advise the committee if any potential investment is in line with government policy.

A Programme Implementation Unit (PIU) headed by a Chief Technical Advisor will serve as the Secretariat of the IC. Donors participating in the fund, in close consultation with the Programme Steering Committee (PSC), will jointly recruit the CTA.

2.1 Role of the Investment Committee in the Fund

The Investment Committee will provide a framework where donors/investors can:

- Receive business plans and funding proposals of FSPs;
- Jointly review potential investments; the IC will also review proposals received by individual donor agencies and submitted for additional technical review by the Secretariat;
- Complement relative strengths and weaknesses (provision of only technical assistance, grants, loans or equity) in order to tailor investment packages to the applicants;
- Utilize standard reporting and performance based contracts with FSPs;
- Review individual investments;
- Identify constraints and opportunities to building an inclusive, sustainable financial sector;
- Jointly supervise the technical assistance provided to participating FSPs;
- Jointly carry out needed technical reviews, evaluations, audits, field monitoring visits, etc. within a commonly (scheduled) agreed time period;
- Jointly review progress in building the enabling environment for sustainable microfinance and a general inclusive financial sector.

This arrangement will increase the cost-effectiveness of donor investments in the sector, while also minimizing transaction costs to FSPs seeking funding, and their Technical Partners.

2.2 Functions

- The IC meets at least annually or whenever at least two of its members request for an IC meeting. Members unable to attend may communicate their interest in funding a proposal via email, or via proxy to an attending member;
- The meetings will be convened by the FIF Secretariat at a venue to be decided by the Chair of the IC;
- The Secretariat will circulate all proposals and the institutional appraisals to all IC members at least four weeks in advance of meetings. The Secretariat will consult in advance with donors/investors on potential interest in funding a proposal, and will draft the agenda and minutes of the meetings;
- The agenda will be compiled after consultations with members of the IC at least one week in advance of the scheduled meeting;
- Any member of the IC may invite to discuss a specific issue on the agenda any one representative of any relevant institution not represented in the IC;
- The draft minutes of meetings will be distributed by the Secretariat not later than 7 days after each meeting. The IC will approve minutes at the subsequent meeting.

2.3 Guiding Principles for Funding

- Decisions to provide funding will be made on merit, and will not be subject to political or disbursement pressures;

- Decisions will be made by consensus to the greatest extent possible. Should consensus be unreachable on a specific issue, the voting members will take the final decision;
- If Proposals are deemed to be in violation of the Government's policy as advised by the BPA, applicants will be requested to provide amended proposals;
- Proposals may be approved on a multi-year basis if the IC determines that the business plan is adequate. For multi-year approvals, the performance agreements will note annual targets and the tranche of funding to be released. If the targets are met, the FSP need not reapply in future years.
- Funders participating in the IC agree to utilize uniform performance based agreements. Possible key indicators of minimum performance standards include:
 - Outreach: number of active borrowers and savers; portfolio size
 - Portfolio quality: Portfolio at Risk (PaR) @30 days;
 - Profitability/Sustainability: Adjusted Return on Assets (AROA) and Financial Self-Sufficiency
- Reporting requirements, using standard terms and definitions as developed by the Consultative Group to Assist the Poor (CGAP). Reporting will include a proxy for financial depth e.g. Average savings balance/GNP per capita; Average loans outstanding/GNP per capita; Percent of loans at or below GNP per capita.

The Secretariat will monitor performance of FSPs against the agreed indicators and targets, and will advise the IC, if a FSP appears non-compliant. Funders will have the right to cease support to an FSP, programme component or the programme if deemed necessary (non-fulfilment of performance criteria, misappropriation of funds). The decision should be discussed in the IC, or between the relevant donors in the case of support to a specific FSP.

3. Outline of Fund Operations

The Fund will have two windows through which funds can be channelled to recipients as grants or loans:

- 1] Support to individual FSPs (NGO-MFIs, Commercial Banks, Non-Bank Financial Institutions, Credit Unions, Credit Cooperatives, etc.)
- 2] Support to networks and business service providers for FSPs (Financial Literacy, AMFITIL, CUF, training/TA providers, auditors, raters, credit reference bureau, ICT, m-banking, etc.)

3.1 Criteria for Applications from FSPs

Proposals may be made from start-ups, institutions currently operating in the country, or those which are outside of the country but wishing to start operations.

In order to assess the scope of potential investments, the IC applies a set of progressively strict eligibility criteria for the loan and grant products made available, and disseminates information on these to the sector at large via the FIF Secretariat. The criteria are based on Good Practices, and include:

- Firm and demonstrated commitment to full financial sustainability, flexible product development, cost effectiveness and transparency;
- Disciplined management;
- Transparency, with donors, government, clients and the public having the right to know status;
- Reporting and accountability, with regular operational, financial and audit reports;
- Gender considerations, enabling the participation of women;

- Governance, sound structures suitable to the institutional type, and largely free from government and political interference;
- Contribution to the expansion of the low-income client base.

To establish an initial baseline of the potential return on investment to funders in the Timor Leste market, a time-specific first Request for Applications from FSPs will be made when the Fund is operational.

3.2 Appraisal and Approval of Investments to FSPs

A time-specific first Request for Applications from FSPs will be announced through the Secretariat to potential applicants.

Proposals received will be scored according to the following criteria:

- Outreach: Change in number of active clients (borrowers/savers), both male and female;
- Profitability: Trend in Adjusted Return on Assets, Financial Self-Sufficiency;
- Portfolio quality: Trend in PaR(30 days);
- Leverage: Amount of funding from other sources (donor grants, savings, loans, equity)/funding requested and change in value of loans outstanding/funding requested;
- Track record of applicant in producing stated results for requested funds in similar situations;
- Management, including staffing and institutional form;
- Financial frontiers: Rural sub-districts served and/or innovation in new products/services
- Regulatory/supervisory burden for BPA;

NGO-MFIs applying should indicate in their proposals if they have a technical partner supporting the proposal, and the funds dedicated to cover the costs of this technical assistance. Technical partners are encouraged to jointly sign proposals with their partner FSPs to indicate mutual commitment to meeting proposed targets.

For proposals that are deemed to meet the selection criteria, the Secretariat will provide an appraisal/analysis with a recommendation to the IC prior to the IC's formal review of the funding proposal. Before the first request for the application is issued, the IC may hire short-term technical consultants to provide the institutional scoring and appraisals, should the UNCDF CTA not yet be in place at the Secretariat. FSPs that require assistance in developing their business plan/proposal may request short-term technical assistance to do so.

3.3 Criteria for Applications from Business Support Service Providers

Proposals may be made from providers of technical assistance, training, and other business services to FSPs (e.g. financial literacy, audit, ratings, credit reference bureau, Cash-In-Transit service providers, Internet Communications Technology (ICT), m-banking, etc.), including private companies, private, public and professional institutes, universities, consultants and professional associations of FSPs currently operating in the country, or those which are outside of the country but wishing to start-up operations.

In order to assess the scope of potential investments, the IC applies a set of eligibility criteria for the grants made available, and disseminates information on these to the sector at large via the Secretariat. The criteria are based on Good Practices, and include:

- Financial Transparency: Contribute to the transparency of financial information to facilitate commercial investment;
- Sustainability: Encourage the long-term sustainability of the services market to gradually remove the dependence on subsidies. The FIF will therefore usually require co-investment by the provider, often as matching grants;
- Competitiveness: Encourage the entrance of a range of providers to ensure that services offered are competitively priced, and customer responsive;
- Specialization, Diversity and Innovation: Encouraging innovations that reduce transaction costs, provide specialization, and promote product diversity;
- Business transactions: Promoting business transactions between the provider and recipient of services, thus grants will often be placed on the demand-side of the equation, enabling recipients of services to pay providers directly.

3.4 Appraisal and Approval of Investments to Business Service Providers

As the nature and size of investments in the business services infrastructure will vary greatly, the potential return on investment in the Timor-Leste market will be assessed on an individual basis, but the IC can consider issuing a time-specific first Request for Applications from providers when the IC Secretariat is operational.

Upon receipt, in addition to the above noted criteria, proposals will be screened according to the following:

- Firm and demonstrated commitment to commercial viability, flexible product development, market responsiveness and cost effectiveness.
- Legal identity and experience;
- Relevance of and demand for proposed service to FSPs (additionality);
- Market outreach and competitiveness (market share and customer composition, current product range, current level of operation, research and development capacity);
- Quality of the governance structure and organizational set up (commitment of the leadership, capacity for planning and management);
- Credibility and stability of management (motivation and capacity of staff/management, experience and capacity to overcome constraints);
- Management information systems and internal controls in place;
- Financial performance and quality of projected financial plan.

Business services providers should indicate in their proposals if they have a technical working relationship with FSPs supporting the proposal, and whether funds from different sources are secured for parts of the proposal. Technical partners are encouraged to jointly sign proposals with their service providers to indicate mutual commitment to meeting proposed targets.

For proposals that are deemed to meet the selection criteria, the FIF Secretariat will provide an appraisal/analysis with a recommendation to the IC prior to the IC's formal review of the funding proposal.

4. Execution/Implementation Arrangements

UNDP and UNCDF will establish a joint programme account, with UNDP serving as the administrative agent. Other funders are encouraged to contribute through this account in order to 1) minimize disbursement pressure; 2) harmonize reporting; 3) reduce administrative costs; and 4) expedite payments and implementation.

Funders will ensure that either: 1] investments approved by the IC can be disbursed within two (2) weeks of approval; or 2] a certain percentage of committed funds is kept in the main project account established by UNDP/UNCDF. It will be replenished upon proof that the previous tranche will be adequately used. Donor funds will be expended annually approximating the percentage of funds placed under the IC's management in accord with IC approvals.

If needed, the IC will review these Terms of Reference to adjust them to changing realities and to ensure smooth implementation arrangements.

5. Reporting to Government

The IC Secretariat, as directed by the Investment Committee, will provide reporting on a semi-annual basis to the Government of Timor-Leste and stakeholders on:

- 1) Investments made;
- 2) Results achieved by FSPs based on standard performance and financial indicators;
- 3) Constraints and opportunities for further developing the sector;
- 4) Recommended policy changes needed to remove the constraints or seize opportunities.

These reports will also be posted on the UNCDF Microfinance Unit website with links to programme partners, based on request. UNCDF Microfinance Unit's webpage will list funder contributions by value of funds pledged/dispensed (in USD).

In addition, the IC will meet with stakeholders and investees supported under the programme once a year to review progress achieved; and actively discuss constraints and opportunities to support the development of an inclusive financial sector. These Annual Meetings shall be hosted by the chair of the IC. Recommendations emerging from these discussions will be referred to the respective bodies with the mandate to review and implement, where possible.

Annex 4

Draft Terms of Reference Chief Technical Advisor (CTA) Inclusive Finance for the Under-Served Economy (INFUSE)

1. Background:

An assessment of the Financial Services Sector in Timor-Leste³³ identified the following three current key constraints to the rapid expansion of the financial sector to reach the majority of the population:

Retail financial service providers (FSPs) need funding to improve their capacity to manage growth, risk and product development;

The absent business support infrastructure for the financial sector needs strengthening through support to networks and potential private sector business support providers; and

The policy framework for the sector needs clarification, streamlining and coordination through the development of a National Policy Statement on Inclusive Finance under which Government and donor agencies can realign and harmonize their hitherto fragmented support to the sector.

To address these constraints, UNCDF and UNDP in cooperation with the Government of Timor-Leste and other interested funding agencies will launch the Inclusive Finance for the Under-Served Economy (INFUSE) Programme in Timor-Leste in 2008³⁴. The Programme, which will run through 2012, will take a sector-wide approach, while focusing on increased access by the poor to sustainable financial services. The Programme goal is to contribute to the achievement of the Millennium Development Goals, in particular Goal 1 of cutting absolute poverty by an adjusted 30% by 2015³⁵, by increasing access to sustainable financial services especially for the poor and low-income people in Timor-Leste. The target is for Financial Service Providers (FSPs) to attain a minimum combined portfolio of 78,100 poor and low-income borrowers and 187,100 voluntary savings accounts by the end of Programme.

2. Expected Results:

The Chief Technical Advisor (CTA) will be contracted by UNCDF, and will have overall responsibility for establishing and managing the Programme to ensure that the results specified in the Programme Document are produced and documented against the indicators set. These results include:

1. Achieving a Coherent GoTL Policy Framework for Inclusive Finance

- 1.1. A national Policy Statement for Inclusive Finance is developed, broadly consulted and adopted by GoTL
- 1.2. Enabling legislation is in place to support the expansion and consolidation of the financial sector

³³ See Hansen and Agus: "Financial Services Sector Assessment", January 2005, <http://www.microfinancegateway.com/content/article/detail/24150> for a more detailed analysis of country context, supply and demand for microfinance, legal environment, prior assistance, government policy, opportunities and constraints, and stages of sector development.

³⁴ See UNCDF Program Document

³⁵ The global baseline year for achieving the MDGs is 1990, but Timor-Leste achieved independence only in 2001, which would therefore be a more appropriate baseline year for an adjusted reduction of poverty by one third rather than by 50%.

- 1.3. Coherent, effective and synergetic donor funding based on the national policy framework has been provided.
2. *Increasing the outreach by sustainable FSPs*
 - 2.1 A Fund for Inclusive Finance (FIF) is operational, providing demand-driven loans and grants to good practice-based FSPs serving primarily the poor and low-income market
 - 2.2. Supported FSPs have made clear progress towards sustainability and considerably increased scale as a result of having addressed institutional weaknesses.
3. *Enhancing the business services infrastructure for the financial sector*
 - 3.1 The FIF operates a grant funding window for providers of business support services to FSPs, including professional networks
 - 3.2 A professional microfinance Association (AMFITIL) is representing the NGO-MFIs in policy dialogues, and serving member's needs for information.
 - 3.3 At least three private or public sector business support services are available to FSPs in Timor-Leste.

3. Duties and Responsibilities:

In close consultation with an Investment Committee (IC) for the Fund for Inclusive Finance, and under the overall guidance of the UNCDF Microfinance Unit, the CTA is entrusted with the overall direction, implementation and management of the Programme. S/He shall organize, coordinate, supervise and administer the personnel and the resources of the Programme in line with UNDP's rules and regulations.

The CTA will accomplish the Programme results through a range of activities including, but not limited to the following:

3.1 Work Planning and Managing Technical Assistance Team:

- Prepare detailed annual workplans and budgets for IC approval. The workplans submitted will cover both the Technical components of the Programme as well as its Management and Administration, and clearly define indicators and targets for activities, as well as input of staff, short-term technical assistance (STTA) and other resources;
- Draft the Programme's Operations Manual for adoption by the IC;
- Establish the Programme Implementation Unit (PIU) in Dili, and provide general management and administration of the PIU, including identification, contracting and management of personnel, administration, and logistics;
- Retain full accountability for Programme finances and assets;
- Prepare a mid-year and annual progress reports (APRs), narrative as well as financial, on progress and results achieved for the Government and funders through the IC of the Fund;
- Establish and manage the institutional relationships of the Programme with the GoTL, Programme funders, and other stakeholders involved in the sector.

3.2 Technical Policy Advice to the Government of Timor Leste:

- Serve as technical advisor and secretariat to GoTL for the design and successful completion of a national vision/policy statement for inclusive finance, bringing together all stakeholders in one process;
- Based on the National Policy, assist GoTL in preparing inputs as required to the next National Development;
- Draft, disseminate, revise and present policy documents/legislation and provide analysis and advice to the GoTL as requested on how current policy, legislation and regulation could be improved and new policies be developed and consulted to remove

constraints and support the rapid development of an inclusive financial sector. Relevant policy areas for review would include, but not be limited to:

- NGO Law and Association/Foundation registration;
 - Banking and Non-bank financial institution legislation and regulations;
 - Other business legislation relevant to the Financial Sector;
 - Legislation and regulation for Credit unions and cooperatives.
- Identify potential constraints that could hinder the development of an inclusive financial sector, with microfinance as an integral part of the financial system. Ensure policy actions required are clearly identified for GoTL review and action, as needed. Monitor implementation of follow-up actions;
 - Assess and to the extent possible within the Workplan and budget meet training needs, including exposure visits to other countries with potential model policy frameworks for inclusive finance.

3.3 Technical Support to Donor Coordination Efforts

- In close cooperation with other financial sector support initiatives, notably the USAID/DAI DSP programme, ADB, World Bank, IFC and ILO, promote the development and adoption by all funders of Good Practice Principles for Donor Support in line with a GoTL National Policy on Inclusive Finance;
- Promote and assist in the development and adoption by all donor agencies of uniform procedures and formats for appraising, contracting and monitoring recipients of funding support, including in particular a joint reporting format for supported FSPs;
- Provide technical assistance to resident donor agencies as per request, e.g. to review applications received, and source and establish links to international finance sector development resources, notably CGAP and the World Bank/DFID Household data survey for Financial Inclusion.

3.4 Establish and Manage the Fund for Inclusive Finance:

- Prepare and design the Fund for Inclusive Finance (FIF) by drafting strategies and guidelines, policies and procedures, eligibility and selection criteria, Requests for Applications and application formats, formats for appraisal, approval, execution, disbursement, monitoring, reporting and completion of loan and grant investments to retail FSPs and (matching) grants to business support service providers, including professional networks, for adoption by the IC;
- Ensure consultations and broadest possible consensus on Fund design and strategies among potential investors, as well as other stakeholders including BPA and GoTL as represented in the PSC;
- Provide information on Fund activities to targeted FSPs and business services providers and other stakeholders, and identify potential FSPs and business services providers for investment, based on capacities for growth and potential to providing financial services in an efficient and financially viable manner;
- Assist applicants as needed to develop solid business plans and robust, performance-based proposals that could serve as the basis for FIF investment, and identify an appropriate blend of grants, loans, equity and technical assistance for FSPs and business services providers to meet agreed performance targets;
- Under the supervision of the IC, build, manage and administer the FIF portfolio of loans and grants to FSPs and business services providers based on screening and appraisals against criteria and procedures and format adopted by the IC, and supported by solid and verifiable financial documentation, and recording of progress of fund recipients against targets set.
- Ensure that funded FSPs have a MIS that can produce relevant and accurate on-time portfolio and financial data and meet FIF reporting requirements;
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The CTA is required to monitor progress of recipient institutions by reviewing and verifying quarterly reported results through field visits, prior to facilitating the posting of participating FSPs' results on the MIX Market website (www.themix.org).

3.5 Serve as Secretariat to the FIF Investment Committee (IC):

- Ensure the timely publication of FIF Requests for Applications, and receipt and screening of responsive applications;
- Liaise with IC members to determine funding interest in specific applications received;
- Promote the inclusion of new investors in the IC, recording and managing commitments, disbursements and programming of Fund contributions;
- Serve as Secretariat to the IC, ensuring that all required documentation is available to facilitate decision-making, and that performance-based agreements with FSPs and business service providers are available for signature upon approval by the IC;
- Manage the resources placed under the IC decision-making framework and provide financial reporting on resources/expenditures to IC members, including the certification of all funds released from the IC to FSPs, and based on sector funding needs, develop strategies to mobilize additional resources, or limit further funding placed under IC management;
- Manage UNDP, UNCDF and cost-sharing funds in Atlas (UNDP and UNCDF enterprise resource planning software) and oversee preparation of payments for UNDP and UNCDF approval;
- Annually, prepare multi-year projections estimating country demand and supply for financial services by the lower segment of the market, including analyses of any gaps in meeting funding needs (loans, grants, technical assistance, and equity) of FSPs and business services providers. Present options to catalyze sector development for the consideration of the IC.

3.6 Technical Support to Investees receiving funds from the FIF:

As part of the application appraisal process and during execution of investments, provide technical assistance as needed to funded FSPs and business services providers, based on their progress against targets to be met in the funding Agreements. This could include helping recipients to identify appropriate technical assistance providers in consultation with e.g. the Association of MFIs in Timor-Leste, AMFITIL, advising on the strengthening of FSP or network boards of directors and options for institutional/transformation, mergers etc., and assisting in the organization of information exchange events nationally or regionally between participating FSPs and lead FSPs in other countries.

4. Organization and Reporting

The CTA will be responsible for the programme secretariat, initially to be staffed with one national technical officer (the Deputy to the CTA) and one finance and administration officer as well as support staff.

The CTA will be answerable to the IC for the proper conduct and sound performance of the Programme. The CTA will report on progress against the targets set on a semi-annual basis to the IC on Fund activities and on all aspects of Programme Management and operations.

The CTA will be appointed as the Imprest Account Holder for the Operations and Administrative budgets for the Programme. All payments and receipts by the Programme will be verified by counter signature by the UN Resident Finance Officer in Dili.

5. Profile of Applicants for CTA

The CTA will hold a Master's degree from a reputable institution in finance or economics, and will have a minimum of 10 years relevant, practical working experience within the financial sector and/or microfinance, preferably in least developed countries (LDCs) similar to Timor-Leste. Experience from Timor-Leste or other Pacific island economies will be preferred. A dynamic, self-motivated personality with a sense of initiative, s/he will have the following skills and experience:

- Documented deep technical knowledge and experience in (Micro) Finance Good practices for industry building, and development of inclusive financial systems and products in emerging markets;
- Bank/MFI management, preferably in an emerging market;
- Strong financial analysis and appraisal skills;
- Demonstrated experience with FSP institutional development (financial, credit, and human resources management, MIS etc.);
- At least 3 years demonstrated experience in managing a development programme in the field of microfinance;
- Excellent organizational, inter-personal, communication and administrative skills, including solid experience in financial management;
- Fluency in written and spoken English, excellent computer skills. Knowledge of or ability to learn Tetun, Bahasa Indonesian and/or Portuguese is a distinct advantage;
- Familiarity with UN/UNCDF rules and procedures is an advantage.

6. Duty station and duration

The CTA will be recruited for an initial period of two years with a three month probation period. Extensions to the Contract can be envisaged pending performance reviews by the UNCDF, the FIF IC, but will in no case exceed a total of five years.

Duty station will be in Dili, Timor-Leste.

Annex 5 Illustrative Work Plan for Year 1

Description of main activities Year 1	Months				Months				Months			
	J	F	M	A	M	J	J	A	S	O	N	D
Mobilization of Resources (UNDP and UNCDF)	X	X	X	X	X	X						
Consultation of TOR for CTA and recruitment of CTA by International Competitive Bid (UNCDF)	X											
Drafting, consultation, adoption of FIF criteria and RFA for FSPs (UNCDF/IC)	X	X										
Issuing of RFA for FSPs with 45 days response time (UNCDF/IC)		X										
Drafting, consultation, adoption of Manual for FIF, including policies, procedures, formats (CTA/ST TA)	X	X										
Screening, scoring, appraisals of FSP applications (CTA/ST TA)				X								
Setting up of Secretariat, recruitment of national staff (CTA)				X	X							
1 st meeting of FIF IC approves investments (IC)						X						
FSP contracts signed, funds disbursed, component 2 (FSPs)						X						
Drafting, consultation, adoption of criteria (and RFA) for networks and BDS (CTA/IC)							X					
Screening, scoring, appraisals of network/BDS providers (CTA)									X	X		
2 nd meeting of FIF IC approves FSP/BDS investments, reviews progress										X		
Contracts signed, funds disbursed, component 3 (BDS)										X		
Vision for Inclusive Finance formulated for GoTL review											X	
Monitoring and reporting on FIF and programme progress							X	X	X	X	X	X