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Enabling poor rural people to overcome poverty

President's report

Proposed loan to the Republic of Uganda for the

Project for Financial Inclusion in Rural Areas

Note to Executive Board representatives

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For: **Approval**

Contents

Abbreviations and acronyms

CCA	Canadian Co-operative Association
CSCG	community-based savings and credit group
MFPED	Ministry of Finance, Planning and Economic Development
MTIC	Ministry of Trade, Industry and Cooperatives
PMU	project management unit
PROFIRA	Project for Financial Inclusion in Rural Areas
RFSP	Rural Financial Services Programme
RFSS	Rural Financial Services Strategy
SACCO	savings and credit cooperative
UCSCU	Uganda Cooperative Savings and Credit Union
VSLA	village savings and loan association
WOCCU	World Council of Credit Unions

Maps of the project area

Uganda

Project for Financial Inclusion in Rural Areas (PROFIRA)

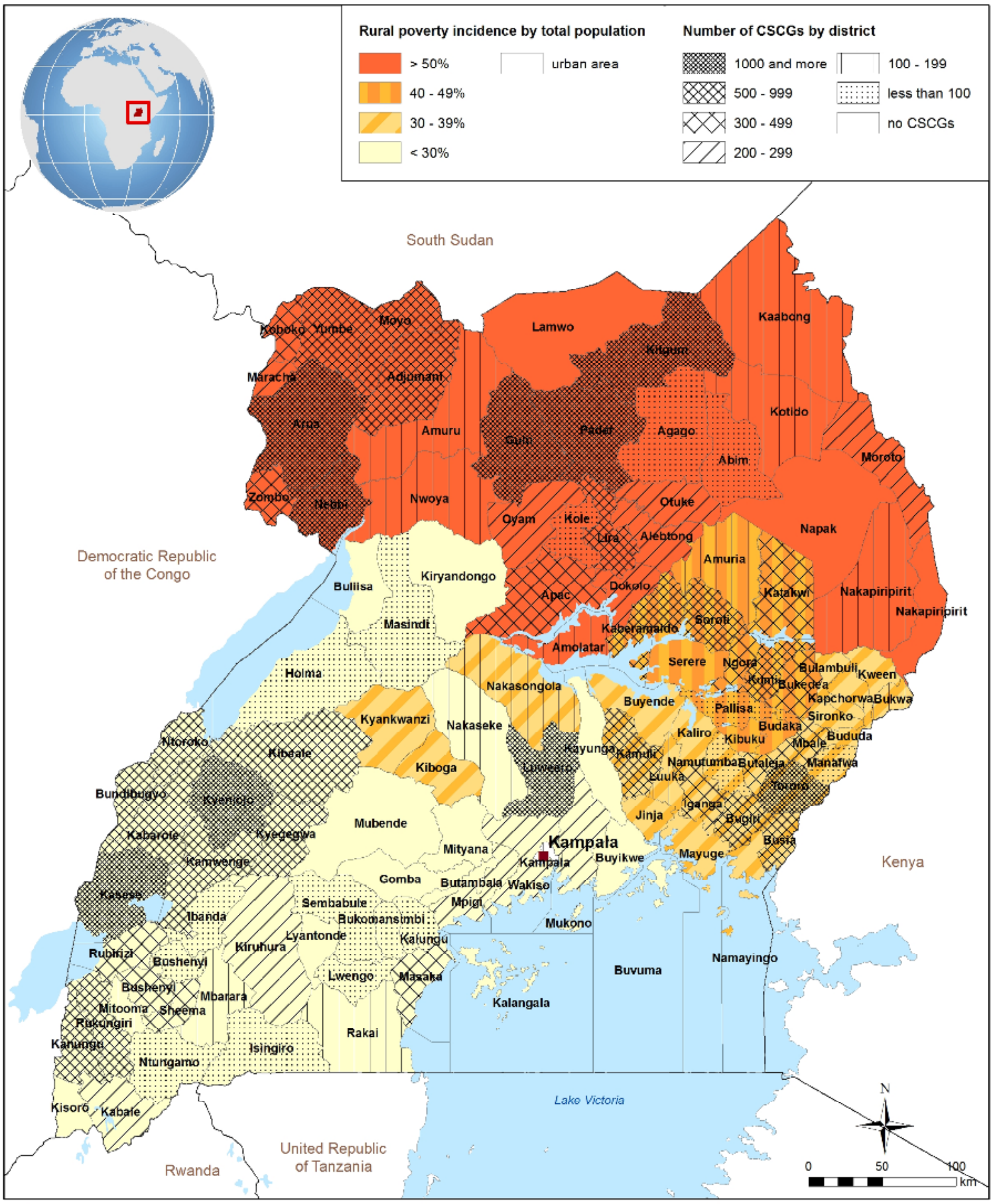
Location of Savings and Credit Cooperative Organizations (SACCOs)

IFAD *Map compiled by IFAD* | 05-11-2012

Uganda

Project for Financial Inclusion in Rural Areas (PROFIRA)

Rural poverty incidence and number of Community Savings and Credit Groups (CSCGs)



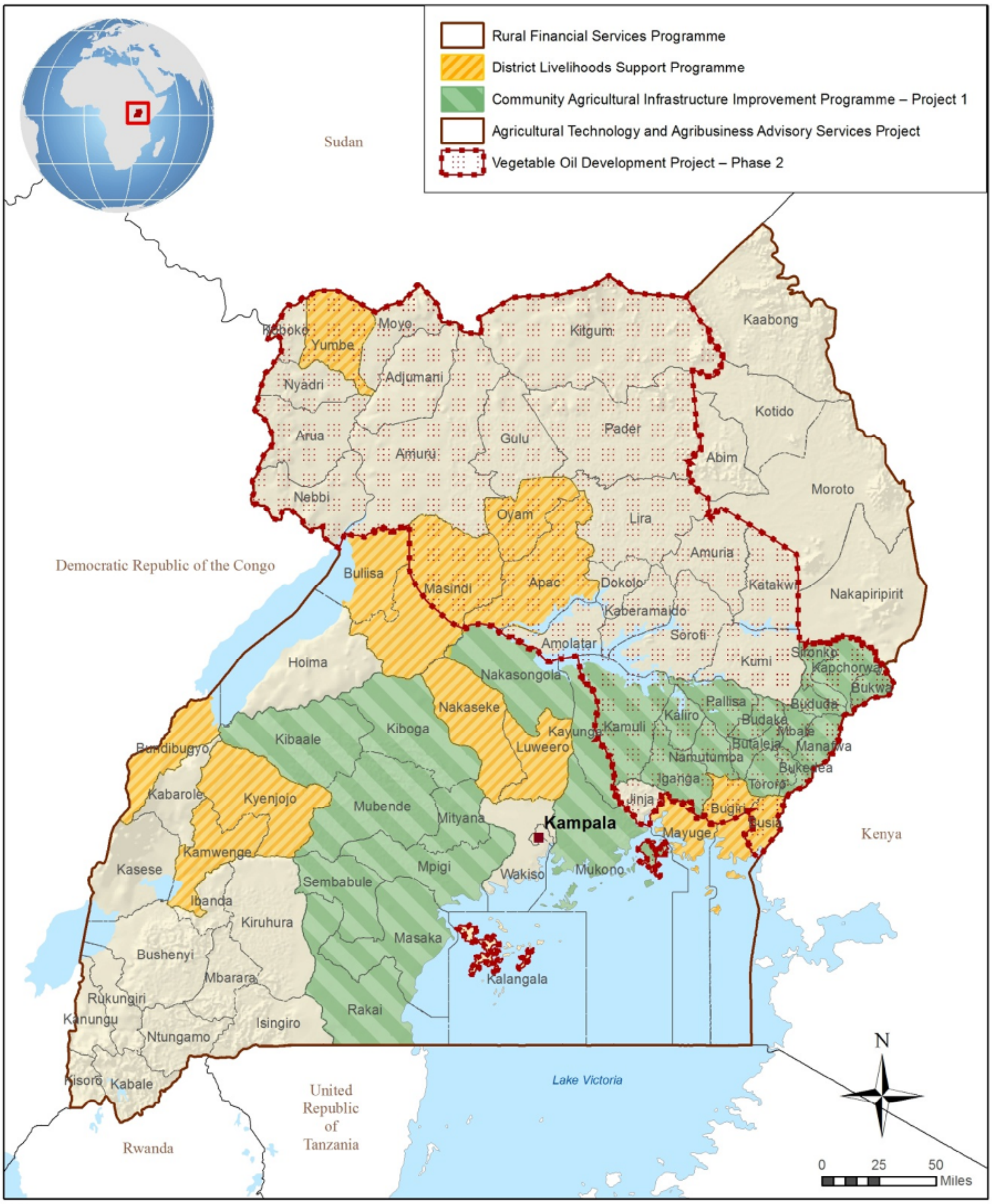
IFAD

The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.

Map compiled by IFAD | 15-03-2013

Uganda

Ongoing IFAD-funded operations



The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.

IFAD *Map compiled by IFAD* | 30-11-2012

Republic of Uganda

Project for Financial Inclusion in Rural Areas

Financing summary

Initiating institution:	IFAD
Borrower:	Government of Uganda
Executing agency:	Ministry of Finance, Planning and Economic Development
Total project cost:	US$36.6 million
Amount of IFAD loan:	SDR 19.3 million (equivalent to approximately US$29.0 million)
Terms of IFAD loan:	40 years, including a grace period of 10 years, with a service charge of three fourths of one per cent (0.75 per cent) per annum.
Cofinancier(s):	IFAD grant to the Canadian Cooperative Association(CCA) and the World Council of Credit Unions (WOCCU) (to be submitted separately for the approval of the Executive Board) CCA/WOCCU (partnership contribution)
Amount of cofinancing:	IFAD grant: US$1 million CCA/WOCCU: US$0.25 million
Terms of cofinancing:	Grant/partnership contribution
Contribution of borrower:	US$4.9 million
Contribution of beneficiaries:	US$1.4 million
Appraising institution:	IFAD
Cooperating institution:	IFAD

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed loan to Republic of Uganda for the Project for Financial Inclusion in Rural Areas (PROFIRA), as contained in paragraph 53.

Proposed loan to the Republic of Uganda for the Project for Financial Inclusion in Rural Areas

I. Strategic context and rationale

A. Country and rural development and poverty context

1. Over the past two decades, Uganda has experienced high economic growth and a significant decline in poverty. Growth accelerated from 6.3 per cent in the 1990s to an annual average of 7.0 per cent during the 2000s, among one of the highest growth rates in the world over the past two decades. By 2011, Uganda had already achieved its 2015 Millennium Development Goal (MDG) target of halving the proportion of the population living on less than one dollar a day, down from 53 per cent in 1993 to 24.5 per cent.

2. While the proportion of people living in poverty significantly declined, the reduction in the number of poor people was much less marked due to the high population growth rate. Based on 2009/2010 survey data, about 8.3 million Ugandans were poor and another 13 million were low-income and vulnerable and risked falling into poverty. Poverty remains mainly a rural phenomenon, with 34 per cent of the rural population living below the national poverty line, against 14 per cent of the urban population. Regionally, rural poverty levels are highest in the Northern Region (65 per cent) and the Eastern Region (40 per cent).

3. **Rural Finance.** As of 2009, only 15 per cent of the population in rural areas used banking services and just 7 per cent were served by other formal institutions. Nearly half of the population was relying on informal financial arrangements (mostly friends and relatives), while 31 per cent lacked access to finance of any kind.

4. On the supply side, the institutions currently providing financial services include: 23 commercial banks (tier 1), only two of which are involved in microfinance and rural finance; three credit and finance companies (tier 2), two of which have a predominantly rural/microfinance-based portfolio; four microfinance deposit-taking institutions (tier 3); plus 60-80 credit-only microfinance institutions and 3,000 registered savings and credit cooperatives (SACCOs), of which only about 2,000 are active (tier 4). At the lower end of the market, thousands of community-based savings and credit groups (CSCGs) operate at the village level in many areas of the country.

5. While there is a relatively broad range of financial intermediaries in Uganda, the supply of financial services to rural areas is still limited and falls significantly short of demand. Despite the large number of commercial banks, the country is characterized by low banking intermediation: key ratios such as deposits to GDP, credit to deposits and private credit to GDP are at considerably lower levels than many sub-Saharan African countries. Furthermore, lending-deposit interest spreads are high, financing for long maturities is rare, and the share of credit to agriculture is very low at around 6 per cent. At present, community-based financial institutions such as the SACCOs and CSCGs are the only financial intermediaries responding to the demand for financial services in most rural communities. These two types of

organizations represent the best opportunity as a first step towards expanding access to finance for the large majority of poor rural households.

6. **Strategic and policy framework.** In 2006, the Government introduced a Rural Financial Services Strategy (RFSS) aimed at establishing SACCOs in every sub-county in order to improve access to financial services in rural areas. The supply-driven top-down approach adopted and the injection of public funds through subsidized credit lines resulted in a focus on loans rather than savings, which undermined the financial sustainability of the SACCOs. The Department of Microfinance is currently engaged in a comprehensive evaluation of the RFSS with the aim of formulating a new strategy. At the same time, the Government is developing a new regulatory framework for tier 4 institutions, including SACCOs and other microfinance institutions, whose guiding principles were approved by the Cabinet in June 2013. Furthermore, the Bank of Uganda has initiated a Financial Inclusion Programme (2012-2015) to respond to the emerging issues of financial innovations, financial literacy and education, consumer protection and financial deepening.

B. Rationale and alignment with government priorities and RB-COSOP

7. There is limited coverage by financial institutions in many rural areas of the country, especially in the north, which was in conflict until recently, but also in other areas such as the centre. Formal financial service providers still reach less than 25 per cent of the rural population, while almost 50 per cent use informal financial arrangements and more than 30 per cent remain unbanked. There are large parts of the country where rural communities, and especially the rural poor, have no access to financial services.

8. The Government and IFAD share a common view regarding the development of the rural financial sector. Both recognize the continuing need to promote rural finance and see the focus on financial inclusion as a key pillar of Uganda’s efforts to eradicate poverty. The Government has realized the importance of fostering the development of community-level financial institutions such as CSCGs and SACCOs as an appropriate tool for financial inclusion, and also the need for a policy and institutional framework for the lower end of the financial service supply.

9. One of the three strategic objectives of IFAD’s country strategic opportunities programme (COSOP) 2013-2018 focuses on access to and use of financial services by the rural population. The emphasis is on facilitating the integration of the rural poor into financial systems by investing in community-based financial institutions as a first entry point to formal financial markets.

10. IFAD has developed a close partnership with the Government thanks to its involvement in the rural financial sector under the Rural Financial Services Programme (RFSP). PROFIRA will build on lessons learned under RFSP, and thereby consolidate the gains made and support selected SACCOs in achieving sustainability.

11. In parallel with the development of the SACCOs, there have been a series of initiatives led by a number of NGOs, some of which are supported by IFAD, to help establish grass-roots rural financial services and promote CSCGs. Given the success of these initiatives and the large number of communities still not reached by such programmes, the demand to establish more CSCGs is high.

12. The strength of SACCOs and CSCGs lies in their ability to generate savings, which in turn provide the foundation on which to extend loans to their members. These institutions are an essential element in invigorating the rural economy by making financial services available directly at the grass-roots level. The clients of SACCOs and CSCGs are rarely reached by higher-level institutions, and they therefore represent the primary and often only entry point to financial systems.

II. Project description

A. Project area and target group

13. The project target groups have been defined in terms of financial inclusion:

- The financially excluded, defined as rural women, men and youth who earn money but do not have access to any financial services, either formal or informal;
- Members of mature CSCGs who have successfully saved and borrowed within their group for at least three years, but do not use formal financial institutions; and
- Women and men who belong to rural SACCOs that are not yet operationally self-sustaining but have the potential to become sustainable.

14. The project's poverty targeting strategy focuses on two main elements: geographic targeting and social inclusion. The project will be implemented nationwide, but with specific areas of focus. These areas have not been identified as part of the design process; instead a set of rigorous criteria, including the level of poverty as a key criterion, has been agreed as the basis for selecting the participating SACCOs at project inception and the locations for establishment of CSCGs.

15. Social inclusion will be emphasized to ensure that the project is effectively focusing on the poor, and particularly on women and youth. Mechanisms will be used to facilitate their involvement in project interventions. In this respect, CSCGs are a self-targeting institution, as they naturally attract the poorest and most excluded members of rural communities. For SACCOs, specific activities are planned to increase the participation of poor households, women and youth as members.

B. Project development objective

16. The project development objective is to sustainably increase access to and use of financial services by the rural population.

C. Components/outcomes

17. The design of the project is driven by two key principles – outreach and sustainability. These principles are critical to developing sound financial institutions capable of serving rural communities and thereby enabling rural households in the poorer, more remote areas of the country to improve their economic activities and livelihoods.

18. **Component 1: SACCO strengthening and sustainability.** The component comprises two subcomponents that together aim to promote a dynamic and financially sound SACCO system in Uganda.

19. **Subcomponent 1.1: SACCO strengthening*.*** The subcomponent will work with approximately 500 selected SACCOs that have the potential to establish sustainable operations. Specifically, the subcomponent will provide a range of capacity-building support tailored to the needs and demands of individual SACCOs in order to improve management, governance, accountability and performance, and in the process expand membership. The capacity development element is designed to consolidate the achievements of RFSP-supported SACCOs, work with those assisted by other institutions, and also strengthen SACCOs that have not yet benefited from external support. Capacity-building will concentrate on eight areas, with the exact mix of training determined by the needs and demands of the individual SACCO: financial literacy, SACCO governance, business development skills, development /refinement of savings and other products, financial management, strategic planning, credit/default management and SACCO automation.

20. **Subcomponent 1.2: Developing a sustainable SACCO union.** The subcomponent will work with the Uganda Cooperative Savings and Credit Union (UCSCU) to enable it to develop into a strong, financially sustainable, member-based apex organization – a prerequisite for a healthy SACCO sector. This will entail reorganizing its internal structure, rationalizing staffing, strengthening its ability to provide relevant services to members and developing complementary income generating activities. In investment terms, the subcomponent comprises:

- Management/technical support. This will involve recruitment of a long-term expert for 3.5 years, supported by a team of short-term experts, to work with the UCSCU board, chief executive officer and management team on: board governance; executive professional development and mentoring; enterprise risk management systems development; institutional re-engineering; government and media relations; strengthening of the management information system and database; piloting of new business-focused initiatives; and development of the central financing facility.
- Performance-based incentives. The performance incentives will fund the annual operating loss as specified in the UCSCU strategic plan, which forecasts decreasing losses until breakeven is reached in five years. The annual release of the performance-based incentives will be linked to the achievement of annual performance benchmarks, measuring progress towards profitability.

21. **Component 2: Community-based financial services.** The main thrust of the component is the expansion of CSCGs using what is commonly referred to as the village savings and loan association (VSLA) methodology – a well-structured, disciplined and successful approach to providing access to financial services for poor rural communities. The project will encourage adaptation of the approach to respond to local conditions and opportunities.

22. **Subcomponent 2.1: Establishment of new CSCGs.** It is anticipated that approximately 15,000 groups will be set up in a phased manner over the seven years of the project. Each group will bring together some 25-30 people, most of whom will be among the poorest members of the community. The approach used will combine forming new groups within the community and working with existing self-help groups that have no structured savings and credit system.

23. In investment terms, the subcomponent will include contracts with service providers experienced in CSCG development. Contracts will be performance-based, specifically linked to the targets set out in the design document.

24. **Subcomponent 2.2: CSCG strengthening, innovations and partnerships.** This subcomponent will complement the previous one and open up opportunities for more mature and dynamic CSCGs with a sound and stable membership to develop ways to expand their operations within the microfinance arena. The subcomponent will support approximately 3,000 mature groups through: (i) advanced business development training, (ii) advanced financial literacy training, (iii) development of the CSCG model to encourage the accumulation/carry-over of group savings, (iv) focused and proactive support to form linkages with financial institutions; and (v) partnership-building between the CSCGs and other economic operators.

25. Experienced service providers will be invited to present project proposals along the lines described above.

26. **Component 3: Policy and institutional support and project management.** The third component will promote a healthy policy and institutional environment for community-based financial institutions and will manage project resources.

27. **Subcomponent 3.1: Policy, regulatory and institutional environment.** The subcomponent will support the establishment of a conducive policy and institutional environment for community-based financial institutions. To achieve this, the subcomponent will support three institutions that are key to the development of the sector: the Microfinance Department of the Ministry of Finance, Planning and Economic Development (MFPED); the Department of Cooperative Development of the Ministry of Trade, Industry and Cooperatives (MTIC); and the Bank of Uganda.

28. The main investments will focus on the following areas:

- Policy and institutional environment, to enable MFPED to develop a conducive framework for rural finance through support for: the passage and subsequent implementation of the new tier 4 regulatory framework; the formulation of the new strategic framework; and coordination among sector stakeholders.
- Monitoring and non-prudential regulation. The capacity of the Department of Cooperative Development will be strengthened to carry out its mandate to register and monitor SACCOs and enforce their compliance with statutory regulations.
- Implementing the National Financial Literacy Strategy. The Bank of Uganda will receive support to implement the strategy, specifically, to develop, translate and print posters, brochures and materials, and prepare training manuals to tailor national messages to SACCOs and CSCGs .

29. **Subcomponent 3.2: Project management.** This subcomponent will support the staffing and operations of the project management unit (PMU), including monitoring and evaluation, knowledge management and communication. The PMU will be under the responsibility of MFPED but will have its own management and staff structure.

III. Project implementation

A. Approach

30. The following principles define the project implementation approach:

- Poverty targeting. This is the foremost concern in the implementation of all project interventions and entails: (i) prioritization of the poorer areas of the country; (ii) inclusion strategies that focus on tailoring approaches to meet the needs of poorer, more risk-averse households; (iii) assistance in adapting innovative technologies to make them more suitable and accessible to poorer members of SACCOs and CSCGs; and (iv) self-targeting and tracking of CSCG members’ evolving status in terms of their level of poverty.
- Outreach and sustainability. Outreach is the key factor driving the CSCG component, while sustainability forms the cornerstone of SACCO development activities.
- Focus on gender and youth. This focus is reflected in the criteria and commitments specified in the tendering for CSCG support; the training programmes for the SACCOs, which are geared to the needs of youth and women; and the promotion of increased participation of women and youth in the SACCO expansion strategies.
- Competition and performance. These constitute a central principle in the tendering for project services and in identifying the best service providers. In addition, contracts will be performance-based to hold the service providers accountable for results.
- Synergies among activities and programmes. Synergy will be pursued through sessions that bring together SACCOs and CSCGs to develop a better understanding of complementarities and scope for mutually beneficial

initiatives. Joint planning and coordination with complementary IFAD projects will be encouraged to promote exchange and synergies and explore the lessons arising from such collaboration.

- Dealing with governance and corruption risks. The risk of corruption and patronage will be addressed through transparency of project procedures, clear accountability in implementation of project activities and proactive communication.

B. Organizational framework

31. The government agency responsible for the project will be MFPED, through its Microfinance Department. MFPED will provide policy direction, coordinate with other ministries and agencies, and chair the project oversight committee. MFPED will also be responsible for counterpart funds. MTIC will play an important supporting role.

32. A project oversight committee will be established to guide project planning and implementation, provide high-level advice, review and approve annual workplans and budgets (AWPBs), review implementation progress and impact, and address key strategic issues.

33. Day-to-day project management will be delegated to the PMU, which will be composed of a project coordinator reporting to the Permanent Secretary/Secretary to the Treasury; a SACCO team (including a SACCO development manager and a SACCO development specialist); a community-based financial services manager; a financial management team (including a financial controller, a procurement/contract manager and two accountants) and a monitoring and evaluation (M&E) and knowledge management team (including an M&E officer, an M&E assistant and a knowledge management and communications officer). The PMU will be in charge of the implementation of project activities and budgets in accordance with the AWPBs and procurement plans as approved annually by MFPED. A major part of its work will consist of managing a series of contracts with service providers, ranging from contracts for the formation and training of CSCGs, to the contracts for capacity-building and training of SACCOs, to the technical and management contract to assist UCSCU.

C. Planning, monitoring and evaluation, and learning and knowledge management

34. The project's planning and M&E arrangements adhere to IFAD's guidelines and experience. They will be built on the existing RFSP system and database, and are consistent with the system used by the MFPED. Knowledge management will generate lessons and capture key experiences to help inform replication and scaling up and provide the analytical basis on which to resolve project challenges.

D. Financial management, procurement and governance

35. The design of the financial management and procurement systems is based on the experience of RFSP and other IFAD-financed projects in Uganda. PROFIRA will use the national system for financial management (i.e. the Integrated Financial Management System), which has been reviewed by IFAD and was found to have strong control features for segregation of duties and budget control. Some gaps and weaknesses have been noted, specifically with regard to tracking cash advances and these will be monitored using appropriate accounting software. An audit firm, acceptable to IFAD, shall be appointed to provide internal audit services to mitigate any risk inherent in the management of the project, in particular in relation to budgeting, flow of funds and disbursement arrangements and internal controls, as these are areas that have been assessed by IFAD to be of high risk. The Internal Auditor, accredited as a professional accountant by a professional accounting body, shall provide work of adequate scope and quality by means of appropriately qualified staff and effective arrangements and will support full compliance with IFAD requirements. For the purpose of financial reporting the PMU will use the

expenditure categories as defined in the project design report. The Public Procurement Disposal Act of Uganda has also been reviewed by IFAD and found to provide an appropriate framework to ensure transparency, efficiency and accountability.

E. Supervision

36. PROFIRA will be directly supervised by IFAD.

IV. Project costs, financing, benefits

A. Project costs

37. Total project costs, including contingencies, are estimated at US$36.6 million (UGX 105.8 billion). Taxes and duties, completely financed by the Government of Uganda make up approximately US$4.9 million or 13.5 per cent of total project costs. Price contingencies account for US$5.3 million, or 17 per cent of base costs. Incremental recurrent costs represent 11 per cent of total costs. A summary of project costs by component is presented in the table below.

Table 1
Project costs summary by component

	(Local Million)					(USD '000)				
	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs
A. SACCO strengthening and sustainability										
SACCO strengthening	18 721	6 600	25 321	26	32	7 488	2 640	10 129	26	32
Developing a sustainable SACCO union	5 615	956	6 571	15	8	2 246	383	2 628	15	8
Subtotal	24 336	7 557	31 892	24	41	9 734	3 023	12 757	24	41
B. Community-based financial services										
Establishment of new CSCGs	13 997	5 738	19 735	29	25	5 599	2 295	7 894	29	25
CSCG strengthening, innovations and partnerships	6 252	2 563	8 815	29	11	2 501	1 025	3 526	29	11
Subtotal	20 249	8 300	28 550	29	37	8 100	3 320	11 420	29	37
C. Policy and institutional support and project management										
Policy, regulatory and institutional environment	3 271	1 342	4 612	29	6	1 308	537	1 845	29	6
Project management	3 141	10 009	13 150	76	17	1 256	4 004	5 260	76	17
Subtotal	6 412	11 351	17 763	64	23	2 565	4 540	7 105	64	23
	50 997	27 208	78 204	35	100	20 399	10 883	31 282	35	100
Physical contingencies	-	-	-	-	-	-	-	-	-	-
Price contingencies	20 406	7 190	27 597	26	35	4 354	993	5 347	19	17
Total	71 403	34 398	105 801	33	135	24 753	11 876	36 629	32	117

38. During negotiations, the Government requested IFAD to consider providing further support to the implementation of the new tier 4 regulatory framework recently approved by the Cabinet, in particular to the establishment of the envisaged Microfinance Regulatory Authority. It was agreed that this matter would be re-discussed after approval of the related law by Parliament, and possibly financed through a supplementary loan to PROFIRA.

B. Project financing

39. It is proposed that the project costs are financed by an IFAD loan of US$29.0 million and an IFAD grant of US$1.0 million; a government contribution of US$4.9 million equivalent, exclusively in taxes and duties; a beneficiary contribution of US$1.4 million equivalent; and a contribution by the grant recipient (Canadian Cooperative Association [CCA]/World Council of Credit Unions [WOCCU]) of about US$250,000 (see table below). The request for the IFAD grant of US$1 million to CCA/WOCCU, to finance the management/technical support to UCSCU under subcomponent 1.2, will be submitted separately to the Board for approval.

Table 2
Financing plan

	GoU		IFAD Loan		IFAD Grant		CCA/WOCCU		Beneficiaries		Total		For.	Local (Excl.	Duties &
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Exch.	Taxes)	Taxes
A. SACCO strengthening and sustainability															
SACCO strengthening	1 774	14.4	9 110	73.9	-	-	-	-	1 443	11.7	12 327	33.7	2 932	7 621	1 774
Developing a sustainable SACCO union	208	7.7	1 258	46.3	1 000	36.8	250	9.2	-	-	2 717	7.4	407	2 102	208
Subtotal	1 982	13.2	10 368	68.9	1 000	6.6	250	1.7	1 443	9.6	15 044	41.1	3 338	9 723	1 982
B. Community-based financial services															
Establishment of new CSCGs	1 346	14.2	8 132	85.8	-	-	-	-	-	-	9 478	25.9	2 513	5 620	1 346
CSCG strengthening, innovations and partnerships	633	14.2	3 823	85.8	-	-	-	-	-	-	4 456	12.2	1 141	2 682	633
Subtotal	1 979	14.2	11 955	85.8	-	-	-	-	-	-	13 934	38.0	3 654	8 302	1 979
C. Policy and institutional support and project management															
Policy, regulatory and institutional environment	372	17.2	1 787	82.8	-	-	-	-	-	-	2 158	5.9	580	1 207	372
Project management	602	11.0	4 891	89.0	-	-	-	-	-	-	5 493	15.0	4 304	587	602
Subtotal	974	12.7	6 677	87.3	-	-	-	-	-	-	7 651	20.9	4 884	1 793	974
	4 935	13.5	29 000	79.2	1 000	2.7	250	0.7	1 443	3.9	36 629	100.0	11 876	19 818	4 935

C. Summary benefit and economic analysis

40. It is estimated that some 750,000 members of SACCOs and CSCGs (58 per cent women) will participate in the project. Assuming that 90 per cent of the SACCOs supported are fully sustainable by the end of the project and that 20 per cent of the members of the SACCOs and CSCGs come from the same household, it is estimated that in total about 576,000 households will benefit fully from the project.

41. While the direct benefits will be in the form of expanded and improved access to financial services, the most important impact will be apparent where the increased loan and savings resources are used by members. As the economy in the project areas is based predominantly on agriculture, the expected impact of the project will be visible in terms of: increased agricultural income through enhanced use of improved inputs and other means of production; increased agriculture-related trade and commerce; and greater engagement in primary agricultural processing. The financial analysis shows clear financial benefits and positive returns from the various rural economic activities. These are expected to lead to higher incomes, improved food security and reduced vulnerability.

42. The economic rate of return (ERR) is estimated at 15 per cent; changes in key variables will not affect the economic viability of the project: a 20 per cent decrease or a two-year delay in benefits would reduce the ERR to 12 per cent.

D. Sustainability

43. Sustainability is a key underlying theme of the project, from enabling SACCOs to become sustainable institutions, to supporting UCSCU in evolving into an operationally and financially sustainable apex body, to promoting CSCGs that are responsive to the needs of poor rural communities and provide a sustainable way to secure savings and foster income generating opportunities.

E. Risk identification and mitigation

44. There are three main risks of relevance for the implementation of the project:

- SACCO sustainability. A high portion of project-supported SACCOs might not be able to attain financial sustainability and become dynamic and viable savings and credit institutions. The project has an ambitious target of 90 per cent in this respect. While there is a risk that a larger portion of the SACCOs could have trouble reaching sustainability, a careful selection of the beneficiary SACCOs from among the potentially sustainable organizations and proper tailoring of capacity-building to their individual needs will increase the likelihood of success.

- UCSCU sustainability. The UCSCU might lack the necessary commitment and capacity to develop into a business-focused institution and attain financial sustainability. The UCSCU's commitment will be measured against its own strategic and business plans, whose soundness and realism have been assessed during design. With strong management support, UCSCU management could be reoriented, the institution rationalized and restructured, and a solid income-generating base for the organization created. In any case, failure by UCSCU to reach long-term sustainability would not totally undermine the achievement of project outcomes in terms of the sustainability of individual SACCOs.

- Conducive policy framework. There are two policy-related risks: (i) the legislative vacuum regarding SACCOs' regulation due to the fact that the tier 4 regulatory framework has not yet been approved by Parliament; and (ii) the success of community savings and credit groups and their broad coverage in rural communities could result in politically motivated injection of funds, resulting in loss of social cohesion and internal trust and dissolution of the groups. The project will support the Government in all the steps necessary to ensure the paper on the tier 4 regulatory framework, now approved by Cabinet, is presented to Parliament approval. Regarding the CSCGs, close dialogue at senior level during the design process has been fruitful and the current position of MFPED is supportive of the spontaneous development of CSCGs, excluding external government injection of funds. Appropriate covenants have been included in the financing agreement in order to protect the envisaged investment from possible policy changes during project implementation.

V. Corporate considerations

A. Compliance with IFAD policies

45. The project is consistent with and supportive of the key IFAD policies and strategies, in particular: the Rural Finance Policy; the Gender equality and women's empowerment policy; the Targeting Policy: Reaching the Rural Poor; the Innovation Strategy; and the Strategy for Knowledge Management.

B. Alignment and harmonization

46. PROFIRA is fully aligned with the overall strategic framework set by the National Development Plan. Enhancing access to financial services in rural areas is a key building block of the strategy to transform Uganda from a peasant to a modern society. The current Rural Financial Services Strategy is being reviewed and there is large consensus among senior policymakers that this strategy is obsolete and that the new strategic orientations will be based on a more market-oriented approach, with an emphasis on financial inclusion and institutional sustainability. These are the key principles driving the design of PROFIRA.

47. Most development partners gradually withdrew from the sector after the policy change in 2006-2007 that made the environment less conducive for investment in micro and rural finance. The current indications about the likely return to a more market-oriented policy framework have made some partners regain interest in the sector. Some of the key partners (the United Kingdom's Department for International Development [DFID] and the German Agency for International Cooperation [GIZ]) have engaged in the design of PROFIRA as members of the task force that steered the process. As a result, PROFIRA is closely harmonized with the investment programmes of the major players in the sector. There is an increasing need for coordination among development partners and with the Government. In this respect, the current Private Sector Development Partners' Group, of which IFAD is an active member, is expected to play an important role.

C. Innovations and scaling up

48. Scaling up is embedded in the PROFIRA design, as this project builds on the lessons emerging from previous investments by IFAD and others. The project will scale up community savings and credit groups as a powerful mechanism for financial inclusion of the rural poor. These groups were already successfully

promoted in Uganda by a few organizations, including the Ugandan Women's Effort to Save Orphans through an IFAD grant that was rated as very successful by the country programme evaluation. In addition, the project will build on the experience of the RFSP and apply it to support SACCOs in reaching sustainability, including by investing in the creation of the policy and institutional space needed to ensure the long-term sustainability of the whole subsector.

D. Policy engagement

49. Through its consistent engagement in support of the rural finance sector, even when most of the other development partners had withdrawn following the policy change of 2006-2007, IFAD has built a considerable reputation with the Government as a supportive and credible partner. For this reason, in PROFIRA the Government requested the inclusion of support for key policy and institutional processes such as: (i) the operationalization of the new tier 4 regulatory framework; (ii) the elaboration by MFPED of the new strategic framework for micro and rural finance; (iii) the revitalization of the Microfinance Forum, chaired by the MFPED, as the main space for dialogue among the different sector stakeholders; and (iv) capacity-building to help UCSCU become a self-sustainable apex body for SACCOs.

VI. Legal instruments and authority

50. A financing agreement between the Republic of Uganda and IFAD will constitute the legal instrument for extending the proposed financing to the borrower. A copy of the negotiated financing agreement is attached.

51. The Republic of Uganda is empowered under its laws to receive financing from IFAD.

52. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the Lending Policies and Criteria.

VII. Recommendation

53. I recommend that the Executive Board approve the proposed financing in terms of the following resolution:

> RESOLVED: that the Fund shall provide a loan on highly concessionary terms to the Republic of Uganda in an amount equivalent to nineteen million three hundred thousand special drawing rights (SDR 19,300,000), and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Kanayo F. Nwanze
President

Negotiated financing agreement

(Negotiations concluded on 11 July 2013)

Loan Number: ______________________

Project Title: Project for Financial Inclusion in Rural Areas (the "Project")

The Republic of Uganda (the "Borrower")

and

The International Fund for Agricultural Development (the "Fund" or "IFAD")

(each a "Party" and both of them collectively the "Parties")

hereby agree as follows:

Section A

1. The following documents collectively form this Agreement: this document, the Project Description and Implementation Arrangements (Schedule 1), the Allocation Table (Schedule 2), and the Special Covenants (Schedule 3).

2. The Fund's General Conditions for Agricultural Development Financing dated 29 April 2009, as may be amended from time to time (the "General Conditions") are annexed to this Agreement, and all provisions thereof shall apply to this Agreement, except for the provisions identified in Section E paragraph 2 below. For the purposes of this Agreement the terms defined in the General Conditions shall have the meanings set forth therein.

3. The Fund shall provide a Loan to the Borrower (the "Financing"), which the Borrower shall use to implement the Project in accordance with the terms and conditions of this Agreement.

Section B

1 The amount of the Loan is nineteen million three hundred thousand Special Drawing Rights (19 300 000 SDRs).

2 The Loan is granted on highly concessional terms as provided for in Article 5.01(a) of the General Conditions.

3. The Loan Service Payment Currency shall be United States Dollar.

4. The first day of the applicable Fiscal Year shall be 1 July.

5. Payments of principal and service charge shall be payable on each 1 June and 1 December.

6. There shall be a Designated Account denominated in United States Dollars and an Operational Account denominated in Ugandan shillings for the benefit of the

Ministry of Finance, Planning and Economic Development (MFPED). Both accounts shall be in the Bank of Uganda.

7. The Borrower shall provide counterpart financing to cover for taxes and duties which are estimated at four million nine hundred thousand United States Dollars (USD 4 900 000).

Section C

1. The Lead Project Agency shall be MFPED.

2. The following are designated as additional Project Parties: the Ministry of Trade, Industry and Cooperatives (MTIC), the Bank of Uganda (BoU), the Uganda Cooperative Savings and Credit Union (UCSCU), and the Uganda Cooperative College, Kigumba.

3. The Project Completion Date shall be the seventh anniversary of the date of entry into force of this Agreement.

Section D

The Loan shall be administered and the Project supervised by IFAD.

Section E

1. The following are designated as additional specific conditions precedent to withdrawal:

i. The Borrower shall constitute a Project Management Unit (PMU) acceptable to the Fund and in accordance with Schedule 1; and

ii. No withdrawal shall be made for Subcomponent 1.2. prior to approval of the IFAD grant as specified in Schedule 1.

2. Section 4.08(a)(ii) of the General Conditions shall be amended as follows:

The expenditure shall be incurred during the Project Implementation Period, except that expenditures to meet the costs of winding up the Project may be incurred after the Project Completion Date and before the Financing Closing Date. In addition, expenditures incurred after the approval of the Project by IFAD's Executive Board but before the Project Implementation Period are eligible for retroactive financing upon meeting the following conditions:

i. The maximum amount of retroactive financing shall be one million United States Dollars (USD 1 000 000);

ii. Retroactive financing for each category of expenditure shall not exceed the amount specified in Schedule 2; and

iii. The expenditure eligibility criteria defined under Section 4.08 of the General Conditions must be satisfied.

3. The following are the designated representatives and addresses to be used for any communication related to this Agreement:

For the Fund:

President
International Fund for
Agricultural Development
Via Paolo di Dono 44
00142 Rome, Italy

For the Borrower:

Ministry of Finance, Planning
and Economic Development
Plot 2/12 Apollo Kaggwa Road
P.O. Box 8147
Kampala
Uganda
Fax:+(256) 414-343023

This Agreement, dated _______, has been prepared in the English language in six (6) original copies, three (3) for the Fund and three (3) for the Borrower.

The Republic of Uganda

____
[Name of the Authorized Representative]
Title
Ministry of Finance, Planning and Economic Development

International Fund for
Agricultural Development

____
Kanayo F. Nwanze
President

Schedule 1

Project Description and Implementation Arrangements

I. Project Description

1. *Objectives*. The goal of the Project is to increase income, improve food security and reduce vulnerability in rural areas. The development objective is to sustainably increase the access to and the use of financial services by the rural population.

2. *Target population*. The Project shall benefit rural women, men and youth who earn money but do not use any formal or informal financial services; members of mature community savings and credit groups (CSCGs) who have successfully saved and borrowed within their informal groups, but do not yet make use of formal financial institutions; and members of rural savings and credit cooperatives (SACCOs) that are not yet but have the potential to become operationally self-sustaining.

3. *Components*. The Project shall consist of the following components:

Component 1: <u>SACCO Strengthening and Sustainability</u>

Sub-component 1.1 - SACCO strengthening. Provide support to about 500 SACCOs in the form of capacity building for management, staff, board members and SACCO members to enhance their operations and sustainability.

Sub-component 1.2 - Developing a sustainable SACCO union. Provide support to UCSCU thereby allowing UCSCU to develop into a strong, member-based SACCO apex organization. The Loan investment for this subcomponent shall be subject to the approval of an IFAD grant to international cooperative organizations tasked to provide technical assistance to UCSCU.

Component 2: <u>Community Based Financial Services</u>

Sub-component 2.1 – Establishment of new CSCGs. Facilitate the establishment of about 15 000 CSCGs through the contracting of service providers.

Sub-component 2.2 – CSCG strengthening, innovations and partnerships. Provide support to about 3 000 mature CSCGs to develop their operations in microfinance and/or link with other financial institutions.

Component 3: <u>Policy and Institutional Support and Project Management</u>

Sub-component 3.1 - Policy, regulatory and institutional environment. Provide support to the relevant authorities for establishing a conducive policy environment for rural finance, with emphasis on community-based financial institutions.

Sub-component 3.2 – Project management. Provide support for the staffing and operations of the PMU.

II. Implementation Arrangements

1. The Permanent Secretary/Secretary to the Treasury (PS/ST) shall have the primary responsibility of supervising Project implementation. Operational responsibilities for day-to-day management shall be delegated to the PMU.

2. Operational responsibilities for project implementation shall include, but shall not be limited to: planning; reporting; monitoring project progress and impact; and financial management, including procurement, disbursement and accounting.

3. The PMU shall be composed of a team of individuals contracted by MFPED and managed by a Project Coordinator who shall be supervised by the PS/ST.
The key PMU staff shall include: a Project Coordinator; a Financial Controller; a Monitoring and Evaluation Officer; a SACCO Development Manager; and a Community Based Financial Services Manager.

The PMU staff shall be appointed by MFPED subject to prior approval by the Fund. Individual staff members shall be selected from the Project Administration Unit of the Rural Financial Services Programme (RFSP), if an objective assessment of the candidate's performance confirms their suitability for the PMU position. Where no suitable candidate is identified, recruitment shall be carried out through an open competitive process.

4. A Project Oversight Committee (POC), to be chaired by MFPED, shall be established with members from public and private institutions that are relevant to the Project's implementation. The POC shall guide Project planning and implementation; review implementation progress; approve all relevant documents including the Annual Work Plans and Budgets; and provide high level advice to project management on key policy and strategic issues.

Schedule 2

Allocation Table

1. *Allocation of Loan Proceeds.* (a) The Table below sets forth the Categories of Eligible Expenditures to be financed by the Loan and the allocation of the amounts of the Loan to each Category and the percentages of expenditures for items to be financed in each Category:

Category	IFAD Loan Amount Allocated (expressed in SDR 000s)	Percentage of Eligible Expenditures to be Financed
Equipment and Materials	190	100% net of taxes
Other investment costs	14 910	100% net of taxes
Operating costs	2 270	100% net of taxes
Unallocated	1 930	
TOTAL	19 300	

(b) *The terms used in the Table above are defined as follows:*

Category II. Other investment costs include technical assistance, training and mentoring support mainly for SACCOs and CSCGs as well as support to the policy framework.

Category III. Operating costs include salaries and allowances and other operating costs.

Unallocated. This is not a Category of Eligible Expenditures available for disbursement. Unallocated funds are available only for reallocation to the Categories of Eligible Expenditures.

2. Retroactive financing. In accordance with Section E of this agreement, retroactive financing shall be limited to USD 1 000 000 for Categories II and III only.

Schedule 3

Special Covenants

In accordance with Section 12.01(a)(xxiii) of the General Conditions, the Fund may suspend, in whole or in part, the right of the Borrower to request withdrawals from the Designated Account if the Borrower has defaulted in the performance of any covenant set forth below, and the Fund has determined that such default has had, or is likely to have, a material adverse effect on the Project:

1. *Conducive Framework for Project Activities*. The Borrower shall ensure that the strategic and policy framework is conducive for the project investment, with particular, though not exclusive, reference to: (i) a legislation on the regulation of Tier 4 institutions that ensures an appropriate governance framework for such institutions as well as the protection of people's savings; and (ii) a policy framework for Government to facilitate the development of CSCGs without directly interfering in their operations, including through the injection of external capital.

2. *Project Implementation Manual*. The Borrower shall ensure that a project implementation manual (PIM) be submitted to the Fund for its comments and No Objection and subsequently finalized by the PMU within nine (9) months from the date of entry into force of this Agreement.

3. *Project Oversight Committee*. The Borrower shall establish within six (6) months from the date of entry into force of this Agreement the POC as outlined in Schedule 1.

4. *Contracts Committee*. The Borrower shall establish within six (6) months from the date of entry into force of this Agreement a PROFIRA Contracts Committee with fully delegated powers from MFPED, with a composition acceptable to the Fund and the required authority to undertake procurement review and selection. The Borrower shall also ensure the continuing operation of the PROFIRA Contracts Committee and shall not alter its composition without first consulting the Fund for the duration of the Project Implementation Period.

5. *Project Management Unit*. Without prejudice to provisions in the Borrower's national legal system, the Borrower shall ensure the continuing operation of the PMU for the duration of the Project Implementation Period and shall further ensure that no key staff of the PMU be dismissed or replaced without first obtaining approval from the Fund.

6. *Planning, Monitoring and Evaluation*. The Borrower shall ensure that the PMU develops a Planning, Monitoring and Evaluation (PM&E) system compatible with the IFAD Results and Impact Management System within twelve (12) months from the date of entry into force of this Agreement, thereby allowing for the appropriate determination of the outcomes and impact of the Project components. A base line survey shall be undertaken within nine (9) months from the date of entry into force of this Agreement.

Logical framework

Results Hierarchy	Indicators	Means for Verification	Risks (R) & Assumptions (A)
Goal. Increase income, improve food security and reduce vulnerability in rural areas	1. 20% of the rural poor in the selected project intervention areas with improvements in assets ownership index at project completion 2. 20% reduction in the prevalence of child malnutrition in rural households, by gender	RIMS baseline and impact study	
Development Objective. To sustainably increase the access to and use of financial services by the rural poor	3. 750 000 men, women and youth are active members of project supported SACCOs and CSCGs	M&E data Progress out of poverty studies	(A) Dynamic economy creates opportunities for investment in enterprises and other income generating activities
Component 1. SACCO strengthening and sustainability			
Outcome 1. SACCOs provide enhanced levels of services to more members	4. 300 000 members of project supported SACCOs (of which 150,000 new - 30% women [non-youth], 15% youth) actively save increasing amounts (min. 50% average increase per SACCO by PY5) and repay SACCO loans 5. At least 80% of project supported SACCOs offer at least 2 savings and 3 loan products to their members	M&E data; service provider reports	(A) Conducive Tier IV regulation passed (R) MITC not able to provide effective regulation /support to SACCOs
Output 1.1 Sustainable SACCOs providing financial services in rural areas **Output 1.2** UCSCU provides sustainable services to members	6. At least 90% of project supported SACCOs attain operational sustainability (OSS ≥ 100%) by project end 7. UCSCU has sustainability of operating income, covering 100% of operating expenses by PY5.	M&E data; service provider reports UCSCU annual report	(R) Project supported SACCOs not able to attain financial sustainability (R) Failure of UCSCU to attain operational sustainability after five years undermines conducive environment for SACCOs
Component 2. Community based financial services			
Outcome 2. Increased outreach of sustainable and dynamic community based financial services in poor and underserved areas	8. 375 000 members of newly created CSCGs actively save in the groups (70% women; 15% youth), with increasing amounts of weekly savings and annual pay-outs in each annual cycle 9. 75,000 members of mature CSCGs have access to improved financial services and have availed themselves of at least one such service (credit, savings or insurance)	M&E data; service provider reports	(R) Self-help group policy paper allows injection of external government financing into community savings and credit groups (A) Targeting poor and underserved areas will ensure inclusion of poor rural people.
Output 2.1 New CSCGs with trained and cohesive membership operational **Output 2.2** Mature CSCGs with advanced methods and linkages developed	10. 15 000 new CSCGs established by end of project 11. 90% of CSCGs formed are operational after 3 years 12. 3 000 mature CSCGs (75 000 members) have improved skills and are exposed to more advanced financial services	M&E data; service provider reports	(R) Lack of willingness of formal financial service institutions to make services and loan financing available to CSCGs and their members
Component 3. Policy and Institutional Support and Project Management			
Output 3.1 Strengthened regulatory framework for SACCOs	13. At least 90% of project supported SACCOs are audited annually by qualified auditors.	SACCO audited accounts & progress	