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IFAD
Investing in rural people

President's report

Proposed loan and grant to the Republic of Malawi for the Financial Access for Rural Markets, Smallholders and Enterprise Programme

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For: Approval

Contents

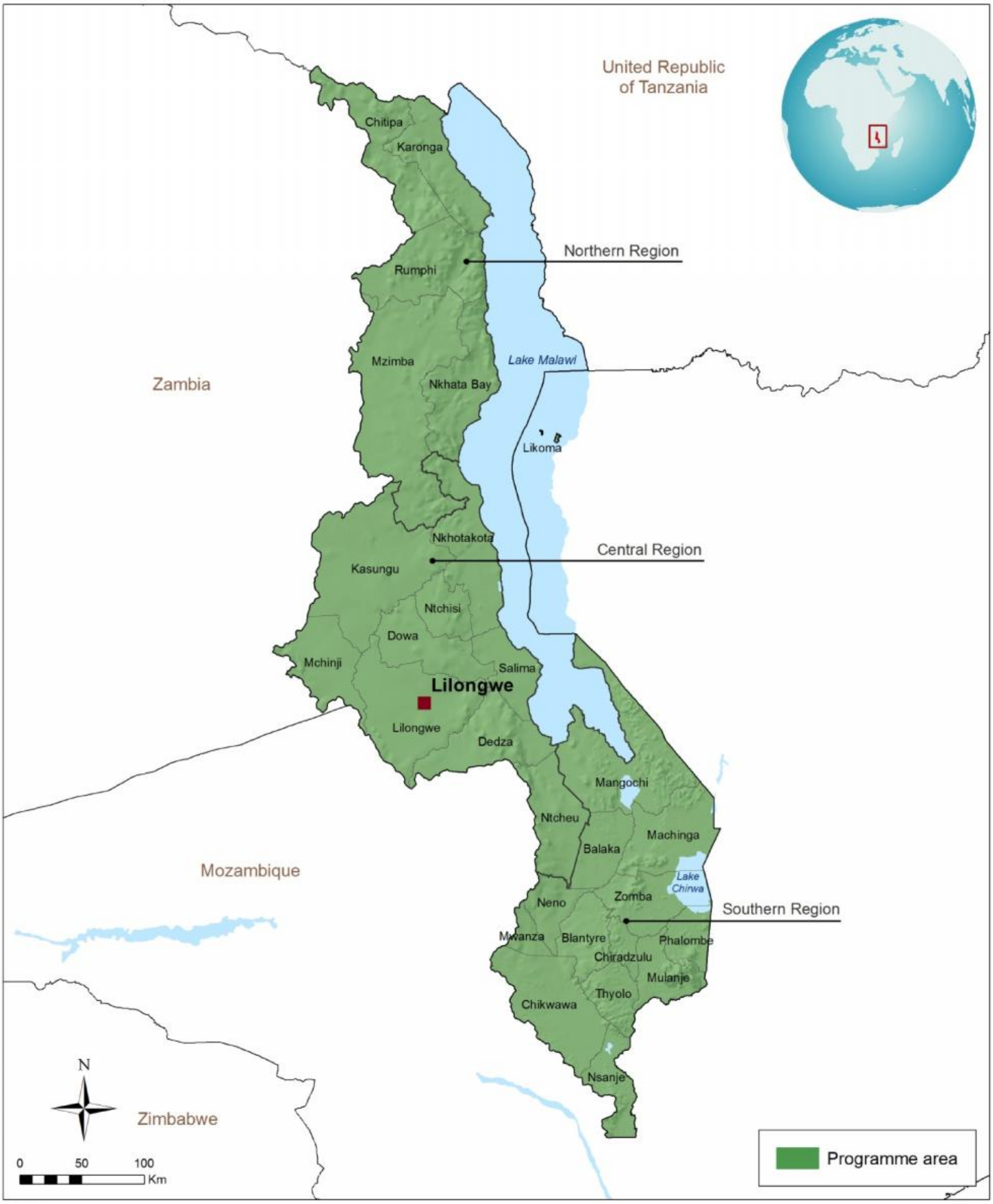
Abbreviations and acronyms

AWP/B	annual workplan and budget
CBFO	community-based financial organization
FARMSE	Financial Access for Rural Markets, Smallholders and Enterprise Programme
FSP	financial service provider
GIZ	German Agency for International Cooperation
IOF	Innovation and Outreach Facility
M&E	monitoring and evaluation
MoFEPD	Ministry of Finance, Economic Planning and Development
MSME	micro-, small and medium-sized enterprise
PMU	programme management unit

Malawi

Financial Access for Rural Markets, Smallholders and Enterprise - FARMSE

President's report



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Map compiled by IFAD | 09-10-2017

Republic of Malawi

Financial Access for Rural Markets, Smallholders and Enterprise Programme

Financing summary

Initiating institution:	IFAD
Borrower:	Republic of Malawi
Executing agency:	Ministry of Finance, Economic Planning and Development
Total programme cost:	US$57.73 million
Amount of IFAD loan:	US$21.00 million
Amount of IFAD Debt Sustainability Framework grant:	US$21.00 million
Terms of IFAD loan:	Highly concessional: Maturity period of 40 years, including a grace period of 10 years, with an annual service charge of 0.75 per cent.
Contribution of borrower:	US$9.58 million
Contribution of beneficiaries:	US$6.15 million
Appraising institution:	IFAD
Cooperating institution:	Directly supervised by IFAD

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed financing to the Republic of Malawi for the Financial Access for Rural Markets, Smallholders and Enterprise Programme, as contained in paragraph 45.

Proposed loan and grant to the Republic of Malawi for the Financial Access for Rural Markets, Smallholders and Enterprise Programme

I. Strategic context and rationale

A. Country and rural development and poverty context

1. Background. Malawi has a population of 16.7 million people, of whom 85 per cent live in rural areas. Two of every three people are under the age of 25. The poverty headcount stands at 50.7 per cent, with 30 per cent being considered extremely poor. Poverty is most pronounced in rural areas that have high rates of malnutrition and the HIV/AIDS pandemic, which undermines the country's productivity and requires major care efforts by family members, especially women. As in other developing countries, in Malawi the micro-, small and medium-sized enterprise (MSME) sector is critical to economic growth and development, and particularly to job creation, food production, income generation and the ability to create a resilient economy. The Government of Malawi collaborates with development partners to address these challenges: the Financial Access for Rural Markets, Smallholders and Enterprise Programme (FARMSE) has been designed to support the Government's poverty reduction efforts by implementing concerted poverty graduation programmes and enhanced rural financial inclusion, with a special focus on women and youth.

2. Economic context. Malawi has experienced difficult economic conditions, including recurrent droughts that have impaired agricultural production over the past several years. The sector is responsible for 33 per cent of the country's GDP of US$4.3 billion (2014), with industry contributing 17.0 per cent and services 49.7 per cent. Real GDP growth in 2014 was estimated at 5.7 per cent, with official unemployment at 6.6 per cent, and youth unemployment over 40 per cent. Inflation has remained above 20 per cent since 2013 (up from 4.1 per cent in 2007), driven by poor crop harvests and subsequent surges in food prices. In 2016, food price inflation was 28.4 per cent, affecting net food buyers and increasing the risk of child malnutrition. Annual interest rates on loans stand at about 27 per cent (while 13.2 per cent is paid on savings deposits).

3. Poverty. In 2015, Malawi had a Human Development Index of 0.445, ranking it 173rd of 182 countries. Its gross national income per capita fell from US$370 in 2011 to US$250 in 2015, mainly due to reduced earnings from export crops. Despite progress made on HIV/AIDS prevention and treatment, 9.1 per cent of the adult population is infected (2010). Poor nutrition and high rates of HIV/AIDS prevalence aggravate already low rural productivity, and caring for family members puts an extra burden on women. About 51 per cent of Malawians live below the national poverty line, with 30 per cent living in severe poverty. Some 25 per cent of the poor are considered ultra-poor; while another 50 per cent are poor, but food secure; and 25 per cent poor, but resilient to falling into deeper poverty. About 25 per cent of all Malawian households are headed by women, of which 57 per cent

are below the poverty line. These households are also more susceptible to food insecurity, as they usually have smaller resource endowments.[1]

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

4. Rationale. The FARMSE, first, will support graduation of poor Malawians along the poverty spectrum from ultra-poor and food insecure to economically active poor and food insecure; and, second, it will support household economic development by improving access to appropriate financial services. Meeting the needs of rural households requires innovative products and services, together with delivery mechanisms that go beyond what the formal financial sector currently offers. The FARMSE will support emerging institutional efforts to overcome the cost inefficiencies, low volumes and product/service design constraints facing the sector, and to overcome the sector's relative lack of experience and the risk perceived in rural markets. It will help financial service providers (FSPs) develop demand-driven and affordable financial products that are simple to use. With a focus on formal financial services, FARMSE-supported value chains will fuel economic opportunity for on- and off-farm rural enterprise, creating employment and generating rural economic multiplier effects. Support is also needed to improve rural financial infrastructure in terms of policy and regulation.

II. Programme description

A. Programme area and target group

5. The FARMSE will be a nationwide programme, with a clustered geographical coverage based on two distinct targeting mechanisms. As such, the programme will combine localized and national geographical targeting approaches. For activities involving implementing agencies, particularly FSPs, care will be taken to select partners with the largest possible combined geographical footprint.

B. Programme development objective

6. The FARMSE's overall goal is to sustainably reduce poverty, improve livelihoods and enhance the resilience of rural households.

7. The programme's development objective is to increase rural household and MSME access to, and use of, a range of sustainable financial services.

C. Components/outcomes

8. Component 1: Graduation of ultra-poor households. This component will support ongoing government efforts to develop and deliver effective graduation programmes in rural areas to reduce extreme poverty levels among ultra-poor households – whether or not labour-constrained. The component will be based on the Government's current graduation concept, and will be delivered by competent service providers identified through a competitive process. The National Social Support Programme, under the Ministry of Finance, Economic Planning and Development (MoFEPD) will participate in the programme. The graduation concept adopted by the Government is aligned with the model developed by the Bangladesh Rural Advancement Committee , which has been universally tested jointly by the Consultative Group to Assist the Poor and the Ford Foundation. This model basically has four steps targeting consumption support, savings, technical skills transfer and asset transfer. IFAD support will only be applied in graduation stages 2 through 5 , while the Government and its other partners, including GIZ, will support stage 1, which involves cash transfers to support consumption. GIZ plans to mobilize parallel funding specifically for stage 1.

9. Component 2: Support for financial innovation and outreach. This component will seek to overcome the numerous barriers facing rural poor people when

[1] Kassie et al., *Gendered Food Security in Rural Malawi* (Springer, 2015).

accessing financial services. It will support the development of informal and formal financial services best suited to the ultra-poor that are not labour constrained but are food secure, emphasizing savings and credit for on- and off-farm enterprise. This component will also carry out financial interventions in selected value chains to enhance economic returns to smallholder participation. The component has two subcomponents.

10. Subcomponent 2.1: Community-based financial organization (CBFO) support. Given the existence of about 65,000 village savings and loan associations (VSLAs) with a membership of 1.1 million, this subcomponent will support the strengthening and consolidation of existing associations, and to a lesser extent the formation of new VSLAs/CBFOs. The programme will promote group lending for value chains and use the Rural Livelihoods and Economic Enhancement Programme's successful elements and partnerships as a starting point – among others with similar experience. The subcomponent will implement three activities: (i) mapping of existing CBFOs and assessing their maturity or development status; (ii) capacity-building in CBFOs to provide opportunities for additional skills and connect them and/or their members to formal financial institutions and high-value markets. This will enhance smallholder income, assets and a number of livelihood/enterprise development opportunities; and (iii) formation of new groups.

11. Some 16,143 existing groups will be supported, along with 5,000 new ones, covering 380,574 households and 2,587,903 household members, with at least 30 per cent of group members being adult women and 20 per cent young people.[2] CBFO support groups/consortia will receive performance-based, multi-year, multiphased service contracts, awarded on a competitive basis.

12. Subcomponent 2.2: Innovation and Outreach Facility (IOF). The activities in this subcomponent will help FSPs enter and expand outreach in rural areas. Support will be provided on a demand-driven and cost-sharing basis through the rural finance Innovation and Outreach Facility. The IOF will make up for FSPs' lack of experience in rural financial markets and their limited expertise in designing and delivering products/services for rural MSMEs. This subcomponent will: (i) increase access to innovative financial services and low-cost delivery mechanisms for poor rural households and MSMEs; and (ii) support the scaling up of proven financial services and delivery mechanisms. The IOF will have three funding windows: (i) market research and feasibility studies to help FSPs identify market opportunities, risks, market entry costs and incomes; (ii) pilot testing of product innovations and/or delivery mechanisms; and (iii) expansion of the outreach of piloted products/services and/or delivery mechanisms. Prospective partners can apply to the window that best suits the nature of their development needs. All projects will be cost shared with FSP partners and selected through competitive procedures.

13. Component 3: Strategic partnerships, knowledge generation and policy. The expected outcome of this component is increased capacity and stronger knowledge bases among rural-finance-sector support organizations. It has three objectives: (i) strengthen macro-level regulatory and financial-sector policy and institutional capacity; (ii) strengthen financial-sector organizations/infrastructure; and (iii) produce and distribute rural-finance-sector knowledge products that enhance the outreach and innovation potential of sector stakeholders. The component has two subcomponents.

14. Subcomponent 3.1: Support for poverty graduation policy and systems. The activities will support efforts being deployed by MoFEPD and its respective divisions to develop and implement coordination policy, build capacity for reviewing the

[2] Although youth is officially defined in Malawi as individuals in the 15-35-year age bracket, the FARMSE definition is 15-25 years of age.

adoption of graduation models, and disseminate best graduation practices to the Government and other stakeholders.

15. Subcomponent 3.2: Support for development of broader rural finance policy. The first activity will support rural-finance-sector policy development and research, with the goal of improving the rural finance operating environment for the FARMSE and other development partners, and structured rural finance including closer links between CBFOs and the formal financial sector. It will also facilitate formal government recognition of good rural finance practices. This will be done in partnership with MoFEPD, the Reserve Bank of Malawi and industry stakeholders such as the Malawi Microfinance Network, the Bankers Association of Malawi and the Malawi Union of Savings and Credit Cooperatives. Other activities will include support for key innovations/lessons, knowledge management, financial training modules, a feasibility study for a microfinance apex fund, and rural financial literacy.

III. Programme implementation

A. Approach

16. The proposed principles of engagement for programme design are:

(a) Graduation will target the ultra-poor, while informal financial organizations such as CBFOs and cooperatives are better suited to people who are ultra-poor but not labour constrained and poor but food-secure. The FARMSE design will provide an appropriate intervention for each group, including youth, with gender-sensitive approaches;

(b) The programme will be national in scope with some interventions targeting strategically identified districts to test/identify effective, efficient and replicable interventions for scaling up. Where possible, components/activities will overlap both geographically and with IFAD programme areas, to maximize impact and potential for scaling up;

(c) The programme will support private and non-profit organizations, either individually or in consortia, often in long-term, multiphased and performance-based partnerships. Private-sector participation will be on a cost-sharing basis;

(d) To underpin the Government's ability to successfully manage and provide oversight for programme implementation, a competitively selected programme management unit (PMU) team, technically qualified to manage a financial inclusion programme, will receive training and long-term technical capacity support; and

(e) Programme partners will be required to employ high-calibre international, regional and national financial-sector experts, as needed, to ensure effective programme implementation.

B. Organizational framework

17. Programme oversight and coordination. MoFEPD will be the lead and executing agency and will work closely with the other line ministries and partners whose mandates have a direct bearing on achievement of the programme's objectives.

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

18. The FARMSE approach to planning and monitoring and evaluation (M&E) will be compatible with the corresponding government and IFAD policies and tools (e.g. the IFAD Results and Impact Management System [RIMS]). Guided by the programme's logical framework, the M&E function will systematically record data

and information on the implementation performance of programme partners, as well as household surveys.

19. Planning. The main planning tools for the FARMSE will comprise the logical framework (logframe), the M&E framework, including its indicators and targets, and the results-based annual workplan and budget (AWP/B). The logframe provides indicators and targets for programme implementation encompassing outputs and outcomes, from development objective to impact levels. The AWP/B will disaggregate physical targets by year and assign financial resources to them. It will present the programme's financial and physical outputs and outcomes for the given year and report on cumulative achievements. Execution of the AWP/B will be monitored through the programme's M&E framework and reported back at regular intervals in quarterly to semi-annual reports.

20. Learning system. Capturing and documenting lessons and innovations through ongoing data collection, monthly/semi-annual reports and thematic studies will be an integral part of FARMSE learning and knowledge management. Disseminating reports and studies (in full or summarized) will enable information sharing and facilitate dialogue with stakeholders. The FARMSE will also have biannual and annual review meetings/workshops. Workshops will report on programme progress, lessons learned, challenges and solutions to implementation constraints.

21. Knowledge development and dissemination. The FARMSE will support the creation of replicable and scalable approaches to graduation and the development of innovative rural financial products, services and delivery mechanisms. The PMU will work closely with programme partners and the M&E function to capture lessons and impacts. The M&E knowledge management function will document and share knowledge through internal mechanisms (e.g. learning events, stakeholder workshop meetings, etc.) and externally (e.g. website, blogs, podcasts featuring programme stakeholders). In addition, the programme will publish a semi-annual programme update (online/print), along with good practices and human-interest stories. Knowledge activities will proactively pursue gender and youth issues and will report success stories related to the reduction of vulnerability and diversification of livelihoods as a form of household risk management.

D. Financial management, procurement and governance

22. MoFEPD, as the lead and executing agency, will be responsible for the programme's financial management through the Pension and Financial Sector Policy Division, which has been appointed FARMSE manager to oversee and coordinate the programme. MoFEPD has not previously directly managed any IFAD-financed projects, but is currently implementing projects funded by the World Bank, the African Development Bank and GIZ. The Government operates under the Integrated Financial Management Information System. However, given the declining rating of some of the key features of the system, as noted in the various public financial management system reports for the country, FARMSE financial reporting will not be managed within the government system, but will use stand-alone accounting software.

23. The programme's financial management risk is rated medium, given the overall country environment and in line with the current risk ratings for Malawi in the IFAD project portfolio. The latest Public Expenditure and Financial Accountability report (2011) noted a deterioration in public financial management performance in the areas of budget credibility; accounting, recording and reporting; and external scrutiny and audit. However, improvement was recognized in the areas of comprehensiveness and transparency. The programme's specific risks arise from its geographical coverage, general staffing capacity, and an implementation strategy involving service providers that may not have worked with IFAD before. The anticipated risks will be mitigated by putting a robust computerized accounting system in place, together with qualified staff and some personnel co-opted from the

closing Rural Livelihoods and Economic Enhancement Programme to ensure timely start-up and awareness of IFAD financial management policies. Continuous capacity-building will be provided to all staff, including the financial management staff of key service providers, to inform them of the financial requirements for expenditure eligibility. This capacity-building will be done at the PMU level. A detailed programme implementation manual, spelling out the financial arrangements, key finance staff and installed accounting package, will be conditions precedent to the first disbursement. The systems governing programme-financed expenditure will be subject to national and IFAD anti-corruption practices.

24. The programme will prepare cash-based financial statements in accordance with International Public Sector Accounting Standards. The MoFEPD Central Internal Audit Unit will ensure that its scope of work also covers the programme and that reports are shared with IFAD during normal programme supervision. As is occurring with current IFAD programmes, external audit will be supervised by the Auditor General's Office in accordance with International Standards of Supreme Audit Institutions.

25. A designated account will be opened at the Reserve Bank of Malawi to receive IFAD funds, and an operating account will be maintained in a commercial bank. The programme's accounts will not be subject to the limits of the Government Credit Control Authority, which in the past have hampered the flow of programme funds. Key service providers/implementers to be selected during implementation will enter into memorandums of understanding, and any funds disbursed to them will be accounted for pursuant to IFAD requirements. They will be required to maintain bank accounts in which the use of these funds can be duly tracked.

26. The Government will provide counterpart financing for the programme in an amount equivalent to approximately US$9.6 million, of which approximately US$3.0 million will be a cash transfer from the Government and the remaining amount in the form of duties and taxes forgone in accordance with the approved AWP/B.

27. *Procurement*. Procurement of goods and services to be financed from the loan proceeds, including human resources, will be executed in accordance with government procurement procedures as defined in Public Procurement Act No. 8, 2003, the Malawi Government Public Procurement Regulations of 2004, and Government of Malawi Desk Instructions for Public Procurement.

28. The Secretary to the Treasury will delegate procurement powers to the FARMSE PMU and will appoint an internal procurement committee consisting of officers from MoFEPD and the PMU. The internal procurement committee will be the overall approval authority for: (i) all procurement plans; (ii) draft advertisements and other bidding documents; (iii) specific terms and conditions relating to contract amounts, completion periods, stages, and conditions for partial payment; (iv) all contracts in amounts above US$10,000 (or as specified in the letter to the borrower/recipient); and (v) variations/amendments to contracts that have been cleared. The operational day-to-day procurement functions, including procurement planning, execution of procurement actions and reporting, will be the responsibility of the PMU procurement unit.

29. All procurement financed from the proceeds of the IFAD grant will be exempt from national and local duties and taxes. Procurement will only be executed against approved procurement plans and AWP/Bs, specifying the items to be procured, responsibility for procurement and the appropriate procurement methods. A robust system of record-keeping will be adopted for the programme and its implementing partners to facilitate procurement verification throughout the implementation period.

E. Supervision

30. The FARMSE will be directly supervised by IFAD. Direct supervision will encompass four discrete processes: (i) loan and grant administration; (ii) procurement review; (iii) audit review; and (iv) supervision and implementation support. Direct supervision will be applied as a continuous process requiring ongoing communication and engagement with the Government and the PMU.

31. IFAD will conduct joint field supervision missions with MoFEPD twice yearly. In addition, MoFEPD will commission independent, external midterm and final reviews. These evaluations will assess processes and results and draw lessons for future programming.

IV. Programme costs, financing and benefits

A. Programme costs

32. Programme costs cover the three technical components, plus a programme management and coordination component. A summary of programme costs by component is shown in table 1.

33. Total programme costs to be incurred during the seven-year implementation period, including price and physical contingencies, duties and taxes, are estimated at US$57.7 million. This includes base costs of US$54.8 million and physical and price contingencies of US$2.9 million. Estimated expenditure in foreign currency is about US$28.1 million; the local cost is about US$20.8 million; and duties and taxes amount to US$6.5 million. Investment costs represent 93 per cent, with recurrent costs accounting for the remaining 7 per cent of the total. Programme management and coordination costs account for 10 per cent of total programme costs.

Table 1
Programme costs by component and financier
(Thousands of United States dollars)

	IFAD loan		*IFAD grant*		*Private sector*		*Borrower/ counterpart taxes*		*Borrower/ counterpart cash transfer*		*Total*
Component	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*
1. Graduation of ultra-poor households	5 337	33.7	5 337	33.7	-	-	2 094	13.2	3 059	19.3	15 829
2. Support for financial innovation and outreach	12 283	36.1	12 283	36.1	6 151	18.1	3 316	9.7	-	-	34 032
3. Strategic partnerships, knowledge generation and policy	763	42.0	763	42.0	-	-	289	15.9	-	-	1 814
4. Programme management and coordination	2 618	43.2	2 618	43.2	-	-	822	13.6	-	-	6 057
Total	**21 001**	**36.4**	**21 001**	**36.4**	**6 151**	**10.7**	**6 520**	**11.3**	**3 059**	**5.3**	**57 731**

B. Programme financing

34. The FARMSE will be financed by the Government of Malawi, IFAD and private-sector participants. IFAD will finance 73 per cent (US$42 million) of programme costs, through a loan of US$21 million (50 per cent) and a grant of an equal amount. The Government will contribute US$9.6 million (17 per cent), of which US$3.1 million (5 per cent) will be financed from its Social Cash Transfer Fund and US$6.5 million (11 per cent) from taxes and duties. The domestic private sector will contribute 11 per cent of total programme costs, or US$6.1 million, through in kind and cash contributions to subprojects financed through the IOF.

Table 2
Programme costs by expenditure category and financier
(Thousands of United States dollars)

	IFAD loan		*IFAD grant*		*Private sector*		*Borrower/ counterpart taxes*		*Borrower/ counterpart cash transfer*		*Total*
Expenditure category	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*
Investment costs											
1. Vehicles	125	41.8	125	41.8	-	-	49	16.5	-	-	300
2. Equipment and materials	27	41.8	27	41.8	-	-	11	16.5	-	-	65
3. Studies and consulting services	7 169	33.1	7 169	33.1	6 151	28.4	1 149	5.3	-	-	21 638
4. Training and workshops	124	47.5	124	47.5	-	-	13	5.0	-	-	262
5. Goods, services and inputs	11 846	41.8	11 846	41.8	-	-	4 681	16.5	-	-	28 373
6. Grants and subsidies	-	-	-	-	-	-	-	-	3 059	100.0	3 059
Recurrent costs	-	-	-	-	-	-	-	-	-	-	-
7. Operations and maintenance	308	41.8	308	41.8	-	-	122	16.5	-	-	738
8. Salaries and allowances	1 401	42.5	1 401	42.5	-	-	495	15.0	-	-	3 297
Total	**21 000**	**36.4**	**21 000**	**36.4**	**6 151**	**10.7**	**6 520**	**11.3**	**3 059**	**5.3**	**57 731**

C. Summary benefit and economic analysis

35. Benefits and beneficiaries. The total number of targeted households is currently estimated at 432,774. Beneficiary households have been classified, according to their initial wealth and economic well-being, into three categories: (i) ultra-poor households (labour constrained/not labour constrained); (ii) poor households; and (iii) households vulnerable to poverty. Component 1. graduation of ultra-poor households activities will target ultra-poor households. Support to CBFOs, in subcomponent 2.1, will target poor and vulnerable households, as will subcomponent 2.2, enhancing innovation and rural outreach by FSPs. For the purposes of analysis, the beneficiaries of subcomponents 2.1 and 2.2 have been split evenly across the poor and vulnerable household categories. Beneficiary households will be both likely and encouraged to participate in more than one programme activity. To minimize double counting, the analysis assumes that households benefiting from access to formal financial services (subcomponent 2.2) also benefit from access to informal services (subcomponent 2.1). Nonetheless, there is a small risk of some double counting of beneficiary households in the total.

D. Sustainability

36. The success of rural-finance-sector development investments largely depends on how well the needs of both supply and demand are met. For suppliers, a reasonable and long-term profit must be achievable. On the demand side, products and services must meet a practical need that improves the household economy, at a cost that is acceptable in relation to the outcomes achieved. Moreover, these conditions must be met under prevailing macroeconomic and environmental conditions, including both currently ongoing and inevitable future challenges for financial-sector stability. Investment also requires a stable and good-practice regulatory and policy environment. Each FARMSE component recognizes these needs and challenges and has built-in mechanisms to safeguard the sustainability of outcomes and impacts as far as possible.

E. Risk identification and mitigation

Table 3
Risk identification and mitigation matrix

Risks	*Current level*	*Possible consequences*	*Mitigation*
1. Slow programme start-up jeopardizes implementation plan	Medium	Component 1. has a staged approach with a relatively tight time line. There is a risk of slow interface between level 1, which will be fully supported by Government/other partners, and levels 2-5, where IFAD support is expected. Component 2. risks not meeting the disbursement targets. Both risks potentially reduce the number of target beneficiaries helped out of poverty.	Provide sufficient support to the Government in the start-up phase. Provide sufficient and capable technical assistance for programme start-up and implementation. Closely monitor potential implementation bottlenecks and provide flexibility to overcome them.
2. Climate change, climate variability and macroeconomic shocks	Medium	Poor crop harvests impair rural economy and financial-sector expansion potential. Unexpected macroeconomic shocks (hyperinflation, devaluation, etc.) negatively affect the national/rural economy.	The FARMSE will stress planning for long-term financial service provision. Proposed financial service innovations/outreach mechanisms will be rigorously tested; and business models/pro forma estimates will be purposely modest to accommodate climate-driven or macroeconomic impacts. Although the programme cannot anticipate economic shocks, every effort will be made to ensure that financial products can effectively withstand/accommodate reduced demand and or increased marketplace risk. The FARMSE will increase households' short-term resilience by increasing financial buffers. Over time, increased investments will reduce exposure to extreme weather events.
3. Lack of interest on the part of financial institutions and agricultural value chain businesses/ organizations in participating in IOF	Low to medium	Without substantial participation from enterprise/organizations, there is a risk that few innovative and/or scalable financial products/services are developed to better serve poor rural people.	Soft commitments by CBFO support organizations and FSPs in the design of programme participation. Provide strong and technically capable PMU staffing. Proactive recruitment of enterprise/organizations for participation and provision of strong technical service providers for product/service development.
4. Financial institutions/agricul-tural value chain actors do not source appropriate technical assistance	Low	Without strong technical assistance, IOF grant recipients will face substantial challenges in designing, developing, testing and rolling out new products for rural markets.	The FARMSE PMU/chief technical advisor for rural finance must have strong international experience and must proactively support recruitment of technical service providers with capacity to support IOF grant recipients in Malawi.
5. Government policy deviates from good-practice inclusive finance	Low	The Government's financial and inclusive financial policies and regulations have thus far generally adopted international good practices. Nonetheless, the Government could introduce subsidy programmes or interest-rate caps, or ignore the modest regulatory and/or policy initiatives (especially concerning mobile money) anticipated by the FARMSE, which could limit private-sector investment interest in rural-finance-sector innovation and outreach development.	Provide proactive support to MoFEPD and other ministries involved, along with the Reserve Bank of Malawi and other relevant sector stakeholders, to bolster the commitment to good practice and inclusive financial-sector development.

V. Corporate considerations

A. Compliance with IFAD policies

37. The FARMSE will be implemented in compliance with the IFAD Strategic Framework 2016-2025, and with IFAD's policies on natural resource management and climate change. The programme recognizes the economic and social value of natural assets through capacity-building for farmers in environmental management and the criteria used to select partners. It will support climate-smart approaches and define minimum standards for grant recipients in relation to climate resilience and capacity-building for environmental, social and climate risk management. It will also adhere to the principle of livelihood diversification to reduce vulnerability and build resilience.

38. The FARMSE is also compliant with IFAD's Targeting Policy and the Gender Equality and Women's Empowerment Policy (2012).

B. Alignment and harmonization

39. The programme supports the Government of Malawi's policy on reducing poverty through agricultural recovery. Within this framework, MoFEPD is expected to focus on its core functions, which include policy formulation, legislation and regulation. The programme has been developed in consultation with partners engaged in projects in Malawi.

C. Innovations and scaling up

40. The FARMSE builds on IFAD experience and will enhance the focus on women and young people as priority target groups.

D. Policy engagement

41. The Malawi Vision 2020 outlines the country's development vision, which aims to make Malawi "secure, democratically mature, environmentally sustainable, self-reliant with equal opportunities for and active participation by all". The vision contains several strategies relevant to the FARMSE, including the Malawi Growth and Development Strategy II (MGDS II: 2011-2016), which is a medium-term strategy for attaining long-term poverty reduction through sustainable economic growth and infrastructure development, inter alia, in agriculture; and the National Agriculture Policy (NAP 2016-2020), which outlines eight priority areas: agricultural production and productivity; irrigation development; mechanization of agriculture; agricultural market development, agroprocessing and value addition; food and nutrition security; agricultural risk management; youth and women's empowerment in agriculture; and institutional development, coordination and capacity-strengthening. Building on this vision, the MoFEPD financial inclusion strategy involves support for: digital payments, informal savings, rural financial services, insurance, consumer empowerment and education. Other ministries also include rural finance in their strategic planning, including the Ministry of Local Government and Rural Development and the Ministry of Agriculture, Irrigation and Water Development.

VI. Legal instruments and authority

42. A programme financing agreement between the Republic of Malawi and IFAD will constitute the legal instrument for extending the proposed financing to the borrower/recipient. A copy of the negotiated financing agreement is attached as appendix I.

43. The Republic of Malawi is empowered under its laws to receive financing from IFAD.

44. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the Policies and Criteria for IFAD Financing.

VII. Recommendation

45. I recommend that the Executive Board approve the proposed financing in terms of the following resolutions:

RESOLVED: that the Fund shall provide a loan on highly concessional terms to the Republic of Malawi in the amount of twenty-one million United States dollars (US$21,000,000), and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

RESOLVED FURTHER: that the Fund shall provide a Debt Sustainability Framework grant to the Republic of Malawi in the amount of twenty-one million United States dollars (US$21,000,000), and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Gilbert F. Houngbo
President

Negotiated financing agreement

Financial Access for Rural Markets, Smallholders and Enterprise Programme

(Negotiations concluded on 21 November 2017)

Loan Number: ___________
DSF Grant Number: __________

Programme Title: Financial Access for Rural Markets, Smallholders and Enterprise Programme ("FARMSE" or "the Programme")

the Republic of Malawi (the "Borrower/Recipient")

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 Programme 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, amended as of April 2014, and as may be amended hereafter from time to time (the "General Conditions") are annexed to this Agreement, and all provisions thereof shall apply to this Agreement. 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 and a Debt Sustainability Framework (DSF) Grant to the Borrower/Recipient (the "Financing"), which the Borrower/Recipient shall use to implement the Programme in accordance with the terms and conditions of this Agreement.

Section B

1. A. The amount of the Loan is twenty one million US dollars (USD 21 000 000).

B. The amount of the DSF Grant is twenty one million US dollars (USD 21 000 000).

2. The Loan is granted on highly concessional terms, and shall be free of interest but bear a service charge of three fourths of one per cent (0.75%) per annum payable semi-annually in the Loan Service Payment Currency, and shall have a maturity period of forty

(40) years, including a grace period of ten (10) years starting from the date of approval of the Loan by the Fund's Executive Board.

3. The Loan Service Payment Currency shall be United States Dollars (USD).

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 May and 1 November.

6. There shall be a designated account at the Reserve Bank of Malawi and an operational programme account held in a commercial bank. The operational programme account will not be subject to the Credit Control Authority operational requirements.

7. The Borrower/Recipient shall provide counterpart financing for the Programme in an amount equivalent to approximately nine million six hundred thousand United States dollars (USD 9 600 000), of which approximately three million dollars (USD 3 000 000) will be Government cash transfer and the rest of which will be in the form of exemption of duties and taxes in accordance with the approved Annual Work Plan and Budget.

Section C

1. The Lead Programme Agency shall be the Ministry of Finance, Economic Planning and Development (MoFEPD).

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

Section D

The Financing will be administered and the Programme supervised by the Fund.

Section E

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

(i) The Designated Account and Programme Account shall have been duly opened;

(ii) The Programme Management Unit shall have been fully constituted and adequately staffed with key staff including the Programme Coordinator, Monitoring and Evaluation Officer, Procurement Officer, and the Financial Controller;

(iii) An off-the-shelf accounting software will have been procured and coded with the Programme chart of accounts to facilitate generation of reports by component, expenditure category and financier; and

(iv) The Programme Steering Committee (PSC) shall have been established.

2. In accordance with the Borrower/Recipient's legislation the Financing Agreement will be signed by a representative of the Borrower/Recipient upon authorization by the Parliament of the Republic of Malawi.

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

For the Borrower/Recipient:

The Minister of Finance, Economic Planning and Development
of the Republic of Malawi
Ministry of Finance, Economic Planning and Development
P.O. Box 30049
Lilongwe 3

For the Fund:

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

This Agreement, dated __________, has been prepared in the English language in two (2) original copies, one (1) for the Fund and one (1) for the Borrower/Recipient.

THE REPUBLIC OF MALAWI

____
Authorized Representative
(name and title)

INTERNATIONAL FUND FOR
AGRICULTURAL DEVELOPMENT

____
Gilbert F. Houngbo
President

Schedule 1

Programme Description and Implementation Arrangements

I. Programme Description

1. Target Group. FARMSE will be a nation-wide programme, its geographic coverage will be clustered based on two distinct targeting mechanisms. As such, the Programme will combine localized and national geographic targeting approaches. For activities involving demand driven implementing agencies, particularly Financial Service Providers (FSPs), care will be taken to select partners with a combined geographic footprint as broad as possible. The Programme will adopt two targeting strategies. Total Programme beneficiaries will number more than 432,000, of which, an estimated 30% will be women, and at least 20% will be youth.

2. Goal. The overall goal of the Programme is to reduce poverty, improve livelihoods and enhance the resilience of rural households on a sustainable basis.

3. Objective. The Programme's development objective is to increase access to, and use of, a range of sustainable financial services by rural households and micro, small, and medium enterprises.

4. Components. The Programmes development objective will be achieved through the effective implementation the three technical components:

4.1 Component 1. Ultra-poor graduation model development and testing at scale. The outcomes of this component are: i) the capacity of ultra-poor households to graduate from poverty, obtain food security and secure livelihood opportunities is improved; and ii) the capacity of ultra-poor women headed households and youth graduate from poverty is improved. The objective of the component is to develop and test at scale a cost-effective, replicable model(s) to graduate households from ultra-poverty and food insecurity into sustainable, self-reliant livelihoods. This component is divided into two stages: selection of operational districts, based on existing Government of Malawi poverty statistics, and in collaboration with MoFEPD, selection and assessment of qualifying ultra-poor households; Roll out the graduation process.

4.2 Component 2. Support to Financial Innovation and Outreach. This component will seek to overcome numerous barriers to financial services to the rural poor. It will support the development of informal and formal financial services best suited to ultra-poor non-labour constrained, poor but food-secure, vulnerable to poverty, and low income but resilient to poverty households, emphasizing savings and credit for on and off farm enterprises. This component has two subcomponents:

4.2.1 Subcomponent 2.1 - Community based financial organization support (CBFO). The outcome of this subcomponent is improved rural financial access through existing, new and innovative informal community based financial organizations and savings and loan products. The objective is to support CBFOs expanded outreach to poor but food secure households, households vulnerable to poverty, and resilient households in rural Malawi.

4.2.2 Subcomponent 2.2 – Innovation and Outreach Facility (IOF). The outcome for this subcomponent is to enhance the capacity of FSPs to deliver demand-driven services in rural areas. The objectives are two: i) increase access to new and innovative financial services and low-cost delivery mechanisms for poor rural households and micro, small and medium, sized enterprises; and ii) to support the scaling up of proven financial services and delivery mechanisms.

4.3 Component 3. Strategic Partnerships, Knowledge Generation, and Policy. The outcome of this component is to increase the capacity and knowledge bases of rural financial sector support organizations, and has three objectives: i) strengthen macro level regulatory and financial sector policy and institutional capacity; ii) strengthen financial sector organizations; and iii) produce and distribute rural finance sector knowledge products which enhance the outreach and innovation potential of sector stakeholders. The component has two subcomponents:

4.3.1 Subcomponent 3.1 – Support for Poverty graduation Policy and Systems. The activities will support efforts at MoFEPD, in particular in the Division of Poverty Reduction and Social Protection, to develop and implement coordination policy, and capacity related to reviews of graduation models adoption, and dissemination of best graduation practices within the Government and to other stakeholders.

4.3.2 Subcomponent 3.2 – Support for development of broader Rural Finance Policy. The first activity will support rural finance sector development, policy, and research. It will also facilitate formal Government recognition of good rural finance practices This will be done in partnership the MoFEPD, the Reserve Bank of Malawi and industry stakeholders. Other activities would include support for key innovations, lessons, knowledge management, financial training modules, feasibility study for a micro-finance apex fund, and rural financial literacy.

I. Implementation Arrangements

5. Lead Programme Agency. The lead agency for Programme implementation shall be the MoFEPD. The Programme will be housed in the Pensions and Financial Sector Policy Division (PFSPD).

6. Programme Steering Committee (PSC). A multi-sector stakeholder Programme Steering Committee, chaired by the Secretary to the Treasury or his/her designate, will be established to provide overall Programme oversight, direction, and advice. The PSC will be made up of representatives of key stakeholders including, inter-alia, government ministries, farmer organisations, financial apex bodies, the private sector, and development partners. The PSC would meet on a quarterly basis to review work plans and budgets, financial and progress reports, receive draft annual reports and approve all major Programme decisions. The multi-sectoral composition of the PSC will ensure the Programme's implementation complements rather than duplicates other government interventions and encourages private sector participation, and harmonizes the Programme's contribution with the Government's strategic priorities and development objectives for the sector.

7. The Programme Management Unit (PMU). The PMU will be hosted by the PFSPD, at MoFEPD. It shall be responsible for day to day management, consolidation of Annual Work Plan and Budgets (AWPBs), procurement plans, progress, and financial reports, and will co-ordinate the procurement of goods, works and services. The PMU will be staffed with: (i) a programme coordinator; (ii) a rural finance specialist; (iii) a financial controller; (iv) a procurement officer; (v) a monitoring and evaluation officer (vi) a knowledge management & communications officer; and (vii) an accountant. Additionally, the PMU will have a long-term rural finance Chief Technical Advisor (CTA) contracted to support implementation of Component 2 and 3, paid through the IOF (subcomponent 2.2). The CTA will work closely with the rural finance specialist, and together with the Programme Coordinator, will develop the AWPB for Component 2 and component 3.

8. Planning. The main planning tools for the Programme will comprise the logical framework, monitoring and evaluation (M&E) framework including its indicators and targets, and the Results Based Annual Work Plan and Budget (RB-AWPB). The Logframe provides indicators and targets for Programme implementation from output over outcome, development objective to impact levels. The RB-AWPB will break physical targets up by year and attach financial resources to them. The RB-AWPB shall present

financial and physical outputs and outcomes of the Programme for the given year, and report on the accumulative achievements. The execution of the RB- AWPB will be monitored along the M&E framework of the Programme and reported back in regular intervals from quarterly to semi-annuals reports. The cycle of planning, monitoring and reporting is essential for efficient management of the Programme and for achieving the results as agreed.

9. Monitoring and evaluation. The Programme's approach to planning, monitoring and evaluation will be compatible with corresponding Government and IFAD policies and tools. Guided by the Programme's logical framework, the M&E function will systematically record data and performance information of Programme partner performance implementation, as well as household surveys. The system will build on the experience of completed and existing programmes as well as provide information that informs management decision making.

10. Financial Management (FM). The Programme will employ similar financial management systems to a stand-alone accounting software as adaptation of a good lesson learned from the Sustainable Agricultural Production Programme (SAPP) and Rural Livelihoods and Economic Enhancement Programme (RLEEP). It is proposed that TOMPRO accounting software be adopted (as it will be in the new IFAD Programme for Rural Irrigation Development). This will allow for joint trainings, support, and programme knowledge sharing.

11. Audit. The audit of the Programme's financial statements will be supervised by the Auditor General of the Borrower/Recipient in accordance with International Standards and the audit report will be submitted to IFAD within six months after the financial year-end. Supervision missions will review internal audit reports and assess management responses to recommendations.

12. Supervision. The Programme shall be directly supervised by IFAD. Direct supervision would encompass four discrete processes: (i) loan and grant administration; (ii) procurement review; (iii) audit review; and (iv) supervision and implementation support. Direct supervision would be applied as a continuous process which requires on-going communication and engagement with the GoM and the PMU. Key supervision processes include: (i) ensuring fiduciary compliance with the loan and grant administration; (ii) assessing Programme performance; (iii) guidance towards the achievement of the Programme's strategic objectives; and (iv) conducting supervisory missions.

13. Programme Implementation Manual (PIM). The Programme shall be implemented in accordance with the approved AWPB and the PIM, the terms of which shall be adopted by the lead Programme agency subject to the Fund's prior approval. The PIM shall include, among other things; (i) terms of reference, implementation responsibilities and appointment modalities of all Programme staff and consultants; (ii) Programme operating manuals and procedures; (iii) monitoring and evaluation systems and procedures; (iv) a detailed description of implementation arrangements for each programme component; (v) terms of references and modalities for the selection of the service providers, to be based on transparent and competitive processes; (vi) detailed modalities of the sub-programmes; (vii) financial management and reporting arrangements including accounting, approval of payments, financial reporting, internal controls, fixed asset management, as well as internal and external audit; and (viii) the good governance and anti-corruption framework.

Schedule 2

Allocation Table

1. Allocation of Loan and Grant Proceeds. (a) The Table below sets forth the Categories of Eligible Expenditures to be financed by the Loan and the DSF Grant and the allocation of the amounts to each category of the Financing and the percentages of expenditures for items to be financed in each Category. All expenses are net of taxes and counterpart contributions:

Category	Loan Amount Allocated (in USD)	DSF Grant Amount Allocated (in USD)
I. Goods services & Inputs	10 800 000	10 800 000
II. Studies & Consultancies	6 550 000	6 550 000
III. Operations	300 000	300 000
IV. Salaries & Allowances	1 250 000	1 250 000
Unallocated	2 100 000	2 100 000
TOTAL	21 000 000	21 000 000

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

"Goods, services and inputs" also includes allocations for vehicles, equipment, and materials.

"Studies and Consultancies" also includes allocations for training & workshops

(c) Start-up costs: Withdrawals in respect of expenditures for start-up costs from the DSF Grant incurred for Programme start-up expenditures before the satisfaction of the additional general conditions precedent to withdrawal shall not exceed USD 200 000.

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/Recipient to request withdrawals from the Loan Account if the Borrower/Recipient 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 Programme:

1. Gender. The Borrower/Recipient shall ensure that gender concerns shall be mainstreamed in all Programme activities throughout the Programme implementation period. The Borrower/Recipient shall also ensure that women beneficiaries shall be represented in all Programme activities and that they receive benefits from the Programme outputs.

2. Tax Exemption. The Borrower/Recipient shall, to the fullest extent possible, exempt the proceeds of the Financing from all taxes. Any taxes which the Programme is nonetheless obliged to pay shall be promptly reimbursed by the Borrower/Recipient.

3. Internal Audit. The Central Internal Audit Unit of the Borrower/Recipient or an independent and qualified internal audit firm acceptable to IFAD will perform Programme internal audits in accordance with an annual risk-based work-plan.

4. Key Programme Staff. The Borrower/Recipient shall ensure that key staff are recruited and in the event of turnover they are replaced on a timely basis. Should the recruitment process be prolonged, where appropriate the Borrower/Recipient shall make recourse to a suitably qualified external service provider acceptable to IFAD.

Logical framework

Narrative Summary	Performance Indicators	Baseline	Targets			Means of verification	MoV Frequency	MoV responsibility	Assumptions (A) / Risks (R)
			Year 1	Midterm	End Programme				
GOAL									
To reduce poverty, improve livelihoods and enhance the resilience of rural households on a sustainable basis.	Reduced prevalence of chronic malnutrition in children under five by at least 15% (RIMS III).	TBD	N/A						
	Improved household assets ownership index by at least 20% (RIMS III).	TBD	N/A						
DEVELOPMENT OBJECTIVE									
Increased access to and use of a range of sustainable financial services by rural households and micro, small, and medium enterprises.	Graduation strategy and systems developed, tested at scale, and approved by GOM.		0	1	1	PMU Progress reports.	Annual	PMU	Stable political and macroeconomic environment. GOM monetary/fiscal policies and macro-economic reforms are conducive to poverty reduction. Commitment of stakeholders (GOM, donors, private sector) to participate in poverty reduction efforts. Absence of political interference into the autonomy financial sector.
	Improved outreach of sustainable rural financial services to rural poor.	TBD	0	167,110	417,774 of which 125,332 will be adult women, and 83,555 will be youth	PMU Progress reports.	Annual	PMU	
OUTCOMES									
Component 1.0 - Ultra-poor graduation model development and testing at scale									
Outcome 1.1 - the capacity of ultra-poor households to graduate from poverty, improve food security and secure livelihood opportunities is improved.	• At least 80% of targeted household attaining food security.	N/A	0	6,000	15,000 of which 4500 will be women headed households and 3000 youth headed households	PMU Progress reports ~~with input from GIZ.~~	Semi-annual.	PMU~~/GIZ~~.	Models can be developed to roll out successful graduation at scale (A) Stakeholders cannot agree on graduation model.
Component 2.0 - Support to Financial Innovation and Outreach									
Outcome 2.1 Improved access to structured and sustainable CFBO financial services.	• Number of retrained CBFO members. • Number of increment rural	0 0	0 0	152,223 36,000	380,574 90,000	PMU progress reports.	Monthly.	PMU/CBFO support organizations	Sufficient demand from CBFO support organization (A) Client take up (R).

Narrative Summary	Performance Indicators	Baseline	Targets			Means of verification	MoV Frequency	MoV responsibility	Assumptions (A) / Risks (R)
			Year 1	Midterm	End Programme				
	CBFO members.							service providers.	
Outcome 2.2 Enhanced capacity of FSPs to deliver demand-driven services in rural areas.	• Number of incremental rural clients of partner FSPs.	0	0	11,160	37,200	PMU progress reports.	Annual.	PMU/Facility Manager.	Sufficient demand from FSP with quality proposals (A) Macroeconomic stability (R), client demand (R)
Component 3.0 – Strategic Partnerships, Knowledge Generation, and Policy									
Outcome 3.1 Rural finance sector support organizations capacity and knowledge increased.	• Number of rural finance support organizations supported with rural inclusive finance good practice knowledge.	N/A	2	5	10	PMU progress reports.	Annual.	PMU/M&E specialist.	Support organizations effectively support sector (A) Support organizations do not work to maintain balance between guidance and commercial dynamism (R)
OUTPUTS									
Component 1.0									
New graduation model selected for rollout.	• Number households reached with graduation activities.		0	6500	15000	PMU~~/GIZ~~ progress reports.	Quarterly	PMU/M&E specialist.	Models amenable to scaling up (A) Cost of scaling up high (R)
Subcomponent 2.1									
CFBO support organizations expand network of CFBO groups.	• No of groups restructure & consolidated. • No of groups linked to FSPs. • Number groups formed. • No of value chain groups linked to markets.		0 0 0	8000 2000 2000 1000	20000 10000 5000 2000	PMU/CBFO support organizations progress reports.	Quarterly	PMU/CBFO support organizations service providers.	Sufficient demand from CBFO support organization (A) Client take up (R)
Subcomponent 2.2									
Designing, innovating, and rolling out demand driven rural financial products/ services for targeted low income households.	• Introduction of five new/Improved sustainable financial products, services or delivery mechanisms targeting rural beneficiaries.		0	2	5	Progress reports TSP reports FSP MIS	Quarterly.	|PMU/Facility Manager	Sufficient demand from FSP (A) Not enough qualified proposals (R) High quality TA not available (R)
Component 3.0									
Good practice financial inclusion knowledge and operating environment provided.	• Approved Rural Finance Policy. • Number of rural finance awareness/knowledge forums/platforms.		0 0	 2	1 4	PMU Progress reports. PMU Progress reports.	Quarterly. Quarterly	PMU. PMU	Organizations with key contributions can be identified and have sufficient capacity to undertake assignments (A) Stakeholder unwilling to work cooperatively (R).