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Investing in rural people

President's report

Proposed loan and Debt Sustainability Framework grant
Federal Democratic Republic of Ethiopia
Rural Financial Intermediation Programme III (RUFIP III)

Project ID: 2000002344

Note to Executive Board representatives

Focal points:

Technical questions:

Sara Mbago-Bhunu
Regional Director
East and Southern Africa Division
Tel.: +39 06 5459 2838
e-mail: s.mbago-bhunu@ifad.org

Han Ulaç Demirag
Hub Director
East and Southern Africa Division
Tel.: +251 1 1617 2439
e-mail: u.demirag@ifad.org

Dispatch of documentation:

Deirdre Mc Grenra
Chief
Institutional Governance and Member Relations
Tel.: +39 06 5459 2374
e-mail: gb@ifad.org

For: **Approval**

Contents

Project delivery team	
Regional Director:	Sara Mbago-Bhunu
Country Director/CPM:	Ulaç Demirag
Project Technical Lead:	Zainab Semgalawe
Financial Management Officer:	Claudio Mainella
Climate and Environment Specialist:	Paxina Chileshe
Legal Officer:	Puri Tola Satué

Abbreviations and Acronyms

AEMFI	Association of Ethiopian Micro Finance Institutions
AGRA	Alliance for Green Revolution Africa
AWPB	annual workplan and budget
CBE	Commercial Bank of Ethiopia
DBE	Development Bank of Ethiopia
EIB	European Investment Bank
EU	European Union
FCA	Federal Cooperative Agency
LOC	line of credit
M&E	monitoring and evaluation
MFI	microfinance institution
NBE	National Bank of Ethiopia
PCMU	programme coordination management unit
PROSEAD	Promotion of Sustainable Ethiopian Agro-Industrial Development
PSC	Project Steering Committee
RUFIP	Rural Financial Intermediation Programme
RUSACCO	Rural Savings and Credit Cooperative

Map of the programme area

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 | 09-09-2019

Financing summary

Initiating institution:	IFAD
Borrower:	Federal Democratic Republic of Ethiopia
Executing agency:	Ministry of Finance
Total programme cost:	US$305.79 million
Amount of IFAD loan*:	SDR 3.60 million (equivalent to approximately US$4.90 million)
Terms of IFAD loan:	Highly concessional
Amount of the IFAD Debt Sustainability Framework grant:	SDR 25.65 million (equivalent to approximately US$35.10 million)
Cofinanciers:	European Union (EU), Alliance for a Green Revolution in Africa (AGRA), European Investment Bank (EIB)**
Amount of cofinancing:	US$192.90 million
Financing gap:	US$20.00 million
Terms of cofinancing:	Part loans and part grants
Contribution of borrower:	US$51.95 million
Contribution of beneficiaries:	US$0.95 million
Appraising institution:	IFAD
Cooperating institution:	Direct supervision by IFAD

* Most of the loan portion of the IFAD11 performance-based allocation system (PBAS) allocation has been used for the Lowlands Livelihood Resilience Project (EB 2019/127/R.28).

** The envisaged cofinancing by the European Investment Bank is subject to the institution's formal approval, which is expected in the fourth quarter of 2019.

Recommendation for approval

The Executive Board is invited to approve the recommendation contained in paragraph 61.

I. Context

A. National context and rationale for IFAD involvement

National context

1. The Federal Democratic Republic of Ethiopia is a fast-growing economy with an estimated population of 102.4 million (2016). The International Monetary Fund (IMF) reported the country's growth rate as 8.5 per cent in 2018. Extreme poverty fell from 55 per cent in 2000 to 24 per cent in 2016. National per capita income increased from US$350 in 2010 to US$993 in 2017. Ethiopia achieved six of the eight Millennium Development Goals, in relation to poverty reduction, advancements in education, reduction of hunger and malnutrition, control of chronic diseases and reduction in child mortality. Despite these gains, Ethiopia is still a poor country and ranks 173rd (out of 189 countries) on the Human Development Index (0.463).[1]

2. The agriculture sector (supporting 80 per cent of the population) suffers from frequent droughts aggravated by climate change. Poverty is higher in vulnerable, drought-prone regions. The pastoral and agropastoral communities living in the arid and semi-arid lowlands lag behind on most of the social and economic indicators. Their livelihoods are highly vulnerable to a multitude of shocks.

3. Ethiopia’s main development objectives are poverty alleviation and eliminating dependence on food aid. The country’s policy, strategy and development programmes are geared towards meeting these objectives. The Government’s second Growth and Transformation Plan (GTP II) sets a long-term goal for Ethiopia to become a middle-income country by 2025, with growth rates of at least 11.2 per cent per year; and the National Financial Inclusion Strategy (NFIS 2017–2022) recognizes the role of access to finance in economic growth and poverty reduction.

Special aspects relating to IFAD's corporate mainstreaming priorities

4. The programme is fully compliant with key IFAD policies, including the Gender Equality and Women’s Empowerment Policy (2012) and the Youth Action Plan (2019-2021). The gender and youth strategies are discussed below under programme description.

5. The programme's targeting and social inclusion strategy will ensure that the rural financial institutions (RFIs) proactively target women, youth and marginalized people in Ethiopia, particularly in drought-prone areas where smallholder farmers are affected by climate shocks, and bring these clients into the financial system. Rural Financial Intermediation Programme (RUFIP) III will apply a combination of self-targeting by RFIs and direct targeting to ensure that the programme serves the intended households.

6. **The gender mainstreaming strategy** will scale up best practices for women's inclusion and outreach through: suitable financial services/products; increased voice for women in decision-making; and provision of financial literacy training. RUFIP II achieved significant outreach to women: women constituted 45 per cent of RFI clients/members, and accounted for 40 per cent of the board members of the Rural Savings and Credit Cooperatives (RUSACCOs) (exceeding the target of 30 per cent). RUFIP III will require implementing partners to reach targets of least 50 per cent in both of these areas (i.e. RFI clients and RUSACCO board composition).

[1] UNDP 2017 Human Development Report.

7. **The youth mainstreaming strategy** recognizes that enabling rural youth to access financial services is an important national priority. The strategy focuses on scaling-up and replicating successful interventions such as the Youth Start Programme supported by the United Nations Capital Development Fund, and Women's World Banking[2] modules to expand finance education among youth, catalyse the growth of the young clientele of RFIs and enhance investment in viable enterprises.

8. **Nutrition.** The number of malnourished people fell to 21.4 per cent of the population in 2015-2017 from 49 per cent in 2000-2003. Although child malnutrition rates have decreased, the country's malnutrition rates are the highest in sub-Saharan Africa. The programme will promote awareness about nutrition at the community level through campaigns and demonstrations, with a focus on areas with higher vulnerability to food insecurity due to negative environmental effects.

Rationale for IFAD involvement

9. The RUFIP programmes have been successful in establishing IFAD as a key partner of the Government of Ethiopia in promoting rural financial inclusion. RUFIP III provides IFAD with an excellent opportunity to consolidate and scale up these achievements, while enhancing the focus on IFAD's corporate priorities and sustainability.

10. As the Government is embarking on various economic reforms, RUFIP III anticipates opportunities for policy engagement in the development of: (i) financial infrastructure, including national payments systems, setting up credit bureaux and collateral registration; (ii) an institution for the protection of depositors; (iii) regulations for agent networks in the financial sector; and (iv) rural and microleasing markets. IFAD's contribution to policy engagement in these areas will be through facilitating periodic events/workshops and discussions.

11. Access to finance is crucial for IFAD to achieve its strategic objectives in Ethiopia. Support in this area complements other IFAD-financed programmes and those funded by other development partners.

B. Lessons learned

12. The RUFIP programmes have played a pivotal role in expanding the outreach of microfinance institutions (MFIs) and RUSACCOs: by the end of 2018, almost 7 million people had gained access to financial services. Despite this, inadequate access to financial services persists as a bottleneck in rural Ethiopia, which lags behind other sub-Saharan countries for financial inclusion (Global Findex database, 2018). The RUFIP programmes and other IFAD-supported operations and activities in the country have yielded lessons that influenced the design of RUFIP III:

    (a) **Line of credit (LOC) as an effective tool.** While addressing the imminent lack of liquidity in RFIs, the provision of credit to RFIs to expand access to finance to a wider client base needs to be complemented with additional mechanisms. These could include guarantees to increase readiness among domestic funders and achieve the catalytic function of the LOC to attract domestic resources.

    (b) **Capacity-building interventions need priority and sequencing**. The capacity-building interventions in RUFIP II were delayed, mainly due to slow procurement attributed to limited institutional capacity. However they were effective in improving the RFIs' operations.

    (c) **Contribution to inclusive and sustainable rural transformation.** RUFIP has helped create the institutional basis and motivation for the transformation of the microfinance sector. RFIs have been able to reach

[2] A non-profit entity working globally for financial inclusion of poor women.

marginalized people with financial services, enabling them to take up income-enhancing livelihood activities.[3]

(d) **Capacity requirements at RUSACCO Union level.** The consolidation of the RUSACCO sector is required to: (i) enhance the institutional capacity of the Unions and RUSACCOs to deliver technical and financial services; and (ii) facilitate the creation of apex institutions for the Unions to enhance the cohesive and sustainable growth of RUSACCOs.

(e) **Digital financial services can improve efficiency and outreach.** The significant outreach realized under the RUFIP programmes provides an opportunity for digital finance development. There is strong recognition that innovative initiatives such as digital finance/mobile banking can transform the landscape for financial inclusion.

(f) **Programme management.** In RUFIP II, overall programme management at Development Bank of Ethiopia (DBE) through the programme coordination and management unit (PCMU) was effective in managing the LOC, but lack of capacity hampered monitoring and evaluation (M&E) and procurement, leading to a slow pace of capacity-building initiatives as well as IT enablement of RFIs.

II. Programme description

A. Programme objectives, geographic area of intervention and target groups

13. RUFIP III’s objective is to improve livelihoods and reduce vulnerability and poverty through increased incomes and better risk management through financial and non-financial measures.

14. The programme's objective will be achieved through a nationwide network of more than 11,000 RUSACCOs, their secondary structures (the Unions) and 38 MFIs, with increased focus on least developed areas. The programme targets 13.5 million clients of whom more than 10.25 million, or 75 per cent, will be poor. About 6.5 million new clients will have access to financial services as a result of RUFIP III. The key outcomes are: (i) strong RFIs with sound operating performance that offer better financial access to vulnerable people; (ii) RFIs receive support to diversify and expand in order to offer a wider range of services and products responsive to customer needs; and (iii) effective financial inclusion of marginalized people across regions.

15. The proposed target group consists of 50 per cent women and 10 per cent youth. People in least developed areas will be supported through savings, credit and insurance products. Beneficiaries of other IFAD-supported programmes will be targeted as well. RUFIP III also aims to facilitate access to finance for rural communities in projects financed by other development partners.

B. Components/outcomes and activities

16. The proposed programme will be implemented over six years and consist of four components:

17. **Component 1: Building capacity of institutions and clients** will enhance uptake of financial products by RUSACCOs and MFIs through financial literacy training and strengthening of the institutional capacity of RFIs to better serve the target groups. The outcome is an operationally and financially sustainable network of RFIs to serve poor people, and more financially literate clients.

[3] ILO Report, 2012

18. **Component 2: Improving regulation, supervision and institutional discipline** will strengthen the capacity of the National Bank of Ethiopia (NBE) and the Federal Cooperative Agency (FCA) to supervise and regulate MFIs and RUSACCOs (and their Unions), respectively. Opportunities for policy engagement are identified as part of the Government's financial sector reform (in para. 10). The outcome is enhanced regulation and supervision as a result of the strengthened capacity of NBE and FCA, resulting in operationally and financially sustainable RFIs.

19. **Component 3: Facilitating funds flow and diversification of business** will support RFIs in securing resources and improve their financial support mechanism to meet the credit requirements of IFAD's target group. The proposed financial instruments include a LOC from IFAD and the cofinancing partners, and domestic funds from the Government, DBE and other financial institutions. To enable RFIs to mobilize funds from commercial banks a guarantee fund**,** in collaboration with AGRA and other partners, is envisaged. To improve the risk mitigation capacity of clients, insurance products will be marketed by RFIs, who will be linked with insurance companies.

20. In collaboration with the Promotion of Sustainable Ethiopian Agro-Industrial Development (PROSEAD) project funded by the EU, about US$32 million of the LOC will be used to finance RFIs in the PROSEAD catchment areas of agro-industrial parks promoted by the Government to provide agricultural value chain financing for farmers, rural small and medium-sized enterprises (SMEs), primary cooperatives and Unions. About US$25 million of EIB's envisaged contribution will be used to develop a leasing portfolio for rural enterprises. The outcome of this component is increased funds and alternative sources for RFIs to meet the credit needs of IFAD's target group and make insurance products available to them.

21. **Component 4: Programme management** will ensure efficient coordination and oversight.

C. Theory of change

22. RUFIP III will improve livelihoods and reduce vulnerability and poverty in Ethiopia through increased incomes and better ability to manage risks at household level. Increasing the rural poor's access to products tailored to their needs will allow them to invest in their farming activities and/or diversify their income through off-farm activities and gradually improve their livelihoods and resilience to climate change-related shocks. RUFIP III will technically and operationally strengthen RFIs, enabling them to deliver an expanded range of financial products and services to a larger number of rural poor. With increased resources from the LOC and through the credit guarantee facility, and increased institutional capacity-building, the financial sector will become more inclusive and sustainable. The regulators will develop regulatory and supervisory capacity (both technical and procedural) to ensure soundness of the RFIs, and meet the rapidly growing industry demands.

D. Alignment, ownership, and partnerships

23. **Alignment.** RUFIP III is fully aligned to the GTP II and NFIS, which together, promote financial inclusion, modern payment systems, regulations based on international standards, a financial consumer protection framework and financial capability of clients.

24. RUFIP III will directly contribute to the Country Strategic Opportunities Programme (2017 **-**2022). It is fully aligned with the IFAD Strategic Framework 2016-2025**,** supports the mainstreaming priorities relating to youth and women and contributes to developing partnerships with public and private entities. RUFIP III will support the achievement of Sustainable Development Goal 1 (SDG1): no poverty; SDG2: no hunger and SDG5: gender equality.

25. **Ownership.** RUFIP programmes carry a high level of ownership by the Government and the implementing partners. The Government will utilize reflows

from RUFIP loans for redeployment to RFIs under RUFIP III. RUFIP III will also create links with other development initiatives, providing access to financial services.

26. **Partnerships.** IFAD is partnering with the EU, African Development Bank, Food and Agriculture Organization of the United Nations, United Nations Fund for the United Nations Industrial Development Organization, EIB and bilateral partners under PROSEAD, creating synergies and opportunities for a private sector-driven development model for rural Ethiopia. Cofinancing is envisaged from the EIB, EU, AGRA and domestic institutions including, DBE, the Commercial Bank of Ethiopia (CBE) and the Ethiopian Insurance Corporation (EIC).

E. Costs, benefits and financing

Programme costs

27. The total cost of the programme is US$305.79 million. RUFIP III will enable 13.5 million clients to access financial services by 2025. Apart from increasing savings and loans of clients, RUFIP III will increase the access of targeted rural individuals and enterprises to other financial services (e.g. insurance, agricultural value chain financing, equipment leasing and lease finance).

28. RUFIP III mainstreams climate change and a substantial part of the credit it provides is likely to help beneficiaries adapt to climate change and enhance household resilience to weather-related shocks. However, as no resources are specifically ring-fenced for investment in climate change adaptation at this time, IFAD climate finance will be monitored during implementation rather than by providing an estimate at design.

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

	IFAD loan		*IFAD DSF grant*		*Other cofinanciers*		*Beneficiaries*		*Borrower/counterpart*		*Financing gap*		*Total*	
Component	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*
1. Building capacity of institutions and clients	-	-	14 437.2	74.0	1 599.6	8.2	951.4	4.9	2 517.5	12.9			19 505.7	6.4
2. Improving regulation, supervision and institutional discipline	-	-	12 727.4	87.0	-	-	-	-	1 908.5	13.0			14 635.9	4.8
3. Facilitating funds flow and diversification of business	4 900.0	1.9	3 993.8	1.5	189 900.0	72.0	-	-	45 000.0	17.1	20 000.0	7.6	263 793.8	86.3
4. Programme management	-	-	3 941.6	50.1	1 400.4	17.8	-	-	2 521.2	32.1			7 863.2	2.6
Total	**4 900.0**	**1.6**	**35 100.0**	**11.5**	**192 900.0**	**63.1**	**951.4**	**0.3**	**51 947.2**	**17.0**	**20 000.0**	**6.5**	**305 798.6**	**100**

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

Expenditure category	*IFAD loan*		*IFAD grant*		*Other cofinanciers*		*Beneficiaries*		*Borrower/ counterpart*		*Financing gap*		*Total*	
	Amount	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*
1.Consultancies	-	-	20 624.6	76.8	2 762.4	10.3	-	-	3 477.0	12.9			26 864.0	8.8
2. Credit & guarantee fund	4 900.0	1.9	3 993.8	1.5	189 900.0	72.0	-	-	45 000.0	17.1	20 000.0	7.6	263 793.8	86.3
3. Equipment & materials	-	-	2 645.2	86.1	10.5	0.3	15.5	0.5	400.6	13.0			3 071.8	1.0
4. Training	-	-	6 876.4	74.4	227.1	2.5	935.9	10.1	1 205.5	13.0			9 244.9	3.0
5. Salaries & allowances	-	-	960.0	52.2	-	-	-	-	879.8	47.8			1 839.8	0.6
6. Operating costs	-	-	-	-	-	-	-	-	984.3	100.0			984.3	0.3
Total	**4 900.0**	**1.6**	**35 100.0**	**11.5**	**192 900.0**	**63.1**	**951.4**	**0.3**	**51 947.2**	**17.0**	**20 000.0**	**6.5**	**305 798.6**	**100**

Table 3
Programme costs by component and programme year
(Thousands of United States dollars)

Component	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**Total**
1. Building capacity of institutions and clients	5 359.9	3 959.9	4 063.0	2 833.7	2 115.1	1 174.1	19 505.7
2. Improving regulation, supervision and institutional discipline	2 533.3	3 487.0	3 225.2	2 401.0	2 216.5	772.9	14 635.9
3. Facilitating funds flow and diversification of business	60 115.1	60 115.1	60 115.1	60 115.1	11 666.7	11 666.7	263 793.8
4. Programme management	2 508.9	1 339.2	1 336.1	874.3	937.5	867.2	7 863.2
Total	**70 517.1**	**68 901.3**	**68 739.4**	**66 224.1**	**16 935.8**	**14 480.9**	**305 798.6**

Programme financing and cofinancing strategy and plan

29. The total outlay is estimated at US$305.79 million over a six-year period. In addition to the proposed IFAD loan of US$4.90 million and Debt Sustainability Framework (DSF) grant of US$35.10 million, EIB envisages a loan of US$112 million (subject to approval in October/November 2019), the EU will contribute US$19.4 million as a grant and AGRA will provide US$1.5 million, also as a grant. Domestic cofinancing from the DBE, CBE and EIC amounts to respectively US$25 million, US$20 million and US$15 million. The borrower/recipient has committed to contribute about US$51.9 million, mostly from reflows from RUFIP programmes. The beneficiaries' contribution will be in the form of client savings with RFIs (which will provide loans to clients) and, in the case of RUSACCO members, capital contributions.

30. The financing gap of US$20 million may be sourced through subsequent PBAS cycles (under financing terms to be determined and subject to internal procedures and Executive Board approval) or by cofinancing identified during implementation.

Disbursement

Funds flow and disbursement

31. A designated bank account will be opened in the NBE to receive funds from IFAD and will be managed by DBE in accordance with government procedures. A corresponding operating account in Ethiopian Birr (ETB), managed by DBE, will be opened in the CBE. There will also be dedicated operating bank accounts managed by the respective participating regional cooperative promotion bureaux and implementing partners to receive both the loan and grant funds and the individual contributions of the regional state governments. EU cofinancing will be disbursed on a parallel basis.

32. A counterpart funding account denominated in ETB will also be opened at the CBE to receive the Government's contribution for taxes and duties and for other activities as agreed. The Government will transfer, based on the approved annual workplan and budget, counterpart funds on a six-monthly basis.

Summary of benefits and economic financial analysis

33. The economic analysis shows that a significant level of outreach to very poor and poor people will be achieved. MFIs are expected to increase their borrowing clients from just over 5 million in 2018, to 10 million in 2025, and in RUSACCOs the number of new members will grow over the six-year period from 1.9 million in 2018 to 3.3 million in 2025.

34. The financial analysis shows that both the MFI and the RUSACCOs subsectors have positive returns. The microfinance subsector returns over an 18-year period a net present value (NPV) of US$3,279 million and a financial internal rate of return (FIRR) of 65.5 per cent, using the LOC. Calculations of the RUSACCO subsector return an NPV of US$111 million over an 18-year period and an FIRR of 20 per cent. The FIRR differs between MFIs and RUSACCOs since MFIs are profit-driven while RUSACOs are membership-driven.

35. The benefit stream is composed of surpluses generated by the RFIs utilizing the LOC and the capacity-building support. At household level, benefit streams arise from the loans taken by 11 million borrowers for their income-generating enterprises. At sector level, a strong RFI network contributes to inclusiveness and sustainability, in addition to building enabling conditions for businesses and for the Government to reach out to poor households. At the macro level, benefits accrue to the country from financial inclusion of poor and vulnerable people.

Exit strategy and sustainability

36. The programme is focused on the sustainability of RFIs and the microfinance sector. Given the diversity of the RFI sector, RUFIP III envisions both scaling-up and focusing on building sustainability with a clear exit strategy. Sustained provision of appropriate financial products and services to the target clients without dependence on external support is the final outcome that would produce the desired impact of poverty reduction and livelihood risk mitigation.

37. At the macro level, sustainability will be achieved through engagement of policy and regulatory institutions, and creating the conditions for RFIs to operate efficiently and gain the confidence of their clients. At the meso level, the provision of a LOC to RFIs (including setting up guarantee facilities and introducing RFIs as credible lenders), and the strengthening of RFIs' technical and operational capacities, IT upgrading and systems improvements will contribute to sustainability. At the micro level, the clients are supported in obtaining access to financial services to improve their livelihoods and reduce risk through financial literacy training, greater proximity of RFIs and insurance services.

38. The key aspects of sustainability addressed as part of the exit strategy are: (i) resource and financial sustainability of the RFIs; (ii) relevance and adequacy of regulatory practice; and (iii) customer confidence in products and services offered by RFIs.

III. Risks

A. Programme risks and mitigation measures

39. The programme carries political, economic, regulatory and operational risks. Mitigating these risks is a core objective of the programme. The main risks and mitigation measures are as follows:

Table 4
Integrated risk framework

Risk	Risk rating	Mitigation measures
Political/governance	Medium	Continuous communication with the Government and strengthening of regulations and supervision capacity
Institutional capacity	Medium	Capacity-building for RFIs
Financial management	Medium	Appropriate accounting software; training on annual workplan and budget (AWPB) preparation compliance with International Public Sector Accounting Standards; streamlined funds flow arrangements; full-time accountant
Procurement	Medium	Training, hiring of a procurement officer
Environment and social	Low	Awareness-raising for RFIs

B. Environment and social category

40. **Environmental, Social and Climate Assessment Procedures (SECAP).** RUFIP III may have some adverse environmental and/or social impacts on human populations or environmentally significant areas, but the likely impacts: (i) are less adverse than those for Category A; (ii) are site-specific and mostly reversible in nature; and (iii) can be readily remedied by appropriate preventive and/or mitigation measures. Based on the National Environment Impact Assessment Guidelines and the SECAP, the programme falls under Category B. The programme provides access to financial products for vulnerable populations and will entail no major adverse environmental and social impact.

C. Climate risk classification

41. RUFIP III carries moderate climate risk. Given that most of the beneficiaries are smallholder farmers and pastoralists their livelihoods and investments are exposed and sensitive to climate shocks. However, the resources accessed through RUFIP III can also be utilized for investments that build the resilience of the beneficiaries and support their recovery following climate-related shocks.

D. Debt sustainability

42. During 2016/2017, stagnant exports, declining external reserves and the maturing of non-concessional borrowing contracted in the last five years resulted in a deterioration of the 2017 IMF Debt Sustainability Analysis indicators. The risk of external debt distress increased to "high" throughout 2018. As a consequence, in 2018 IFAD's lending terms softened to DSF grant/highly concession loan (from highly concessional loan).

IV. Implementation

A. Organizational framework

Programme management and coordination

43. Implementation arrangements for RUFIP III will be strengthened based on lessons learned. The Ministry of Finance will represent the Government. The project steering committee (PSC) – composed of representatives of key institutions such as the Ministry of Finance, NBE, FCA, DBE, one insurance company and one commercial bank – will provide policy and strategic leadership/guidance and oversight to the programme. The programme director will provide support to the PSC.

44. DBE will establish a PCMU which will ensure oversight of implementation at national and regional levels. The main partners will include the NBE, FCA and Association of Ethiopia Microfinance Institution (AEMFI). The unit will oversee the annual workplan

and budget and the release of funds under the plans, collect and analyse data, and prepare reports.

Financial management, procurement and governance

45. **Financial management.** DBE is the lead programme agency and will oversee programme implementation at the national level and regional level. A full-time finance manager and at least two accountants will be assigned to the programme. Focal points from each implementing agency will be assigned to handle day-to-day financial management. An M&E officer will take the lead in AWPB preparations and consolidation in consultation with finance staff. Under RUFIP II, some control gaps were identified by statutory audits and supervision missions. As the use of Microsoft Excel limited RUFIP II reporting, a critical start-up activity for RUFIP III will be the procurement and installation of off-the-shelf accounting software. Quarterly reporting will be a requirement of the more comprehensive financial reporting in place for RUFIP III. Given the moderate fiduciary risk, DBE internal auditors will undertake internal audits of RUFIP III.

46. **External audit**. The annual programme audit report will be submitted to IFAD within six months from the end of the fiscal year. The Office of the Federal Auditor General (OFAG), or a qualified auditor nominated by the OFAG and acceptable to IFAD, will carry out the audit in accordance with the International Standards on Auditing. In accordance with the policies of IFAD and the International Development Association, audited financial statements will be disclosed to the public.

47. **Procurement arrangements**. DBE, as a public sector entity, will be responsible for the overall procurement function. The PCMU will have a full-time procurement specialist who, in partnership with the DBE procurement unit, will be responsible for: (i) consolidating the procurement plans from implementing agencies (IAs) into IFAD format, and monitoring and reporting on their implementation, (ii) reviewing procurement processes by IAs and ensuring that they conform to both government and IFAD requirements, and (iii) following up on procurement processes with the DBE procurement unit and ensuring that all processes are rapidly executed and carried out in accordance with the law.

48. **Procurement methods and prior review amounts.** Procurement will be undertaken using the methods set out in the Public Procurement and Property Administration Proclamation. Although the proclamation sets certain thresholds, IFAD’s handbook on procurement will be used for international competitive bidding thresholds.

49. **Governance**. All participating institutions are legal entities with clear management and governance structures. At PCMU level, the PSC will have overall responsibility for programme governance.

50. **Governance and anticorruption measures.** The Government established the Federal Ethics and Anti-Corruption Commission of Ethiopia in May 2001. IFAD’s anticorruption policy and whistle-blowing procedures are incorporated into the programme implementation manual elaborated at start-up. The ethics and anticorruption structures and reporting mechanisms of implementing agencies will also apply to the programme.

B. Planning, monitoring and evaluation, learning, knowledge management and communications

51. AWPBs will be developed through a bottom-up participatory planning process with technical support from the PCMU. The PCMU will consolidate AWPBs received from the MFIs, FCA (consolidating the plans of their respective RUSACCOs and Unions), NBE and AEMFI for validation by the PSC.

52. Each AWPB will include a procurement plan, disbursement plan and targeting strategy. RFIs will be required to prepare a strategy for meeting targeting priorities relating to poor segments, gender, youth and least developed areas with the help of baseline data, which they will be required to track and report. The PCMU will submit a quarterly progress report to DBE management and IFAD.

53. RUFIP III will upgrade the existing M&E system to drive results-based planning and reporting, aligned to government IFAD requirements. The capacity of the M&E team will be strengthened. M&E arrangements will include knowledge management activities. Data collection will be improved with the scaling-up of the activities related to the management information system currently being piloted by AEMFI and FCA. A database management system to monitor the implementation progress and logical framework indicators will be introduced in the first year. The system will be used as a learning and decision tool throughout the programme.

54. Additional information will be collected periodically using thematic and follow-up studies. Annual outcome surveys will be conducted in the target area starting from the second year, supported by a baseline survey to be carried out during the first year that will provide benchmark data for subsequent comparisons.

Innovation and scaling-up

55. While scaling-up of achievements under RUFIP and RUFIP II, RUFIP III will also promote innovations. In addition to improving targeting, tracking and measurement of results, key innovative features include:

    (a) establishment of a guarantee facility to induce a steady flow of domestic funds as part of the exit strategy for securing resources for RFIs;

    (b) facilitating access to insurance products to rural clients at scale. RFIs will receive support to become agents of insurance companies and market their products. Given the favourable conditions, the potential for scaling-up use of insurance in rural areas through this model and the client-level impact on vulnerability reduction are very high;

    (c) positioning of the programme as a financing hub for other projects of different agencies where livelihood strengthening takes place, but access to finance is a constraint.

C. Implementation plans

Implementation readiness and start-up plans

56. Since this is the third phase of a well-performing programme, readiness for implementation is high. While EIB is planning to proceed to appraisal in October/ November 2019, during which the leasing modalities will be finalized, aspects that will be confirmed during the first year of implementation include: (i) implementation modalities of the guarantee facility (in partnership with AGRA); (ii) insurance agency business framework involving RFIs and insurance companies; (iii) baseline studies to inform RFIs' specific targeting strategies; (iv) identification of technical assistance providers to track client-level outcomes; and (v) procurement of off-the-shelf accounting software.

Supervision, midterm review and completion plans

57. The programme will be supervised by IFAD and EIB. Key features likely to require implementation support include: (i) programme management; (ii) M&E and knowledge management; (iii) procurement; (iv) IFAD corporate priorities (gender, youth targeting, and nutrition); (v) rural poor targeting; and (vi) policy engagement.

V. Legal instruments and authority

58. A programme financing agreement between the Federal Democratic Republic of Ethiopia and IFAD will constitute the legal instrument for extending the proposed

financing to the borrower. A copy of the negotiated financing agreement is attached in appendix I.

59. The Federal Democratic Republic of Ethiopia is empowered under its laws to receive financing from IFAD.

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

VI. Recommendation

61. 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 Federal Democratic Republic of Ethiopia in an amount of three million six hundred thousand special drawing rights (SDR 3,600,000) upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein,

> RESOLVED: that the Fund shall provide a grant under the Debt Sustainability Framework to the Federal Democratic Republic of Ethiopia in an amount of twenty-five million six hundred fifty thousand special drawing rights (SDR 25,650,000) 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

Negotiated financing agreement: "Rural Financial Intermediation Programme III (RUFIP III)"

(Negotiations concluded on 8 November 2019)

Loan No: ___________

Programme name: Rural Financial Intermediation Programme III (RUFIP III) (the "Programme")

The Federal Democratic Republic of Ethiopia (the "Borrower")

and

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

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

WHEREAS the Borrower has requested financing from the Fund for the purpose of financing the RUFIP III;

WHEREAS, the Programme shall be co-financed by the European Investment Bank, European Union, Alliance for a Green Revolution in Africa (AGRA) and domestic financial institutions;

WHEREAS, the Fund has agreed to co-finance the Programme and provide a loan and a grant for the activities described in Schedule 1 to this Agreement;

WHEREAS, a separate Financing Agreement shall be concluded between the FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA and the Fund for the activities financed through the Grant;

NOW THEREFORE, 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), the Special Covenants (Schedule 3) and the General Conditions. In the event of a conflict between this document and any of the Schedules, the provisions of this document shall take precedence.

2. All provisions of the Fund's General Conditions for Agricultural Development Financing dated 29 April 2009, amended as of December 2018, and as may be amended hereafter from time to time (the "General Conditions") 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, unless the Parties otherwise agree in this Agreement.

3. The Fund shall provide a Loan to the Borrower which the Borrower shall use to implement the RUFIP III in accordance with the terms and conditions of this Agreement.

Section B

1. The amount of the Loan is three millions six hundred thousand Special Drawing Rights (SDR 3 600 000).

2. The Loan is granted on highly concessional terms and shall be free of interest but bear a fixed service charge of three fourths of one per cent (0.75%) per annum payable semi-annually in the Loan Service Payment Currency. The Loan 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 Financing by the Fund's Executive Board.

3. The Loan Service Payment Currency shall be the US dollar.

4. The first day of the applicable Fiscal Year shall be 8th of July.

5. Payments of principal and service charge shall be payable on each 1st April and 1st October.

6. A single designated bank account for the Loan and the Grant will be opened in the National Bank of Ethiopia (NBE) to receive funds from IFAD and will be managed by Development Bank of Ethiopia (DBE) in accordance with Borrower procedures. A corresponding operating account in Ethiopian Birr (ETB) managed by DBE will be opened in the NBE. There will also be dedicated operating bank accounts managed by the respective participating Regional Cooperative Promotion Bureaus and implementing partners to receive both the Loan and Grant proceeds and the individual Regional State Governments' contribution.

7. A single counterpart funding account denominated in ETB will be opened at the NBE to receive Borrower contributions for the Programme taxes and duties and for other activities as allocated. The Borrower shall transfer, based on approved AWPB, counterpart funds on a semester basis.

8. The Borrower shall provide counterpart financing for the Programme as provided for in the Financing agreement for the Grant.

Section C

1. The Lead Programme Agency shall be the Development Bank of Ethiopia (DBE).

2. The following implementing parties are designated as Programme Parties: the National Bank of Ethiopia (NBE), the Federal Cooperative Agency (FCA), Regional Cooperative Promotion Bureau (RCPB) the Association of Ethiopian Micro Finance Institutions (AEMFI), participating microfinance institutions (MFIs), and participating Rural Savings and Credit Cooperatives (RUSACCOs) and their Unions.

3. A Mid-Term Review will be conducted as specified in Section 8.03 (b) and (c) of the General Conditions; however, the Parties may agree on a different date for the Mid-Term Review of the implementation of the Programme.

4. The Programme Completion Date shall be six years after the date of entry into force of this Agreement or such other date as the Fund may designate by notice to the Borrower and the Financing Closing Date will be established as specified in the General Conditions. The Agreement shall enter into force on the date of receipt by the Fund of the instrument of ratification.

Section D

IFAD will administer the Loan and supervise the Programme.

Section E

1. The following are designated as additional grounds for suspension of the right of the Borrower to request disbursements under IFAD Financing: The Programme Implementation Manual (PIM) has been waived or amended without the prior agreement of IFAD.

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

a) The PIM has been approved by IFAD;

b) IFAD no objection to the appointment of the Programme Director, and the Finance Manager;

3. This Agreement is subject to ratification by the Borrower.

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

For the Borrower:

Ministry of Finance
P.O. Box 1905
Addis Ababa
Ethiopia

Facsimile No.: (2511)551355

Copy to:

Development Bank of Ethiopia
P.O. Bosx 1900
Addis Ababa
Ethiopia

Facsimile No.: (2511)511606

For the Fund:

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 and shall enter into force as provided for in the General Conditions.

FEDERAL DEMOCRATIC
REPUBLIC OF ETHIOPIA

____
Name and title of the Authorised Representative

Date: ____________

INTERNATIONAL FUND FOR
AGRICULTURAL DEVELOPMENT

____
Gilbert F. Houngbo
President

Date: ______________

Schedule 1

Programme Description and Implementation Arrangements

I. Programme Description

1. *Target population*. The Programme shall benefit at least 13.5 million clients in the rural areas of Ethiopia targeting small holder farmers, pastoralists, agro-pastoralists, rural enterprises, women, youth, and people in least developed areas. Synergies will be sought with IFAD's ongoing Programmes throughout the country and Programmes financed by other development partners.

2. *Programme area*. The Programme shall not be confined to any geographic location but will have increased focus on least developed areas.

3. *Goal.* The goal of the Programme is improved livelihoods and reduced vulnerability and poverty through increased incomes and better ability to manage risks at household level.

4. *Objectives.* The objectives of the Programme shall be to provide access to a range of financial products and services for an estimated 13.5 million rural households in Ethiopia building through sustainable rural financial institutions (RFI).

5. *Components.* The Programme shall consist of the following four components: (i) Building capacity of institutions and clients; (ii) Improving regulation, supervision and institutional discipline; (iii) Facilitating funds flow and diversification of RFI business; and (iv) Programme coordination and management.

5.1 <u>Component 1. Building capacity of Microfinance Institutions (MFIs) and Cooperative Subsector and clients</u>: This component shall support: (a) human resource development through a range of appropriately structured training Programmes and exposure to good practices for senior management and operating staff across the sector; (b) client training in investment aspects, especially for youths to enhance their ability to invest in productive enterprises; (c) design and delivery of financial literacy Programmes for MFI and RUSACCO clients with focus in remote areas, to enhance uptake of financial products and services; and, (d) development of internal systems and processes.

5.2 <u>Component 2. Improving regulation, supervision and institutional discipline</u>: This component shall support: (a) Knowledge and skill development of staff of National Bank of Ethiopia (NBE) on innovative financial products; (b) training on supervisory and regulatory subjects specified by the regulators (NBE and FCA), and (c) policy seminars.

The Programme will also finance technical assistance (TA) to the NBE supporting: (a) policy development for MFIs in aspects referred in the PIM; (b) economic reforms in the development of the financial infrastructure; (c) the development of protocols to facilitate rural and micro-leasing markets; (d) policy dialogue in economic reform areas. At the FCA, the Programme shall support: (a) the process of separating the legal, as well as regulatory and supervisory responsibilities between financial and non-financial cooperatives; (b) setting up a dedicated financial cooperatives regulation wing in FCA; (c) implementation of tiered regulation/inspection; and (d) the establishment of regional/national apex financial institutions.

5.3 Component 3. Facilitating funds flow and diversification of business: This component shall support the growth of the savings and loan portfolios of the MFIs and RUSACCOs. This component shall also support: (a) a guarantee fund to enable MFIs and RUSACCO Unions to borrow from commercial banks; (b) agriculture value chain financing; (c) insurance marketing through MFIs and RUSACCOs; and (d) leasing products to meet rural requirements for investment in equipment.

5.4 *Component 4*: *Programme management.* This component will support the management of the Programme implementation through Programme Steering Committee and Programme Coordination and Management Unit (PCMU) in DBE. The PCMU will be strengthened with appropriate expertise to address the technical needs of the Programme as described in the PIM.

II. Implementation Arrangements

6. *Lead Programme Agency*. The Programme shall be coordinated through the Development Bank of Ethiopia (DBE). It will ensure overall oversight for the implementation of the Programme at national level.

7. *National Rural and Microfinance Policy Steering Committee (PSC)*. The Ministry of Finance (MoF) will establish a National Rural and Microfinance Policy Steering Committee (PSC) which will ensure overall Programme governance. The PSC shall assume the responsibility to proactively champion the development of enabling policy and regulatory framework for rural financial sector, and address new policy implications on the Programme.

8. The PSC shall also provide an interface to IFAD for policy dialogue and consultative processes. The PSC shall be a key pillar of the management structure of the Programme, setting the tone for the overall development and direction of the microfinance sector. The PSC shall be constituted by the NBE, with expanded representation and terms of reference acceptable to IFAD. The PSC shall be headed by the Vice-Governor, NBE, or such other senior official as may be agreed between the Borrower/Recipient and IFAD.

9. *Programme Management Committee (PMC)*. DBE shall re-establish the Programme Management Committee (PMC) created for the RUFIP II with representation for all stakeholders and with enlarged terms of reference. In addition, the PMC shall establish a sub-committee comprised of the President of DBE, the Executive Director of the AEMFI; the Director of Microfinance Institutions Department of NBE, the RUFIP III Programme Director and the National Programme Coordinator in the Federal Cooperative Agency (FCA) to deal with routine operational matters. The membership of the sub-committee may be changed from time to time by agreement of the Borrower/Recipient and the Fund.

10. *The Programme Coordination and Management Unit (PCMU)*. DBE shall be resposibile for recuritment and assigning of adequate staff to the PCMU as required in the PIM, and as may be satisfactory to IFAD. DBE shall ensure, as specified in the PIM, the assignment of Programme Director, Finance Manager, Monitoring and Evauation Officer, Procurement Specialist dedicated full-time to RUFIP III, Social Performance, Linkage Officer, and Fiancial Sector Specialist. The Programme Director shall directly report to a member of DBE’s senior management, and shall be delegated financial and operational powers sufficient to provide operational autonomy for the PCMU, as may be necessary. The PCMU shall function like a special purpose vehicle under the overall direction of the PMC and senior management of DBE. The removal of any key Programme staff by the Borrower will be subject to prior consultation and agreement with the Fund.

11. *Credit guarantee sub-committee*. The PCMU shall, in collaboration with AGRA, set up a credit guarantee fund to secure bank loans. A sub-committee shall be established to steer the process, while DBE, in collaboration with qualified experts shall develop and implement the fund.

12. *Insurance sub-committee.* The PCMU shall estabish a sub-committee to steer the initiatives on marketing of rural insurance products to the clients of RFIs.

13. *Standing Committee*. The FCA, specifically the National Training Coordinator at federal level, and the Regional Training Coordinators at regional levels, where available, shall establish a Standing Committee to guide the TA process and capacity building of RuSACCO and Union staff, as well as of the members, guided by the PIM.The committee will be chaired by Director, FCA.

14. *Programme Implementation Manual (PIM)*. The Borrower shall carry out the Programme also in accordance with the PIM. The Borrower will finalize the development of the PIM for the Fund's consideration and approval. The PIM will include: (a) Programme framework and strategies for target groups; (b) Programme governance structure and institutional arrangements and responsibilities of Lead Agency and PCMU, Implementing Agencies and partners; (c) detailed implementation modalities for Component 1 (Building capacity of institutions and clients), Component 2 (Improving regulation, supervision and institutional discipline), Component 3 (Facilitating funds flow and diversification of businesses); and, Component 4 (Programme management); and, (d) detailed Programme procedures for: annual work plan and budget (AWPB) process; monitoring and evaluation, knowledge management and communication; and procurement. The PIM will also include annexes of various reporting formats, templates, checklists, draft terms of reference for PCMU staff and for technical assistance as well as information on the guarantee fund. The PIM may be updated at any time, as needs arise, during implementation, but shall require prior approval by IFAD.

15. *Procurement arrangements*. As per the Federal procurement proclamation, directive and manual, the actual practice of procurement is decentralized to public bodies or procuring entities that poses a structure that will ensure internal control in the decision-making process. In this case, the DBE is the public body under which RUFIP III will operate and will therefore be responsible for the overall procurement function. At regional level, although procurement is governed by the Public Procurement and Property Administration Proclamation, each region has specific procurement directives.

Schedule 2

Allocation Table

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

Category	Loan Amount Allocated (expressed in SDR)	Percentages
I. Credit, Guarantee Funds	3 600 000	100% net of Government and other co-financiers contribution
TOTAL	3 600 000	

(b) The term used in the Table above is defined as follows*:*

(i) Credit, Guarantee Funds - includes line of credit.

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 Loan 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 Programme:

1. Within 6 months of entry into force of the Financing Agreement, the Programme will procure an accounting software as it is the practice in IFAD on-going supported Programmes or customize the DBE accounting system, to satisfy International Accounting Standards and IFAD's requirements.

2. The PCMU shall review and ensure action is taken on internal and external audit findings as well as recommendations of supervision and implementation support missions.

3. *Compliance with the Social, Environmental and Climate Assessment Procedures (SECAP).* The Borrower shall ensure that the Programme will be implemented in compliance with IFAD's SECAP and more specifically that the following measures shall be taken: (a) all Programme activities are implemented in strict conformity with the Borrower relevant laws/regulations; (b) women and men shall be paid equal remuneration for work of equal value under the Programme; (c) recourse to child labour is not made under the Programme; and (d) all necessary and appropriate measures to implement the Gender Action Plan to ensure that women can participate and benefit equitably under the Programme are duly taken.

4. *Anticorruption Measures*. The Borrower shall comply with IFAD Policy on Preventing Fraud and Corruption in its Activities and Operations, taking appropriate action to prevent, mitigate and combat Prohibited Practices.

Negotiated financing agreement: "Rural Financial Intermediation Programme III (RUFIP III)"

(Negotiations concluded on 8 November)

Grant No: _________

Programme name: Rural Financial Intermediation Programme III (RUFIP III) (the "Programme")

The Federal Democratic Republic of Ethiopia (the "Recipient")

and

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

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

WHEREAS the Recipient has requested financing from the Fund for the purpose of financing the RUFIP III;

WHEREAS, the Programme shall be co-financed by the European Investment Bank, European Union, Alliance for a Green Revolution in Africa (AGRA) and domestic financial institutions;

WHEREAS, the Fund has agreed to co-finance the Programme and provide a loan and a grant for the activities described in Schedule 1 to this Agreement;

WHEREAS, a separate Financing Agreement shall be concluded between the FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA and the Fund for the activities financed through the Loan;

NOW THEREFORE, 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), the Special Covenants (Schedule 3) and the General Conditions. In the event of a conflict between this document and any of the Schedules, the provisions of this document shall take precedence.

2. All provisions of the Fund's General Conditions for Agricultural Development Financing dated 29 April 2009, amended as of December 2018, and as may be amended hereafter from time to time (the "General Conditions") 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, unless the Parties otherwise agree in this Agreement.

3. The Fund shall provide a Grant to the Recipient which the Recipient shall use to implement the RUFIP III in accordance with the terms and conditions of this Agreement.

Section B

1. The amount of the Grant is twenty-five million six hundred fifty thousand Special Drawing Rights (25 650 000 SDR).

2. The first day of the applicable Fiscal Year shall be 8th of July.

3. A single designated bank account will be opened for the Grant and the Loan in the National Bank of Ethiopia (NBE) to receive funds from IFAD and will be managed by Development Bank of Ethiopia (DBE) in accordance with Recipient procedures. A corresponding operating account in Ethiopian Birr (ETB) managed by DBE will be opened in the NBE. There will also be dedicated operating bank accounts managed by the respective participating Regional Cooperative Promotion Bureaus and implementing partners to receive the Grant proceeds and the individual Regional State Governments' contribution.

8. A single counterpart funding account denominated in ETB will be opened at the NBE to receive Recipient contributions for the Programme taxes and duties and for other activities as allocated. The Recipient shall transfer, based on approved AWPB, counterpart funds on a semester basis.

8. The Recipient shall provide counterpart financing for the Programme in the equivalent of fifty one million nine hundred fifty thousand United States dollars (USD 51 950 000).

Section C

1. The Lead Programme Agency shall be the Development Bank of Ethiopia (DBE).

2. The following implementing parties are designated as Programme Parties: the National Bank of Ethiopia (NBE), the Federal Cooperative Agency (FCA), Regional Cooperative Promotion Bureau (RCPB) the Association of Ethiopian microfinance institutions (AEMFI), participating microfinance institutions (MFIs), and participating Rural Savings and Credit Cooperatives (RUSACCOs) and their Unions.

3. A Mid-Term Review will be conducted as specified in Section 8.03 (b) and (c) of the General Conditions; however, the Parties may agree on a different date for the Mid-Term Review of the implementation of the Programme.

4. The Programme Completion Date shall be six years after the date of entry into force of this Agreement or such other date as the Fund may designate by notice to the Recipient and the Financing Closing Date will be established as specified in the General Conditions.

Section D

IFAD will administer the Grant and supervise the Programme.

Section E

1. The following are designated as additional grounds for suspension of the right of the Recipient to request disbursements under the Grant: The Programme Implementation Manual (PIM) has been waived or amended without the prior agreement of IFAD.

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

(a) The PIM has been approved by IFAD;

(b) IFAD no objection to the appointment of the Programme Director, and the Finance Manager;

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

For the Recipient:

Ministry of Finance
P.O. Box 1905
Addis Ababa
Ethiopia
Facsimile No.: + (2511) 551355

Copy to:

Development Bank of Ethiopia
P.O. Bosx 1900
Addis Ababa
Ethiopia
Facsimile No.: + (2511) 511606

For the Fund:

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 Recipient and shall enter into force as provided for in the General Conditions.

THE FEDERAL DEMOCRATIC
REPUBLIC OF ETHIOPIA

____
Name and title of the Authorised Representative

Date: ____________

INTERNATIONAL FUND FOR
AGRICULTURAL DEVELOPMENT

____
Gilbert F. Houngbo
President

Date: ______________

Schedule 1

Programme Description and Implementation Arrangements

I. Programme Description

1. *Target population*. The Programme shall benefit at least 13.5 million clients in the rural areas of Ethiopia targeting small holder farmers, pastoralists, agro-pastoralists, rural enterprises, women, youth, and people in least developed areas. Synergies will be sought with IFAD's ongoing Programmes throughout the country and Programmes financed by other development partners.

2. *Programme area*. The Programme shall not be confined to any geographic location but will have increased focus on least developed areas.

3. *Goal.* The goal of the Programme is improved livelihoods and reduced vulnerability and poverty through increased incomes and better ability to manage risks at household level.

4. *Objectives.* The objectives of the Programme shall be to provide access to a range of financial products and services for an estimated 13.5 million rural households in Ethiopia building through sustainable rural financial institutions (RFI).

5. *Components.* The Programme shall consist of the following four components: (i) Building capacity of institutions and clients; (ii) Improving regulation, supervision and institutional discipline; (iii) Facilitating funds flow and diversification of RFI business; and (iv) Programme coordination and management.

5.1 <u>Component 1. Building capacity of Microfinance Institutions (MFIs) and Cooperative Subsector and Clients</u>: This component shall support: (a) human resource development through a range of appropriately structured training Programmes and exposure to good practices for senior management and operating staff across the sector; (b) client training in investment aspects, especially for youths to enhance their ability to invest in productive enterprises; (c) design and delivery of financial literacy Programmes for MFI and RUSACCO clients with focus in remote areas, to enhance uptake of financial products and services; and, (d) development of internal systems and processes.

5.2 <u>Component 2. Improving regulation, supervision and institutional discipline</u>: This component shall support: (a) Knowledge and skill development of staff of National Bank of Ethiopia (NBE) on innovative financial products; (b) training on supervisory and regulatory subjects specified by the regulators (NBE and Federal Cooperative Agency (FCA)), and (c) policy seminars.

The Programme will also finance TA to the NBE supporting: (a) policy development for MFIs in aspects referred in the Programme Implementation Plan; (b) economic reforms in the development of the financial infrastructure; (c) the development of protocols to facilitate rural and micro-leasing markets; (d) policy dialogue in economic reform areas.

At the FCA, the Programme shall support: (a) the process of separating the legal, as well as regulatory and supervisory responsibilities between financial and non-financial cooperatives; (b) setting up a dedicated financial cooperatives regulation wing in FCA; (c) implementation of tiered regulation/inspection; and (d) the establishment of regional/national apex financial institutions.

5.3 Component 3. Facilitating funds flow and diversification of business: This component shall support the growth of the savings and loan portfolios of the MFIs and RUSACCOs. This component shall also support: (a) a guarantee fund to enable MFIs and RUSACCO Unions to borrow from commercial banks; (b) agriculture value chain financing; (c) insurance marketing through MFIs and RUSACCOs; and (d) leasing products to meet rural requirements for investment in equipment.

5.4 Component 4. Programme management: This component will support the management of the Programme implementation through Programme Steering Committee and Programme Coordination and Management Unit (PCMU) in DBE. The PCMU will be strengthened with appropriate expertise to address the technical needs of the Programme as described in the PIM.

II. Implementation Arrangements

6. *Lead Programme Agency*. The Programme shall be coordinated through the Development Bank of Ethiopia (DBE). It will ensure overall oversight for the implementation of the Programme at national level.

7. *National Rural and Microfinance Policy Steering Committee (PSC)*. The Ministry of Finance (MoF) will establish a National Rural and Microfinance Policy Steering Committee (PSC) which will ensure overall Programme governance. The PSC shall assume the responsibility to proactively champion the development of enabling policy and regulatory framework for rural financial sector, and address new policy implications on the Programme.

8. The PSC shall also provide an interface to IFAD for policy dialogue and consultative processes. The PSC shall be a key pillar of the management structure of the Programme, setting the tone for the overall development and direction of the microfinance sector. The PSC shall be constituted by the NBE, with expanded representation and terms of reference acceptable to IFAD. The PSC shall be headed by the Vice-Governor, NBE, or such other senior official as may be agreed between the Recipientand IFAD.

9. *Programme Management Committee (PMC)*. DBE shall re-establish the Programme Management Committee (PMC) created for the RUFIP II with representation for all stakeholders and with enlarged terms of reference. In addition, the PMC shall establish a sub-committee comprised of the President of DBE, the Executive Director of the AEMFI; the Director of Microfinance Institutions Department of NBE, the RUFIP III Programme Director and the National Programme Coordinator in the Federal Cooperative Agency (FCA) to deal with routine operational matters. The membership of the sub-committee may be changed from time to time by agreement of the Recipientand the Fund.

10. *The Programme Coordination and Management Unit (PCMU)*. DBE shall be resposibile for recuritment and assigning of adequate staff to the PCMU as required in the PIM, and as may be satisfactory to IFAD. DBE shall ensure, as specified in the PIM, the assignment of Programme Director, Finance Manager, Monitoring and Evauation Officer, Procurement Specialist dedicated full-time to RUFIP III, Social Performance, Linkage Officer, and Fiancial Sector Specialist. The Programme Director shall directly report to a member of DBE's senior management, and shall be delegated financial and operational powers sufficient to provide operational autonomy for the PCMU, as may be necessary. The PCMU shall function like a special purpose vehicle under the overall direction of the PMC and

senior management of DBE. The removal of any key Programme staff by the Recipient shall be subject to prior consultation and agreement with the Fund.

11. *Credit guarantee sub-committee*. The PCMU shall, in collaboration with AGRA, set up a credit guarantee fund to secure bank loans. A sub-committee shall be established to steer the process, while DBE, in collaboration with qualified experts shall develop and implement the fund.

12. *Insurance sub-committee*. The PCMU shall estabish a sub-committee to steer the initiatives on marketing of rural insurance products to the clients of RFIs.

13. *Standing Committee*. The FCA, specifically the National Training Coordinator at federal level, and the Regional Training Coordinators at regional levels, where available, shall establish a Standing Committee to guide the TA process and capacity building of RuSACCO and Union staff, as well as of the members, guided by the PIM.The committee will be chaired by Director, FCA.

14. *Programme Implementation Manual (PIM)*. The Recipient shall carry out the Programme also in accordance with the PIM. The Recipient will finalize the development of the PIM for the Fund's consideration and approval. The PIM will include: (a) Programme framework and strategies for target groups; (b) Programme governance structure and institutional arrangements and responsibilities of Lead Agency and PCMU, Implementing Agencies and partners; (c) detailed implementation modalities for Component 1 (Building capacity of institutions and clients), Component 2 (Improving regulation, supervision and institutional discipline), Component 3 (Facilitating funds flow and diversification of businesses); and, Component 4 (Programme management); and, (d) detailed Programme procedures for: annual work plan and budget (AWPB) process; monitoring and evaluation, knowledge management and communication; and procurement. The PIM will also include annexes of various reporting formats, templates, checklists, draft terms of reference for PCMU staff and for technical assistance as well as information on the guarantee fund. The PIM may be updated at any time, as needs arise, during implementation, but shall require prior approval by IFAD.

15. *Procurement arrangements.* As per the Federal procurement proclamation, directive and manual, the actual practice of procurement is decentralized to public bodies or procuring entities that poses a structure that will ensure internal control in the decision-making process. In this case, the DBE is the public body under which RUFIP III will operate and will therefore be responsible for the overall procurement function. At regional level, although procurement is governed by the Public Procurement and Property Administration Proclamation, each region has specific procurement directives.

Schedule 2

Allocation Table

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

Category	Grant Amount Allocated (expressed in SDR)	Percentages
I. Consultancies	13 600 000	100% net of Government and other co-financiers contribution
II. Credit, Guarantee Funds	2 600 000	100% net of Government and other co-financiers contribution
III. Equipment and Material	1 750 000	100% net of Government, beneficiaries and other co-financiers contribution
IV. Training	4 600 000	100% net of Government, beneficiaries and other co-financiers contribution
V. Salaries and Allowances	600 000	100% net of Government contribution
Unallocated	2 500 000	
TOTAL	25 650 000	

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

(ii) Consultancies - includes technical assistance to strengthening AEMFI, capacity building of RUSSACOs, support to improved regulation and supervision of MFIs and RuSACCOs, and strengthen the PCMU/DBE.

(iii) Credit, Guarantee Funds - includes line of credit.

(iv) Equipment and material – includes purchase of motor cycles.

(v) Training – includes training to MFIs, exposure visits, capacity building activities of RuSACCOs and PCMU/DBE.

(vi) Salaries and allowances – includes cost of senior lead technical staff.

2. *Start-up Costs*. Withdrawals in respect of expenditures for start-up costs in all the Categories, incurred before the satisfaction of the general conditions precedent to

withdrawal shall not exceed an aggregate amount of USD 500 000. Activities eligible for financing include baseline studies, recruitment of service providers for tracking client-level progress out of poverty, procurement of an accounting software for the PCMU or proper customization of the DBE one. Procurement of consultancy to conduct the need assessment (financial and technical assistance) of MFIs and RUSACCOs/ their unions in least developed areas, and other activities as specifically agreed and approved in the first Annual Work Program and Budget (AWPB).

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 Recipient to request withdrawals from the Grant Account if the 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. Within 6 months of entry into force of the Financing Agreement, the Programme will procure an accounting software as it is the practice in IFAD on-going supported Programmes or customize the DBE accounting system, to satisfy International Accounting Standards and IFAD's requirements.

2. The PCMU shall review and ensure action is taken on internal and external audit findings as well as recommendations of supervision and implementation support missions.

3. *Compliance with the Social, Environmental and Climate Assessment Procedures (SECAP).* The Recipient shall ensure that the Programme will be implemented in compliance with IFAD's SECAP and more specifically that the following measures shall be taken: (a) all Programme activities are implemented in strict conformity with the Recipient relevant laws/regulations; (b) women and men shall be paid equal remuneration for work of equal value under the Programme; (c) recourse to child labour is not made under the Programme; and (d) all necessary and appropriate measures to implement the Gender Action Plan to ensure that women can participate and benefit equitably under the Programme are duly taken.

4. *Anticorruption Measures*. The Recipient shall comply with IFAD Policy on Preventing Fraud and Corruption in its Activities and Operations, taking appropriate action to prevent, mitigate and combat Prohibited Practices.

Logical framework

Results Hierarchy	Indicators				Means of Verification			Assumptions (A) / Risks (R)
	Name	Baseline	Mid-Term	Programme End Target	Source	Frequency	Responsibility	
Outreach	**1. People receiving services and products promoted or supported by the programme**				PCMU quarterly report from programme MIS	Annually	PCMU	
	Total	7.000.000	10.250.000	13.500.000[4]				
Programme Goal Contribution to the reduction of poverty in rural Ethiopia	**2. Annual income of participating households**				Baseline, mid & end line survey, Annual Outcome surveys	Annually	PCMU	Sustained national and regional economic and political stability (A)
	% increase	*	20%	50%				
	3. Increase in ownership of assets among beneficiaries (data disaggregated by gender)				Baseline, Midline, end line surveys, Annual Outcome surveys and Poverty tracking tool results	Annually		Competent TA provider available and able to offer the tools and train RFI and PCMU staff
	%	*	**35%**	Min of 75% increase from baseline				
Development Objective Increased access for rural households by a range of financial services and products	**4. Increase in access to savings from MFIs and RUSACCOs** **5. Increase in access to credit from MFIs and RUSACCOs** **6. Increase in access to insurance through MFIs and RUSACCOs**				Baseline, mid & end line survey	Baseline, mid-term and completion	PCMU	
	% increase	*	35%	Min of 75% increase from baseline				
Outcome 1 **Strong RFIs with sound operating performance offering better Financial access to vulnerable people (Improved sustainability of RFI**)**	**7. Percentage of partner MFIs and RUSACCOs with operational self Sufficiency above 100% (95 % MFIs and 90% RUSACCO Unions to have OSS above 100%)**				NBE, FCA quarterly, annual reports	Yearly/Mid-term and completion	PCMU	Regulatory policies and economic environment remain favourable to RFIs
	%	*	8400 RUSACCOS 35 MFI	95% MFIs 90% unions				
	8. Percentage of partner MFIs and RUSACCOs with less than 5% PAR 90 days ((60 % MFIs and 90% RUSACCO Unions to have PAR 90 days less than 5%)				NBE, FCA quarterly, annual reports	Yearly/Mid-term and completion	PCMU	
	%	60 % MFIs; 90% RUSACCOs	80% MFIs; 90% RUSACCOs	90% MFIs; 90% RUSACCOs				
	9. Percentage of partner MFIs and RUSACCOs with 25% reduction in operating costs							
	%	0	75% MFIs; 50% RUSACCOs	95% MFIs; 90% RUSACCOs				
Output 1.1 Social performance& customer protection practices adopted	**10. Number of RFIs with effective social and customer protection policies**				Data from RFIs – reported by AEMFI and FCA	Yearly/Mid-term	PCMU	RFI are willing to adopt new practices (A)
	%. of RFI	10%	50%	100%				
Output 1.2	**11. Number of RFIs with industry standard MIS/M&E**							

[4] 50% female, 10% youth
*The values are to be taken from baseline survey data.

Results Hierarchy	Indicators				Means of Verification			Assumptions (A) / Risks (R)
	Name	Baseline	Mid-Term	Programme End Target	Source	Frequency	Responsibility	
MIS/M&E improved from scaling-up of RUFIP II IT and MIS	No RFI	50 RUSACCO Unions[5] 20 MFI	100 RUSACCO unions 35 MFI	140 RUSACCO unions 100% MFIs				
Output 1.3 Capacity and financial resources of MFIs and LFIs to provide financial access to farmers, cooperatives, unions and SMEs operating in the value chains and in the AIPs are increased*** (PROSEAD).	**12. Percentage increase of number of farmers as clients of financial entities in the park catchment areas supported by the programme (disaggregated by sex)**				RFIs M&E and reporting on lending portfolio against targets	Yearly/Mid-term	PCMU	
	% increase	*	15%	40% (to be decided with PROSEAD)				
Outcome 2 **Wider offer of services and products responsive to customer needs**	**13. New/modified services and products developed and marketed in response to customer needs[6]**				DBE quarterly reports, annual reports	Yearly/Mid-term and completion	PCMU	
	% of RFIs offering new products	0	50%	90%				
Output 2.1. Funding from financial institutions and other programs mobilised	**14. Number of RFI accessing financing from other sources**				RFIs reports, FCA, AEMFI	Yearly/Mid-term	PCMU	
	No. of MFIs	*	50%	80%				
	% increase							
Outcome 3 **Effective Financial inclusion for marginalised people and regions****	**15. Increase in clients in underserved regions**				Poverty tracking tool results, Annual Outcome surveys	Annually	PCMU	Sound industry reporting (A)
	% increase	*	Annual increase of 25%	Annual increase of 25%				
	16. Percentage of marginalised people/households reporting using rural financial services**				Annual Outcome surveys	Yearly/Mid-term and completion	PCMU	
	% of HH	*	25% annual increase	25% annual increase				
Output 3.1 Access to loanable funds for RFI improved and criteria made more equitable	**17. Percentage increase of medium and small RFI accessing LoC**							
	% of MFIs % of RUSACCOs	80% *	85% 50%	90% 75%				
Output 3.2 Establishment and implementation of partnerships with other	**18. Partnership coordination framework**							
	Number of Clients referred to by other partner/projects working with	nil	1.600.000	3.200.000				

[5] In case of RUSACCOs, IT enabled MIS is being implemented at the Union level.
[6] Market research, product development, Product marketing
* The values are to be taken from baseline survey data

Results Hierarchy	Indicators				Means of Verification			Assumptions (A) / Risks (R)
	Name	**Baseline**	**Mid-Term**	**Programme End Target**	**Source**	**Frequency**	**Responsibility**	
government and PTF initiatives working with under-deserved regions and marginalized people	under-deserved regions and marginalized people							
Output 3.3 Nutrition of vulnerable households improved	**19. Percentage of households starting backyard/kitchen garden as a results of the trainings received.**	0	25%	50%				
Output 4 Policy engagement	**20. Regulation Development in Financial infrastructure: National Payments, Credit Bureau or Collateral Registration**				NBE Reports	Annual	PCMU	A= Probable area of policy engagement for RUFIP III, among all Reform areas.
	Number of Regulations issued by NBE	0	1	2				
	21. User participation of financial infrastructure				NBE	Annual	PCMU	
	Number of MFIs participating	0	5	40				