Wholesale Microfinance Support Facility: Myanmar

Sterren, Jos van der
Van der Sterren Research/ Consulting/ Management
josvdsterren@gmail.com
Breda
11/11/2013

Livelihoods and Food Security Trust Fund

LIVELIHOODS AND FOOD SECURITY TRUST FUND

Acknowledgements

This report was funded by the Livelihoods and Food Security Trust Fund (LIFT). The author would like to thank people who meet with him for the report in September 2013. The author acknowledges the crucial contributions of Mr. Myint Kyaw, Mr. Clay O' Brien, Mr. Steve Dovall, Mr. Paul Luchtenburg, Mr. Sanjay Sinha, Mr. Roy Bevaqcuia, and Ms. Anthea Kerr.

Copyright notice

Disclaimer

Livelihoods and Food Security Trust Fund
UNOPS Fund Manager Office

No. 12 (O), Pyi Thu Lane, 7 Mile, Mayangong Township, Yangon, Myanmar
Phone: +95 1 65 7703~06, 65 7280~87, Fax: +95 1 65 7702, +95 1 65 7279
Email: lift@unops.org
Website: www.lift-fund.org

Table of Contents

List of acronyms

CARD	Center for Agriculture and Rural Development
CCS	Central Co-operative Society
CENFRI	Centre for Financial Regulation and Inclusion
CGAP	Consultative Group to Assist the Poor
CSR	Corporate Social Responsibility
EU	European Union
FIND	Financial Inclusion for National Development
GDP	Gross Domestic Product
GRET	Groupe de Recherche et d'Échanges Technologiques (Group for Research and Technology Exchanges, France)
IFC	International Finance Corporation
INGO	International Non-governmental Organization
LIFT	The Livelihoods and Food Security Trust Fund
MADB	Myanmar Agricultural Development Bank
MAP	Making Access Possible
MIS	Management Information System
MFI	Microfinance Institution
MSME	Micro- and Small and Medium Enterprises
MMSE	Myanmar Microfinance Supervisory Enterprise
NGO	Nongovernment Organization
OSS	Operating Self-Sufficiency
PACT	Partner Agencies Collaborating Together (USA)
SME	Small and Medium Enterprise
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
UNOPS	United Nations Office for Project Services
WB	World Bank

Executive summary

General findings

- There is a diverged opinion on the image and even the word of Microfinance in Myanmar. Whereas public, commercial banking and cooperative representatives strongly associate the word with poverty alleviation and as such expect MFIs to be non-profitmaking, at the same time international MFIs see microfinance as a business opportunity and are striving for professionalization through converting their portfolios into for-profit institutions. This results in miscommunication and lack of a shared vision on the microfinance sector and its desired future development.
- At the level of MFIs performance, correct and verifiable data on portfolio management are lacking. As a consequence, a real assessment of the strength and profitability of leading MFIs (even the larger ones) is impossible.
- The current regulatory framework with caps on lending and savings rates, as well as the tendency towards caps on maximum loan sizes (though not yet regulated), pushes MFIs from rural to urban areas for achieving profitable operations.
- As declining interest rates will become the norm, as more effective MMSE control and sanctions will take place soon, consequently many of the newly approved and smaller MFIs will not survive.
- National leaders, including the Minister of Finance and Governor of the Central Bank, are aware of the need for change and are seeking new approaches, tools, and methodologies for microfinance institutions. A new, more enabling Financial Institutions Law that will include specific attributes to non-banking financial institutions is pending.
- The lack of an effective national microfinance association acting as interface with MMSE and Central Bank, may lead to sub-optimal regulatory frameworks and supervision mechanisms. LIFT may focus on building such an interface.
- At this moment (end 2013) and for 2014 to continue, no MFI has achieved sufficient profitability AND is willing to assume debt at commercial interest rates. To the moment, all MFIs are expanding their portfolios on the basis of retained earnings which is slowing down growth and outreach potential.
- It is estimated that a critical mass of some 10-12 retailers that could take on debt would be needed for a wholesale institution to be a financially viable option at the medium term. This seems realistic, since there is increased demand for loans for on lending at the medium (2015-2018) term, which justifies the creation of a wholesale microfinance support facility.
- The wholesale microfinance support facility should not exclude MFIs, and should deliver financial as well as non-financial services. It should be small and with a limited scope (max. 5 years) of existence. It should be managed by a professional and independent fund manager and its investment decisions should be guided by sound business principles.
- Its main goal should be to contribute to the development of a strong critical mass of sustainable retail microfinance institutions. There will be need for a combination of grant and loan funding to this institution.

Advice

Considering the need to move away from grants as funding instrument, LIFT is advised to take a two-step approach to introduce non-grant funding instruments for further development of the microfinance industry in Myanmar:

- Short term (2014): The creation of a team of financial experts that would advise MFIs on moving away from grants to non-grant funding. It is suggested that this team, on a retainer contract could deliver MFI due diligence, MFI industry analysis, tailored technical assistance and if required other (administrative, auditing, legal and other) services to MFIs as well as investors. In case MFIs are negotiating liabilities, this team may provide technical support, to achieve a number (3-4) of non-grant investment agreements (guarantees, concessional loans) between MFIs, donors and interested international and domestic investors (including Myanmar Microfinance Bank). Ideally the team develops common standards of reporting and MFI performance that include a refinance as well as non-financial service component. These should be in line with government prudential policy and would also allow MFIs to start moving away from grants.

Research, deal-making technical assistance and consulting towards MFIs, could be financially supported through the financial inclusion window of LIFT. However it is important that part of costs of services are borne by MFIs.

Parallel, but also during the year 2014, on the basis of the projections indicated in this advice, a business plan and related legal structure could be prepared, and subsequently a call for proposals to hire a Fund manager could be issued.

- Medium term (2015): based on an analysis of the results of the first year and a deeper assessment of quantity and quality of demand, an independent fund management company could be created, moving from a case-to-case approach into a more standardized approach to wholesale microfinance. This “Myanmar Performance-based Microfinance Investment and TA Facility” (My PerMIT) could combine non-grant refinancing products (loans and guarantees) with non-financial services (technical assistance and training). The institutional structure of MyPerMIT would be independent from LIFT and have a limited time frame.

- The following positive developments could speed up the design and implementation of My PerMIT:
  - Approval by Ministry of Finance, to allow MFIs take on liabilities;
  - Further revision of the MFI regulatory environment enabling MFIs to operate with a business perspective;
  - Availability of an increased number (at least 3 in 2014, 5-10 in 2015, and growing) of well governed and high quality MFIs, that can be benchmarked to international standards and best practices;
  - Availability of concessional loans from domestic /international investors;
  - A full business plan for a Fund manager, including at least an updated market assessment of initial pipeline, an independent governance structure /appropriate fund management structure/ elaborated investment and monitoring policies.

- The first step may be seen as the kick-start of the facility and might be funded through a combination of grants from the current LIFT financial inclusion programme, combined with additional grant and/or loan-financing from international donors that have expressed interest (such as UNCDF and IFC).
- The funding of the second step (My perMiT) preferably is assured through a well elaborated business plan presented through a road show to potential social responsible investors such as IFC, UNCDF, KfW and other donors interested).

Chapter I: Introduction

Upon the approval by National Parliament of the Microfinance Law in 2011, microfinance institutions (MFIs) in Myanmar have received a framework of operation. Though not perfect, the law has defined the criteria for operating a microfinance institution, which is a first step towards creating a level playing field in the Myanmar microfinance industry.

The number of requests for licenses has since then increased fast, and until Sept 2013, a total number of 166 licenses have been granted to MFIs[1]. Next to NGOs, the legal framework appears to have fulfilled expectations of local commercial and individuals, who see an opportunity to deliver microfinance services under the current market environment.

One of the earlier promoters of microfinance activities has been the Livelihoods and Food Security Trust Fund (LIFT)[2]. Through various intervention strategies, it has supported the creation and professionalization of the microfinance industry, since 1997. LIFT cooperates with over 55 organisations, not only including microfinance but also agricultural and other sectors.

In 2012, LIFT started a financial strategy, which aims to address lack of access to financial services in Myanmar for farmers, micro, small, and medium enterprises (MSMEs), traders, livestock breeders, and other urban as well as rural populations. In particular, LIFT has supported the microfinance programmes of four major International NGOs: PACT, Save the Children, Proximity, MercyCorps and GRET, as well as four local MFIs Ratana Metta Organization, Border Development Associations, ECLOF, and Ar Yone Oo[3].

While devising its strategy for the period until 2018, LIFT is suggesting to analyse the opportunities for a "wholesale microfinance institution" or Microfinance APEX facility. To achieve this goal, it has conducted the present research, with the goal: "to determine whether an Apex[4] Fund would speed up the development of the financial sector in Myanmar and to scope out the structure of a potential Apex Fund."[5]

Methodology

The present study was prepared over a 30 working days period, between August and October 2013, including 15 days in Myanmar. There were four key parts of the methodology.

Desk research was conducted on best practices on APEX Institutions and recent research outcome as to the effectiveness of these institutions in developing a microfinance sector. References used for this research are included in the Annexes.

Interviews with experts, representatives of MFIs, relevant public stakeholders, commercial banks and INGOs: During a period of two weeks, a total of 30 interviews have been sustained with above mentioned actors. An overview of meetings is presented in Annex B. Field research was structured in the following manner:

- Demand issues: interviews with MFI and cooperative representatives on actual demand for microfinance (outreach as well as products) and projected growth for the period 2014-2016

1 Source: MMSE, interviews

2 For more information on LIFT, please visit: http://lift-fund.org/

3 By August 2013

4 Though normally referred to as an "apex institution", or simply as an "apex", in this case the term "Wholesale Microfinance Institution" will be used, to avoid confusion with the Myanmar "APEX Bank".

5 The detailed Terms of Reference of the assignment are included as Annex A to this report.

- Supply issues: interviews with representatives of donors and selected investors as well as experts, as on expected funding available for investments (loan portfolio) in microfinance at retail and wholesale level, as well as for non-financial support (technical assistance/ training/ business development services etc.)
- Regulatory and market development issues: interviews with senior representatives of commercial banks and Cooperative Sector, as well as experts, on the current market dynamics, regulations, specific issues of competition and market distortion as well as expected developments related to opening of ASEAN Economic Union (2015).

Workshop on findings: On September 16th 2013, all interviewed persons during the field research in Myanmar as well as representatives of LIFT, were invited to a working session, where the first findings of the study were presented and their feedback could be received. The PowerPoint of this presentation is included as Annex C.

Report and advice: on the basis of components collected, a draft report was composed and submitted to LIFT for revision on September 29th, after which comments were received and integrated in this final report.

Chapter II: Best practices on Wholesale Microfinance Institutions

2.1. What is a wholesale microfinance institution?

A "wholesale" or APEX institution in the microfinance sector is a second-tier organization that channels funding in the form of grants, loans and/or guarantees to microfinance institutions (also referred to as "retailers") in a single country or region. It is aimed at raising levels of access to capital, given constraints in this being obtained from domestic (savings and other sources) and foreign capital markets/commercial sources. Next to this, APEXES may aspire to increase outreach and MFI performance, or have other social objectives. Costs of these interventions of wholesale institutions usually are subsidized by donors (Duflos & El- Zoghbi, 2010).

Though it may be provided with or without supporting training and/or technical services, the main focus of microfinance wholesale institutions has been on channelling funding to relevant microfinance institutions. Support to MFIs is based on agreed selection; reporting and other criteria, to ensure MFIs meet specific (internationally benchmarked) performance standards. There is thus consensus that wholesale services may only be provided to MFIs with all requisite governance, compliance, management, MIS and related internal control systems being in place, whatever the legal structure and business model utilized.

2.2. Best practices with wholesale microfinance institutions

Wholesale microfinance institutions can be appropriate vehicles to deliver funding, along with training and technical services, in countries where MFIs are too small or too numerous for direct funding relationships. Wholesale institutions can be attractive to governments, donors and others; they allow them to delegate the task of MFI selection and due diligence, as well as monitoring of investments, to a specialized institution with competent skills.

A critical related consideration is of course to achieve a critical mass, so the number of MFIs seeking funding support and the scale of such funding: simply put, how many MFIs have valid funding needs that are not or cannot be met directly by donors or other means? And how large are the funding needs of these MFIs? Current external funding sources are usually related to multi-lateral, bi-lateral, international foundations and NGOs donors. In some cases MFI funding may be locally sourced by private and public equity and through (government) grants.
The key question to answer is, if there is a projected funding shortage for the growing microfinance industry and, in case there is, would this be best met through the design and establishment of a wholesale microfinance institution?

Unfortunately, not many apex microfinance institutions internationally have performed to expected levels, with the majority having produced disappointing results (Duflos, 2013). This is most often because they were set up in countries without a critical mass of good MFIs with the capacity to absorb such wholesale funding, as noted one of the key questions to be answered in the case of Myanmar.

International best practice indicates that a move towards more market driven funding sources, such as commercial and quasi-commercial (e.g. social investment) lending, where external funding is needed by MFIs, would (other factors aside) be preferable.

Funding MFIs through a wholesale facility and investment instruments may contribute to a level playing field, less likely to be based on subjective assessment by donors. Wholesale investment vehicles support MFIs moving along the continuum from grant to increased liability funding. The case for apexes is usually strongest in environments where other funding is in short supply—for instance, where commercial banks do not yet have confidence in MFIs' creditworthiness, or where an unfavorable regulatory environment keeps MFIs from taking deposits or foreign investment (Nichols, 2009).

Recognized best practice for apex microfinance institutions indicates seven key characteristics: (Duflos, 2013)

Table 1: Key Characteristics

	Key Characteristics of Good Apex institutions
1	The apex institution has a clear goal of nurturing the development of sustainable microfinance providers, including banks where they provide microfinance services. Evidence shows that developing a group of permanent, sustainable MFIs - and not maximizing the number of MFIs - is the most effective way to expand the number of poor people served.
2	The apex is politically independent, with a strong board able to protect the institution from political intervention, ensuring that management can make decisions on technical grounds and not on other bases.
3	The apex receives funding based on a realistic assessment of the number of qualified MFIs in the country or region that can absorb apex funding.
4	Apex funding of MFIs is based on clear selection criteria, such as portfolio quality, depth of outreach, quality of management and governing board, and progress towards financial sustainability. The apex must have the authority to discontinue funding to MFIs that fail to meet these criteria.
5	Apex funding is tailored to the cash flow patterns and planning needs of MFIs, not to pre-set or supply-driven disbursement plans.
6	The apex monitors MFIs on the basis of a few, precisely defined performance targets that are seriously enforced.
7	Apex management is of very high quality, possessing a blend of senior microfinance expertise, managerial and financial skills, and integrity.

The following main challenges have been mentioned when analysing APEX structures (Isa, 2011):

- The number of viable MFIs presents a genuine constraint for most apexes. Projections of APEX institutions often are optimistic on the number of MFIs that meet sound selection and performance criteria. As a result of this optimistic market assessment and also, many times because of donor preferences, Apex institutions in many countries have had significantly greater funding available than there were qualified MFIs / retail institutions capable to absorb and capitalize these funds.
- Replicating a 'successful' apex model from one country in another context (country or region) is rarely successful. No single methodological approach is appropriate in all countries (Nichols, 2009).
- Donors and other stakeholders pressure to disburse funds quickly. If microfinance investment due diligence and targeting criteria are taken seriously, quick fund disbursement is impossible: typically fewer qualified MFIs can be found than were anticipated. In some cases this

leads to fund low quality MFIs, which impacts negatively on Apex risk and performance.

- Political pressure adversely affects MFI funding decisions. Government involvement in an apex institution can compromise its mission by inducing the apex to disburse funds to unqualified MFIs.
- Apex institutions rarely build bridges between MFIs and commercial funding sources in practice. If cheaper apex funding remains available this is reduces incentives for MFIs to seek commercial funding.
- Apexes have not been funding much innovation. Most institutions offer local currency loans that enable MFIs to spur growth, without moving into areas of product diversification or innovations. (Duflos, 2013)

While looking at examples, a study on the Pakistan Poverty Alleviation Fund (PPAF) indicated the following lessons learnt relevant for Myanmar (Isa, 2011):

- Apexes need to evolve in order to stay relevant: Apexes created in a new microfinance sector have to take on the role of sector developers. In case of PPAF, a greater focus was placed on institution strengthening and capacity building at the initial stage. As MFI partners grew stronger and more confident, PPAF began to focus on sustainability and viability by moving towards market-based pricing and crowding in commercial funding for the sector.
- Being multi-dimensional positively affected the microfinance portfolio the APEX. PPAF follows an inclusive participatory development approach and understands that microfinance alone cannot be a panacea for impacting poverty. Consequently, every intervention and interaction with the communities is demand based. This on the one hand assists communities according to their requirement and on the other hand results in reducing cost of the project as it is partly funded by them.
- Selection of MFI partners - what works as a criterion and what does not. In PPAF's experience, selection of organizations as partners should be driven by commonality of vision and mission. In order to work with the APEX the institutions have to demonstrate a commitment to the double bottom line i.e. social returns and a desire to be sustainable.
- Sustainability of apexes themselves. Becoming sustainable as an apex is not a very challenging task. What is challenging is to stay true to the envisioned values AND remaining sustainable. This largely depends upon the governance structure and the human resource capacity of the apex. Unless the apex is able to make financial decisions transparently, independently and without any political influence, its sustainability will remain questionable. Despite being a public-private partnership, PPAF has not sought any budgetary support from the government. This independence, coupled with the oversight of an effective Board, has been instrumental in this APEX success.
- As market developers, apexes implicitly complement the role of regulators. In the process of developing the market and institutionalizing best practices, even if this is from the point of view of protecting its own portfolio, apexes end up complementing the work of regulators. Closely monitoring the partners, and focusing on key principles of microfinance helps protect the APEX portfolio as well as the partners.
- Good governance is key. As it advocates for transparency and professionalism within its partners, the APEX should internalize the value of good governance. Without a balanced and independent Board that provides active oversight and guidance PPAF would not have been able to deliver against its mission. Independence from political interference and the ability to make financial decisions freely have been vital for the APEX' sustainability and performance.

- Work closely with sector stakeholders. Although apexes are financial intermediary, their role tends to be much broader and bigger. In order to effectively perform this role, apexes need to interact closely with other important players who drive the sector. These include policymakers, donors and associations.

2.3. Conclusions for microfinance wholesale initiatives in Myanmar

During a recent workshop (Duflos, 2013), CGAP formulated some advice on the next steps as far as Myanmar and wholesale financing is concerned, worth mentioning here:

EARLY STAGE MARKETS (MYANMAR):

- In an early stage market like Myanmar, an Apex supporting start-up or young MFIs should include intensive supervision and handholding. It may be best in a start-up market to invest in a relatively small number of MFIs, and to be prepared to deploy extensive technical assistance to help build institutional capacity. Though overcoming MFI performance problems can be seen as part of the process, an Apex should be disciplined in lending support to non-performing MFIs unless there are strong reasons to expect a turnaround.
- Especially in Myanmar, pursuing donor harmonization (as done by LIFT) for building unified market infrastructure (auditing standards, governance and united reporting by international standards), is crucial. This includes responsible behavior and avoiding overheating of credit market through disbursement pressure.
- An Apex facility in Myanmar is temporary. The ultimate financial inclusion should be delivered through a well-functioning banking system, based on delivery of client focused savings and credit products.

GUIDELINES FOR SET UP:

- A thorough assessment of MFI retail capacity and demand for funding, as well as supply is the starting point. (e.g. MAP and LIFT).
- The objective of an Apex is to support the development of sustainable retailers. This should be embodied in a qualified board, the protection of political independence, clear expectation of the services (financial and/or non-financial), clarity of the apex's own financial performance. It should also include the design of an exit strategy from inception onwards and transparent public reporting. It also includes a strong investment in the Apex's own staff capacity building.

SELECTION AND MONITORING MFIs

- In the short to medium term, the focus of an Apex in Myanmar should be on building sustainable retailers, more than on reaching out to significant numbers of poor clients. Apex institutions are no development NGOs and their management needs to be governed by sound business principles.
- In terms of the MFI investees:
    1. Be selective: only mfis that will become financially sustainable;
    2. Performance-based contracts that focus on key-performance indicators (profitability and portfolio at risk standards). Make sure these are independently evaluated, at least twice a year.
    3. Supervision should focus on overall institutional performance and not just one component. Adhere to international rating standards.
    4. MFIs selected should adhere to codes of responsible finance, protect their customers and

avoid over indebtedness actively.

STRUCTURING OF FUNDING

- Pricing of apex loans is an imperfect indicator of whether the apex is crowding out commercial funding. Even where an apex charges commercial interest rates, it may still offer an advantage over bank loans, in terms of longer loans or lower collateral requirements.
- The Apex should not restrict product terms and methodologies or target markets. Its focus should be to deliver high quality financial (and non-financial) services that are paid for. It should thus keep red tape to a minimum and lend at market rates.

Chapter III: Recent developments in Myanmar Microfinance[6]

3.1. Huge demand for financial services…

There is common agreement on the fact that in Myanmar there is a huge unmet demand for credit, estimated at USD 1 billion (CGAP; UNDP, 2013). However, there are also clear indications that families search for new credit to repay existing debt and that many families spend a large amount of their income to several money lenders. Credit is commonly used (between 30-80% of households) in Myanmar.

When analysing demand for savings, it is indicated that most families do not trust financial institutions and invest in gold or fixed assets. Since interest rates on savings are lower than estimated current inflation rate of 10-12%, banks and MFIs find it difficult to increase the level of deposits accumulation. Also, it is not worth investing in savings products, with deposit interest rate floors of 8% (banks) and 15% (MFIs) per annum.

3.2. ..but appropriate supplied?

Supply of financial services in Myanmar is mainly delivered through informal channels. Either formal suppliers are not available or not trusted. As a consequence of this, no real formal markets exist and savings and credit transactions take place at individual basis, between households. Wealthy people in rural areas prefer to invest their financial resources (through their family connections) in informal credit systems, since these are more lucrative than formal ones. Banks and MFIs face challenges attracting savings. Pawnshops are the largest segment of suppliers of credit in Myanmar (estimated outreach of app. 2 million clients).

During 2012 and 2013, regulations for banks and financial intermediation have been changing fast.

Early 2013, the US treasury Department eased sanctions on four major banks granting them licenses and access to the US financial system. It is expected that soon foreign banks will be allowed to take majority shareholding in local banks and recently, the Ministry of Finance is restructured, with the Central Bank now being created as an independent institution of supervision.

As for licenses, the last two banks to receive a license (July 2013) were the Myanmar Microfinance Bank and the Housing Development Bank. Most recently, since August 2013, interbank daily currency trading was introduced.
It is expected that in the short term, no more bank licenses will be granted, until at least the new financial institutions act will be finalized ad approved (expected by the end of 2013).

Banks however, are not allowed to facilitate credit beyond 12 months and the fixed ceilings on

6 This paragraph summarizes relevant developments from the Myanmar sector assessment implemented August 2012, Paul Luchtenburg/ Eric Duflos, complemented with preliminary data from recent research on cooperatives and on consumer credit and savings demand, commissioned by LIFT, as per August 2013

interest rates do not enable them to fix appropriate pricing related to risks in their lending. Even though they attract limited voluntary savings, banks deposit taking rates have increased, mainly because blocked deposits are required to get licenses (for example for the import of vehicles) and international transactions.

3.3. Regulations help…

Microfinance is seen by the Myanmar Government as an instrument to explicitly contribute to rural poverty alleviation. The 2011 Microfinance Law and related supervision structure us strongly linked to rural development and the law was also written with that purpose. The equity threshold for creating an MFI is low, there are interest rate caps on lending and floors on saving, and the microfinance law explicitly expresses the link with rural development.

Though the Microfinance Law has provided a framework for operation and some say that it is better to have a bad law than no law at all, most MFIs in Myanmar operate in urban areas. Given the current regulatory and market situation, MFIs are unlikely to rapidly expand credit provision in general let alone to more challenging rural areas at any scale. Three developments that may discourage and possibly inhibit expansion of credit to priority rural and agriculture areas may be mentioned:

- **Interest rates**: there is clear evidence that interest rates on loans are reduced by most MFI operators, from 2,5% effective monthly rates (sometimes adding fees to this) to an effective 30%-35% per annum. Most INGOs indicate that this rate is a challenge considering the high operating costs. At the same time, funding through savings is no option for most MFIs considering the interest floor and required management and governance level, which most institutions indicate they do not have yet. So if expansion into rural areas remains a public objective, the current interest rate spread ceiling may just achieve the opposite.

- Regulatory practice currently requires Myanmar Microfinance Supervisory Enterprise (MMSE) to approve all increases in capital and to take on foreign and domestic debt. Recently, the first MFI was allowed to take international liabilities from a foreign investor, which however was seen as an exception. Definite approval of MFIs to take on debt has not yet been granted. So, while on the one hand, less donor funds are available for operational expenses, the above regulatory limitations result in complications in sourcing foreign and domestic capital.

- Though not officially approved, the current implicit level of caps on maximum loan size communicated to MFIs (of app. USD 500) is not contributing to an effective and inclusive microfinance intermediation market.

- Current regulations do not allow MFIs to borrow to small companies: only individuals are eligible as clients of MFIs. This neglects the strong impact that SMEs have in developing employment and income opportunities and their contribution to poverty alleviation. These micro- and small enterprises are drivers of economic added value and have usually no access to commercial banks, because their loan sizes are still far below the minimum amounts of USD 50.000 that commercial banks usually will lend. MFIs should be enabled to grow with their customers and allowed to have a balanced portfolio of still low-income people. They should be enabled to facilitate this funding gap

Next to this, recent economic developments in Myanmar and gradual liberalisation of markets will most probably influence the Microfinance Industry:

- Increased salary costs: median salaries in USD of managers (50%) and supervisors (over 20%) have increased strongly between 2010-2012 ((ed.), 2013). Most MFis confirm they have more difficulties finding and retaining adequate staff, which will be more problematic when the sector grows and more specialized functions are required. Also, staff poaching is already happening and it may be expected that staff will move to urban areas in search of better payment conditions.
- Urbanisation: it is expected that between now and 2030, one quarter of the population will live in cities with over 200.000 (McKinsey Global Institute, 2013) inhabitants and that Myanmar large cities inhabitants will increase with over 10 million people. This process will generate increased demand on urban microfinance services.

For further development of regulations, it is recommended to avoid considering MFIs as institutions purely focusing on rural poverty alleviation. Central Bank and MMSE regulations, support and interventions might be framed more widely, taking a Non-Banking Financial Company approach. That would include not only MFIs. Prudential regulations could be driven by the need mainly by the obligation to protect savers' deposits, for example through putting in place relevant prudential measures and cross guarantee mechanisms. A cap on the size of loans may risk of cutting off existing MFI clients and excluding small and microenterprise from non-collateralised funding sources.

3.4. …but still an imbalanced intermediation market

Currently, the microfinance supply is dominated by a large rural based player (PACT) and a limited number of smaller MFIs, mainly operating in urban markets. Whereas some banks have received MFI licenses and are considering entering the microfinance market, these cannot be seen as serious supplier in the short term.

PACT has been operating since 1997 and reports sustainable operations. PACT combines the management of a Project on behalf of UNDP (100 branches) as well as an official registered MFI (34 branches and 125.000 borrowers), with an Operational Self Sufficiency ratio[7] (OSS) of above 300%. PACT is heavily dependent on donor funding. It is definitely suitable for loan financing and it would thus be a good sign and international example of best practice if the donor consortium could arrange non-grant contracts with PACT the soonest. This would enable PACT to show that it is an industry leader in rural areas, professionally managed in a business oriented and sustainable way and capable to face competition from international NGOs and MFIs moving in.

International NGOs such as Save the Children and World Vision are currently in the process of enabling their microfinance portfolios to spin off as separate companies. This is firstly a tedious legal process; parallel institutional capacity building takes place, focusing on increasing operational efficiency, improved service quality as well as improved management and governance. For these processes, grant support is still channelled through donors and/or parent NGOs and it is expected that 3 to 4 MFIs will be achieving financial sustainable operations during the coming 24 months (2014-2015).

7 Operating Self-Sufficiency indicates whether or not enough revenue has been earned to cover the organization's costs and is calculated by dividing operating income (loans & investments) with the sum of operating costs, loan loss provisions and financing costs. This allows management to determine whether operations are becoming increasingly self-sustaining.

Most MFIs indicate they could absorb increases in funding during the coming years, though there are serious concerns on their staff and operating systems capacities in the short term. Only 2-3 seem to be having the operational infrastructure to achieve scale. Others may face serious operational risks if they push scale. Even if feasible, expansion of outreach needs time and can only be achieved through intense and extensive capacity building. This is a major challenge, considering the current educational levels in Myanmar and lack of training institutes and capacity building instruments, especially in Myanmar language.

3.5. Conclusions for microfinance wholesale initiatives in Myanmar

The increased focus on financial sustainability of MFIs may result in business models targeting a broad spectrum of urban and peri-urban poor, with higher average loan amounts and shorter loan cycles. It will depend on the way how these MFIs are capable to reach their scale of operations, how they will make use of technology in their Management Information Systems and what microfinance products they will design.

The current legal and regulatory framework with caps on lending and savings rates, pushes MFIs to use the average loan size as the only variable for achieving profitable operations. Increased competition, most probably through the new MICROLEAD programme that will enable experienced MFI institutions with savings-led best practices to move into rural areas, should be beneficial to deepen the rural microfinance outreach, in case fuelled with financial and non-financial services.

For the short term the following summary is relevant:
- Declining interest rates will become the norm;
- More effective MMSE control as well as effective sanctions will improve regulatory framework;
- The MFI interest rate spread will be maintained;
- MFIs will be enabled to assume foreign and domestic debt;
- Demand for urban microfinance grows fast but competition in urban areas will also increase;
- International (social) investors are interested in borrowing to better performing Myanmar MFIs, and take credit as well as foreign currency risks, and most probably accepting less than 100% collateral protection;
- Many of the newly approved and smaller MFIs will not survive.

These conclusions give input for the further analysis of options and constraints for the design of a wholesale microfinance institution that will be addressed in the next chapter.

Chapter IV: Challenges for wholesale financing / non-financing services

4.1. Introduction

As observed in the two former chapters, the Myanmar microfinance sector is still in its infancy stage, with only a few years of experience built after the 2011 Microfinance Law and international sanctions have been lifted.

At the same time, though conditions for growth from the demand side perspective seem to be enormous, supervisory frameworks, and regulatory frameworks seem to be not conducive for a level playing field in microfinance. The number of microfinance suppliers seems to have increased fast and in an uncontrolled manner, but the question is if there is sufficient critical mass and professional management and governance capacity available in the market to justify the start of a wholesale microfinance support facility. This while taking into account lessons learnt in other areas and CGAP overview of best practices in a start-up market environment like Myanmar.

4.2. Assessment method

This chapter zooms into the challenges that a wholesale microfinance support facility would face. Since no quantitative data are available, an attempt has been made to create a qualitative analysis framework has been created. This constitutes a scoring framework has to assess the following five components relevant for such a decision:

- The extent to which unmet demand is there for microfinance services
- The availability of a critical mass of reliable retail microfinance institutions
- The gap of available funding sources for microfinance institutions
- The presence of a regulatory and supervision framework conducive to microfinance
- The presence of an overall positive environment in the microfinance sector.

Each of these five components is composed of sub questions that are rated on the following scale:

++	+	+-	-	--

++ / green	No risk factor, sufficient elements to judge, positive
+ / light green	some risk factors, sufficient elements to judge, positive trend
+- / yellow	risk factors, no clear sign
- / orange	strong risk factor, insufficient elements to judge, negative trend
-- / red	crucial risk factor, no elements for judging, negative

This exercise has resulted in the following scoring. Each of the components will be analyzed in the following paragraphs:

Component	Specific items	Score
1. Unmet demand for microfinance	1. Credit demand > supply rural	++
	2. Credit demand > supply urban	+
	3. Low risk of overindebtedness	--
	4. Good level of financial literacy at client level	--
	5. Low risk of default	--
2. Critical mass of qualified MFIs	1. Number of MFIs	-
	2. PAR within acceptable limits	++
	3. Profitability, (FSS >100%)	-
	4. Benchmark to international (CGAP) standards (ratings)	--
	5. Management information systems in place	--
	6. Minimal scale of operations (>5000 microfinance clients) and positive track record	+
	7. Currently eligible for debt	+-
	8. Explicit demand for debt funding (growth/ business plan)	+
3. Gap in current sources of wholesale funding	1. Current supply of wholesale funding sources matches demand	--
	2. Grants available for operational deficits/ risk mitigation through donors	-
	3. Foreign investors available (local currency debt)	+
	4. Savings accessible as source of liquidity	--
4. Regulatory and supervision policy conducive to level playing field	1. Regulatory framework for MFIs positive for deposit mobilization and debt financing	--
	2. Transparent supervision of high quality	--
	3. Flexible interest rates	--
	4. Transparency in collateral requirements and taxation	-
	5. Level playing field for banks and non-banking financial companies	-
5. Overall positive environment financial sector	1. Quality local staff /governance for wholesale structures available	--
	2. Credit bureau services available	--
	3. Specialized Auditing services available	--
	4. Capacity building/ universities/ training institutes for loan officers /back office staff available	-
	5. Legal and Business Development Services available	-

4.2.1. Unmet demand for microfinance

Component	Specific items	Score
Unmet demand for microfinance	Credit demand > supply rural	++
	Credit demand > supply urban	+
	Low risk of overindebtedness	--
	Good level of financial literacy at client level	--
	Low risk of default	--

The continuum of funding needs of MFIs ranges from grant to grant matching to semi-commercial lending (initially with guarantee and/or other support) and, in the long term, to commercial lending (with and then without guarantee support). Current funding support to Myanmar MFIs is almost exclusively grant and donor based, reflecting current and historic need, with no MFIs accessing commercial or even quasi-commercial funding. Some indicate that the take-up of commercial loan funding is unlikely to take place in the short to medium term (say less than the next three years at least). In order to estimate future MFI demand for debt and grant funding, the following section uses historical data to develop a theoretical estimation of future demand under various scenarios.

4.2.2. Critical mass of qualified MFIs

Component	Specific items	Score
Critical mass MFIs	Number of MFIs	+-
	PAR within acceptable limits	++
	Profitability, (FSS >100%)	+-
	Benchmark to international (CGAP) standards (ratings)	--
	Management information systems in place	--
	Minimal scale of operations (>5000 microfinance clients) and positive track record	+
	Currently eligible for debt	+-
	Explicit demand for debt funding (growth/ business plan)	+

The Myanmar MFI sector (Duflos, et al., 2013) is divided into six main groupings: informal and semi-formal sector, banks, cooperatives, NGOs, specialized agricultural development companies and government organizations.

The Minister of Finance of Myanmar, through MMSE, commenced registration of MFIs following the approval of a microfinance law in 2011. Since then, a total number of 166 licenses have been granted. Registered MFis serve app. 730,000 clients, divided as follows over categories:

6 International NGOs (app. 570,000 clients)
30 domestic NGOs (app. 30,000 clients)
75 cooperatives (app. 100,000 clients)
5 international companies (app. 20,000 clients)

67 domestic companies (app. 10,000 clients)

The total number of actual registered MFIs, is no indication for the real size of supply. MMSE indicates that to date, 20 MFIs have not yet started operations and the total number of active microfinance institutions is believed to be a fraction of the registered institutions. It is expected that within a few years (2015-2016), a limited number of 30-40 MFIs will be effectively operating successfully in Myanmar.

Not all microfinance groupings in the Myanmar sector are expected to be neither interested nor eligible for wholesale financial services. Therefore, an attempt is made to analyse each of the groupings and compose a more realistic list of MFI suppliers and potential candidates for eligibility for wholesale funds:

Informal and semi-formal sector: These consist of pawnshops and village and community based financial mechanisms. Though some pawnshops have requested a MFI license, for the purpose if this research, this category is not taken into account as they mostly base their transactions on gold.

Commercial private banks: Some private banks have created a microfinance institution. To date, they operate these MFIs at a minimum scale. For some it is a CSR (Corporate Social Responsibility) strategy, but it could evolve into a line of business, especially since private banks have been successful attracting savings and are looking for profitable investments. As soon as MFIs are allowed to work with liabilities, some private banks are expected to enter the (urban) market. Depending on the nature of their activities and their fund sourcing strategy, some of these MFIs might become eligible for wholesale microfinance facility on lending.

Government and public owned banks: Myanmar Economic Bank is not active in microfinance and will not be. It expresses though its interest to borrow to MFIs, in case allowed by Central Bank, and provided loans could be guaranteed for example through stand by L/C or cash collateral up to 50%.
Cooperative Bank is expected to become one of the major (up to 30%) investors in the recently approved Myanmar Microfinance Bank. MMB is created as a private bank, but is expected to float a minority of its shares to public villages, most probably though the CCS network. A close collaboration with the Cooperative Bank is to be expected.

Development banks: Myanmar Agricultural Development Bank is being fuelled for growth through international bilateral government borrowing. Next to this, also, it is expected that, as part of the new Financial Institutions Act, the recently created MMB will be supported and enabled to approve uncollateralized loans, guaranteed through Myanmar government. MMB could then develop as a wholesale bank towards MFIs at concessional rates.

International NGOs: This category includes a limited number of NGOs, with many years of experience in testing and developing microfinance methodologies. They have been supported by grants through the LIFT programme and the recent approval of microfinance regulations and creation of supervisory mechanisms has allowed these NGOs to structure and implement a growth path, leading to profitable operations and the conversion of their loan portfolio assets into locally registered limited liability companies, fully or partially owned by their foreign mother companies. Some have recently received support from MICROLEAD to penetrate the

Myanmar microfinance market with different savings-led methodologies, such as BASIX, ASA. These NGOs are spurring growth and looking for a fast process of transformation and searching for profitability. As a consequence these are in need for (commercial and concessional) financial liability resources other than grants. Thus these MFIs are potential eligible clients for a wholesale support facility.

Local NGOs: This category may be split into two subsectors;

- Specialized microfinance entities. It is expected that these entities at a certain stage will, just like their international counterpart, convert their legal structure into for-profit limited liability companies or associative or cooperative structures. The total number of these MFis is limited and their size is small. If managed in a professional way, these entities might develop in two-three years' time into eligible clients for a wholesale facility.
- Multi-sectoral NGOs. These entities will remain as NGOs and most probably offer microfinance services in addition to other non-financial support to targeted beneficiaries. These are not seen as eligible clients for wholesale funding.

Cooperatives: CCS is one of the most important institutional providers of micro-finance operations in Myanmar and microfinance operations are the primary revenue source for CCS. Since 2007, Asian Association Confederation of Credit Unions (AACCU) has supported CCS through designing a model of microfinance operations.

CCS provides seed funding, three staff per MFI, technical assistance in auditing and operations, and additional, larger loans as cycles of payment and repayment were completed. At this moment, according to MMSE, 75 cooperatives have a microfinance license, mainly in urban areas. CCS offers MFI services to over 100,000 borrowers and over 1,5 billion Kyat in outstanding loans. Delinquency rates within its MFIs are reportedly low, thanks in large part to the rigidity of the MFI model employed. A new request for support to further expansion and professionalization of CCS microfinance operations, searching to make them more integrated into a savings-led approach, is currently under review in the MICROLEAD programme. Considering their strong performance, access to funding and TA and existing professional structure, though some may apply and be eligible, cooperatives are not seen as an interesting market for a wholesale microfinance support facility.

Commercial companies: These are either converted MFIs or new international companies registered such as ACLEDA, AEON, LOLC. Though some of these companies are planning to use their MFI license for retail and consumer finance purpose, the category also include companies that have a social mission and focus on small and micro business development. Though many of these MFIs operate with access to foreign equity and liability sources, they indicate that their future growth strategy is based on a funding diversification strategy, sourcing savings as well domestic loans from commercial and concessional sources. As a consequence these companies are potential eligible clients for a microfinance wholesale support facility.

From the above, it can be concluded that there is a mixed list of urban as well as rural microfinance retailers that could comply with eligibility criteria for a wholesale facility. On the basis of interviews and data provided during the mission, the following table of potential eligible microfinance institutions was composed for the three coming years:

Table 2: Estimated number of MFIs eligible for wholesale financial services, per category

Category	2014	2015	2016	TOTAL
INGOs	3	6	8	8
International companies	2	4	4	4
Local companies	1	1	2	2
Local NGOs/ Cooperatives		3	4	2
Total eligible MFIs	**6**	**14**	**18**	**18**

4.2.3. Gap in current sources of wholesale funding

Component	Specific items	Score
Gap in current sources of wholesale funding	Current supply of wholesale funding sources matches demand	--
	Grants available for operational deficits/ risk mitigation through donors	-
	Foreign investors available (local currency debt)	+
	Savings accessible as source of liquidity	--

Estimates of demand for capital can be determined through analysis of MFI balance sheets. Table 2 presents data on aggregate and average balance sheets of the 20 largest MFIs, information that was compiled from reports submitted to the MMSE.

Table 3: basic information on top 20 MFIs reporting to MMSE

Item	report oct 2013
Total active clients	335865
Average active clients	16793
Total loans outstanding USD	9,813,960
Average loans outstanding USD	990,698
OSS Average	137%
FSS Average	76%

The accuracy of this data is highly questionable. The MMSE reporting is calculated manually on the basis of data supplied by MFIs and no in-situ audits are taken place. Especially the calculation of OSS and FSS is not correct. Secondly, the average number of clients and loans outstanding do give a strange picture, considering the fact that the largest MFi PACT reports 100.000 clients.

Analysis of portfolio quality of Myanmar MFIs is not possible, since no aggregated analysis is available at MMSE. Data from CGAP (Duflos, et al., 2013) and other suggest that reported NPL (Non-Performing Loans) may not be a good indicator. Most MFis state their loan-loss ratio is less than 2% and that portfolio without arrears usually is higher than 99%. There are at least two reasons to take these figures with serious doubts:

- The current definition classifies loans as doubtful if they are overdue for more than 12 months. Bad debt is only reported once overdue by 24 months. Both benchmarks are not accepted in most microfinance markets, especially since average loan terms are less than 6 months mostly.
- Loan terms are lower than 6 months and subsequent loans with increased amounts are usual-

ly given without deeper assessment. In absence of audited financial statements and deep MFI rating exercises, and with MFIs administrative systems mostly operating on paper-based, accrual-based accounting, there is no real insight in level neither of refinancing nor over indebtedness of clients.

Upon request, none of the major MFIs indicated they would be eligible for funding for portfolio growth through loans. Even though repayment rates are high and Operational Self Sufficiency should be achievable at approximately 10.000 clients, Myanmar MFIs have been struggling to achieve profitable operations, mainly due to increased salary and operational expenses. At the same time, staff of MFIs seems to be unclear on what figures to include in operational expenses and how to separate financial from non-financial services.

At this stage, it seems that none of the larger MFIs is profitable. Because reliable data are missing, deeper analysis is required on issues such as depreciation of assets, calculation of interest income and costs, and correct allocation of expenses to MFIs income statements. On the basis of the information and experience indicated above, some observations and assumptions can be made about future demand and eligibility for debt funding for Myanmar MFIs:

a) In September 2013 there were 166 registered MFIs. There have been many new registrations per year over the past two years. Some have estimated that only one out of every five license will eventually be effectively implemented. It is therefore expected that a maximum number of 30 MFIs will be operational during the coming three years.
b) Myanmar MFIs are currently meeting only a small fraction of the demand for microfinance services, in particular in rural areas. For the purposes of projecting sector growth, it is therefore considered that retail demand will not present any restriction on the growth of the sector in the next 3-5 years.
c) Since most balance sheets cannot give accurate representation of equity / total assets ratio, the demand for liability funding is based on expected FSS moment, as well as portfolio growth.
d) The amounts of grants for operational expenses will shrink during the coming 3-5 years.
e) A funding strategy based on attracting savings is complicated in the short term, due to the interest floor on savings and current limitations in MFI governance and management capacity.
f) Urban as well as rural MFIs are eligible for funding from a wholesale support facility.
g) Currently, no MFIs have externally audited financial statements. Most MFIs struggle with loan loss provisioning, depreciation, accounting for grants, and other basic accounting functions.
h) MMSE is gradually improving its skills and capacities and as a result, data delivered by MMSE may not be correct. In the absence of audited financial statements it is unlikely that any commercial or quasi-commercial lender would lend to these MFIs at the present time.
i) As at September 2013, it is not clear which of the registered MFIs are both profitable (OSS>100%) and have good portfolio quality (PAR30<5%). As the sector matures and MFI management performance improves in the coming 3-5 years, the use of audit services increases, and PAR levels improve, it could be expected that more MFIs may meet basic eligibility requirements for debt funding.

In projecting theoretical scenarios for MFI growth and demand levels, the assumptions presented above have been projected in two scenarios: an optimistic scenario related to fast growth (2015) and a realistic scenario with moderate growth (2016-18).

The assumptions underlying these projections are based on a very limited track record and are not robust enough to project beyond 3 years. On the basis of the current 2013 data received of MFIS included in the previous table (estimated eligible MFIs for debt financing), the following growth projections were based.

Table 4: Estimated growth of selected eligible MFIs.

	Est. nr. Clients			Est. Loans outstanding in USD		
MFI	**Sep-13**	**Sep-14**	**Sep-15**	**Sep-13**	**Sep-14**	**Sep-15**
INGO (2015:n=8)	560,000	765,000	907,500	84,680,000	118,300,952	153,589,524
Int. company (2015:n=4)	5,000	103,000	225,000	1,900,000	45,050,000	107,000,000
Local company (2015: n=2)	21,000	37,000	55,000	3,150,000	5,550,000	8,250,000
Local NGO/ (2015: n=4)	9,500	19,000	38,000	1,425,000	2,850,000	5,700,000
GRAND TOTAL	**595,500**	**924,000**	**1,255,500**	**91,155,000**	**171,750,952**	**274,539,524**

Table 5: Estimated demand for wholesale finance in USD of MFIs eligible, per category, realistic growth scenario

Category	2014	2015	2016	TOTAL
INGOs	1,000,000	3,250,000	6,000,000	10,250,000
Intern. companies	500,000	1,250,000	1,750,000	3,500,000
Local companies	-	500,000	750,000	1,250,000
local NGOs	-	150,000	200,000	350,000
Total	**1,500,000**	**5,150,000**	**8,700,000**	**15,350,000**
Nr. MFI retailers	4	12	16	16
avg loan to MFI	375,000	429,167	543,750	-

While analysing this low growth scenario, based on the information presented by the MFIs, a maximum amount of app. USD 15 million would be needed for no more than 16 MFIs by 2016. This would assume that the MICROLEAD programme will deliver in total 3 eligible INGO-MFIs, next to the existing 4 that already have been supported through the LIFT financial inclusion window.

Demand for refinancing through debt, would be mainly driven by urban MFIs and through PACT, currently the only major rural MFI in the country achieving positive annual returns. In rural areas it is expected that MFIs approved under the MICROLEAD programme will also be competing with PACT.

In the following table, a more optimistic scenario is presented, which is based on the figures included in the MFIs growth projections and business plans.

Table 6: Estimated demand for wholesale finance in USD of MFIs eligible, per category, optimistic growth scenario

Category	2014	2015	2016	TOTAL
INGOs	1,750,000	6,500,000	11,500,000	19,750,000
Intern. companies	1,000,000	3,750,000	5,500,000	10,250,000
Local companies	500,000	1,500,000	2,250,000	4,250,000
local NGOs	-	225,000	550,000	775,000
Total	**3,250,000**	**11,975,000**	**19,800,000**	**35,025,000**
Nr. MFI retailers	5	12	18	18
avg loan to MFI	650,000	997,917	1,100,000	-

In this scenario, growth is not hindered through tedious regulations and red tape related to inflow of funds. Though it is not expected that more MFIs would be requiring refinancing support, the average amounts might double in relation to the slow scenario, requiring refinancing needs of app. USD 35 million in the coming three years.

4.2.4. Regulatory and supervision policy conducive to level playing field

Component	Specific items	Score
Regulatory and supervision policy conducive to level playing field	Regulatory framework for MFIs positive for deposit collection and debt financing	--
	Transparent supervision of high quality	--
	Flexible interest rates	--
	Transparency in taxation and collateral requirements	-
	Level playing field between banks and non-banking financial companies	-

As indicated in the paragraphs above, currently the legal framework is not helping MFIs to assume growth strategies based on increased savings collection. Though MMSE is improving in taking its role as supervisory department to MFIs, the team has still to undergo a strong process of capacity building. At present there is no knowledge on global best practices in microfinance supervision, absence of technical expertise to calculate effective interest rates and returns (OSS and FSS percentages).

As a consequence, besides trusting on retained earnings, most MFIs pursue other funding sources for their loan portfolio expansion, such as grants and loans. The volume of grants for portfolio expansion will be limited and most probably tied to specific regions of targeted beneficiaries. Currently, many issues remain unclear when it comes to implementation of the regulatory framework. MFIs are not allowed to assume liabilities, but the first loan to Proximity has been approved. It would however be not a wise strategy for the Microfinance Supervision Committee to approve all requests for MFIs assuming debt. This is not their role and is a matter of the lender and borrower.

Domestic commercial debt is not available to MFIs, since banks are requiring 200% collateral on loan amounts, only accepting properties and land. Commercial banks interviewed indicated they would be reluctant to lend to MFIs without full collateral and a track record of profitability. Some banks have indicated they would be willing to borrow to MFIs if allowed by Central Banks, and they would, in that case, consider taking a 50% risk provided a 50% cash collateral through deposit or standby L/C would be available.

It is to be expected that the Central Bank will further develop its supervisory role. Also, Myanmar Microfinance Bank is announced to start operations in January 2014, though it is unclear if this bank will take a retail and/or wholesale position in the microfinance market. To date it remains unclear if MMB is allowed to provide uncollateralized lending to MFIs, but it has been suggested that an online loan window could be opened to MFIs backed by state guarantees. Since the bank license was given without a thorough business plan, it may be doubted if the MMB bank will be capable to deliver microfinance online services soon.

Lastly, supply of credit will increase in rural areas, since Myanmar Agricultural Development Bank has increased the ceiling for rice lending from Kyat 50,000 to Kyat 100,000 per acre (more in line with current production costs). Since this bank is borrowing at subsidized rates and has received concessional loans for rural on lending, agricultural credit may pose a competitive threat for rural MFIs such as PACT. On the other hand, this loan size ceiling may fast dilute if inflation stays at the current high rates of approximately 10% per annum, resulting in still high demand for rural microfinance.

Interest rate caps and floors (within banks as well as MFIs), impede the introduction of new models and competition amongst MFIs. Also, it hinders transitions from MFIs towards banks which under optimal market circumstances would be the track that MFIs should undergo while growing in their service delivery.

4.2.5. Overall positive financial sector environment

Component	Specific items	Score
Overall positive financial sector environment	Quality local staff /governance for wholesale structures available	--
	Credit bureau services available	--
	Specialized rating and auditing services available	--
	Capacity building/ universities/ training institutes for loan officers /back office staff available	-
	Legal and Business Development Services available	-

At all (macro, meso as well as micro) levels there is still a huge gap between existing capacities and those required to facilitate further expansion and deepening of the sector. If not addressed, this gap will widen and have serious consequences for the stability, not only of the microfinance sector, but for the whole Myanmar financial market:

At macro level, emerging Myanmar financial sector is in urgent need of qualified staff at all levels (administrative, middle-level and senior-level staff, as well as governance capacities). There are no academic and professional education courses available. At the same time, operations in all MFIs are paper-based, with an absolute absence of Basic English in most levels, which does not allow the sector to benefit from international best practices such as CGAP publications and handbooks. Though some support at this level is provided (Worldbank through The FIND project), more resources are needed to strengthen Central Banks, MMSE as well as Ministry of Finance capacities to deal with microfinance industry issues.

There is a chance of the country to achieve competitive advantage in the South East Asian region, in case it is capable to 'leapfrog' in ICT and mobile technology. The recent approval of two licenses to international Telecom companies for creating mobile networks might allow the financial sector to deepen its outreach and services through 'branchless banking' concepts and mobile wallet technology. In order to be successful in this development, high levels of staff skills and service development are required.

At meso-level there is absence of the service industries required to assure a transparent and fair level playing field in the microfinance sector. These refer to the following: rating and benchmarking/ auditing/ university degree education in banking, management and accounting/ ICT services/ bookkeeping and accounting services/MIS services). In case of further growth of the industry, there is a need of high qualified professionals that deliver services for MFIs to perform effectively and adhere to microfinance best practices.

Support should not only focus on the micro-level, as this is part of the creation of a stronger microfinance sector should be built both in outreach and in service quality. The result should be ultimately a competitive and client-focused microfinance market with a number of competing and financially sustainable microfinance institutions.

At micro-level, best strategy to achieve this is to offer support to institutional capacity building of MFIs, focusing on training of human resources, as well as technical assistance on technology and management and governance, to meet identified skills constraints in MFI staff and governance. Also it is a tool to support MFIs that wish to move away from grants and could access to loans and investments for expansion.

Non-financial services offered should adjust to the current capacity levels within MFIs. There is need for introductory to advanced level trainings, with weighting in the short-term to the more introductory levels. Training programs must be needs-based, and structured institutional training needs assessments should be undertaken prior to any training intervention to determine the nature and scale of demand and the desirability for related training interventions.

Training interventions at micro-level should be related to performance-based financing agreements, through measuring and monitoring key indicators, such as operational sustainability, PAR, adherence to regulatory and reporting requirements, and good governance measures. Technical assistance (potentially combined with hand-holding or coaching) usually follows delivery of training in a particular topic, to ensure that skills developed during training are able to be applied to the context of specific MFIs and result in tangible outcomes.

Donors that would support the microfinance sector together with government and other stakeholders should agree on performance indicators as well as the system of reporting and monitoring. The ultimate focus is the delivery of a critical mass of financially sustainable MFIs.
Currently, the enabling environment to support the financial sector is weak or absent.

For an effective strategy of non-financial training and TA services to be realized, the following steps are needed:

- analysis of capacity-building needs at macro, meso and micro (MFI) level;
- assessment of current supply of providers of capacity-building;
- creating a structure of local high-qualified trainers for the MFI sector, capable to also follow up on training and assure monitoring of behavioural change and performance-based agreements;
- on the basis of international best practices, design of training material and methods as well as tailored technical assistance services, assuring their availability in Myanmar language.

For the design and delivery of non-financial services, it is eminent to make use of existing donor coordination, taking place through the LIFT programme. However, the current capacity of staff available at LIFT lacks specialized banking and financial market knowledge and expertise so requires strengthening. Since currently staff capacities is limited in the team of LIFT, a strong process of capacity building and exposure visits to other countries is advisable. This could target LIFT as well as staff of best performing MFIs.

4.3. Conclusions for microfinance wholesale initiatives in Myanmar

In this chapter, an attempt has been made to present the challenges a wholesale microfinance support facility in Myanmar would face. Based on an indicative analysis on five major categories, the overall conclusion is that, even in a modest scenario, considerable financing is needed to facilitate growth of MFIs and assure increased outreach. There is good prospect of some MFIs reaching sustainable operations and eligibility criteria for debt financing, though not in the short term. It is however not advisable to continue funding these MFIs through grants.

At the same time, current capacities at macro, meso as well as micro -level are weak and most probably not suitable for creating and managing a wholesale facility. In the short term there is a need for a strong training and technical support programme towards the indirect stakeholders (Central Bank, Ministry of Finance, MMSE), as well as the creation of an effective meso-level service infrastructure. Last but not least, MFIs that are in processes of creating sustainable independent companies require strong TA and training support.

It is therefore suggested to take a two-step approach during the coming years:

PHASE A (2014): NON-FINANCIAL SERVICES INCLUDING FINANCIAL ENGINEERING

The current developments in the Myanmar financial sector, combined with the rapidly changing developments within the few MFIs, leads to a conclusion that it is a risky venture to start with a wholesale microfinance facility in the coming 6 months. The number of microfinance institutions that will be able to meet even basic selection criteria for on lending is limited. At the same time, there are a limited number of institutions capable and willing to move away from grants into non-grant funding.

In this Phase A, it is recommended to focus on the micro-level and build a solid structure of high qualified training and TA services, to be delivered by a team of (international AND Myanmar) independent professionals to MFIs only.

Products/ services:

- Support MFIs that try to attract loans from commercial banks and other wholesale funding agencies (e.g. international social lenders to the microfinance sector such as NORFUND, IFC, KFW, others). This could be financial engineering, for example through loan guarantee mechanisms/ legal support/ technical advice on the business plan development and cash flow and loan fund projections.
- Inform potential social investors on MFI qualifications/ loan portfolio quality. Support rating and due diligence exercises through data collection.
- Design and develop a set of training courses and services, benchmarked against international (CGAP) best practices and tailored to the Myanmar microfinance market in content as well as language. These training services could be delivered at cost to MFIs and could be part of performance based financing agreements that MFIs make with social investors.
- At this stage there will be negligible demand for wholesale loan funding amongst microfinance institutions. The market for support from commercial and quasi-commercial sources is currently very low.

Organisation

It is suggested that the two programmes that are currently supporting capacity building initiatives (LIFT and UNCDF MICROLEAD) analyse where this service unit of two-three specialists could be created to avoid duplication of efforts.

Besides delivering services, the team should explicitly build local capacities of training companies and service institutions that undertake these training as business models. There is potential for training companies and agencies in these areas to provide technical assistance to microfinance institutions.

Macro-level: Policy & regulation

- Train MMSE staff: exposure visits/ best practices/ MIS systems/ supervision poloicies and technical microfinance areas
- Support on-going revisions to microfinance regulations and related policies (approval of debt and investment, interest rates, maximum loansize, etc) – through information sharing, workshops and technical assistance
- Provide TA support to new Financial Institutions Act and specific attention to non-banking financial institutions
- Support innovations in mobile and other e-banking mechanisms to expand outreach to remote communities – through research and advocacy

Meso-level: Financial infrastructure

- Create a number of training and technical assistance providers – through adaptation, translation and dissemination of a range of training materials; support trainers to become certified
- Strengthen accounting and audit services – through development and promotion of industry standards, training and certification
- Strengthen MIS capacity – by supporting development of improved Myanmar language MIS applications, and a range of service providers
- Assist in the development of a microfinance association– through strategic planning, exposure visits, and support to the secretariat; development of good practice guidelines; funding of research and sector studies in topical areas

Micro-level: MFIs

- Design and deliver training and technical assistance services, including formal training, internships, exposure visits, and on-site technical assistance
- Support Financial engineering of MFIs in their search to commercial and quasi commercial debt – introductions to lending agencies, assistance in preparing for application, assessment and reporting; potential provision of loan guarantees

PHASE B (2015 -2018):MYANMAR PERFORMANCE-BASED MICROFINANCE INVESTMENT AND TA FACILITY (My PerMIT)

If PHASE A can be implemented and deliver, it may be expected that, during a period of 18-24 months, quality of institutions supply in Myanmar microfinance market will increase, due to several programmes implemented by donors (UNCDF/MICROLEAD) and social investors (NORFUND and others).

Next, most probably, government will proceed opening up to international financial markets, allowing investors to enter the microfinance market. At the same time, it is expected that urban and peri-urban demand for microfinance services will increase. In case this situation materializes, the next phase for support of the Myanmar microfinance sector could be facilitated through LIFT and other donors.

Strategy:

Establish a wholesale microfinance support facility that combines several non-grant financial services (debts and guarantees) with non-financial services (training and technical assistance) through performance based agreements. In order for the facility to lend to companies, it is recommended to create a private limited company. This company would continue offering services of training and technical assistance already developed in the year before, in principle as a business activity, charging fees for services. A proposed structure for this company will be further explored in the next chapter.

Chapter V APEX: the Myanmar Performance-based Microfinance Investment and TA Facility (My PerMIT)

5.1. Introduction: what is a Performance-Based Investment and TA Facility ?

The essential characteristic of a performance-based facility is that it combines tailor-made non-grant financial instruments (loans and guarantees) with (limited duration) grants for training and technical assistance, according to pre-determined selection criteria, to successful applicants on a competitive basis. To ensure shared ownership and commitment, cost sharing models are considered.

The nature of the support provided and the targeted outcome may vary, depending on the focus and design of each facility. This will in turn depend on the nature and extent of the perceived "market failure" and on the institutions, constraints and opportunities being targeted.

The principal advantage of this facility lies in its explicit linkages between the performance expected by the MFI during a given time-frame and the type of investments (financial engineering) and non-financial services (training and TA) delivered. It focuses on improving key indicators selected per MFI, through a targeted support of financial as well as non-financial services.

5.2. Overall goal and objective

My PerMIT will promote a financial sector development in Myanmar oriented towards the low income but economically active population as well as micro and small businesses. As such My PerMIT will financially and technically support Microfinance Institutions (MFIs), legally licensed through MMSE, meeting specific eligibility criteria. In compliance with best practices objective of keeping donor interventions at a minimum presence on a transient basis it is suggested to limit the lifetime of My PerMIT to 5 years. Its strategy, policy and operations will be harmonized with other donor interventions in the Myanmar financial sector (LIFT Financial Inclusion Window and UNCDF, as well as Worldbank and others).

My PerMIT will be a Wholesale Facility. It will offer two distinct types of services: financial services and non-financial services. The two services will be accounted and controlled separately, but their use will be combined in performance-based agreements with MFIs, in order to achieve the most effective and significant impact on their institution building and operation performance.

My PerMIT: Examples of non-financial training services

- Delinquency Management
- Interest Rate Setting
- Financial Management/Accounting
- Financial Analysis
- Human Resource Management
- Internal Controls
- Group Loan Methodology
- Institutional Framework
- Business Planning
- Governance
- Product: Individual Lending
- Client Financial Analysis
- Management Information Systems
- Financial Performance
- Monitoring for Board Directors
- Branch Management
- Product Development
- Business Planning

Management of My PerMIT will be outsourced to a consulting company to be tendered internationally for this purpose. The consulting company will act as manager subject to detailed guidance and governance and will contract MFIs directly. Donors and investors will be invited to pool their funds earmarked for My PerMIT.

Non-financial products

The My PerMIT non-financial services include grants for:

- training (in cash or in kind).
- technical assistance (TA in cash or in kind)

Each agreement with an MFI sets out a series of performance indicators, based on the needs and plan of the institution, and linking these to financial services as well as non-financial services to be delivered to the MFI. These at least include quantitative targets for:

- rural /urban outreach (number of clients),
- adjusted return on asset,
- Operational and/ or financial Self-Sufficiency
- Portfolio at risk.

Disbursements are tied to the MFI meeting the performance criteria linked to that tranche. Also courses and training should be offered on partial cost recovery basis.

Next to training, My PerMIT may offer tailored TA and tools for MFIs, such as a reporting format which calculates standard ratios. It will perform in-depth due diligence on each of its MFIs to provide feedback and recommendations on improving their operations.

It may support MFIs in selecting board members, and attends board meetings. As needed, it provides institution-specific trainings. Where possible, it helps MFIs in approaching commercial banks and social investors. The My PerMIT team will perform due diligence on and regular monitoring of the MFIs receiving technical and financial assistance. The team also would collect and compile data in industry reports on a regular basis with regards to microfinance supply and demand. While not specifically a training role, this information role is also a core function.

Financial services

Four financial instruments are initially proposed for My PerMIT:

- Loans;
- partial guarantee facilities for refinancing of MFIs;
- partial guarantee facilities for savings enhancements and rural expansion plans;
- quasi equity in the form of subordinated debt.

In practice, further study and results of the Phase A will indicate which instrument is most relevant for which segment of the Myanmar microfinance sector. Instruments should be designed not to replace but to address a gap identified in the existing market.

5.3. Design and set up

Eligibility

The selection of MFIs should be conducive to the objectives of My PerMIT. MFIs should :

(i) have a promising potential in terms of business as well as institutional growth; and

(ii) strive to comply with CGAP's best practice principles;
In order to make the fund demand driven, a performance-based approach is applied. This means that the MFIs always will be rewarded only when they meet agreed performance. The goal is to avoid disbursement pressure, and the fund manager should be patient to let the institutions develop in their own right. In this context the introduction of a cost sharing component additionally serves the demand driven approach. The linkage to performance is a key feature of the fund. The fund should incorporate mechanisms which call for performance and progress thereof. In order to measure performance improvements of a supported MFI a detailed baseline analysis is required as well as permanent and close monitoring. Quality and performance of the MFI represent My PerMIT's monitoring and support criteria. Further, while designing eligibility criteria the following is relevant:

- Invest in institutions with capacity to grow sustainably. My PerMIT should search to support institutions that can be industry leaders.
- Technical assistance and training to be offered on a competitive basis. Trainings and technical assistance could be open to any interested institution as a paid service. Subsidies, however, could be offered considering both need and capacity of the financial institution.
- Lo ng-term TA (resident advisors and handholding) may be applied in remote areas with thin human capital.
- International exposure may be very beneficial for MFIs staff. In order to keep managers up to date with global sector evolution, sponsorship to attend conferences and workshops would be positive.
- Develop standardized reporting tools and data collection, which is a critical need in the sector.
- Investment decisions to be based on institutional capacity. While it is still advisable to ensure that local MFIs have adequate access to the facility, larger institutions which require and have the capacity to manage greater loan funding should not be limited because of their international affiliations. Investment decisions should be made based on capacity and My PerMIT should thus invest in new urban entrants to achieve the greatest potential outreach.
- Restrict loans to portfolio growth. This policy has proven to be prudent in other areas.
- Link disbursements to achievement of performance targets. This should follow best practices and be in line with the submitted business plan.
- Structure the facility to ensure that disbursements can be made efficiently.

An MFI would need to fulfil following minimum criteria in order to qualify for My PerMIT's services:

- Comply with My PerMIT's Objectives.
- Be adequately licensed.
- Adopt CGAP principle incl. good & transparent governance, qualified management.
- Commitment to portfolio quality and financial self-sufficiency.
- PAR30 < 5%;
- Write off ratio p.a. < 2% per annum
- Sufficiently detailed and consistent business plan incl. meaningful projection.
- Qualified accounting and proper external audit.

The My PerMIT services and the conditions of the performance-based agreement with an MFI will be subject to a detailed due diligence and the approval of an Investment committee.

Legal setup

The legal l set up for My PerMIT should be conducive to operational activities:

- Contract, disburse, collect and monitor loans to MFIs (refinance facilities, senior loans, subordinated loans, quasi equity);
- Contract, disburse and monitor grants for technical assistance and fixed asset finance;
- Offer (partial) guarantees to commercial banks in return for refinance facilities to MFIs;
- Receive income from its lending, financial investments and guarantee operations;
- Assume liabilities;
- Manage investment for third parties (donors or private investors).

While analysing relevant options, preferably, My PerMIT is preferably an independent institutional setting. My PerMIT would be legally entitled as a corporate body to receive funds and contract services in its own name. The sponsoring donors and investors would transfer their funds to the institution, that would have a recognized legal status. The company would be owner of the funds and would also be the legal contractual party to the MFIs it would fund. A Fund manager is contracted to manage the fund subject to detailed terms of reference and operating guidelines. A Corporate approach to the Fund allows the structure to create an investor image, and avoid disbursement pressure. A detailed legal study is required to select the best option. Initially, the following legal acts are relevant: the Myanmar Companies Act (1913), the Myanmar Companies Rules (1940) and the Myanmar Companies Regulations (1957). Currently, the 1913 Act is under revision as is the 1957 Regulations. In addition to this, in 2012, a new foreign investment law was sanctioned.

Two options are open for the legal framing of the Fund:

1. Private limited company:
    - must have at least 2 members (shareholders)
    - limits members up to 50
    - restricts transfer of shares
    - prohibits public subscriptions for its shares or debentures
2. Public limited company:
    - must have at least 7 members
    - must apply for a Certificate of Commencement of Business

Similarly, two options in terms of ownership appear:
1. Myanmar Company
    - wholly owned and controlled by Myanmar citizens
    - company with one or more foreign shareholders would be classified as foreign company
2. Foreign company
    - incorporated in Myanmar other than Myanmar company or a special company formed under the Special Company Act 1950 (with State equity)
    - incorporated outside Myanmar and having established place of business in Myanmar (foreign branch)

As an advantage of a public company (Myanmar Company) it could be stated that it is a clear Myanmar company owned by Myanmar stakeholders at all times. This is a positive signal towards local stakeholders. However it entails a potential risk of political interference and related image. Also, foreign investors like IFC and USAID prefer to work with non-public companies. This option is therefore not preferred. For the same reason, it is recommended to create a structure that allows foreign investment. Therefore a private company limited by shares, allowing joint venture ownership with foreign investors is recommended as a first option. It would allow the inclusion of international financial institutions as well as private investors. In order to assure its mission, majority ownership could be in hands of social investors. A disadvantage of this option might be that it is not acceptable to some donors for allocating grants.

Governance

It is common for an investment fund to at least have three levels of governance: a Supervisory Board, an Investment Committee and a Fund manager. For each of these levels, below some tasks and responsibilities will be mentioned:

General Principles: The members of the Supervisory Board and Investment Committee will abide to the following principles: transparency; independence and objectivity; responsibility; adherence to microfinance best practices, consideration of the national priorities for microfinance. None of the members of the Supervisory Board or the Investment Committee will receive remuneration in return for their services.

Supervisory Board

Supervisory Board will reflect a proper representation of the country's microfinance industry on all macro, meso and micro levels. It will be chaired by the Governor of the Central Bank of Myanmar, and shall at least consist of one representative of each of the following organizations: MMSE, donors, MFIs. The CEO of Fund Manager will serve as the Secretariat to the Supervisory Board.

Meetings and Voting: The Supervisory Board will meet at least once every 6 months, either in person or by phone. Each member will have one vote. All decisions will require at least 66% of the votes of the attending members (supermajority principle).

Responsibilities: In order to support the development of a competitive, sustainable pro-poor financial sector, the Supervisory Board will provide a framework where stakeholders will:

1. Provide strategic guidance to the project and ensure that it is aligned and coordinated with all applicable components of the Myanmar financial sector strategy.
2. Review the results, work plan and budgets of the Fund manager;
3. Valuate potential investments on their adherence to microfinance best practices and the Myanmar Government policy of building a pro-poor, sustainable financial sector;
4. Provide recommendations to the Investment Committee.
5. Decide on any fundamental change in the business or scope of business or any fundamental change in the operating policy;
6. Approve the annual audited financial statements of and the annual report;
7. Approve recommendations submitted by the Investment Committee;
8. Remove or appoint the auditor;
9. Dissolute or liquidate or terminate My PerMIT.

Investment Committee

The Investment Committee will be restricted to sponsors for My perMIT operations (donor organizations and investors). In order to encourage fund contributions of meaningful size, sponsors should commit to at least a minimum capital contribution to qualify for a representation in the Investment Committee. The chairman of the Investment Committee will be appointed in rotating order.

Meetings and Voting: The Investment Committee will meet at least once every three months (four times a year), either in person or by phone. Each member will have one vote. All decisions will require at least 66% of the votes of the attending members (supermajority principle).

Responsibilities: The function of the Investment Committee shall comprise the following: Determine the business policy within the framework of the operating policy guidelines as outlined by The Fund manager upon taking office;

- Approve the 5 year business plan (to be established by the Fund manager upon commencement of the management agreement) and amendments thereof;
- Approve the annual budget and amendments thereof;
- Approve performance-based investment proposals;
- Monitor the performance of the Fund manager along the performance indicators defined in the management agreement and approve the performance based fee;
- Determine the signing and disbursement authorities of the Fund manager;
- Recommend to the Supervisory Board decisions on the management contract with the selected consulting company (e. g. appoint or dismiss the CEO and the other key members of the Fund manager; terminate the management contract for cause; propose a new management contract; adjust the performance indicators);
- Establish sub-committees and determine their responsibilities as the case may be (e. g. audit committee).
- Approve any type of legal action within the context of risk and default management

Management comprises the day to day operation of My PerMIT as further specified below. The terms and conditions of the management will be governed by a management agreement to be concluded between the Manager and sponsoring donors and investors, who are entitled to allocate part of their funds for management remuneration.

Fund Manager: An independent consulting company will be selected through an international tender and contracted on the basis of a separate management agreement. The Fund-Management agreement will be concluded for 5 years equal to the scheduled lifetime. The Fund Manager will manage the funds pooled by the sponsoring donors and contract these financial and non-financial services to MFIs.

Income achieved through the Financial Services will be credited to MY PERMIT and used for funding of further operations. Financing limits per institution will be reviewed regularly and adjusted as needed in line with market changes or changes in the availability of funding sources.

Tasks and Responsibilities:

General:

- Manage My perMIT in conformity with its overall objective, operating policy and guidance provided by its governance bodies;
- Establish systems and procedures, and draft respective manuals;
- Establish and implement an adequate MIS and a transparent and efficient accounting system,
- Hire, train and supervise required professional and support staff, whether full time employees or associated consultants;
- Communicate with relevant authorities as the case may be,

- Communicate with the donor community and introduce other donors and investors to My perMIT,
- Produce an initial 5-year business plan for approval by the Investment Committee to be adjusted from time to time;
- Submit an annual budget for approval by the Investment Committee;
- Report to the Supervisory Board and Investment Committee in regular intervals;
- Disseminate sector information to all relevant and potential partners;
- Other duties as may be determined by the Supervisory Board and the Investment Committee.

Financial Services:
- Develop and market financial services as agreed by business plan and contract (loans, guarantees, quasi-equity);
- Screen the market and develop a project pipeline subject to the eligibility criteria;
- Carry out due diligence of MFI investments (loans, quasi equities, guarantees),
- Negotiate and execute investment agreements in accordance with the operating policy;
- Disburse funds according to contracted conditions precedent and defined signing authority.
- Monitor proper procurement of equipment to be purchased and use of funds,
- Control proper servicing of the investment agreements, in particular collection of receivables,
- Carry out prudent liquidity management,
- Establish and implement an appropriate risk management,
- Carry out timely and effective default management
- Propose an exit strategy for approval by the Investment Committee
- Other duties as may be determined by the Supervisory Board and the Investment Committee,

Non-Financial Services:
- Develop and market products of the non-financial services,
- Screen the market and develop a project pipeline subject to the eligibility criteria
- Carry out weakness analyses of potentially eligible MFIs,
- Design tailor-made and inclusive institution building packages containing time frames,
- workable objectives and verifiable success indicators,
- Negotiate and execute the performance-based agreements in accordance with the operating policy,
- Disburse funds according to contracted conditions precedent and defined signing authority and in particular subject to evidenced success criteria resp. procurement documents/ proposed procurement process,
- Monitor proper use of funds on the basis of verified indicators,
- Control the execution of performance-based agreements, in particular the adherence of the MFIs to the contracted covenants incl. the cost sharing covenants
- Carry out prudent liquidity management,
- Collect, aggregate and disseminate information on the microfinance industry
- Other duties as may be determined by the Supervisory Board and the Investment Committee,

Remuneration

It is recommended to build a success element into the Fund manager's remuneration scheme. Banking on other programs with similar objectives the fee structure could consist of following two components:

- a fixed annual fee based on level of effort (man days, running costs)
- a performance fee based on pre-defined milestones, which would top off the Fund manager's fixed annual fee by to 10%. In turn the Fund manager will lose his success fee in case of verified underperformance. The indicative projection of MY PERMIT 's annual business development may serve as a benchmark for determining the Fund manager's entitlement for his annual success fee.
- The ultimate fee payable to the Fund manager will be determined through the international tender process. Bidders will be requested to propose a remuneration scheme including a success element. The bidding process should ensure a competitive fee level.

Responsible Finance

As in many other countries Myanmar may experience the downside effect of dynamic loan portfolio growth, namely non-transparent lending practices of unsound MFIs especially with financially illiterate population groups, which ultimately put them at the risk of over-indebtedness and of losing their savings. Responsible Finance is ultimately a precondition for increasing the well-being of all stake- holders involved.

My PerMIT shall be fully dedicated to Responsible Finance and will deploy both its refinance and non- Financial Services to equally ensure that its MFI will be committed and enabled to adopt a lending policy conducive to the spirit of Responsible Finance:

- Systems, policies and procedures ensuring the avoidance of client over-indebtedness;
- Non-deceptive and non-aggressive marketing of loan products;
- Transparent disclosure of loan terms and conditions;
- Appropriate debt collection practices respecting privacy and human dignity;
- Facilitated complaint management;
- Ensured data protection and privacy of client related data;
- Restrictive provision of consumer loans;
- Appropriate incentives and training of credit staff to discourage aggressive lending practices.

5.5. Fund projections

In the Annex, first estimated projections have been presented on the financial services. These estimates are composed on the basis of scarce information received and taking the following parameters as input:

My PerMIT INPUT PARAMETERS		Year 1	Year 2	Year 3
Average loan amount to MFI USD	450,000			
nr of refinancing loans approved MFIs		4	12	12
interest rate annual rural declining balance	12%			
loan term in years	3			
repayment terms		20%	38%	38%
loan loss per year	2%			
processing fees initial	0.50%			
interest earned on savings	8%			
average disbursment per loan	60%	40%		
operating expenses as mgt fee % of loan portfolio approved	6%			
exchange rate losses as % of portfolio	2%			
interest paid on loans received	5%			
annual repayment schedule loans received		25%	33%	50%

In addition, in the following table, some indicative prudential fund management policies are presented.

The results show that My PerMIT will not be able to function without subsidies, due to the limited size of the market, and risks related to the investments(currency and projects).

My PerMIT: Example of prudential policies of fundmanagement (Khalaf & Miamidian, 2009)

Quantitative covenants for decisions on loans, guarantees and quasi-equity products:

maximum exposure per MFI:	400% of the MFI equity
maximum exposure per MFI:	15% of the available funds for onlending
maximum exposure per urban areas:	50% of the available funds for onlending

Quantitative covenants of the investee MFIs:

Minimum risk weighted capital adequacy of MFIs:	20%
Minimum outreach (number of borrowers):	to be based on business plan
Minimum outreach in terms of portfolio size:	to be based on business plan
Maximum PAR 30 for future disbursements:	5%
PAR 30 that triggers recall	10%
Maximum Loan Loss Rate:	3%
Minimum Adjusted Return on Equity (AROE):	10%
Minimum Adjusted Return on Assets (AROA):	10%
Minimum Operational Self Sufficiency (at time of funding):	100%
Minimum Financial Self Sufficiency (at time of funding):	100%

Loans and financial services shall not be used:

- to refinance financial substitutions, rescheduling or rehabilitations.
- to refinance loans subordinate to other loans obtained by the MFIs, unless specifically structured as quasi equity loans with a profit based upside potential

Funds of the Non-Financial Services will not be used for:

- Funding or subsidizing operating costs,
- Funding the loan portfolio growth or other operating services of the MFI,
- Reporting requirements, using standard terms and definitions as developed by the Consultative

Group to Assist the Poor (CGAP). Performance parameters:

Outreach (number of active clients);
Portfolio quality (PAR30);
Profitability/Sustainability: (Adjusted Return on Assets & on Equity);
Productivity (average loan numbers per credit officer)

Chapter VI: Summary of recommendations

1. It is recommended to set up My PerMIT as an independent Microfinance APEX in Myanmar, based on the initial structure as included in this advice and use a two-step approach:
    - During the first six months of 2014, LIFT could provide active support to MFIs in finding and closing loan and guarantee agreements between individual MFIs and social responsible (foreign) investors. This could be done on-demand, on a case-by-case basis, by a team of specialists hired on a retainer consulting contract. The team could advice on due diligence, on drafting and preparing as well as closing non-grant microfinance investment deals. International investors like IFC might collaborate with such an approach.
    - Similarly, LIFT and other donors, through an international call for proposals, could join hands in assuring:
    - The design and drafting of a business plan and legal structuring of the facility, before the summer of 2014.
    - The process of fundraising (grants and non-grants) on the basis of projections included in this advice.
    - In Phase II, starting end 2014, and based on initial funds available, the business plan could be the basis for the call of proposals for an international fund manager that could start operating the facility as of 2015.
2. It is strongly recommended, that LIFT continues its consultation with a wide range of public as well as private sector stakeholders, and collaborates with other donor agencies to change microfinance regulations as well as current funding and investment practice.

Whereas the country context has changed the last few years, still many interventions in the microfinance sector are taken from a poverty alleviation perspective, without analysing the current and projected profitability of MFI operations. There is huge potential for donors and investors to use a combination of grants and non-grant instruments and design performance based financing instruments. These are relevant tools to encourage MFIs to strive for sustainable operations, allowing less dependency on grants. For this however, MFIs require space to operate their financial intermediation services as a business, which means that, as was mentioned in this report, certain regulatory frameworks require urgent revision. This is again a matter of collaboration and consultation.

Bibliography

- ACTED, 2010. Microfinance Industry Report Myanmar, Australia: Foundation for Development Cooperation.
- Central Bank of Myanmar, 2012. Annual reprot 2011-2012, Yangon: Central Bank of Myanmar.
- CGAP; UNDP, 2013. Emerging Microfinance Sector in Myanmar: regional lessons on selected issues. Yangon, s.n., p. 80.
- Duflos, E., 2013. A New Look at Microfinance Apexes,results of a global research. Yangon: CGAP.
- Duflos, E. & El- Zoghbi, M., 2010. CGAP Brief: Apexes, an important source of local funding, Washington: CGAP.
- Duflos, E., Luchtenburg, P., Ren, L. & Chen, L. Y., 2013. Microfinance in Myanmar Sector Assessment, s.l.: IFC.
- Isa, Q. A., 2011. What makes a microfinance APEX work?, Islamabad: PPAF.
- Khalaf, R. & Miamidian, E., 2009. Restructuring of MITAF, s.l.: internal publication.
- LIFT, 2012. Baseline Survey Results, Yangon: LIFT.
- McKinsey Global Institute, 2013. [Online]
- Available at: http://www.mckinsey.com/insights/asia-pacific/myanmars_moment
- M-CRIL, 2013. CHIN MFI GRET rating report, Yangon: internal document .
- MIFA, 2008. Pakistan: Microfinance and Financial Sector Diagnostic Study, s.l.: IFC.
- Nichols, S., 2009. Apex Microfinance Institution in the LAO PDR, Manila: Asian Development Bank.
- Pentax Management consultancy, 2009. operational manual for IFAD- RafiP, s.l.: IFAD.
- PWC, 2012. Myanmar Business Guide, s.l.: PWC.
- Sarah Forster, E. D. R. R., 2012. A new look at microfinance apexes, Washington: CGAP.
- Save the Children, 2013. DAWN Business plan, Yangon: internal document.
- World Vision, 2013. World Vision Myanmar Business Plan Summary 2014-2015 , s.l.: World Vision.

ANNEX A: TERMS OF REFERENCE

Under the direct supervision of the LIFT Programme Officer - Markets and Microfinance, the Apex Fund Specialist will perform the following duties:

a) Consult with the LIFT Fund Manager's Office (FMO) and LIFT funded MFIs/IPs about their objectives and priorities with regard to better financing and TA.
b) Conduct an initial desk-based review, followed by on the ground analysis, of
   a. existing MFIs and other FSPs in Myanmar, including those funded or supported by LIFT, and the funding they currently receive, and
   b. institutions, funds and donors currently financing MFIs and other FSPs in Myanmar, with the aim of identifying:
      i. funding constraints experienced by MFIs and FSPs;
      ii. obstacles to direct funding, e.g. technical capacity (governance, institutional, human etc.); and
      iii. Potential benefits from setting up an Apex Fund, drawing on the experience in other countries.
c) Consider the need and desirability of establishing an Apex Fund for Myanmar, primarily in terms of whether current and projected demand for funding, legislative/regulatory issues and key stakeholder inputs, warrant a specialized wholesaler.
d) Outline the structure and scope of a potential Apex Fund containing, but not limited to, the following elements:
   a. The alternative institutional structures for an Apex Fund, such as a national microfinance institution, local company, trust fund etc.;
   b. The potential
      i. overall objectives,
      ii. governance,
      iii. management arrangements and
      iv. internal processing procedures

      for the proposed Apex Fund;
   c. Funding sources for, and ownership of, the Apex Fund;
   d. Range of financing, grants, technical assistance and other services (e.g. guarantees) to be provided by the Apex Fund and the range of costs that MFIs and FSPs would pay for such assistance;
   e. MFIs and FSPs who would most likely benefit from access to an Apex Fund;
   f. Possible levels of performance sought from FSPs receiving products and services from the Apex Fund and other possible reporting indicators, such as responsible finance, client protection and development goals;
   g. Advantages and disadvantages, costs and risks of each alternative option, based on issues such as sustainability, funding, impact on/possible crowding out of other sources of support, time to achieve results/robust outputs and exit strategies; and
   h. Advice on the most appropriate structure and services to be provided by the Apex Fund.
e) Estimate whether other players, such as the banking sector or commercial investors, would be willing to take on that role in the short or near term, bearing in mind the overall objective of LIFT with regard to rural stakeholders and agriculture.
f) Examine whether there are technical and/or service organizations that could be supported to take on a TA role or whether this might need to be built into the Apex Fund.
g) Facilitate a workshop amongst LIFT IPs and others to discuss preliminary findings and seek interest in becoming a recipient of funding and/or TA from an Apex Fund.

ANNEX B SCHEDULE OF MEETINGS

Interviews Myanmar		
Date	**Organisation**	**Name**
3/sep/13	LIFT	Mr. Andrew Kirkwood
	PACT	Mr. Jason Meikle/ Mr. Fahmid Karim Bhuiya
4/sep/13	MADB	Ms. Khin Nan Myint
	World Vision	Mr. Neil Younquist
	Planet Finance	Mr. Ron Bevaqcua (skype)
	Proximity	Ms. Gil Pattison
5/sep/13	ACLEDA Myanmar	Mr. Kim Bunsocheat
	CARD	Ms. Juvy Gucatan
	CGAP	Mr. Eric Duflos (mail/skype)
	DFID	Mr. Khin Maung Lwin
6/sep/13	EDA Rural Systems	Mr. Sanjay Sinha (skype)
	CCS	Mr. U Min Lwin, GM
	Kan Baw Za Bank	Mr. U Than Lwin
	Save the Children	Mr. Aung Aung; Ms. Janis Sabetta
9/sep/13	UNCDF	Mr. Feisal Hussain (skype)
	UNCDF	Mr. Paul Luchtenburg
	LIFT	Mr. Steve Dowall
10/sep/13	Tun Foundation Bank	Mr. Joe Barker-Bennet
	Local market expert	Mr. U Thein Myint
11/sep/13	AEON Microfinance	Mr. Yuro Kisaka
	Ar Yone Oo	Mr. Cin Khan Lian
	Central Bank Myanmar	Mr. U Maung Maung
12/sep/13	World Bank	Mr. Masaru Tanaka
	Lawyer	Ms. Thida Aye (mail)
	DFID	Ms. Anthea Kerr (skype)
13/sep/13	Myanmar Investment Commission (DICA)	
	Myanmar Economic Bank	Mr. Kyaw Kyaw, Mr. Thu Ra
	Microfinance Supervisory Enterprise	Mr. U win Aung
16/sep/13	IFC	Ms. Linda Ren
17/sep/13	EU	Mr. Alberto Menghini
	UNDP	Mr. Heinz Willems

ANNEX C: PRESENTATION WORKSHOP SEMINAR SEPT 16

To see the presentation file presentd in workshop, please visit to following web link.

http://www.lift-fund.org/Publications/vdSterren_wholesaleMMsmall.pdf

ANNEX D: FINANCIAL PROJECTIONS/ ESTIMATES ON My PerMIT FACILITY

A. new loans committed to MFI	2014	2015	2016	2017	2018	TOTAL
2014	2,000,000					**2,000,000**
2015		5,449,840				**5,449,840**
2016			5,513,331			**5,513,331**
2017				1,949,645		**1,949,645**
2018					3,000,000	**3,000,000**
TOTAL	**2,000,000**	**5,449,840**	**5,513,331**	**1,949,645**	**3,000,000**	**17,912,816**

B. Repayment on loans outstanding	2014	2015	2016	2017	2018	TOTAL
2014	392,000	744,800	744,800			**1,881,600**
2015		1,068,169	2,029,520	2,029,520		**5,127,209**
2016			1,080,613	2,053,164	2,053,164	**5,186,942**
2017				955,326	955,326	**1,910,652**
2018					2,940,000	**2,940,000**
TOTAL	**392,000**	**1,812,969**	**3,854,933**	**5,038,011**	**5,948,491**	**17,046,404**

C. Total gross portfolio	2014	2015	2016	2017	2018	TOTAL
2014	2,392,000	744,800	744,800			**3,881,600**
2015		6,518,009	2,029,520	2,029,520		**10,577,049**
2016			6,593,944	2,053,164	2,053,164	**10,700,273**
2017				2,904,971	955,326	**3,860,298**
2018					3,000,000	**3,000,000**
TOTAL	**2,392,000**	**7,262,809**	**9,368,264**	**6,987,656**	**6,008,491**	**32,019,220**

D. Portfolio outstanding	2014	2015	2016	2017	2018	TOTAL
2014	1,435,200	956,800				**2,392,000**
2015		3,910,805	2,607,203			**6,518,009**
2016			3,956,366	2,637,578		**6,593,944**
2017				2,904,971		**2,904,971**
2018					3,000,000	**3,000,000**
TOTAL	**1,435,200**	**4,867,605**	**6,563,570**	**5,542,549**	**3,000,000**	

E. Loans received from investors	2014	2015	2016	2017	2018	TOTAL
2014	-					**-**
2015		4,000,000				**4,000,000**
2016			4,000,000			**4,000,000**
2017				-		**-**
2018					-	**-**
TOTAL	**-**	**4,000,000**	**4,000,000**	**-**	**-**	**8,000,000**

F. Repayment on long term liabilities from investors	2014	2015	2016	2017	2018	TOTAL
2014	-	-	-	-	-	**-**
2015	-	-	1,333,333	1,333,333	1,333,333	**4,000,000**
2016	-	-	-	1,500,000	1,500,000	**3,000,000**
2017	-	-	-	-	-	**-**
2018	-	-	-	-	-	**-**
TOTAL	**-**		**1,333,333**	**2,833,333**	**2,833,333**	**7,000,000**

G. Financial income interest	2014	2015	2016	2017	2018	TOTAL
2014	172,224	114,816				**287,040**
2015		469,297	312,864			**782,161**
2016			474,764	316,509		**791,273**
2017				348,597		**348,597**
2018					360,000	**360,000**
TOTAL	**172,224**	**584,113**	**787,628**	**665,106**	**360,000**	**2,569,071**

H. Financial income fees	2014	2015	2016	2017	2018	TOTAL
2014	10,000					**10,000**
2015		27,249				**27,249**
2016			27,567			**27,567**
2017				9,748		**9,748**
2018					15,000	**15,000**
TOTAL	**10,000**	**27,249**	**27,567**	**9,748**	**15,000**	**89,564**

I. Financial income on time deposits	2014	2015	2016	2017	2018	TOTAL
2014	114,816	35,750	35,750			**186,317**
2015		312,864	97,417	97,417		**507,698**
2016			316,509	98,552	98,552	**513,613**
2017				139,439	45,856	**185,294**
2018					144,000	**144,000**
TOTAL	**114,816**	**348,615**	**449,677**	**335,408**	**288,408**	**1,536,923**

J. Total financial income	2014	2015	2016	2017	2018	TOTAL
2014	297,040	150,566	35,750			**483,357**
2015		809,410	410,281	97,417		**1,317,109**
2016			818,840	415,061	98,552	**1,332,453**
2017				497,783	45,856	**543,639**
2018					519,000	**519,000**
TOTAL	**297,040**	**959,977**	**1,264,872**	**1,010,262**	**663,408**	**4,195,558**

K. Loan loss expenses	2014	2015	2016	2017	2018	TOTAL
2014	47,840	14,896	14,896			**77,632**
2015		130,360	40,590	40,590		**211,541**
2016			131,879	41,063	41,063	**214,005**
2017				58,099	19,107	**77,206**
2018					60,000	**60,000**
TOTAL	**47,840**	**145,256**	**187,365**	**139,753**	**120,170**	**640,384**

L.Operating expenses	2014	2015	2016	2017	2018	TOTAL
2014	143,520	44,688	44,688			**232,896**
2015		391,081	121,771	121,771		**634,623**
2016			395,637	123,190	123,190	**642,016**
2017				174,298	57,320	**231,618**
2018					180,000	**180,000**
TOTAL	**143,520**	**435,769**	**562,096**	**419,259**	**360,509**	**1,921,153**

M. Exchange rate losses	2014	2015	2016	2017	2018	TOTAL
2014	47,840	14,896	14,896			**77,632**
2015		130,360	40,590	40,590		**211,541**
2016			131,879	41,063	41,063	**214,005**
2017				58,099	19,107	**77,206**
2018					60,000	**60,000**
TOTAL	**47,840**	**145,256**	**187,365**	**139,753**	**120,170**	**640,384**

N. Financial expenses	2014	2015	2016	2017	2018	TOTAL
2014						
2015		200,000	200,000	66,667	66,667	**533,333**
2016			200,000	125,000	125,000	**450,000**
2017						
2018						
TOTAL		**200,000**	**400,000**	**191,667**	**191,667**	**983,333**

O. Total expenses	2014	2015	2016	2017	2018	TOTAL
2014	239,200	74,480	74,480			**388,160**
2015		851,801	402,952	269,619		**1,524,372**
2016			859,394	330,316	330,316	**1,520,027**
2017				290,497	95,533	**386,030**
2018					300,000	**300,000**
TOTAL	**239,200**	**926,281**	**1,336,826**	**890,432**	**725,849**	**4,118,589**

RESULTS	2014	2015	2016	2017	2018	TOTAL
TOTAL INCOME	297,040	959,977	1,264,872	1,010,262	663,408	4,195,558
TOTAL EXPENSES	239,200	926,281	1,336,826	890,432	725,849	4,118,589
RESULT OF THE YEAR	57,840	33,696	(71,955)	119,829	(62,442)	76,969

P. CAPITAL GRANTS APEX	2014	2015	2016	2017	2018	TOTAL
2014	2,000,000					**2,000,000**
2015		1,000,000				**1,000,000**
2016			1,000,000			**1,000,000**
2017				1,000,000		**1,000,000**
2018					1,000,000	**1,000,000**
TOTAL	**2,000,000**	**1,000,000**	**1,000,000**	**1,000,000**	**1,000,000**	**6,000,000**

Livelihoods and Food Security Trust Fund
UNOPS Fund Manager Office

No. 12 (O), Pyi Thu Lane, 7 Mile, Mayangong Township, Yangon, Myanmar
Phone: +95 1 65 7703~06, 65 7280~87, Fax: +95 1 65 7702, +95 1 65 7279
Email: lift@unops.org
Website: www.lift-fund.org