Government of the People's Republic of China

United Nations Development Programme (UNDP)

Project Document

June 2008

Building an Inclusive Financial Sector in China (BIFIC)

The development objective is to contribute to building an inclusive financial sector in China. The immediate objectives are (i) to establish a national strategic plan to build an inclusive financial sector and (ii) to create commercially viable financial institutions that provide access to finance to the lower segments in the market (i.e to poor and low-income households).

The project consists of two main components.

First, multi-stakeholder dialogues and demand based research will be organized to identify and analyze the constraints and opportunities on building an inclusive financial sector. This process will result in a national strategic plan that will act as a road map for joint and coordinated action of all stakeholders in their aim to build an inclusive financial sector in China.

Second, an Inclusive Finance Fund will be established to provide technical and financial support to a carefully selected group of entities that show high promise to be able to provide financial services on a commercially viable basis to a large number of poor and low-income households in the rural and less developed areas of China.

"The great challenge before us is to address the constraints that exclude people from full participation in the financial sector….. Together, we can and must build inclusive financial sectors to help people improve their lives"

Kofi Annan, Secretary General, United Nations

Press release on the opening of the International year of Microcredit, 23 December 2003

UNDAF Outcome:

Outcome 1: Social and economic policies are developed and improved to be more scientifically based and human centered for sustainable and equitable growth

Country Programme Outcome/Indicators:[1]

Outcome 1: Social and economic policies are developed and improved to be more scientifically based and human centered for sustainable and equitable growth

Output 1.4: Poverty reduction approach piloted on target population

Outcome 2: National efforts to lead and manage Xiaokang/MDG implementation supported through a variety of instruments and capacity building initiatives

Output 2.4: Policy and action oriented research and strategy on emerging poverty challenges developed and disseminated to key stakeholders

Output 2.5: Establishment of legal environment conducive to pro-poor provisions in the financial system

Outcome 5: Capacities to pursue gender-equity efforts enhanced through advocacy, gender sensitive analysis and implementation

Output 5.2: Pilot interventions to benefit women and their livelihoods modelled

Implementing Partner: China International Center for Economic and Technical Exchanges (CICETE)

National Cooperating Agencies: People's Bank of China (PBC)
China Development Bank (CDB)

Project Period: 2008-2011
Project Component: Achieving the MDGs and reducing human poverty
Project title: Building an Inclusive Financial Sector in China
Duration: 2008-2011
Management Arrangements:

Budget (US$)	US$ 14,400,000
• UNDP TRAC	US$ 1,000,000
• CDB parallel	RMB 100,000,000 (US$ 13,000,000)
• PBC parallel	RMB 3,000,000 (US$ 400,000)

Agreed by:	Signature	Date
Government Coordinating Agency and Implementing Partner (CICETE):		2008.6.26
National Cooperating Agency (PBC):		2008.6.25
National Cooperating Agency (CDB):		08年6月20日
UNDP:	Alessandra Tisot Sr. Deputy Resident Representative	8/7/08

[1] Refer to UNDP Country Programme Document. Currencies use official UN rate in June 2008 of 6.95 RMB/US$.

Table of Contents

List of abbreviations

ACWF	All China Women's Federation
CASS	Chinese Academy of Social Sciences
CBRC	China Banking Regulation Commission
CDB	China Development Bank
CICETE	China International Centre for Economic and Technical Exchanges
CPAP	Country Programme Action Plan
CZWSDA	Chifeng Zhaowuda Women's Sustainable Development Association
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
HDR	UNDP Human Development Report
IFAD	International Fund for Agricultural Development
IMAR	Inner Mongolia Autonomous Region
KfW	Kreditanstalt für Wiederaufbau
MCC	Microcredit company under the PBC pilot program
MDGs	Millennium Development Goals
MFI	Microfinance Institution
MIS	Management Information System
MOFCOM	Ministry of Commerce
NGO	Non-Governmental Organization
PBC	People's Bank of China
RCC	Rural Credit Cooperative
RMB	Renminbi (Chinese Currency)
SOCBs	State Owned Commercial Banks in China
SOE	State owned enterprises
SMAP	Sustainable Microfinance to Alleviate Poverty
SME	Small and medium sized enterprises
UNDAF	United Nations Development Assistance Framework
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund

Chapter 1 Situation Analysis and Justification

1.1 Current international paradigm on building inclusive financial sectors

In recent years, microfinance has come increasingly into the public spotlight and household vocabularies worldwide. However, in its several decades of existence, the world of microfinance has also dramatically changed and evolved. The policy emphasis has shifted from government subsidy to separate sustainability; recipients have gone from being viewed as poor destitutes to business clients with ideas, skills and potential; the donors have moved from direct provision of credit through small projects to an institution building approach and then further still to a strategy of engagement and integration with the overall financial system; microfinance providers are reaching beyond poor subsistence farmers only to reach broader types of unbanked and are providing a range of financial services rather than credit alone.

For many donors such as UNDP, this evolution of approaches over time can be usefully described by the project, institutional and sectoral approaches outlined in Figure 1 below. The project approach focuses on the number of clients that get access to loans. Reaching as many of these beneficiaries as possible in the project period is the overall aim, while the profitability and sustainability of operations is not taken into account.

The institutional approach puts more emphasis on the performance of the institution(s) supported. Capacity building, technology development, management information systems and improved monitoring and reporting are important components of the support provided. The quality of the loan portfolio and ability of the institution to cover its costs are seen as important, and funding can be given in tranches depending on performance.

This financial sector approach takes as its starting point the realisation that the best way to provide poor and low-income clients with access to affordable and tailored financial services is that microfinance services become integrated into the overall financial system. It puts emphasis on removing macro and meso level obstacles to inclusiveness and convincing financial institutions (FIs) that the poor are not only bankable but a strong business opportunity missed. Thus it aims to deepen the financial system both by encouraging the downward reach of traditional FIs as well as the improved financial sustainability and responsibility of extant microfinance institutions (MFIs).

This progression implies a fundamental shift in the way donors view both the nature of microfinance and their own role in supporting it. Building on previous initiatives corresponding to the first two approaches, this project document instead reflects the sectoral development approach.

Figure 1 Comparison of Project, Institutional and Microfinance Sector Approaches[2]

Criteria	Project Approach	Institutional Development Approach	Microfinance Sector Development Approach
Vision	Many entrepreneurial poor need credit to start or expand a business. Credit will help improve their livelihoods.	Poor and low-income people can improve their lives through access to financial services. Building sustainable microfinance institutions will guarantee that more people will have access to financial services.	Poor and low-income people can improve their lives through access to financial services. To optimally address such need at large scale, the capacity of the whole sector of microfinance should be developed as an integrated part of the financial sector.
Objective	Decrease poverty of targeted beneficiaries through direct provision of credit	Support microfinance institutions to provide sustainable access to financial services for their clients.	Build inclusive financial sectors that provide sustainable access to financial services to poor and low-income people throughout the country
Policy	Funds should be disbursed within a time period to a fixed number of targeted beneficiaries.	Supported institutions should adhere to sound microfinance principles and aim for institutional sustainability and outreach.	Stakeholders should aim to establish a conducive environment for financial sector development and aim to build a competitive microfinance industry as an integrated part of the financial system

[2] Source: UNCDF (2007) *Concept Paper on the Microfinance Sector Development Approach*

Strategy	1. Set up a revolving fund or project component 2. Select beneficiaries and disburse funds 3. Collect repayments to disburse as new loans	1. Select institution 2. Conduct institutional appraisal to decide on funding and support 3. If appraisal is positive, provide funding for on-lending and/or capacity building	1. Conduct a financial sector assessment and develop a consensus on vision, constraints and opportunities 2. Establish policy, national strategy and action plan based on a shared vision 3. Implement national strategy to address constraints and untapped opportunities to develop the sector
Target group	Project beneficiaries	Microfinance institutions	All stakeholders
Key Performance indicators	Cumulative number of beneficiaries reached during the project period.	Profitability, Portfolio at Risk, outreach	Number of people that have a financiaLaccounts; number of branches; profitability industry; degree of competition; taxes received/subsidies spent on building the sector
Advantages	- Ease of implementation - Quick results - Targeted implementation - Direct control - Low requirement for support from experienced specialists	- Ease of implementation - Increased sustainable access to financial services for poor and low-income customers of MFI - strong emphasis on local capacity building	- More coordinated approach - Harmonization of donor funding - Involvement of all key stakeholders - National ownership - Increased sustainable access to financial services for poor and low-income customers - Focus on integration from the start.; leveraging private capital - Broad inclusive policy and strategy mitigates the risk of funding bad practices and enhance the speed of sector development - Strong emphasis on local capacity building
Disadvantages	- Not sustainable - Might undermine sector development - Limited accountability - Low cost effectiveness - Chances to in-debt poor are high - Limited capacity building	- May distort market and level playing field - Introduces donor preferences for non-profit institutions - Bias of donors for "their" MFIs - Does not address the risk of unfavourable environment that could hamper sustainability of MFIs or hamper potential clients to gain access - Potential lack of participation of Central bank and government -Takes time to build viable microfinance institutions or units - Need for support of experienced experts	- Complex approach involving the building of partnerships - Donors and politicians might prefer to play their own agenda's which would inhibit implementation of a common strategy - Risk of one interest group monopolizing the process. This would result in donors to fall back on project or institutional development approach - Takes time to build a sustainable and competitive microfinance industry and an enabling environment - Need for support of experienced experts

1.2 UN Year of Microcredit 2005

1.2.1 The Blue Book—why are so many bankable people unbanked?

Building Inclusive Financial Sectors for Development is the title of the landmark summary of the extensive global dialogue held as part of the International Year of Microcredit published by United Nations Capital Development Fund (UNCDF) and United Nations Department of Economic and Social Affairs (UNDESA). Also known as the Blue Book, the publication will soon be published in a Chinese edition by the joint efforts of PBC, UNDP and CICETE.

The Blue Book was a real example of donor collaboration, with the DESA and UNCDF staff team supported by a multilateral agency group representing the World Bank, the International Monetary Fund, the International Fund for Agricultural Development, and the International Labour Organization. This team was further supported by the Consultative Group to Assist the Poor, the Advisors Group of the International Year of Microcredit, the Group of Friends of the Year of Microcredit, the African Microfinance Network, the African Development Bank, the Asian Development Bank, the Inter-American Development Bank, the Economic Commission for Latin America and the Caribbean, Women's World Banking, the World Savings Banks Institute, and the Microcredit Summit Campaign.

To ensure regional credibility a series of regional "multi-stakeholder consultations" were organized in the Middle East , Africa , Asia and Latin America . The views of governments, international organizations, financial institutions, the private sector and civil society were gathered in informal roundtable discussions at these meetings. A global e-conference in the spring of 2005 mobilized over 800 participants. Material was also gathered from an on-line questionnaire, in-depth interviews with experts in the field and seminars organized by partner organizations. This consultative process culminated in a May 2005 Global Meeting on Building Inclusive Financial Sectors in Geneva .

The result of these extensive collaborations is the book. It offers a vision of what inclusive finance could be. It does not dictate policy prescriptions to realize that vision. Even before publication, the book has gained some notoriety in the microfinance industry where it has become known as the "Blue Book" after the colour of the United Nations flag. It is indeed a blue book, but it is not a "blueprint." The vision of inclusive finance is clearly stated:

> "Supported by a sound policy, legal and regulatory framework, each developing country should have a continuum of financial institutions that, together, offer appropriate products and services to all segments of the population. This would be characterized by:
> - access at a reasonable cost of all households and enterprises to the range of financial services for which they are "bankable," including savings, credit, leasing and factoring, mortgages, insurance, pensions, payments, local and international transfers;
> - sound institutions, guided by appropriate internal management systems, industry performance standards, and performance monitoring by the market, as well as by sound prudential regulation where required;
> - financial and institutional sustainability as a means of providing access to financial services over time; and
> - multiple providers of financial services, so as to bring cost-effective and a wide variety of alternatives to customers."

A number of important considerations need to be taken into account to realize this vision of inclusive financial sector development: the right to fair treatment of the individual in his or her society; the degree of financial literacy of customers; the recognition of the need for some civic or government intervention to open access; the need for financial policy interventions to take a long-run view on access, regardless of short-run exigencies; and the recognition that the vision is dynamic and eclectic, allowing for the possibility of new forms of service provision arising through social, policy, technological and financial innovation.

This book provides UN member countries with the very latest in the UN's learning about building inclusive financial sectors.

Access for All: Building Inclusive Financial Systems (2006) has also recently been published by CGAP[3] following up on Building Inclusive Financial Systems: Donor Guidelines on Good Practice in Microfinance December 2004. UNCDF is a member of CGAP.

This is a good compliment to the UN book with lots of practical examples of progress at each of the macro/policy level, the meso/infrastructure level and micro/retail level of the financial system. It shares the experience of CGAP's hands on work at each of the different levels and is easily understood by both policy makers and practitioners.

[3] CGAP – is a consortium of XX donors and foundations involved in the provision of financial services to poor clients and is housed at the World Bank.

"The new vision recognizes that large-scale sustainable microfinance can be achieved only if financial services for the poor are integrated into all three levels of a financial system: micro, meso, and macro. In general, integration allows greater access to capital on the part of institutions serving the poor, better protection of poor people's savings, and increased legitimacy and professionalization of the sector. Ultimately, integration into the financial system could open financial markets to the majority of people living in developing countries, including poorer and more geographically remote clients than are currently reached.

Success in building inclusive financial systems hinges on the contributions of a wide range of actors and their ability to work together effectively. In addition, financial systems for the poor depend on existing conditions, such as infrastructure, access to markets, production technology, and availability of information to mitigate risk. The backbone of financial systems remains retail institutions that provide services directly to clients ("micro-level"). In addition, a supporting infrastructure comprising quality auditors, rating agencies, professional networks, trade associations, credit bureaus, transfer and payments systems, information technology, technical service providers, and trainers is required to reduce transactions costs, increase outreach, build capacity, and foster transparency among retail institutions.7 This infrastructure, known as the "meso-level," can transcend national boundaries and include regional or global actors.

Finally, a conducive and stable macroeconomic and policy environment is necessary to underpin a pro-poor financial system. Central banks, ministries of finance, and other national government entities constitute the primary "macro-level" players. It is important to note that all aspects of an inclusive financial system may be difficult to apply in all countries. As in every other area of development, one of the most important starting points should be the country context. For instance, in countries with dysfunctional or non-existent financial systems, the entry point for building permanent access to financial services for poor people will differ from the entry point in countries with flourishing financial systems.

A functioning financial system should be seen as a necessary, but certainly not sufficient, condition to assure permanent access to financial services for poor people.

1.2.2 Data project

Financial Access for All: Better Measurement, Monitoring and Policy Action was the subject of a technical meeting in June 2005 hosted by UNCDF in conjunction with the Advisors Group to the International Year of Microcredit, Agence Française de Développement (AFD) the World Bank and the UK's Department for International Development (DFID). Its purpose was to further examine the critical issue of how to measure access to finance. The reason the issue of measurement is so important to building inclusive financial systems is that there is a lack of reliable, systematic, comparable data. Surprisingly little is known about who has access to financial services, what affects the supply and demand of financial services and consequently how best to promote access to finance for the poor. Some data exist on firms' access to finance, and previous research and analysis has concentrated the determinants of that access. So far, little has been documented on how individuals and households fare in their access to finance.

This lack of data is partly due to the inherent difficulty of documenting household or individual access to financial services and the wide variety of concepts used to measure access. To address this, the International Year of Microcredit, the World Bank and the International Monetary Fund initiated a working group on measuring access in October 26, 2004. The effort aims to create an international guideline on the collection of survey individual and household and other access indicator data to ensure comparability across countries and across time, and thereby allow systematic research and better policy advice. In addition to helping policy makers, practitioners, researchers and the private sector more fully understand the current and potential supply and demand for financial services; more comparative data will also serve to motivate countries to reform their financial systems so as to encourage greater access. Four main core concepts were discussed that require more common definitions – usage and access; individual and household; financial functions (products); and formal and informal services.

1.3 A brief history of rural finance in China

The formal financial service providers in rural China include rural credit cooperatives (RCCs), the Agricultural Bank of China (ABC), Postal Savings and the Agricultural Development Bank of China (ADBC) - a policy bank set up to finance the procurement of farm goods, mainly grains. The People's Bank of China (PBC) is a central bank and China banking Regulation Commission (CBRC) was separated from PBC in 2003.

Subsidized loans have been perhaps the most important means for the Central Government to support economic development and poverty alleviation in rural China. The subsidized loans in China include the following:

- Heavily subsidized poverty loans at a lending rate of around 3 per cent per annum, disbursed by the ABC with the subsidies provided by the Ministry of Finance. The total poverty loan portfolio reached over 80 billion RMB by 2002-2003, 4.5 per cent of the total rural lending from the formal financial institutions in 2003.
- PBC Agricultural On-lending to RCCs since the late 1990s. The rate of the on-lending is around 2 per cent, below the cost of funds for some RCCs in the poor and more remote areas of China. The total PBOC on-lending reached over 70 billion RMB by 2002-2003, about 5 per cent of the total rural lending from formal financial institutions. RCCs have been ordered to disburse such on-lending to rural households for agricultural development at the subsidized rates of interest
- The Agricultural procurement loans through ADBC, as the repayment rate for such loans have been very low and ADBC is heavily subsidized by the state (this is more to subsidized consumers).
- Most institutional loans in China (include loans from RCCs and ABC) can be regarded as policy loans as the rates of interest for these formal loans, as set by the state, are much lower than either the market rate, or the sustainable lending rate of interest. As a consequence, many RCCs have operated at a financial loss even at Chinese accounting standard.

As occurred in other parts of the world, the heavily subsidized poverty loans channelled through the ABC in China have failed to target the poor and the repayment rate of such loans have been very low (around 50 per cent). The reforms in 1994 and 1996 failed to make rural financial markets more competitive, although the ADBC was created and the supervision authority of RCCs was shifted from the ABC to PBC. On the contrary, China' rural institutional lending markets have become dominated by RCCs, as the reforms led to the gradual withdrawal of the ABC from rural lending and the collapse of RCFs (Rural Credit Foundations) and other informal financial institutions. These were the major competitors for RCCs in rural financial markets. Non-price competition for rural deposits has become fierce, especially in more developed areas, as the ABC stays on fighting for rural deposits and the share of rural deposits held by rural post savings has grown over time.

RCCs have been the major suppliers of micro-loans in rural China, following the close down of RCFs in the late 1990s and the withdrawal of ABC from rural areas. In August 2003, the Chinese

Government finally launched RCC pilot reform that allows restructuring the ownership of RCCs by introducing private ownership. Under the supervision of CBRC, RCC pilot reform first initiated in eight selected provinces. The main contexts of this round of reform include: handing over the management responsibilities of RCCs to provincial governments; refinancing the historical losses through central bank fund; other fiscal subsidies to compensate for losses incurred on indexed deposits taken by RCCs in the 1990's; and tax exemptions. The pilot reform was expanding to other provinces in 2004, and the estimated costs are RMB165 billion.

RCCs however face the competition from Postal Savings for their savings and remittance services. Currently, Postal Savings have grabbed 20-per cent of rural savings market and over 30 per cent of rural remittance markets. The postal savings is in the process of being transformed into a Postal savings Bank (see next section). The PBC on-lending has increased RCC outreach, but it is still difficult for such loans to reach the poorer section of the rural households and the program itself is not sustainable. As a consequence, a considerable part of the demand for loans from rural households, especially poor households, has not been met, or met by informal rural finance.

MFIs in China can be regarded as something between formal and informal financial service providers. The first microfinance experiment in China started in 1993 in Yixian County of Hebei Province, operated by a group of researchers from Rural Development Institute (RDI) of the Chinese Academy of Social Sciences (CASS). By the end of 2005, there have been more than 200 county level donor funded microfinance programs in China, with a total investment of more than 1 billion RMB. The major external donors for microfinance in mainland China include the multilateral donors of UNDP, UNICEF, IFAD, WFP, ILO, UNFPA and the World Bank; the bilateral donors of AusAID, CIDA; International NGOs of Grameen Trust, Oxfam Hong Kong, World Vision. Compared with MFIs elsewhere, the MFI programs in China have the following features:

- Overall, microfinance in China is still at the stage of experimentation, as these MFIs have not been legalized and they do not have a permit or license to engage in microfinance operations. Since the late 1990s, some programs have turned themselves into NGOs by registering with the local Departments of Civil Affairs.
- Aimed at reducing rural poverty, the microfinance programs in China have been dominated by rural programs. Most MFPs in China are located in the very poor and remote Western areas where the transaction costs are higher and the investment opportunities are few.
- The funds for microfinance experiments have been mainly provided by donors

Many NGO MFIs are suffering from the possible moral hazard problem, as the ownership of the microfinance funds is not clarified and managers of the MFIs do not have any stake in their institutions, and moreover they could be transferred out of the MFI by the local governments and government agencies.

1.4 Current developments and national policy initiatives in rural financial services

The Big Four state banks have for many years now been moving out of rural areas due to commercialization and competitive pressures, reducing their presence in rural areas by over 43% in the last ten years and closing 30,000 branches in the last five years alone. This means that the onus shifts heavily towards the RCCs as essentially the only institutions left in rural areas to provide financial services there. They are, however, in most cases burdened with low efficiency and high rations of non-performing loans and thus are ill equipped for the task.

The government recognizes this problem and is actively pursuing or contemplating a variety of potential solutions. Several number one documents from the state council have increasingly emphasized the need to extend access to rural financial services, and the January 2007 meeting of the national financial working group (convened every five years) gave considerable further impetus to this task.

One approach applied in India and elsewhere is to regulate the uses of funds for the State owned commercial banks (SOCBs) and other commercial banks in China by setting a ratio of loans for agricultural support. There has been strong opposition by the commercial banks in China. Another approach is to provide incentives for the commercial banks to provide loans for agricultural support and poverty alleviation, through tax concessions and exemptions.

In order to improve the access of the rural households to formal loans and increase the competition in China's rural financial market, the State Council has set up a working group for microfinance pilot, with the PBC, CBRC, the Ministry of Commerce (MOC) and the Ministry of Finance (MOF), and the leading Group for Poverty Reduction (LGOPR) as members.

PBC in December 2005 launched a pilot initiative creating microcredit companies (MCCs) in Sichuan, Guizhou, Shanxi, Shaanxi and Inner Mongolia. Instead of full status financial institutions, the institutions and individuals that provide micro-loan services are treated as semi-financial institutions. They are lending-only institutions and thus not allowed to mobilize deposits from the public, which limits the scope of their services and possible sources of funding. This has proven a constraint on the seven MCCs currently conducting operations.

Otherwise funds for the MCCs can come from various sources, including 'grant funds from domestic sources or overseas, funds from investors, wholesale funds from domestic financial institutions, including the State Development Bank (SDB), ADBC, Postal Savings and or other financial institutions in China. In principle, an MFI shall use the wholesale loans from one wholesaler only. Rates of interest shall not exceed 4 times the base rate of interest set by the PBOC.

CBRC in December of 2006 issued their own pilot initiative, opening the door for village banks that are allowed to take deposits. This was a very encouraging development which was well received by most observers. Some restrictions still apply, however, including the requirement for a licensed domestic bank to take 20% stake and limiting the share of individual non-FI investors to 10%. Like the MCCs, these institutions are also subject to geographical constraints, limiting potential for scale and making sustainability more difficult. The half dozen village banks and half dozen community funds that have been created under the CBRC initiative have not been in operation long enough for conclusive assessments to be made, but anecdotal evidence suggests that these restrictions are both limiting their scale and dampening investor interest in these institutions.

The newly established Postal Savings Bank, which has 40,000 branches and RMB 900 billion in savings, has initiated a large scale microfinance experiment in the three provinces of China (Fujian, Shaanxi and Hubei) in March 2006. All the micro-loans provided by Postal Savings are collateralized by the deposits at the Postal Office, so it can be regarded as risks free. The terms of the loans are within 12 months, and the micro-loans are provided at the base-lending rate set by the PBC (around 5.7 per cent per annum). Clearly, the micro-loans tested by the Postal Savings s far are still a long from micro-finance that aims at outreach and financial sustainability. The Postal Savings however intends to extend the current microcredit experiments to all the provinces in China, start trials without deposit certificate as collateral and replicate experiments on non-deposit guaranteed loans by the end of 2007 and beginning of 2008.

By supporting and legalizing microfinance institutions in China, PBC and CBRC as the bodies responsible for policy and regulation in China's financial markets aim to achieve two objectives:

- Create more competition in China's rural financial markets, hence to improve the market efficiency and the financial services to farmers and rural enterprises. The market is currently dominated by RCCs.
- Encourage the flow of funds back into rural areas, of particularly poor rural areas of China. This is consistent with the current government policy emphasis supporting agriculture and poor areas.

Yet the newly created institutions under both PBC and CBRC pilot initiatives, while rapidly disbursing a volume of loans, still seem to consistently remain focused on urban or peri-urban areas and relatively large loan sizes. This means that however useful they are in meeting unmet demand for formal financial services—a valuable contribution to the inclusiveness of the financial sector—they are still not extending access to the rural or low-income populations.

The result is that they on current trends will have limited usefulness in reversing the striking and possibly worsening lack of access to services in rural areas. As one indicator of unmet demand, PBC estimates the informal finance market at around RMB 1 trillion, or more than the formal lending of all the RCCs put together (920 billion). Some observers believe it is 2 or 3 times higher, which would make it larger than the total sum of formal deposits in rural areas (RMB 2 trillion). Clearly, a very big share of the market is not being served by existing financial institutions; and to that should of course be added the millions of people who lack access to either formal or informal systems.

Informal finance in rural China consists mainly of borrowing and lending among relatives and friends with low rate of interest or interest free, moneylenders, and informal financial mechanisms organized by rural households, such as revolving savings and credit associations, as well as informal financial institutions. Officially, rural financial institutions in China do not include informal financial institutions, as these institutions are neither regulated nor supervised by the PBOC and the deposits with these institutions are not protected by the state.

1.5 Impediments to an Inclusive Financial Sector in China

The main impediments include the following:

- Lack of knowledge about the inclusive financial system
- Restrictions on the entry and exit of financial institutions, which has constrained competition in China's rural financial markets
- Unclarified ownership structure and poor corporate governance for formal financial institutions in China, which gives rise to moral hazard problems.
- Low lending rates of interest for formal financial institution. Although the interest rate ceilings for formal institutions have been removed recently, formal financial institutions are still required to provide loans to rural households for agricultural uses at low rates of interest
- Subsidized loans provided by the state, including the poverty loans and agricultural on-lending and other cheap loans provided by formal financial institutions, which tends to distort rural financial markets.

Chapter 2 Project Strategy

2.1 Objective

The development objective is to contribute to building an inclusive financial sector in China. The immediate objectives are (i) to establish a national strategic plan to build an inclusive financial sector and (ii) to create commercially viable financial institutions that provide access to finance to the lower segments in the market (i.e to poor and low-income households).

2.2 Justification

As mentioned in Chapter 1, there is a high unmet demand for financial services at the lower segments of the market. In addition, the current trends are that the established financial industry is moving to the higher ends of the market and to urban areas. Addressing the high unmet demand for financial services in a sustainable manner is therefore of high priority of the Government in China in particular in the rural and less developed areas of China.

To build a sustainable inclusive financial sector, particularly in rural and less developed areas, is generally recognized that a legal and regulatory environment is required that is conducive for building an inclusive financial sector while maintaining the integrity of the financial system and that a profitable, diverse and competitive financial sector needs to be established that targets all segments of the market.

International experience demonstrates that access to finance for the lower segments of the market allows people to improve their livelihoods. In China there are two main reasons why many poor and low-income people lack access to financial services:

1. The lack of a coherent framework of policies, laws and regulations to build an inclusive financial sector.
2. The lack of proven, profitable business models that are specialized in targeting the lower end of the market in particular the provision of credit for farm households and micro and small enterprises

While in recent years a growing collective consensus and increasing political emphasis has emerged on the need to extend access to finance in China's rural areas and initial steps have been made to improve the legal and regulatory environment, there is still a wide variety of opinions on how to implement such a vision. Some policy makers see a strong role for Government in implementation while others policy makers consider that the market should be allowed to build such a sector whereby the Government has the main function to create a conducive environment. Hence at the upstream level it is necessary to bring together key stakeholders of the financial sector to arrive to a consensus and formulate a national strategy aimed at implementing the joint vision of building an inclusive financial sector. Such a strategy would particularly aim at the lower segments of the market and especially in rural and less developed areas of China. The project therefore includes an up-stream component to address the know-how.

International experience demonstrates that often the best way to create a conducive legal and regulatory environment is when the market shapes the regulations. The issue in China is that profitable commercial financial institutions that are specialized in providing services to the lower end of the market are virtually non-existent. Hence the project includes a down stream component to facilitate the establishment of commercial viable business models that show how to provide access to finance to poor and low income people on a large scale and in a profitable manner.

2.3 Implementation strategy

The project consists of two main components.

Component 1. Development of a National Strategy.

Multi-stakeholder dialogues and demand based research will be organized to identify and analyze the constraints and opportunities on building an inclusive financial sector. This process will result in a national strategic plan that will act as a road map for joint and coordinated action of all stakeholders in their aim to build an inclusive financial sector in China.

Component 2. Establishment of an Inclusive Finance Fund

An Inclusive Finance Fund will be established to provide technical and financial support to a carefully selected group of entities that show high promise to be able to provide financial services on a commercially viable basis to a large number of poor and low-income households in China.

2.3.1 Component 1: National Strategy

Objective: The objective of this component is to develop a national strategy on building inclusive financial sectors with an emphasis on access to finance for the lower end of the market especially in rural and less developed regions of China.

It is expected that the process of development and implementation of a national strategy will create awareness among stakeholders on actions required conditional to building inclusive financial sector. In addition it is expected that this process will positively influence policy makers and other stakeholders through knowledge building and systematic and joint collaboration on the identification of constraints and opportunities related to financial inclusion.

Strategy: The project strategy is to bring key stakeholders together to identify constraints and opportunities to build an inclusive financial sector. These constraints and opportunities will be analyzed through research on financial sector development in China and countries abroad. The findings and recommendations will be used to develop a nationally owned strategy to build an inclusive financial sector that will e endorsed by the highest levels. After the strategy is approved all stakeholders will contribute to the implementation of the national strategy. The accomplishments will be reviewed on an annual basis.

Implementation Arrangements: This component will be headed by a Coordination Committee that is composed of high level representatives of stakeholders that play a key role in building an inclusive financial sector in China *(like PBC, CBRC, CDB, Key Ministries, Universities, CAM, State banks, Private Financial Institutions, Development Banks, RCC's, PA groups, Foundations*). The Coordination Committee is responsible for managing the development and finalization of an agreed upon national strategy on building inclusive financial sectors. In particular the Coordination Committee will guide the multi stakeholder dialogue to identify constraints and opportunities to build an inclusive financial sector. The Coordination Committee will be chaired by PBC.

The Coordination Committee will be supported by a Technical Unit that will be housed in the PBC and staffed by:

1. A Financial Sector Expert full-time (18 months) who will act as the project manager of this component
2. A National Project Officer full time

3. A Staff member responsible for administration and translation support.
4. A regional technical advisor from UNCDF (on request basis, regularly)

The Technical Unit is supported by short-term national experts on financial sector development in general and microfinance in particular and resource persons from stakeholders that can be contacted by the task force to provide expertise and other support. All key stakeholders should give commitment in first meeting that they are willing to provide ad-hoc expertise support to the technical taskforce on a request basis and assign a focal point to provide support to the Technical Unit.

UNDP is the funding agency and will facilitate the execution of this component. CICETE will act as the executing agency

UNCDF will act as the technical and policy advisor to UNDP. UNCDF will share its experience on development of national strategies and will provide technical support and advice to the process management of the development of a national strategy. UNCDF will also advise on research issues and support in the identification of countries for study tours.

UNDP will facilitate the execution of this component through a grant contribution of $350,000 for technical assistance for Component 1, including US$100,000 for conducting research activities accepted by the Committee. The project partners will continually mobilize resources throughout the project.

Process and Activities: The following key activities will be executed

1. Agreement with PBC, UNDP, CICETE and UNCDF on the implementation arrangements and process
2. Identify and recruit the staff of the Technical Unit
3. Prepare and approve a list of key stakeholder groups
4. Organize an initial conference with the objective to launch the Project: "Building Inclusive Financial Sectors: Development of National Strategy" with the objectives to:
    i. Create awareness and publicity on the project and the concept of inclusive financial sectors
    ii. To officially establish the Coordination Committee and appointment of its members
    iii. To approve the process and work plan through which a national strategy will be formulated and to set the agenda for upcoming regular meetings
    iv. To reach agreement that each stakeholder representative will discuss with and assemble from its constituency (stakeholder group) the constraints and opportunities to build an inclusive financial sector in China (each representative discusses this with its members)
    v. To reach agreement that each stakeholder representative will assign a focal point for the Technical Unit
6. Organize a second Coordination Committee meeting with the following objectives:
    i. Each stakeholder representative (member) presents and explains the constraints and opportunities identified including recommendations to address those constraints and opportunities.
    ii. Discussion on constraints and opportunities

7. The Technical Unit processes the output of the Coordination Committee meeting into a working document of constraints and opportunities including recommendations. This will includes research and knowledge already available. The Unit will draft a plan for additional research to be done and fact finding in other countries. The Unit will consult with the Chair of the Coordinating Committee and the focal points of the stakeholders to draft a list of constraints and opportunities and the composition of multi-stakeholder research teams to do further research. This would include the required budgets for the research teams.
8. Organize a Coordinating Committee meeting to discuss, revise and approve working document. This working document spells out the constraints and opportunities identified, the composition and tasks of the multi-stakeholder research teams, the research methodology, the expected output per team and the budget per team
9. After approval of the working document the research team conduct their research and reports its findings to the Technical Unit
10. The Technical Unit documents these and prepares a first draft of the National Strategy based on the findings. A first draft is circulated among the research teams for technical comments on the basis of which the technical Unit prepares a second draft for circulation. This process continues until sufficient consensus has been reached. Submit the final draft to the Coordination Committee including a list of issues that are still under discussion where no broad agreement could be reached
11. Organize a Coordination Committee meeting to discuss the semi-final draft of the National Strategy and revise the semi-final draft where required.
12. Organize a conference on the semi-final draft with the objectives to
    i. Provide publicity and public awareness on the draft National Strategy
    ii. Obtain comments and suggestions from the interested parties and a broader stakeholder group
13. Include the outcome of the conference in the final draft
14. Approval of the final draft by the Coordination Committee and commitments by stakeholders on the implementation of the National Strategy
15. Approval PBC
16. Submission to the State Council
17. Establishment of a Coordination Committee that oversees the implementation of the National Strategy and progress made on a regular basis.

Input: The following inputs are required for Component 1: National Strategy

1. Project Financial Sector Expert for 18 months (sponsored by UNDP, PBC)
2. National Project Officer and interpreter for 18 months (sponsored by UNDP, PBC)
3. National experts (sponsored by stakeholders, others)
3. Infrastructure (housing, computer etc) sponsored by PBC
4. Two conferences (sponsored by stakeholders)
5. Research in country (sponsored by stakeholders)
6. Research abroad (sponsored by, UNDP, other donors, Government, stakeholders)
7. Publications (Government, other sponsors)
8. UNCDF support
9. Travel
10. Miscellaneous
11. Monitoring and Evaluation

Expected Output: The main output of this component is a nationally owned national strategy to build an inclusive financial sector in China. The strategy will be supported by key stakeholders in China. It is expected that there will be a general recognition that China is well on its way to develop a legal, regulatory and political environment conducive for inclusive finance at the end of the project period.

Risks: The main risk is that the stakeholders will not be fully committed to spend time and resources to jointly formulate a national strategy. This risk is mitigated by the recent development that access to finance, in particular in rural areas is one of the main priorities of the Government. This risk is further mitigated by the involvement of high level involvement of PBC as Chair of the Coordination Committee. In addition, the Technical Unit will remain in close contact with all stakeholders to ensure commitment and interest.

Another risk is that it might be difficult to identify a Project Manager that has sufficient in-depth knowledge of the financial sector in China as well as the international experience on building inclusive financial sectors. To mitigate this risk the PBC could provide strong support in the identification of the Project Manager that can be made available to the project full-time while funding will be made available for study tours for the project manager to other countries if broader international experience is required for an identified candidate.

Finally a risk is a weak implementation of the National Strategy. This risk is mitigated by the role of the PBC as Chair. This risk is further mitigated by having all key stakeholders joining the process and acquiring an ownership in the national strategy and implementation thereof. This risk is also mitigated by establishing a Coordinating Committee that oversees the implementation of the strategy.

2.3.2 Component 2: Inclusive Finance Fund

Objective: The Objective of this component is the establishment of commercial financial institutions that provide financial services to the lower end of the market especially in rural areas of the less developed regions of China. It is envisaged that these institutions could reach scale of operations and become demonstration models for commercial microfinance in China

Strategy: At present there are virtually no profitable commercial financial institutions that target the lower end of the market in a profitable and unsubsidized manner. The strategy of this component is to (a) create an Inclusive Finance Fund that attracts promising entities willing to take the risk to establish commercial microfinance banks in China (b) support promising MFIs to transform and scale up by providing them with technical assistance as well as with capital through the Fund. The investment fund will provide loans and equity to support scale of operations.

The Fund in all its operations will be based on two bedrock principles:
1. Commercial sustainability
2. Targeting poor and low-income clients

The Fund established by the project is intended to remain an active catalyst for the expansion of access to rural microfinance and greater inclusiveness of the financial system in China long beyond the end of the project. As per standard practice and corporate policy, the active role of UNDP will be limited to the project period, after which UNDP will no longer participate in any decision making or funding capacity in the Fund and its operations.

The Fund will target start-up microfinance companies and existing entities like MFIs that want to transform into commercial financial institutions and banks that want to scale down to the lower segments of the market. Detailed criteria and process for selection will be jointly developed by the Fund Investment Committee (FIC) in the inception stage of the project, and shall include financial performance as well as business plan, governance structure and other tangible expressions of both viability and commitment to the dual bottom line.

The Fund will be explicitly targeted towards supporting efforts to extend access to financial services for the low-income population, and both its constituent charter and selection criteria will be drawn up accordingly (see Annex 3 Draft selection criteria and process). This will also ensure that the Fund continues to support these objectives after the end of the project and withdrawal of UNDP from decision making in the Fund.

Implementation arrangements: The investment fund will be headed by a Fund Investment Committee (FIC) composed of CDB and other invited investors. The main role of the FIC is to approve project proposals as well as to approve and modify the fund management policy and procedures and fund strategy. The FIC will also be responsible for the recruitment of the staff of the Technical Unit with the support as well as advice from UNDP and other TA fund Provider. FIC members/shareholders will be endowed with various decision-making rights in accordance with each capital proportion invested in this fund.

As per corporate policy, at the end of the project, UNDP will withdraw from all decision making and funding responsibilities of the Committee, but may remain affiliated in an advisory and consultative capacity if so by the partners.

CDB as the investment fund's principal investor will submit the requisite applications and formal procedures for the establishment of the fund. Efforts shall be made jointly by the Partners to mobilize additional investors into the fund, and its initial structure accordingly be set up with sufficient flexibility to easily accommodate future entrants and their potential requirements. This flexibility will however not extend to altering the fundamental focus of the Fund on the expansion of access to microfinance and greater inclusiveness of the financial system in China, which will remain its unequivocal mission. The fund will begin to operate only after being finally approved by the State Council or other government agencies.

Technical Unit will act as the implementation and technical assistance section of the investment fund to secure the fund reach its dual bottom line of being commercially sustainable and promoting social development. In parallel with the Fund, UNDP will provide TA to selected MFIs during the lifespan of the project. If a continued TA function is perceived to have value added, a TA component of the investment fund can be designed based on the lessons learned from the project TA provision. The Technical Unit will be housed in CDB and mainly staffed by:

1. A Chief Technical Advisor (CTA) for Microfinance, fully funded by UNDP
2. A Fund Manager, as CDB in-kind contribution of staff
3. A Regional Technical Advisor from UNCDF (on request basis, regularly)
4. Local staff responsible for assisting the work of the Fund Manager and the CTA including administration and translation support

The Technical Unit will be responsible for managing the fund and scrutinizing the proposals as well as provision of technical assistance to applicants when relevant, as well as for short-listing and presenting recommended proposals to the FIC.

UNDP will facilitate the execution of this component through a grant contribution of $400,000 for technical assistance, as part of the US$650,000 contribution for Component 2, with the purpose of providing capacity building and support to transformation for the MFIs selected as well as necessary technical support for setting up the investment fund. The project partners will continually mobilize further resources for technical assistance throughout the project.

CICETE will act as the executing agency of the project. As such, it has the following responsibilities: (a) Effectively manage the project on the basis of clear and updated work plans, ensuring that outputs are produced and objectives achieved in accordance with the project document (b) Effectively mobilize project inputs, either directly or through implementing agencies, ensuring that these inputs are delivered and converted into outputs in accordance with the project document and work plans (c) Assume primary accountability to the Government and UNDP for the management and audit of the use of UNDP resources by ensuring compliance with existing rules and procedures on the use of project funds, particularly in the procurement and application of project inputs (d) Internally monitor, evaluate and report on the project's substantive and financial performance to UNDP and the Government coordinating authority.[4]

UNDP/CICETE will allocate staff time in-kind to facilitate the recruitment of the Chief Technical Advisor as well as the Technical Service Provider (TSP) tasked with providing TA for the investment fund, based on terms-of-reference mutually agreed with the members of the FIC.

CDB as the investment fund's principal investor will raise at least RMB 100 million from which MFIs selected can access financing on favourable yet commercial terms in correspondence with their needs, plans and absorptive capacity. With the participation of additional partners in the Fund and along with the development of microfinance in China it is hoped that the size of the investment fund will expand to RMB 1 billion. CDB will also provide Technical Unit office facilities and staff time in-kind for the implementation of the project.

UNCDF will act as the technical and policy advisor to UNDP. UNCDF will share its experience on development of national strategies and will provide technical support and advice to the process management of the development of a national strategy. UNCDF will also advise on research issues and support in the identification of countries for study tours. UNCDF will provide quality assurance.

PBC and CBRC as member of Project Steering Committee will keep observing and advising this Fund on policy aspect.

Process and Activities: The following key activities will be executed

1. Agreement with UNDP/UNCDF, CICETE, CDB, PBC, CBRC on the implementation arrangements and process
2. FIC approves TOR of the staff of Technical Unit and finishes the recruitment
3. The Technical Unit designs a Fund Manual which addresses the fund policies and procedures, fund management and the Fund strategy. This will include eligibility criteria,

[4] As per the UNDP-China National Execution Manual

selection criteria, selection process, procedures for due diligence, approval process, disbursement policies, follow-up and relevant legal and administrative issues

4. The Technical Unit prepares a work plan, a model business plan and application forms
5. The Fund manual and work plan is approved by the Fund Investment Committee
6. Mobilization of additional resources for the Inclusive Finance Fund
7. Marketing of the Inclusive Finance Fund
8. Selection of applicants
9. Initial due diligence of selected applicants.
10. Applicants that have met the minimum criteria will be rated
11. Each application, rating report and advice of the fund manager/Technical Unit including a draft performance based agreement will be submitted to the Fund Investment Committee for approval
12. After approval of each application the Technical Unit will follow-up as stipulated in the performance based agreement
13. The technical unit will submit a quarterly and annual progress report to the Fund Investment Committee

Input: The following inputs are required for Component 2: Inclusive Finance Fund

1. Chief Technical Advisor (CTA) for Microfinance full-time for as long as required
2. Technical Unit full time during project period, including Fund Manager
3. A regional technical advisor from UNCDF (on request basis, regularly)
4. Grant funds. It is expected that each applicant will be eligible for a grant for capacity building, infrastructure development and on lending. The size of the grant fund will be determined based on the business plan, the request of the applicant, the due diligence report of the Technical Unit and the rating report.
5. Loans and Equity. The size of the grant fund will be determined by the contributor of the loan and/or equity
6. Travel
7. Miscellaneous
8. Monitoring and Evaluation

Expected Outputs:

1. At the end of the project period several commercial microfinance institutions have been established or transformed with support of the Fund. These institutions demonstrate that financial services targeted at the lower end of the market can be profitable. These institutions also demonstrate that they are poised to become large scale operations. One success criteria is that these institutions have become able to attract equity and loans from (semi-A) commercial sources.

2. It is expected that the demonstration model will lead other institutions to transform or create into commercial entities specialized in microfinance.

3. It is expected that the demonstration models will provide market and sector information to the PBC and CBRC which could support to further the development of a conducive legal and regulatory environment for building an inclusive financial sector in China.

Risks:

There is a risk that insufficient eligible candidates will be identified because at resent there are virtually no financial institutions in China that successfully provide microfinance on a commercial basis. This risk in inherent to the purpose of the fund can act as an incentive for financial institutions and a catalyst of financial sector deepening. This risk can be mitigated by increasing the incentives the funds can provide for pioneers in the lower end of the financial sector. It is not recommended that the bar for eligibility will be put too low to mitigate this risk with the consequence that selected candidates will not be able to prove commercial viability even after support of the fund.

There is a risk that selected entities will not be able to reach scale due to legal geographic restrictions or lack of access to loans and equity. This risk can be mitigated by PBC, CBRC and potential investors to play an active role in the Fund Investment Committee and through resource mobilization efforts.

2.4 Partnership Strategy

The core partners will jointly make efforts to engage a wider constituency in project activities.

Since increasing communication and mutual understanding between the very diverse actors contributing to an inclusive financial sector is a key objective of the project, the partnership effort will be key. It will target a wide audience of government bodies, MFIs, commercial banks, potential microfinance investors and aid organisations both by engaging them in directly the roundtable and by reaching out to them with information about the process and its results. It will also aim to engage less directly involved but still potentially significant actors such as insurance providers and regulators, whose functions can impact the efficiency of delivery of financial services and the inclusiveness of the sector. An important emphasis will also be placed on securing political support at senior levels for its conclusions and recommendations.

Mobilization of additional resources for both TA and investment funds will also be important for the scale and long term viability of the Inclusive Finance Fund. Partnership efforts will be directed towards commercial banks, potential microfinance investors and international development organisations. Discussions already initiated with IFC, BlueOrchard, Standard Chartered Bank and others who have expressed interest will be followed up in the initial phase of the project, while additional partnership mobilization efforts will proceed throughout the lifespan of the project in order to reach the eventual target of $100 million for the total size of the Fund.

Partnerships offering openings around the benefits of new technological solutions to lower costs and increase outreach for microfinance providers will be explored. In particular, synergies between this project and the initiative currently being developed between UNDP China and Ericsson on mobile banking services for microfinance will continue to be explored and leveraged.

Synergies and complementarities will be sought with international NGOs actively supporting the development of the sector, including Accion, Grameen Foundation and PlaNet Finance, on practical aspects such as establishing standards for monitoring social impact and commercial performance, building MFI capacity on business planning and investment promotion, etc.

2.5 Target Beneficiaries

The main intended beneficiaries are the millions of Chinese poor and low-income households currently deprived of access to basic financial services. The project will for the most part benefit them indirectly and in the medium and longer term, by providing an improved policy and regulatory environment as well as strong examples raising awareness and confidence for more providers to enter the lower segments of the Chinese microfinance market.

The direct beneficiaries of the project are as follows:

- Component 1: the widest possible coverage of stakeholders in the sector, including regulators, donors, NGOs, policy banks, commercial banks etc, including domestic actors as well as international ones with a domestic presence
- Component 2: a small number of selected MFIs supported with technical assistance and facilitation of contacts with investors and regulators

Financial service provision will be targeted to the poor and low-income population through the selection criteria and performance indicators inscribed in the statutes of the Fund. Thus limits will be set for supported MFIs on indicators such as average loan outstanding across the loan portfolio and the largest loan to a single borrower. Detailed arrangements to be determined by experts and partners in the setup phase of the Fund.

3 Management Arrangements

A **Coordination Committee** will be established under component 1, composed of high level representatives of stakeholders that play a key role in building an inclusive financial sector in China (like PBC, CBRC, CDB, Key Ministries, Universities, CAM, State banks, Private Financial Institutions, Development Banks, RCC's, PA groups, Foundations). The Coordination Committee is responsible for managing the development and finalization of an agreed upon national strategy on building inclusive financial sectors. In particular the Coordination Committee will guide the multi stakeholder dialogue to identify constraints and opportunities to build an inclusive financial sector. The Coordination Committee will be chaired by PBC.

The Coordination Committee will be supported by a **Technical Unit** housed in the PBC and staffed by:

1. A Financial Sector Expert full-time (18 months) who will act as the project manager of component 1
2. A National Project Officer full time
3. A Staff member responsible for administration and translation support.
4. A regional technical advisor from UNCDF (on request basis, regularly)

The Technical Unit is supported by **short-term national experts** on financial sector development in general and microfinance in particular and resource persons from stakeholders that can be contacted by the task force to provide expertise and other support. All key stakeholders should give commitment in first meeting that they are willing to provide ad-hoc expertise support to the technical taskforce on a request basis and assign a focal point to provide support to the Technical Unit.

A **Fund Investment Committee** (FIC) with CDB and other invited investors. The main role of the FIC is to approve project proposals as well as to approve and modify the fund management policy and procedures and fund strategy. The FIC will also be responsible for the recruitment of the staff of the Technical Unit with the support from UNDP. FIC members/shareholders will be endowed with various decision-making rights in accordance with each capital proportion invested in this fund.

CDB will submit the requisite applications and formal procedures for the establishment of the fund. Efforts shall be made jointly by the Partners to mobilize additional investors into the fund, and its initial structure accordingly be set up with sufficient flexibility to easily accommodate future entrants and their potential requirements. The fund will begin to operate only after being finally approved by the State Council or other government agencies.

Technical Unit will act as the implementation and/or technical assistance section of the investment fund to secure the fund commercially sustainable development. The Technical Unit will be housed in CDB and mainly staffed by:

1. A Fund manager/Microfinance expert
2. A National Programme Officer
3. A regional technical advisor from UNCDF (on request basis, regularly)
4. Local staff responsible for assisting the work of fund manager and national programme officer including administration and translation support

The Technical Unit will be responsible for managing the fund and scrutinizing the proposals as well as provision of technical assistance to applicants when relevant, as well as for short-listing and presenting recommended proposals to the FIC.

UNDP will facilitate the execution of this component through a grant contribution of $400,000 for technical assistance, as part of the $650,000 contribution for Component 2, with the purpose of providing capacity building and support to transformation for the MFIs selected as well as necessary support for setting up the investment fund.

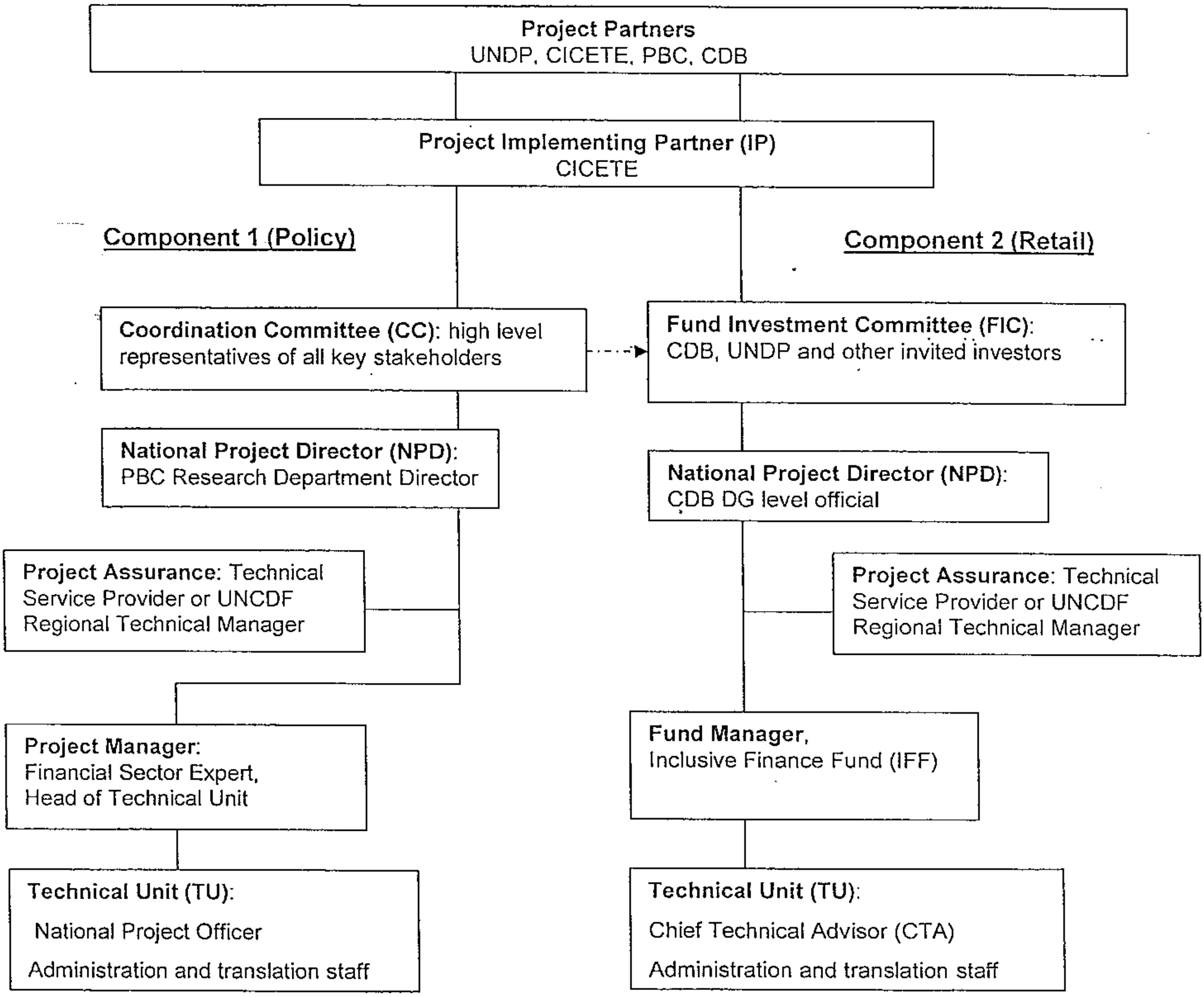
CICETE will act as the executing agency of the project. UNDP/CICETE will allocate staff time in-kind to facilitate the recruitment of the Chief Technical Advisor as well as the Technical Service Provider (TSP) tasked with providing TA for the Fund/investment fund, based on terms-of-reference mutually agreed with the members of FIC.

CDB as the investment fund's principal investor will raise at least RMB 100 million from which MFIs selected can access financing on favourable yet commercial terms in correspondence with their needs, plans and absorptive capacity. With the participation of additional partners in the Fund and along with the development of microfinance in China it is hoped that the size of the investment fund will expand to RMB 1 billion. CDB will also provide Technical Unit office facilities and staff time in-kind for the implementation of the project.

UNCDF will provide review and support to the process as mandated by the UNDP Policy on Microfinance (see Annex 4 UNDP Microfinance Policy, bullets five and six), sharing its experience from similar initiatives elsewhere. UNCDF will act as or recommend other suitable Technical Service Provider (TSP) to provide technical support on the design of the Fund (incl. selection criteria and due diligence methodology) and review/recommendation on short-listed candidates as well as technical assistance to the institutions selected for support.

PBC and CBRC as members of the Project Partners will observe and advise the Fund on policy aspects.

Proposed Management Structure



4 Monitoring and Evaluation

Monitoring and evaluation (M&E) of the project will be undertaken in line with the UNDAF results matrix and monitoring and evaluation plan.

Project monitoring and evaluation (M&E) will be conducted with focus on outcomes and outputs of interventions, institutional results and partnerships, policy advice and dialogue, advocacy and coordination.

The M&E should aim at the following key objectives: 1) focus on results at output level as well as at outcome level, 2) to enhance management efficiency of the project and ensure consultation/participation of all stakeholders and 3) to not only focus on assessment of progress of the project, but also on experiences and lessons learnt to support more informed decision-making and dissemination of project results.

Monitoring progress towards achievement of outcomes and outputs will be undertaken at both the level of the overall project and at the individual MFI level. For the latter, this will include assessments to support the performance based disbursement of grant funds awarded under the project. The extent to which the desired outcome of the project has been achieved will be monitored through a system of M & E activities, annual work plans and budgets, and peer group review and evaluation.

UNDP, CICETE and the Cooperating Agencies will invite the review meetings to evaluate project progress, results, experiences and lessons learned during project implementation and work plan for the following years. The annual review will be a tool to ensure periodic assessment on whether the approach and interventions will produce the expected outcomes. The Technical Units will support convening of the review meetings and will assist in preparation of annual project reports.

Monitoring visits to supported MFIs will be conducted by UNDP and CICETE in order to assess progress and results through consultations with relevant stakeholders and beneficiaries. Supported MFIs will prepare quarterly progress updates to support monitoring and steering as well as information sharing.

Peer reviews will be conducted on views and experiences of project participants and beneficiaries regarding demonstration results and capacity building activities. Case studies on lessons learned should be collated and shared regularly during project duration and at the end of the project to scale up.

CICETE will provide periodic reports (annual review) on the progress, achievements and results of their projects, outlining the challenges faced in project implementation as well as resource utilization as articulated in the AWP.

5 Legal context

This document together with the CPAP signed by the Government and UNDP which is incorporated by reference constitute together a Project Document as referred to in the SBAA [or other appropriate governing agreement] and all CPAP provisions apply to this document.

Consistent with the Article III of the Standard Basic Assistance Agreement, the responsibility for the safety and security of the implementing partner and its personnel and property, and of UNDP's property in the implementing partner's custody, rests with the implementing partner.

The implementing partner shall:

a) put in place an appropriate security plan and maintain the security plan, taking into account the security situation in the country where the project is being carried;
b) assume all risks and liabilities related to the implementing partner's security, and the full implementation of the security plan.

UNDP reserves the right to verify whether such a plan is in place, and to suggest modifications to the plan when necessary. Failure to maintain and implement an appropriate security plan as required hereunder shall be deemed a breach of this agreement.

The implementing partner agrees to undertake all reasonable efforts to ensure that none of the UNDP funds received pursuant to the Project Document are used to provide support to individuals or entities associated with terrorism and that the recipients of any amounts provided by UNDP hereunder do not appear on the list maintained by the Security Council Committee established pursuant to resolution 1267 (1999). The list can be accessed via http://www.un.org/Docs/sc/committees/1267/1267ListEng.htm. This provision must be included in all sub-contracts or sub-agreements entered into under this Project Document.

6 Budget

The duration of the project is 3 years, running from 2008 to 2011. The total budget for the Project is US$ 14.4 million, including US$ 1 million UNDP core funding, RMB 100,000,000 as counterpart parallel financing provided by the China Development Bank, RMB 3,000,000 as counterpart parallel financing provided by the People's Bank of China.

In addition to secured funds, the project will seek further sources of funding from multilateral and bilateral donor agencies, to meet research needs on the national strategy and to expand the support provided to successful applicants under the Inclusive Finance Fund.

The detailed budgeting for the intended outputs and activities are specified in the Results and Resources Framework; with outcomes; outputs; activities, time-frame and specified budget.

7 Results and Resources Framework

UNDAF Outcome Social and economic policies are developed and improved to be more scientifically based and human centred for sustainable and equitable growth.				
Outcome Indicator as stated in the Country Programme Results and Resources Framework: National efforts to lead and manage Xiaokang/MDG implementation supported through a variety of instruments and capacity building initiatives.				
Country Programme Action Plan Output/Indicators: Policy oriented research on emerging poverty challenges developed and disseminated to key stakeholders.				
Applicable MYFF Service Line: 1.2. Pro-poor policy reform to achieve MDG targets.				
Partnership Strategy:				
Project Title and ID:				
Intended Outputs	**Output Targets for (years)**	**Indicative Activities**	**Responsible parties**	**Inputs**
1. A National Strategy to develop an inclusive financial system is produced and submitted to the State Council	2008: i. Conference held to launch programme and Blue Book ii. Coordination Committee established and convened iii. Research commissioned based on CC priorities 2009: i. Draft National Strategy produced	1.1 Agreement with PBC, UNDP, CICETE and UNCDF on the implementation arrangements and process 1.2 Identify and recruit the staff of the Technical Unit 1.3 Prepare and approve a list of key stakeholder groups 1.4 Organize an initial conference with the objective to launch the Project: "Building Inclusive Financial Sectors: Development of National Strategy" with the objectives as outlined in the section on Implementation Strategy in the project document. This will	UNDP, PBC, CICETE	**UNDP TRAC $350,000** **PBC in-kind** ￥3,000,000

	ii. Conference held to discuss draft National Strategy iii. National Strategy finalised and submitted 2010: i. Long term mechanism established to follow up implementation of the National Strategy	leverage and promote a Chinese edition of the UN Blue Book on Building Inclusive Financial Sectors 1.5 Organize a second Coordination Committee meeting to present and discuss the constraints and opportunities identified by the stakeholder groups 1.6 The Technical Unit will i. Process the output of the Coordination Committee meeting into a working document of constraints and opportunities including recommendations ii. Draft a plan for additional research to be done and fact finding in other countries iii. Draft a list of constraints and opportunities and the composition of multi-stakeholder teams to do further research, including required budgets 1.7 Organize a Coordinating Committee meeting to discuss, revise and approve the working document 1.8 After approval of the working document the research team conduct their research and reports its findings to the Technical Unit 1.9 The Technical Unit prepares a first draft of the National Strategy based on the findings. A first draft is circulated among the research teams for technical comments on the basis of which the technical Unit prepares a second draft for circulation. This process continues until sufficient consensus has been reached. Submit the final draft to the Coordination Committee including a list of issues that are still under discussion where no broad agreement could be reached 1.10 Organize a Coordination Committee meeting to discuss the semi-final draft of the National Strategy and revise the semi-final draft where required. 1.11 Organize a conference on the semi-final		

		draft with the objectives to i. Provide publicity and public awareness on the draft National Strategy ii. Obtain comments and suggestions from the interested parties and a broader stakeholder group 1.12 Include the outcome of the conference in the final draft 1.13 Approval of the final draft by the Coordination Committee and commitments by stakeholders on the implementation of the National Strategy 1.14 Approval PBC 1.15 Submission to the State Council 1.16 Establishment of a Coordination Committee that oversees the implementation of the National Strategy and progress made on a regular basis.		
2. An Inclusive Finance Fund is established and several commercially sustainable microfinance initiatives are supported with TA and capital	2008: i. Fund Investment Committee established ii. Fund Manual describing the structure, policies and procedures of the Fund created and approved iii. Additional resources mobilized for the fund 2009: i. Fund formally established and started operations ii. First round of tenders invited and processed iii. TA provided to selected candidates iv. First lending disbursed v. Additional resources	2.1 Agreement with UNDP/UNCDF, CICETE, CDB, PBC, CBRC on the implementation arrangements and process 2.2 Recruit staff of Technical Unit 2.3 The project manager designs a Fund Manual which addresses the funds policies and procedures, the Fund strategy and fund management. This will include eligibility criteria, selection criteria, selection process, procedures for due diligence, approval process, disbursement policies, follow-up and relevant legal and administrative issues 2.4 Preparation of a work plan 2.5 Preparation of a model business plan and application forms 2.6 The Fund manual and work plan is approved by the Investment Committee 2.7 Mobilization of additional resources for	UNDP, CDB, CICETE	**UNDP TRAC $650,000,** (including US$400,000 of TA for MFIs) CDB in-kind ￥100,000,000

	mobilized for the fund 2010: i. Refinements of the Fund and its processes made as necessary ii. Further TA and lending disbursed to MFIs iii. Fund evaluation held to gather lessons learned for the longer term strategy iv. Awareness activities held to publicize Fund results and mobilize resources	the Inclusive Finance Fund 2.8 Marketing of the Inclusive Finance Fund 2.9 Selection of applicants 2.10 Initial due diligence of selected applicants. 2.11 Applicants that have met the minimum criteria will be rated by a reputable rating agency 2.12 Each application, rating report and advice of the Project manager including a draft performance based agreement will be submitted to the Investment Committee for approval 2.13 After approval of each application the Technical Unit will follow-up as stipulated in the performance based agreement 2.14 The technical unit will submit a quarterly and annual progress report to the Investment Committee		

8 Annual Work Plan (draft) budget sheet for 2008

EXPECTED OUTPUTS	PLANNED ACTIVITIES	TIMEFRAME				RESPONSIBLE PARTY	PLANNED BUDGET		
and indicators including annual targets	*List all activities including M&E to be undertaken during the year towards stated CP outputs*	Q1	Q2	Q3	Q4		Source of Funds	Budget Description	Amount
TOTAL									

Annex 1 TOR Financial Sector Expert

Terms of Reference

Job Title: **Financial Sector Expert**
Project Title: **Building Inclusive Financial Sectors in China (BIFIC)**
Project period: **2008-2011**
Location: **Beijing**
Duration contract: **18 months (1 year full-time, 6 months short-term)**

The development objective of the project is to contribute to building an inclusive financial sector in China. The immediate objectives are (i) to establish a national strategic plan to build an inclusive financial sector and (ii) to create commercially viable financial institutions that provide access to finance to the lower segments in the market (i.e to poor and low-income households). The Project consists of two main components (i) Development of a National Strategy and (ii) Establishment of a Inclusive Finance Fund.

With respect the development of the national strategy on financial inclusion, multi-stakeholder dialogues and demand based research will be organized to identify and analyze the constraints and opportunities on building an inclusive financial sector. This process will result in a national strategic plan that will act as a road map for joint and coordinated action of all stakeholders in their aim to build an inclusive financial sector in China.

This component will be headed by a Coordination Committee that is composed of high level representatives of stakeholders that play a key role in building an inclusive financial sector in China The Coordination Committee is responsible for managing the development and finalization of an agreed upon national strategy on building inclusive financial sectors. In particular the Coordination Committee will guide the multi stakeholder dialogue to identify constraints and opportunities to build an inclusive financial sector. The Coordination Committee will be chaired by PBC.

The Coordination Committee will be supported by a Technical Unit that will be housed in the PBC headed by the Financial Sector expert. The Financial Sector Expert will act as a project manager of the component for development of a national strategy. The Financial Sector Expert will report directly to the Chair of the Coordination Committee.

Specifically the expert will:

- Organize an initial conference with the objective to launch the Project: "Building Inclusive Financial Sectors: Development of National Strategy
- prepare a draft work plan for the development of a national strategy
- provide support and technical assistance to stakeholders on the constraints and opportunities identified including recommendations to address those constraints and opportunities.
- Analyze and process the outcomes of multi-stakeholder meetings
- Draft a plan for additional research to be done including fact finding in other countries.
- Consult with the focal points of the stakeholders to draft a list of constraints and opportunities and the composition of multi-stakeholder research teams to do further research. This would include the required budgets for the research teams.

- Draft working document that spells out the constraints and opportunities identified, the composition and tasks of the multi-stakeholder research teams, the research methodology, the expected output per team and the budget per team
- Provide technical assistance to the research teams
- Based on research findings and other input from key stakeholders prepare a first draft of the National Strategy. Discuss draft with research teams and stakeholders
- Organize a conference on the semi-final draft with the objective to
- Prepare final draft of the national strategy in close collaboration with stakeholders
- Any other task as requested by the Chair of the Coordination Committee within the competence of the expert

Requirements

- University degree in banking, economics or finance
- At least 10 years experience in financial sector development
- At least 5 years of central bank experience
- Experience in financial services that target the lower end of the market
- Excellent communication skills
- Strong ability and proven experience to work with high level official from both the public and private sector
- Experience in Asia and in particularly in China is a strong advantage
- Fluent in English. Fluency in Chinese is a strong advantage

Annex 2 TOR Inclusive Finance Fund Expert

Terms of reference

Job Title:	**Inclusive Finance Fund Expert**
Project:	**Building Inclusive Financial Sectors in China (BIFIC)**
Project period:	**2008-2011**
Location:	**Beijing**
Duration contract:	**4 years full-time**

The development objective of the Project is to contribute to building an inclusive financial sector in China. The immediate objectives are (i) to establish a national strategic plan to build an inclusive financial sector and (ii) to create commercially viable financial institutions that provide access to finance to the lower segments in the market (i.e to poor and low-income households). The Project consists of two main components (i) Development of a National Strategy and (ii) Establishment of a Inclusive Finance Fund.

The Inclusive Finance Fund will be established to provide technical and financial support to a carefully selected group of entities that show high promise to be able to provide financial services on a commercially viable basis to a large number of poor and low-income households.

This component will be headed by a Fund Investment Committee with the authority to approve and modify the fund management policy and procedures and fund strategy. The Fund Investment Committee has the authority to approve project proposals. The Investment Committee will also be responsible for the recruitment of the staff of the Technical Unit. The Fund Investment Committee will be supported by a Technical Unit that will be housed in the China Development Bank. The Microfinance Fund Expert manages the Technical Unit and will be responsible for managing the fund and scrutinizing the proposals as well as provision of technical assistance to applicants when relevant. The Expert will report directly to the Fund Investment Committee.

Specifically the expert will:

- Design a Fund Manual which addresses the policies and procedures, daily management and overall strategy of the Fund. This will include eligibility criteria, selection criteria, selection process, procedures for due diligence, approval process, disbursement policies, follow-up and relevant legal and administrative issues
- Preparation of a work plan
- Preparation of a model business plan format, application forms and performance based agreement format
- Support the Investment Committee in resource mobilization for the Fund
- Marketing of the Inclusive Finance Fund
- Manage identification and selection of applicants
- Initial due diligence of selected applicants.
- Identify and recruit a rating agency for pre-selected applicants
- Prepare technically approved proposals to be submitted to the Fund Investment Committee
- provide technical assistance, when relevant, to promising and selected applicant
- Formulate performance based agreement
- Submit progress reports

Requirements

- University degree in banking, economics or finance
- At least 10 years international experience in commercial microfinance
- Familiarity with Fund management
- Excellent communication skills
- Strong ability and proven experience to work with high level official from both the public and private sector
- Experience in Asia and in particularly in China is a strong advantage
- ~~Fluent in~~ English. Fluency in Chinese is a strong advantage

Annex 3 Draft selection criteria and process

1.1 Eligibility criteria

i. Existing microfinance NGOs with more than three years operational experience and more than 1000 active borrowers and a Portfolio at Risk of repayments overdue > 30 days of less than 5% and a write off rate of less than 2% in the last year

ii. Commercial banks or finance companies based in China that provide microfinance or have successfully engaged in SME finance and wish to downscale.

1.2 Approval criteria

- Eligible for a license by CBRC for a township microfinance bank or by local government for a PBC piloted Microcredit Company or other legal MFIs
- Fully fledged realistic business plan including financial projections that demonstrate projected profitability and outreach
- Board approval of the business plan
- Sound ownership and governance structure
- Adherence to regulatory requirements
- Additional capital mobilized
- Average loan outstanding of microfinance portfolio loan portfolio is less than 30,000 Yuan
- Non-discrimination against clients based on gender, health status (including HIV/AIDS infection), religious faith or ethnicity is present in both policy and practice

1.3 Approval process

1. Approval by fund manager of application.
2. External rating by a reputable rating agency or Technical Unit of the Fund. Rating includes a SWOT, advice on funding needed to optimally strengthen the applicant and judgment of business plan
3. Draft performance agreement agreed upon by project and applicant to be submitted to the investment committee
4. Approval of the investment committee
5. Funding is disbursed in tranches, subject to acceptable performance in terms of financial and social objectives of the Fund (i.e. profitability and faithfulness to low-income focus)

Annex 4 UNDP Microfinance Policy

UNDP has committed, together with many of our leading stakeholders, to improve our work in the area of microfinance. In February 2004, UNDP co-hosted a High Level Meeting of Development Ministers whose agencies had also participated in the Peer Review process. These agencies committed to reconvene in 2006 to review progress. The Ministers agreed that " accountability and transparency on performance of the portfolio are more important than looking good." We also noted that transparency is critical to reaching our shared vision of creating sustainable access to financial services for poor and low-income people. In that spirit UNDP asked the Consultative Group to Assist the Poor (CGAP) for an independent review of UNDP's microfinance portfolio and committed to publish the results.[1]

CGAP's Portfolio Review confirms many of the issues indicated in our initial Peer Review.[2] These recommendations provide a solid basis to improve our performance. The good news is that we do have models that have proven successful. To assure that we utilize these models and their associated best practices, all new microfinance related programming in UNDP will be done within the following framework:

UNDP will use the principles of UNCDF's MicroStart model whenever it funds, or administers the funding of others for, microcredit operations. The key elements are:

- Project implementation should be done, or very closely guided by, a technical service provider (TSP) that has a proven track record to produce sustainable microfinance.[3] These should come from a list of providers screened by UNCDF. Other TSPs who meet requirements may be used only with the approval of the responsible regional microfinance specialist. Many of these TSPs are practitioners from the South. This presents an excellent opportunity for TCDC.
- Each UNDP-supported microfinance institution should report key performance indicators every quarter to the MIX Market.[4] Costs of reporting should be included in programme budgets. The indicators should include at a minimum the number of active clients, average loan size, portfolio quality, and cost recovery.[5] Calculation of these indicators should follow accepted guidelines.[6]
- Performance based grant agreements should be utilized in all cases.[7] MFIs that do not meet performance standards should be dropped from the programme unless the technical service provider is confident that MFI managers will promptly correct the problems.
- Grant Agreements should be prepared between UNDP and a private[8] financial services entity and approved by a steering committee with minority Government representation. Microfinance and financial services are essentially a private sector activity. Government efforts should focus primarily on removing constraints in the enabling environment.
- Regional technical experts should collaborate closely with the Country Office in design, implementation, and monitoring of the project. These experts should clear each new programme and certify its compliance with UNDP policy prior to approval. These experts should also assure and track quarterly reporting and inform management where inadequacies are found.
- UNDP Regional Bureaus will be responsible for the quality of microfinance programming within their respective regions. Together with UNCDF they will select well-qualified regional microfinance experts to support country programming. These experts will report jointly to the Regional Bureau and UNCDF.[9]
- In the Least Developed Countries (LDCs), UNCDF should be actively involved in the design and implementation of any microfinance programme. UNCDF should also co-invest with Regional Bureaus and Country Offices in microfinance activities in the LDCs to the greatest extent possible.
- All UNDP staff and their counterparts in Central Banks or partner ministries responsible for microfinance related programming will be trained with resources from country programme budgets at courses such as Turin (www.itcilo.org/microfinance) or the CGAP course http://www.cgap.org/direct/special/training.php.
- Country Offices must consult with government, all other donors, and stakeholders before approving any new microfinance support in a specific country or with specific institutions to ensure complementarity and avoid undermining others in the market.

- Microfinance programming will be done within stand-alone programmes whenever possible. Credit components in broader programmes tend not to get adequate management attention and have performed poorly.
- Microfinance programmes should generally exceed U.S.$ 500,000 in the aggregate and should target programme budgets of more than U.S.$1 million. This is to assure that the programmes have sufficient scale and resources to attract skilled technical experts and also to have sustainable impact.[10]
- As a general rule, because their results to date have been very poor, UNDP will no longer fund Community-managed revolving loan Funds.[11] Community-managed revolving loan fund projects involve external funding of loans within community-based groups where a credit fund for members operates without substantial oversight and management from professional staff of a specialized financial institution.

The Office of Audit and Programme Review (OAPR) is requested to include compliance with this framework in its risk assessment. Where Country Offices have programmes that are in progress, we encourage you to bring them in line with these standards.

UNCDF will continue to serve as policy advisor to UNDP for all microfinance matters. In addition, UNCDF will continue to represent UNDP in CGAP and to provide policy support to the Office of the Administrator. UNCDF will be responsible for monitoring the implementation of this policy and advising on changes, as needed.

Please contact John Tucker (john.tucker@undp.org), Microfinance Advisor at UNCDF, for clarifications on implementing this policy.

Footnotes

1] See http://www.cgap.org/docs/UNDP_MFProjEvaluation.pdf

2] See http://www.cgap.org/projects/donor_peer_reviews.html

3] See the MIX Market http://www.themix.org/en/index.html for institutions with a proven track record.

4] http://www.themix.org/en/index.html. We have negotiated with the MIX to expand its database to capture quarterly reporting by end 2006.

5] Country offices can implement this reporting immediately using Excel formats available from UNCDF or the MIX Market.

6] See Review of the UNDP Microfinance Portfolio, CGAP, Annex 3: Core Performance Indicators for Microfinance, http://www.cgap.org/priorities/donor_effectiveness.html and Consensus Guidelines: Definitions of Selected Financial Terms, Ratios and Adjustments for Microfinance, CGAP, 2003 http://www.cgap.org/docs/Guideline_definitions.pdf

7] See Resource Management Guide for guidance on micro-capital grants.

8] Private includes NGO-MFIs, Non-Bank Financial Institutions, Commercial Banks, Credit Unions, etc.

9] UNDP Africa and UNCDF have a pre-existing regional programme with special circumstances.

10] The limits on grants to individual institutions remain as previously delineated in chapters 4.3.5 and 6.4.6 of the previous UNDP programming manual:

> 2. Micro-capital grants for credit and non-credit activities may be included among the inputs financed by UNDP. An individual micro-capital grant may not exceed $150,000. A recipient organization may receive multiple grants provided the grants do not exceed on a cumulative basis $300,000 within the same programme or project. To receive multiple grants, the recipient organization must have

produced the results agreed to in the prior grant agreement, and a new micro-capital grant agreement must be approved by the steering committee. If the $300,000 cumulative limit is to be exceeded, the country office must submit a request through the Regional Bureau for clearance by BOM. On all requests related to credit or microfinance, technical clearance from UNCDF/SUM is also required.

3. Of a country's TRAC allocation, no more than 10 per cent may be spent on micro-capital grants over the Country Programme period. If this percentage is to be exceeded, in addition to the clearances from BOM and UNCDF/SUM noted in paragraph 2, approval must be given by the Associate Administrator. The restrictions of paragraph 3 take precedence over the restrictions of paragraph 2.

Note: The criteria for approval for grants greater than $300,000 or allocation of the Country Programme above 10 percent shall be: 1] documentation that the recipient has produced the results agreed to in the prior grant agreement; 2] that the results proposed in the next grant agreement will contribute to the sustainability of the activity.

11] This prohibition does not include revolving funds where the lending is financed by members' savings rather than injection of external funds, or Village Banking and Self Help Group/Bank Linkage models where a specialized financial institution's profession staff is involved.

Annex 5 Risk log

Risk Log

Date of revision:

Award Title:
Award ID:

Project Title:
Project ID:

ID	Description	Category	Impact & Probability	Countermeasures / Management response	Owner	Author	Date Identified	Last Update	Status
01	Insufficient buy-in and commitment from key stakeholders on national strategy	Political Operational Strategic	Component 1 loses impact P = 2	Rural finance high and increasing priority of Government. PBC has signaled strong buy-in as chair of the Coordinating Committee.	PM/Technical Unit	UNDP	Formulation	*When was the status of the risk last checked*	*e.g. dead, reducing, increasing, no change*
0	Weak implementation of national strategy process	Political Operational Strategic	Component 1 loses impact Reputational risk for UNDP P = 2	PBC has signaled strong buy-in of the concept of inclusiveness and the proposed process, including chairing the Coordinating Committee.	PM/Technical Unit	UNDP	Formulation	*When was the status of the risk last checked*	*e.g. dead, reducing, increasing, no change*
0	Reversal of progressive	Political Strategic	Difficult for this project to	Project will keep well attuned to political		UNDP	Formulation		

	policy and regulatory environment		achieve its objectives P = 1	changes and ensure appropriate measures taken (changing the scope/goals of the project, suspension or closure) should political changes mean that results become unachievable					
0	No additional funding from partners	Financial Operational Strategic	Comp. 1: Research agenda limited Comp. 2: Fewer MFIs can be selected P = 2	Regular Steering Committee meetings and quarterly reports on financial and operational progress from the Project Manager means and additional need for resources will be brought up in time for extra resource mobilization, or project revision accordingly		UNDP	Formulation		
0	Unable to recruit project staff with the requisite experience and technical skills	Operational Organizational	Comp. 1: National strategy is unsubstantial and lacks credibility Comp. 2: Unsuitable MFIs chosen and failing. Reputational damage to microfinance	Give PBC strong role in identification and selection. Provide targeted initial training on weak areas.		UNDP	Formulation		

			sector reverses policy achievements Reputational risk for UNDP P = 2						
0	Insufficient technical oversight in management of the project	Operational Organizational	Policy disc. lacking in substance, credibility. Project fails to adhere to best practice, commits basic errors Project failure. Reputational damage to UNDP. P = 3	UNCDF and/or RBAP technical expertise involved at key steps Mandatory training of project staff for ongoing work		UNDP	Formulation		
0	Women not well represented in project activities	Political Strategic Other	Project fails core mandate on gender equity and awareness P = 3	Ensure balanced participation incorporated into activities, e.g. female participant quotas for seminars, study trips		UNDP	Formulation		
0		Environmental Financial Operational				UNDP	Formulation		

		Organizational Political Regulatory Security Strategic Other	P =						
0		Environmental Financial Operational Organizational Political Regulatory Security Strategic Other	P =			UNDP	Formulation		

Annex 6 Lessons Learned log

Lessons Learned Log

Date of revision:

Award Title:
Award ID:

Project Title:
Project ID:

ID	Date logged	Type	Description	Recommendation
01	*01/01/2004*	*Good*	*P2 worked as capacity building method*	*Should have P2 foundation as part of project initiation to standardize project management method*
02	*01/10/2006*	*Bad*	*Congress did not pass the legislation on gender balance*	*Should involve and sensitize political party members prior to discussion, premature discussion in congress itself yielded non productive discussion*
03				
04				
05				
06				

Issue Log

Date of revision:

Award Title:
Award ID:

Project Title:
Project ID:

ID	Type	Date Identified	Description and Comments	Status	Status Change Date	Author
01						
02						
03						
04						
05						
06						

Annex 8 AWP Monitoring Tool

Annual Work Plan (AWP) Monitoring Tool Year______

CP Component____________________

Executing Entity ______________

EXPECTED OUTPUTS AND INDICATORS including annual targets	PLANNED ACTIVITIES *List all the activities including monitoring and evaluation activities to be undertaken during the year towards stated CP outputs*	EXPENDITURES *List actual expenditures against activities completed*	RESULTS OF ACTIVITIES *For each activity, state the results of the activity*	PROGRESS TOWARDS ACHIEVING OUTPUTS Using data on annual indicator targets, state progress towards achieving the CP outputs. Where relevant, comment on factors that facilitated and/or constrained achievement of results including: ▪ *Whether risks and assumptions as identified in the CP M&E Framework materialized or whether new risks emerged* ▪ *Internal factors such as timing of inputs and activities, quality of products and services, coordination and/or other management issues*
OUTPUT 1: INDICATOR 1.1 WITH TARGET FOR THE YEAR: INDICATOR 1.2 WITH TARGET FOR THE YEAR:				
OUTPUT 2: INDICATOR 2.1WITH TARGET FOR THE YEAR: ETC.				