OFFICIAL USE ONLY
IDA/R2018-0020/1

February 8, 2018

Closing Date: Wednesday, February 28, 2018 at 6:00 p.m.

FROM: Vice President and Corporate Secretary

Madagascar - Madagascar Financial Inclusion Project

Project Appraisal Document

Attached is the Project Appraisal Document regarding a proposed credit to Madagascar for a Madagascar Financial Inclusion Project (IDA/R2018-0020), which is being processed on an absence-of-objection basis.

Distribution:
- Executive Directors and Alternates
- President
- Bank Group Senior Management
- Vice Presidents, Bank, IFC and MIGA
- Directors and Department Heads, Bank, IFC and MIGA

Document of

The World Bank

FOR OFFICIAL USE ONLY

Report No: PAD2579

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 31.6 MILLION
(US$45 MILLION EQUIVALENT)

TO THE

REPUBLIC OF MADAGASCAR

FOR A

MADAGASCAR FINANCIAL INCLUSION PROJECT
FEBRUARY 6, 2018

Finance, Competitiveness and Innovation Global Practice
Africa Region

. Click here to enter text.

CURRENCY EQUIVALENTS

(Exchange Rate Effective Dec 31, 2017)

MGA =	3239.99
=	US$1
US$ 1.42 =	SDR 1

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

ACH	Automated Clearing House system
ADM	Accountability and Decision-Making
AFD	Agence Française de Développement (French Development Agency)
AFDB	African Development Bank
APB	Association of Banks
APIMF	Association of Microfinance Institutions
ATM	Automated-Teller Machine
BCM	Banque Centrale de Madagascar (Central Bank of Madagascar)
BDS	Business Development Services
BFM	Banky Foiben'I Madagasikara (Central Bank of Madagascar)
BP	Bank Procedures
CAMELS	Approach for risk-based supervision
CEM	Caisse d'Epargne de Madagascar (Savings Bank of Madagascar)
CNFI	Coordination Nationale de la Finance Inclusive (National Coordination for Financial Inclusion)
CPF	Country Partnership Framework
CSBF	Commission de Supervision Bancaire et Financière (Malagasy financial sector regulator)
DA	Designated Account
DB	Doing Business
DDP	Direction Générale de la Dette Publique (Directorate General of Public Debt)
DFID	UK Department for International Development
DFIL	Disbursement and Financial Information Letter
DOF	Financial Operations Department
DPO	Development Policy Operation
E&Y	Ernst & Young
ECF	Extended Credit Facility
EDP	Economic Development Paper
EMI	Electronic Money Institution
ESMF	Environmental and Social Management Framework
FAS	Financial Access Survey
FI	Financial Intermediary (Project assessment category)

FINDEX	Financial Inclusion Index Database
FINTECH	Financial Technology
FM	Financial Management
FRAM	Fikambanan'ny Ray Amandrenin'ny Mpianatra (contract teachers)
FSAP	Financial Sector Assessment Program
G2P	Government-to-Persons payments
GDP	Gross Domestic Product
GIL	Gender Innovation Lab
GRM	Grievance Redress Mechanism
IAS/IFRS	International Accounting Standards/International Financial Reporting Standards
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion Report
IDA	International Development Association
IFC	International Finance Corporation
IFR	Integrated Fiduciary Review
ILO	International Labor Organization
IMF	International Monetary Fund
ISR	Implementation Status & Results Report
ISP	Implementation Support Plan
IT	Information Technology
IPF	Investment Project Financing
JIRAMA	State-owned electricity company
LIC	Low income country
M&E	Monitoring and Evaluation
MFB/MOF	Ministry of Finance and Budget
MFI	Microfinance Institution
MGA	Malagasy Ariary
MIS	Management Information System
MNO	Mobile Network Operator
MoJ	Ministry of Justice
MSMEs	Micro, Small and Medium-sized Enterprises
NDP	National Development Plan
NFIS	National Financial Inclusion Strategy
NOE	National Office for the Environment
NPL	Non-Performing Loans
OC	PPCG Orientation Committee
OP	Operational Policy
P2G	Person-to-Government payments
PAD	Project Appraisal Document
PAFI	Payment Aspects of Financial Inclusion
PAOMA	Postal Service
PASEF	World Bank Financial Services Project

PCB	Private Credit Bureau
PDO	Project Development Objective
PFI	Participating Financial Institution
PFM	Public Financial Management
PIC	Project Implementation Committee
PIP	Project Implementation Plan
PIU	Project Implementation Unit
POM	Project Operations Manual
PPA	Project Preparation Advance
PPCG	Partial Portfolio Credit Guarantee
PPSD	Project Procurement Strategy for Development
PSC	Project Steering Committee
PWC	PricewaterhouseCoopers
RC	PPCG Remuneration Committee
RCF	Rapid Credit Facility
RF	Retroactive Financing
ROA	Return on Assets
ROE	Return on Equity
RTGS	Real-Time Gross Settlement system
SCD	Systematic Country Diagnostic
SDR	Special Drawing Rights
SME	Small and Medium-sized Enterprise
SOE	Statement of Expenditures
SOLIDIS	Name of a guarantee fund manager based in Madagascar
SSC	PPCG Supervision Committee
STEP	World Bank online procurement and tracking tool
SWITCH	Transaction processing platform
TA	Technical Assistance
TOR	Terms of Reference
TTL	Task Team Leader
US$	United States Dollar
WA	Withdrawal Applications
WB	World Bank

Regional Vice President: Makhtar Diop
Country Director: Mark R. Lundell
Senior Global Practice Director: Ceyla Pazarbasioglu-Dutz
Practice Manager: Douglas Pearce
Task Team Leader(s): Francesco Strobbe, Christoph Ungerer

Click here to enter text.
Click here to enter text.

BASIC INFORMATION

Is this a regionally tagged project?	Country(ies)	Financing Instrument
No		Investment Project Financing

[ ] Situations of Urgent Need of Assistance or Capacity Constraints

[✓] Financial Intermediaries

[ ] Series of Projects

Approval Date	Closing Date	Environmental Assessment Category
28-Feb-2018	31-Jul-2022	F - Financial Intermediary Assessment

Bank/IFC Collaboration
No

Proposed Development Objective(s)

The development objective of this project is to promote the financial inclusion of individuals and MSMEs in Madagascar.

Components

Component Name	Cost (US$, millions)
Digitalization of transactions to increase usage of transaction accounts	25.50
Access to credit for MSMEs	16.50
Project Management and Impact Evaluation	3.00
Contingent Emergency Response	0.00

Organizations

Borrower :	Ministere des Finances et du Budget

Implementing Agency :	Ministere des Finances et du Budget

PROJECT FINANCING DATA (US$, Millions)

[ ] Counterpart Funding	[ ] IBRD	[✓] IDA Credit	[ ] IDA Grant	[ ] Trust Funds	[ ] Parallel Financing

Total Project Cost:	Total Financing:	Financing Gap:
45.00	45.00	0.00
	Of Which Bank Financing (IBRD/IDA):	
	45.00	

Financing (in US$, millions)

Financing Source	Amount
IDA-61890	45.00
Total	**45.00**

Expected Disbursements (in US$, millions)

Fiscal Year	2018	2019	2020	2021	2022	2023
Annual	1.30	8.00	15.00	10.00	10.70	0.00
Cumulative	1.30	9.30	24.30	34.30	45.00	45.00

INSTITUTIONAL DATA

Practice Area (Lead)

Finance, Competitiveness and Innovation

Contributing Practice Areas

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Gender Tag

Does the project plan to undertake any of the following?

a. Analysis to identify Project-relevant gaps between males and females, especially in light of country gaps identified through SCD and CPF

Yes

b. Specific action(s) to address the gender gaps identified in (a) and/or to improve women or men's empowerment

Yes

c. Include Indicators in results framework to monitor outcomes from actions identified in (b)

Yes

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	High
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Substantial
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and Social	Moderate
8. Stakeholders	Substantial
9. Other	
10. Overall	Substantial

COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

[ ] Yes [✓] No

Does the project require any waivers of Bank policies?

[ ] Yes [✓] No

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	✓	
Natural Habitats OP/BP 4.04		✓
Forests OP/BP 4.36		✓
Pest Management OP 4.09		✓
Physical Cultural Resources OP/BP 4.11		✓
Indigenous Peoples OP/BP 4.10		✓
Involuntary Resettlement OP/BP 4.12		✓
Safety of Dams OP/BP 4.37		✓
Projects on International Waterways OP/BP 7.50		✓
Projects in Disputed Areas OP/BP 7.60		✓

Legal Covenants

Sections and Description

The Recipient shall furnish to the Association, as soon as available, but in any case not later than November 30 of each year, the annual work plans and budgets approved by the Steering Committee and the evidences referred to in subparagraph 1(b) of the FinancingAgreement, for the Association's review and approval; except for the Annual Work Plan and Budget for the Project for the first year of Project implementation, and the evidence which may be required for the implementation of the activities included in the draft Annual Work Plan and Budget for such period, which shall be furnished no later than one (1) month after the Effective Date. Only the activities included in an Annual Work Plan and Budget expressly approved by the Association (each an "Annual Work Plan and Budget") are eligible to a financing from the proceeds of the Financing.

Sections and Description

The Recipient through the CNFI, Ministry of Finance and BCM (including CSBF) shall, not later than three (3) months of the Effective Date, establish a working group to coordinate the financial education activities and to prepare and follow-up on an action plan for a mutualized MIS for MFIs.

Sections and Description
The Recipient shall not later than three (3) months after the Effective Date, establish, and at all times during Project implementation maintain, a grievance redress mechanism at all times during Project implementation.

Sections and Description
The Recipient shall, not later than three (3) months after the Effective Date, establish and, at all times during Project implementation, maintain the PPCG Supervision Committee (SSC).

Sections and Description
The Recipient shall, not later than three (3) months establish, and at all times during Project implementation, maintain the PPCG Orientation Committee (OC).

Sections and Description
The Recipient shall, not later than three (3) months after the Effective Date, cause the PPCG Fund to establish, and at all times during Project implementation, maintain, and publicize the availability of, a grievance redress mechanism, in a form and substance satisfactory to the Association, to hear and determine fairly and in good faith all complaints raised in relation to the Project, and take all measures necessary to implement the determinations made by such mechanism in a manner satisfactory to the Association.

Conditions

Type	Description
Effectiveness	The Recipient has adopted the POM in form and substance acceptable to the Association.
Effectiveness	The Recipient has established the PIU and staffed it with a Project Coordinator, a financial management specialist, an accounting specialist, a procurement specialist, a monitoring and evaluation specialist and an environment focal point, all under terms of reference acceptable to the Association.
Disbursement	No withdrawal shall be made for payments made prior to the Signature Date except that withdrawals up to an aggregate amount not to exceed three million eight hundred thousand Special Drawing Rights (SDR 3,800,000) may be made for payments made prior to this date but on or after September 1, 2017,for Eligible Expenditures.

Type	Description
Disbursement	No withdrawal shall be made under Category 5 of the Financing Agreement, unless and until the Association is satisfied that the following conditions have been met: (i) the Recipient has determined that an Eligible Crisis or Emergency has occurred, has furnished to the Association a request to include such activities in the Project, in order to, respond to said Eligible Crisis or Emergency, and the Association has agreed with such determination, accepted said request and notified the Recipient thereof; (ii) the Recipient has ensured that all safeguard instruments required for said activities have been prepared and disclosed, and the Recipient has ensured that any actions which are required to be taken under said instruments have been implemented, all in accordance with the provisions of Section I.F of Schedule 2 of the Financing Agreement; (iii) the entities in charge of coordinating and implementing the CERC have adequate staff and resources, in accordance with the provisions of Section I.F of Schedule 2 of the Financing Agreement, for the purposes of said activities; and (iv) the Recipient has adopted the CERC Operating Manual, in form and substance acceptable to the Association, and the provisions of the CERC Operating Manual remain - or have been updated in accordance with the provisions of Section I.F of Schedule 2 of the Financing Agreement so as to be - appropriate for the inclusion and implementation of the CERC.

PROJECT TEAM

Bank Staff

Name	Role	Specialization	Unit
Francesco Strobbe	Team Leader(ADM Responsible)		GFCAE
Christoph T F Ungerer	Team Leader		GMTE3
Sylvain Auguste Rambeloson	Procurement Specialist(ADM Responsible)		GGOPF
Maharavo Harimandimby Ramarotahiantsoa	Financial Management Specialist		GGOAC
Aly Salman Alibhai	Team Member	BDS, Impact Evaluation	AFRGI
Andre Ryba	Team Member	SME finance	GFCAS
Andrea Vasquez-Sanchez	Team Member		GFCAS

Andrianjaka Rado Razafimandimby	Social Safeguards Specialist	Social development	GSU20
Brinda Devi Dabysing	Team Member		GFCAS
Dorothee Delort	Team Member	Payments system	GFCFI
Honglin Li	Team Member		OPSPQ
Marco Traversa	Team Member	Consumer protection and financial literacy	GFCFI
Maria Eileen Pagura	Team Member	Microfinance	GFCAW
Noro Aina Andriamihaja	Team Member		GFCAS
Paul-Jean Feno	Environmental Safeguards Specialist		GEN07
Peter F. B. A. Lafere	Social Safeguards Specialist	Social development	GSU01
Tenin Fatimata Dicko	Team Member	Microfinance	GFCAW

Extended Team

Name	Title	Organization	Location

Click here to enter text.

MADAGASCAR
MADAGASCAR FINANCIAL INCLUSION PROJECT

TABLE OF CONTENTS

I. STRATEGIC CONTEXT

A. Country Context

1. **While Madagascar is an island nation blessed with many assets, repeated political crisis have held the country back.** With a population of near 24 million of which 64 percent is less than 25 years of age, Madagascar has the potential to reap a demographic dividend. Agricultural lands, forest areas, and access to the sea could make it the "food basket" of the Indian Ocean, if not beyond. An unparalleled biodiversity and cultural wealth could drive tourism expansion. The workforce is relatively literate and its small - but reasonably diversified - private sector could thrive. However, repeated political crises have held Madagascar back. Over the last fifty years, all heads of state (excluding the current President) have either gained or lost power as the result of an unconstitutional event. The application of existing institutions and legal norms has been repeatedly undermined by the political networks of a few. The Malagasy population have borne the cost of this political instability.

2. **Madagascar has one of the highest rates of poverty in the world.** The average Malagasy is 42 percent poorer today than in 1960, the year of Madagascar's independence. As of the latest data available (2012), only 30 percent of Malagasy live above the national and only 10 percent above the international poverty line. Poverty is not only widespread, it also runs deep: the average Malagasy consumes 32 percent less than a person living directly at the national poverty line. The most recent poverty analyses[1] show that Madagascar made little progress in improving the welfare of the poor between 2001 and 2012. The incidence of extreme poverty is higher among female-headed households, which make up one-fifth of all households. Close to 80 percent of Madagascar's population lives in rural areas, and rural poverty rates are more than twice as high as urban rates. Because most of the rural poor depend on agriculture for their livelihood, they are particularly vulnerable to the frequent and severe climatic shocks that burden the country.

3. **Since the return to constitutional order in early 2014, Madagascar is progressively putting itself back on a positive macroeconomic development track.** The elected government that took office in 2014, after a five-year long political crisis, has made tangible progress stabilizing the economy and restarting growth. This has been supported by two consecutive IMF Rapid Credit Facility (RCF) programs, followed by a six-month IMF staff-monitored program and an ongoing three-year Extended Credit Facility (ECF) program that started in 2016. Madagascar's macroeconomic reform agenda was further supported by the World Bank's Reengagement DPO in 2014, the Resilience DPO in 2015 and the on-going 2016-17 Public Finance Sustainability & Investment programmatic DPO series. These efforts have contributed to a gradual macroeconomic recovery in Madagascar, with real GDP growth expected to reach 4.1 percent in 2017. Inflation is projected at 8.0 percent in 2017.

4. **A key challenge for Madagascar is to ensure that economic growth becomes more inclusive and benefits the many poor that have so far been left behind.** Mining and the tertiary sector, including public works, are the main drivers of Madagascar's recent macroeconomic growth. Export processing zones are also growth sectors. Yet, the main sector of employment for the bottom 80 percent of

[1] World Bank (2016). "Recent Trends and Analytical Findings on the Causes of Madagascar's Persistent Poverty." It uses household survey data from EPM 2001, 2005, 2010, and ENSOMD 2012. Also see World Bank (2014). "Face of Poverty in Madagascar: Poverty, Gender, and Inequality Assessment." The next household survey is expected to take place in 2018, following the census.

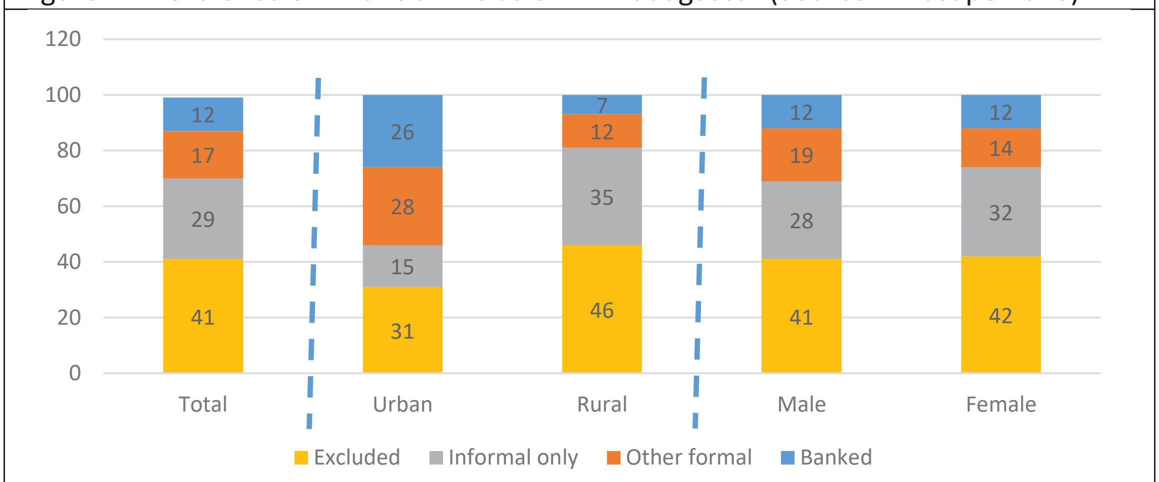
households is agriculture. Madagascar's urban poor remain locked in often unproductive micro enterprises, without access to better employment opportunities.[2] Economic growth has therefore largely bypassed the poor.

5. **Recognizing this challenge, the country is embarking on an ambitious reform program to promote the inclusiveness and resilience of economic growth.** The Madagascar National Development Plan (NDP) 2015-19 has set out the national goal of "*development through inclusive and sustainable growth, taking into account the spatial dimension*". Supporting this goal, the World Bank Country Partnership Framework (CPF) has designed its 2017-2021 program around two focus areas: (i) increase resilience and reduce fragility and (ii) promote inclusive growth. The World Bank has put in place lending projects to support this strategic focus: **t**his proposed Financial Inclusion Project is closely coordinated with and supported by a parallel Inclusive and Resilient Growth Development Policy Operations (DPO) series. The DPO series, among other things, supports the enactment of the new e-money law setting up the institutional foundations for many of the activities linked to the promotion of the use of transaction accounts and it also develops the legal foundations for the establishment of a private credit information bureau in Madagascar, a crucial infrastructure for increasing access to credit for MSMEs.

B. Sectoral and Institutional Context

6. **The World Bank 2017-21 CPF has identified access to finance as one of its key objectives to promote inclusive growth in Madagascar.** A 2016 FinScope survey found that 41 percent of households were fully financially excluded. Only 12 percent of Malagasy households had access to banking services, 17 percent had access to other non-bank institutions and 29 percent only had access to informal mechanisms to manage their finances. Lack of access to basic formal financial services, starting from transaction accounts and credit for micro, small and medium-sized enterprises (MSMEs), has severe repercussions on the life of the Malagasy.

Figure 1: Prevalence of Financial Exclusion in Madagascar (Source: Finscope 2016)



[2]In 2012, over 87 percent of employed workers worked in enterprises with five or fewer workers (World Bank, 2016. Shifting Fortunes and enduring poverty in Madagascar).

7. **Transaction accounts provide a safe store of value, an efficient means to execute transactions and a stepping stone to more advanced financial services such as credit.** Lacking formal transaction accounts, many Malagasy households are currently forced to rely on risky informal means to store value, including "in a secret place or at home" (FinScope 2016: 40 percent of respondents) or through livestock (39 percent of respondents). This limits their ability to accumulate resources for investment and to develop buffers to strengthen resilience against shocks.[3]To conduct transactions, such as repaying a loan or collecting a salary, these financially excluded households – particularly in rural areas - are often forced to physically travel significant distances at considerable cost in terms of time and money, carrying large amounts of cash despite widespread criminality. Without an account, many Malagasy never take the first step to start a relationship with a financial institution, which could eventually give them access to more advanced financial services such as credit or insurance.

8. **Credit for MSMEs allows productive businesses to grow, develop economies of scale and create better employment opportunities for all.** According to the World Economic Forum Executive Opinion Survey 2016, access to finance was ranked 3rd most problematic factor for doing business in Madagascar (after political instability and corruption). Madagascar ranks at 133th place (out of 190 countries) in terms of "Getting Credit" in the 2018 World Bank Doing Business (DB) report. Some evidence suggests that credit constraints are particularly acute for micro enterprises, women entrepreneurs and exporters.[4]Lacking access to formal credit (and given the limited size of informal loans within small local communities), many high-potential Malagasy MSMEs cannot grow sufficiently to develop economies of scale and to create employment opportunities. Households and businesses have difficulty mobilizing funds to rebuild their livelihoods after they have been hit by one of the many shocks that frequently torment Madagascar's poor, ranging from climatic to personal health shocks. This reduces the resilience of Madagascar's poor.

9. **A range of factors limit the use of traditional bank transaction accounts in Madagascar.** Latest data from the IMF's 2017 Financial Access Survey (FAS) database shows that there are only 97.3 bank accounts for every 1,000 adults (2016) in Madagascar.[5]Several factors help explain this low rate of bank account penetration. First, given pervasive poverty, many households and enterprises are not considered to be profitable customers for traditional banking services. Potential depositors are deterred by relatively high account fees. Second, many households lack identification documents and

---

[3] Evidence by Jack & Suri (2014), for instance, finds that access to an e-account increases the resilience of household consumption to shocks. Dupas and Robinson (2013) find that commitment savings accounts increased productive investment by women informal business owners by 38-56 percent in Kenya.

[4] While the 2013 enterprise survey finds that credit usage among small firms is significantly lower (5-19 employees: 3.8 percent of firms report a bank loan or credit line) than among medium firms (20-99 employees: 32.6 percent) or large firms (100+ employees: 30.1 percent), small firms are less likely to report credit as a major constraint (8 percent) than medium (21.8 percent) or large firms (12.4 percent). A plausible explanation for this combination of results may be that – as reported by financial institutions – (i) many micro enterprises exhibit low productivity, do not have growth potential and hence do not need credit and (ii) many of those micro enterprises that do have growth potential do not request credit due to lack of business development skills. This indicates the importance of stimulating demand for credit among high-potential micro enterprises. While credit usage is roughly gender-neutral, female-led companies are more likely to report credit access as a major problem (female top manager: 20.8 percent; male top manager: 9.3 percent). Exporters are also particularly credit constrained, with 24.7% of enterprises reporting credit as major constraint (non-exporters: 9.3 percent).

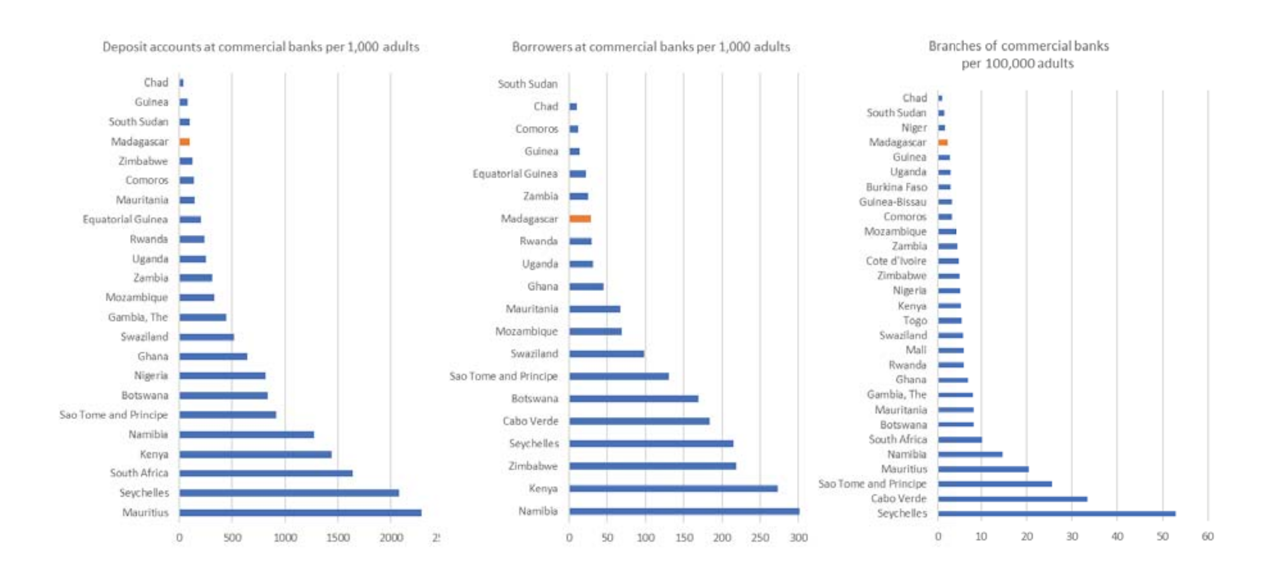
[5]The 2014 World Bank Findex report (to be updated in 2018) finds that there were 86 accounts per 1000 adults (+15) in Madagascar – as opposed to 275 accounts per 1000 adults on average in Low Income Countries (LIC).

many businesses are informal - which excludes them from opening a bank account.[6] Third, many Malagasy live far from a bank branch. There are only 2.2 bank branches per 100,000 people in Madagascar – and most of these branches are clustered in urban areas. Banks face high costs[7] in expanding their branch network into rural areas, where 80 percent of the population live - particularly given that few households in these remote areas have sufficient income to make them conventional bank customers. Fourth, limited interoperability of accounts worsens the problem of a sparse branch network. Accounts are particularly unattractive, because funds cannot be withdrawn (or only at significant fee) through the branch or Automated-teller machine (ATM) of another bank. Fifth, households and micro enterprises are often unfamiliar with banking services. Greater financial literacy and consumer protection are needed to reduce their suspicion of financial institutions.[8]

10. **Additional factors limit access to bank credit.** For every 1,000 adults, there are only 28.8 borrowers at commercial banks (IMF FAS 2017) in Madagascar. First, because banks have a hard time attracting deposits, the cost of funding for banks is high and lending is risky, banks - in turn - offer credit only at high interest rates.[9] Second, banks are deterred from offering credit to applicants that lack a formal credit history and that cannot offer financial statements of sufficient quality - making it difficult to assess credit worthiness.[10] Third, many Malagasy cannot offer sufficient collateral or - if they do - enforceability of this collateral in the courts is in doubt. Concerns about collateral have been heightened by the lack of a centralized collateral registry. Fourth, credit demand is limited, given that many micro enterprises either do not have a business model that can be scaled profitably or do not have the entrepreneurial mindset to move forward with expansion.

[6] According to Ensomd 2012-2013, only 83 percent of 0-4 years had a birth certificate in 2012-2013. According to latest data from ILO (2012), 97.3 percent of employment is informal.
[7] Costs of branch expansion are high given poor road conditions, safety concerns, limited electricity access (rural households: 16%), mobile phone usage (rural households: 21%) and internet usage (rural households: 1%).
[8] According to the 2016 FinScope survey, 58 percent of adults felt they needed more information about managing money. 27 percent of adults said they would like to receive more information on the terms and conditions of a product.
[9] A 2016 interest rate study in Madagascar (financed under the previous PASEF project) found spreads for effective loan interest rates between 11 percent and 127%. Spreads were even higher and more variable among MFIs. The financial sector supervisor has not put in place interest rate caps or restrictions. Interest rates are set at market-determined rates.
[10] The Government of Madagascar has recently enacted a new law for Private Credit Bureaus (PCB), supported by IFC technical assistance and the World Bank Inclusive and Resilient Growth DPO. The PCB will allow financial institutions, and others such as telecom and energy companies, to share the repayment history of customers – reducing information asymmetries and helping more Malagasy build a credible credit history. This will alleviate the problem of evaluating the credit worthiness of applications.

Figure 2: Penetration of the banking sector in Madagascar relative to African peers in 2016 (Source: IMF FAS 2017)



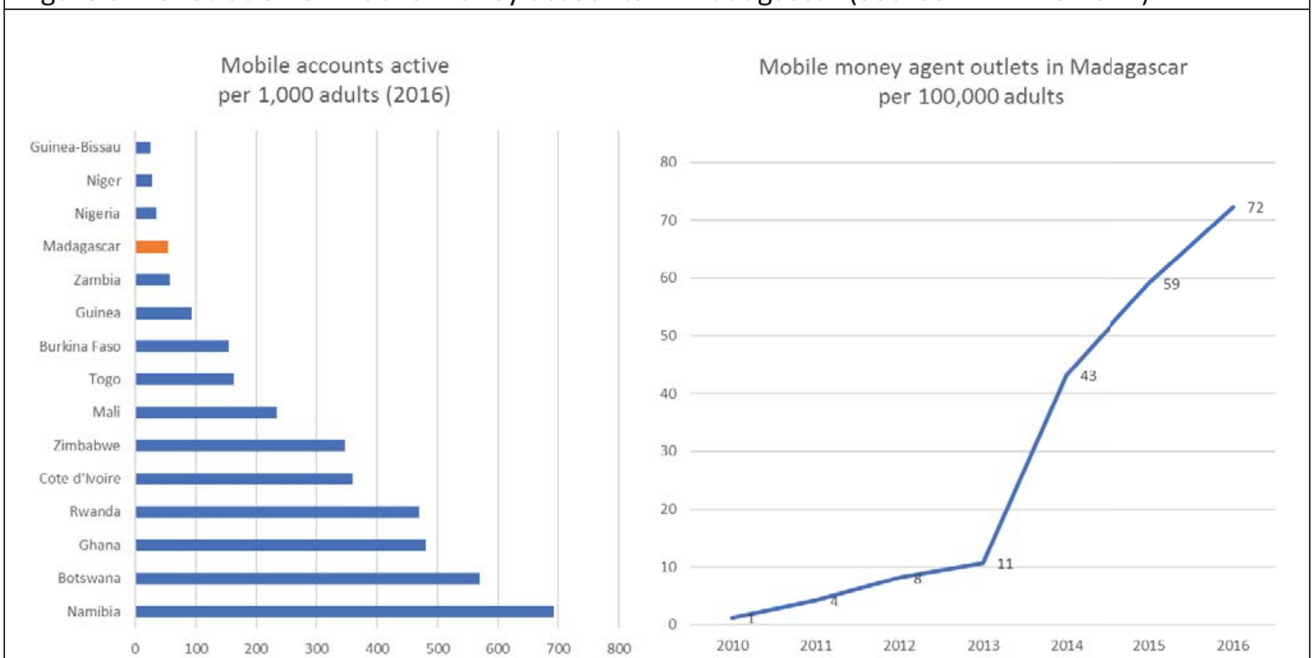
11. **Despite these constraints, traditional banks have the potential to play a larger role in promoting financial inclusion in Madagascar – particularly if they are given incentives to overcome their risk aversion and lend to MSMEs.** Madagascar's banking sector exhibits strong financial fundamentals. The sector has capital ratios of 12.8 percent on aggregate (June 2017) - well above the required minimum of 8 percent. Liquidity is ample, with banks' deposits exceeding loans. As of end-2016, the 11 banks present in Madagascar had outstanding deposits of 20.1 percent of GDP and outstanding loans of 12.2 percent of GDP (IMF FAS 2017). To promote financial inclusion, the sector needs support to overcome risk aversion and utilize its high liquidity ratios to lend to MSMEs – learning to identify and lend to promising borrowers, even if they lack conventional credit history and collateral.

12. **Madagascar's Microfinance Institutions (MFIs), specializing in providing financial services to low income and poorly documented customers, can play a key role in bringing credit to the poor – though the sector needs to overcome governance challenges and strengthen its capabilities.** MFIs have developed alternative business models to offer account, credit and other financial services to poorly documented and low-income customers (including in-depth face-to-face client screening interviews, group lending schemes, micro and short-maturity credit, increased focus on financial education to generate customer demand). The reach of this subsector has become important. According to the IMF FAS 2017, there are now 55.6 MFI depositors and 16.8 borrowers per 1,000 adults. Given a business model focused on small loans to the poor, outstanding loans remain small at 0.8 percent of GDP. But there are now 4.6 MFI branches per 100,000 Malagasy – a wider network than Malagasy banks. While most MFIs have until recently focused on reaching the urban small and medium-sized enterprises (SMEs), efforts are now under way to reach micro enterprises as well as more remote rural locations. The MFIs however face several challenges. First, the rapid growth of the sector has come along with a deterioration of credit portfolio quality at some MFIs. A consolidation of the sector is expected. Second, many MFIs face liquidity constraints and are thus limited in their

ability to take risks and expand their branch network into rural areas. Third, to improve financial management, many MFIs need to upgrade their IT systems. Fourth, many MFIs are exploring the use of digital technology to offer mobile financial services to their customers, which would broaden their appeal and reach – though MFIs so far lack experience in this domain.

13. **The rapid growth of mobile money accounts offers an opportunity to broaden access to transaction accounts to those that cannot be reached by traditional banks – though the Malagasy need to become more comfortable with digital finance.** Madagascar's three mobile operators offer e-money services, which enable cash-in and cash-out functions through their agent network, transfers across e-money accounts, bill payments for partnering services, remittances and other services. Since mobile phone coverage and the agent network are already vast, while technology significantly reduces costs per customer[11], this business model holds great promise for financial inclusion in Madagascar – especially as mobile phone ownership (and sharing) increases. In line with this, the demand for e-money has increased rapidly. According to the IMF FAS 2017, there are now 54.2 active mobile money accounts (and 277.3 registered mobile money accounts) per 1,000 adults – a rise of 86.9 percent relative to 2014. There are 72.3 mobile money agent outlets per 100,000 adults. Mobile money account balances stand at 0.35 percent of GDP.

Figure 3: Penetration of mobile money accounts in Madagascar (Source: IMF FAS 2017)



14. **Overall, Madagascar's payment landscape is rapidly evolving.** Madagascar has already introduced key payment systems infrastructures – though they need updating - such as an interbank system for retail electronic funds transfers (ie an automated clearing house (ACH)), and a large-value interbank

[11] According to the McKinsey Global Institute (2016) flagship report on Digital Finance, digital financial services can be provided at between 80 percent to 90 percent lower cost than conventional services.

settlement system (ie a real-time gross settlement system (RTGS). However, businesses as well as Government institutions are still largely cash-based. Card transactions are not popular – and e-money transactions through mobile phones still represent only a small, albeit rapidly growing, part of the market.

15. **Relevant changes in the regulatory framework regulating microfinance and electronic money have recently been introduced.** The microfinance law has been revised to further promote stability.[12] The revised law (and accompanying implementing decrees) seeks to introduce: (i) resolution powers for the financial sector regulator (*Commission de Supervision Bancaire et Financière* - CSBF); (ii) the principle of a deposit guarantee fund for MFI clients; (iii) more stringent prudential and non-prudential measures such as minimum capital requirements, consumer protection;[13] (iv) simplified categorizations of MFIs;[14] and (v) enhanced risk-based supervision for the CSBF, including tools derived from the "CAMELS" approach.[15] On December 16, 2016, the Malagasy Parliament adopted Law No. 2016-056 on e-money and electronic money institutions (EMI), which regulates the issuance of electronic money and defines the regime of issuers of electronic money.[16]The enactment of the e-money law, putting the sector on a solid legal footing, has sown the seeds for further expansion. It is now key that more Malagasy become comfortable adopting digital finance.

16. **The recently closed World Bank Madagascar Financial Services Project (PASEF – P109607) has already put in place key measures to encourage lending to MSMEs in Madagascar – though further support is needed to build on this successful initiative.** Among others, the project established a partial portfolio credit guarantee (PPCG) for credits extended by banks and MFIs to MSMEs in July 2014 with an initial capital of 4 million US dollars. The PPCG is managed by the local fund manager SOLIDIS Garantie. Over the course of the PASEF, it was highly effective in expanding financial inclusion: With a capital of 4 million US dollars, the guarantee supported cumulatively 46 million US dollars in credit. Six banks and two MFIs participate in the MSME window of the PPCG. The guarantee covers 50 percent of credits meeting eligibility criteria. It is a portfolio guarantee: participating institutions must enter in the guarantee all credits meeting the eligibility criteria. The Fund must accept all the credits meeting the eligibility criteria without analyzing them. The registration of a credit on the guarantee is thus very quick. The PPCG Fund has thirty days to make payments on legitimate claims. The PPCG is silent: borrowers do not know that the credits they receive are covered by the PPCG. The guarantee is aimed at borrowers who could not otherwise have access to credit. In fact, 75 percent of the number of credits guaranteed are extended to new borrowers. Participating financial institutions benefit from in house technical assistants paid by the project. Annex 5 expands on the structure and the operations of the PPCG and the reasons behind its success. It explains how the participating financial institutions and the Fund manager are chosen. Today, for the PPCG to continue growing, a further increase of its capital endowment is needed and requested by financial institutions participating in the scheme.

[12] The revised microfinance law has been submitted to Parliament and has been approved.
[13]Prudential measures include: strengthened minimum capital requirements, prudential ratios, internal control mechanisms to manage risks, governance in particular for cooperatives and non-prudential measures such as consumer's protection
[14]From level 1-2-3 to MFI "A" or "B", merging *de facto* the categories 2 and 3.
[15]CAMELS is the acronym of Capital adequacy, Asset quality, Management, Earnings, Liquidity (ALM) and Sensitivity to market risks.
[16] Mobile phone providers can issue e-money without partnering with a bank or MFI according to this law.

17. **Other financial players in Madagascar are limited.** Insurance and pension institutions, which should play a more effective role in mobilizing long-term resources and providing important insurance and retirement services, have a very limited footprint in Madagascar.[17]The government-owned Caisse d'Epargne de Madagascar (CEM) and the postal service (PAOMA), which could potentially play a larger role in financial inclusion, face governance concerns[18].Capital markets remain very limited, with no corporate debt market, fixed income market limited to short-term government securities, no sovereign rating and no stock exchange or derivatives market. Informal savings groups are present at small scale (70,000 groups with total membership of 300,000 persons).[19]

18. **Several Malagasy government institutions play a key role in the development of the country's financial sector.** The Central Bank of Madagascar (BCM) has a financial sector arm - the CSBF. The CSBF regulates and supervises financial sector stability, including banks and MFIs. Key current challenges for the CSBF include: (i) strengthening banking supervision and developing a special resolution regime for financial institutions, including deposit insurance, and (ii) reducing the high non-performing loans (NPL) ratio (9.8 percent in June 2017, though on a declining trend) and exposure to related parties in the banking sector; (iii) facilitating the restructuring of the microfinance sector. The Ministry of Finance (MoF) has put in place a National Coordination to promote financial inclusion (the CNFI), which monitors progress on financial inclusion and develops the government's national strategy. The 2013-2017 National Strategy for Financial Inclusion focused on expanding the MFI network. The CNFI is currently preparing a new strategy for the period 2018-2022. The objective is to improve the access to the financial services of the malagasy population by increasing the number of adults having access to the formal financial services from 29 percent in 2016 to 45 percent before 2022. This strategy leans on three axes: (i) Financial education and consumer protection; (ii) access and usage of financial services; (iii) strengthening policies, legal, regulatory and institutional framework.

C. Higher Level Objectives to which the Project Contributes

19. **This project supports the development of an "inclusive financial system" – a focus area of the Government's 2017-2019 Economic Development Paper (EDP).** The EDP details a wide range of reforms that the government intends to execute to address the constraints for growth and reducing poverty. As an enactment of the National Development Plan (NDP), the different reform areas of the EDP are aligned with the pillars of the NDP. This project supports the EDP focus area on an inclusive financial system.

20. **The project also contributes to key objectives of the World Bank Country Partnership Framework**

[17] A new FIRST-funded project on the insurance sector is prepared in parallel to this operation.

[18]Independent audits of CEM and PAOMA, conducted with assistance from the World Bank, have identified the need to develop a clear strategy and action plan for each institution. The Board of PAOMA will adopt an action plan by end-March 2018 for the implementation of the provisional measures suggested in the audit report, including plans for a comprehensive audit of PAOMA's customers' accounts by an internationally recognized private sector audit firm.

[19]On average, each savings group saves less than 80 US$ and has outstanding credit of less than 50 US$, granted to 7 clients within the group (i.e. less than US$10 of credit per member). Most of the members are women. These groups are mostly present in the East, South East, and Southern areas of Madagascar. Such informal entities have achieved success (on a small scale) due to their low cost, simple, and informal operations. Risks are generally contained as such entities are small scale and rely on local social cohesion. Relations with formal financial service providers are very limited.

(CPF) 2017-2021 for Madagascar (Report No. 114744-MG). This includes promoting "enhanced resilience of livelihoods of vulnerable households in rural and urban areas" (objective 2) under "focus area 1: increase resilience and reduce fragility" and supporting an "improved business environment and access to finance" (objective 6) under "focus area 2: promote inclusive growth". It is also grounded in the World Bank Systematic Country Diagnostic (SCD) for Madagascar from 2016, which identifies broadening of financial access as a measure with large poverty impact over the long run and with a strong evidence base. As such, the project contributes to the broader World Bank twin goals of eliminating poverty and boosting shared prosperity.

21. **The design of the project is aligned with some of the key findings and recommendations of the 2015 Financial Sector Assessment program (FSAP)**. A joint WB/IMF assessment of the financial sector, conducted in close cooperation with the Government of Madagascar in 2015, revealed that low financial inclusion, weak financial sector supervision and an outdated legal framework are key challenges for Madagascar. Thus, the sector is underdeveloped with less than 9 percent of the adult population having an account in a financial institution (Findex 2014) and a pronounced difficulty for the poorest part of the population to access financial services compared to similar countries. The government has made progress in implementing the recommendations of the FSAP. This project continues to support key FSAP recommendations, including upgrading the collateral registry system and the national payments infrastructure.

22. **This project aims to maximize finance for development.** By strengthening financial inclusion, the project aims to leverage World Bank funding to activate private financing and maximize the development impact of the project. In particular, this project will increase the capital of the PASEF partial portfolio credit guarantee fund (PPCG) that has so far catalyzed over US$46 million in private sector lending (cumulatively) using an endowment of only US$4 million.

23. **The project also contributes to the achievement of the Universal Financial Access (UFA) agenda.** An estimated 2 billion adults lack access to a transaction account (Global Findex 2014) and are excluded from the formal financial system. In response, the World Bank Group (WBG) with private and public sector partners set an ambitious target to achieve Universal Financial Access (UFA) by 2020. The UFA goal is that by 2020, adults globally have access to a transaction account or electronic instrument to store money, send and receive payments. Financial access is the first step toward broader financial inclusion, where individuals and firms can safely use a range of appropriate financial services, including savings, payments, credit and insurance.

24. **Subject to successful performance, this four-year project (2018-2022) is expected to be followed by a second project (2022-2026) on financial inclusion.** This second project aims to recalibrate the project design (i) based on lessons learned from the previous project and (ii) adapting to the rapidly changing structure of financial markets in Madagascar.

II. PROJECT DEVELOPMENT OBJECTIVES

A. PDO

25. **The development objective of this project is to promote the financial inclusion of individuals and MSMEs in Madagascar.** This is achieved by increasing usage of transaction accounts and access to credit for MSMEs.

B. Project Beneficiaries

26. **The key project beneficiaries are those Malagasy individuals and enterprises that are currently not financially included. A specific focus is on targeting women and women-owned enterprises, to reduce disparities in access to finance for women.** According to the 2016 Finscope survey, about 4.5 million adults are fully financially excluded (of which about 2.4 million are female), without access to formal or informal financial services. The direct beneficiaries of the project will include:

- Teachers, students and taxpayers that will receive the option to receive and make government payments through an e-money transaction account
- MFI customers (particularly in rural areas) that will receive access to MFI services through digital service offerings and/or new physical branches
- Malagasy households that will benefit from an improved financial infrastructure, financial education and consumer protection
- MSMEs that will benefit from increased credit access and business development services (BDS)
- Banks and MFIs that will benefit from credit guarantees and strengthened capabilities. Mobile money operators will benefit from increased use of their e-money services as well as expansion of their agent network.
- Government Institutions will benefit from progress on their financial inclusion targets, better cash management through digitalization of government payments and capacity building.

C. PDO-Level Results Indicators

27. **To assess progress towards achievement of the PDO, the project will focus on two key indicators.** First, to evaluate the increase in usage of transaction accounts, the project will monitor the number of currently unbanked[20] (i) FRAM teachers/students that receive their government salary/scholarship payments through a transaction account and (ii) businesses that pay the “impôt synthetique” to the central government through an e-money account; baseline (2016): 0; target (2021): 130 thousand

[20] By “unbanked” this project component refers to beneficiaries that currently make or receive respective payments in cash.

people or more. Second, to assess progress on increasing access to MSMEs, the project will monitor the cumulative number of MSME borrowers that banks and MFIs have registered under the partial portfolio credit guarantee since effectiveness of the project; baseline (2017): 0 ; target (2021): 5000 or more.[21]

III. PROJECT DESCRIPTION

A. Project Components

Figure 4: Project Design Diagram

Financial Inclusion Project

Component 1: Increasing usage of transaction accounts

1.1 Digitalization of Government Payments

- *Payment of teacher salaries and scholarships*
- *Selected tax revenues*

1.2 Digitalization of MFIs

- *Front office: integration of MFI mobile services*
- *Back office: Mutualized Management Information System (MIS)*

1.3 Enabling environment for usage of transaction accounts

- *Upgrade of payment systems infrastructure*
- *Financial education campaign*

Component 2: Increasing access to credit for MSMEs

2.1 Credit supply

- *Capital increase for the credit guarantee fund*
- *Innovation fund to support adoption of Fintech solutions*

2.2 Credit demand

- *Business development services (BDS) for MSMEs*
- *Cost-sharing of MFI branch expansions into underserved areas*

2.3 Enabling environment for access to credit for MSMEs

- *Centralized electronic collateral registry*
- *Upgrade of consumer protection framework*

Component 3: Project Management and impact evaluation

[21] Additional indicators monitored are described in section 7 and annex 8.

28. **This project proposes to finance activities to support financial inclusion in Madagascar over four years for US$45 million.** Under component 1, the project supports activities to increase adoption and usage of transaction accounts. The core strategy is to facilitate the digitalization of selected transactions of individuals and enterprises with the government and with MFIs, enabling direct beneficiaries to gain by moving from cash to digital transactions. Supported by a stronger enabling environment, these measures also aim to contribute to the wider socialization of digital finance and the broader adoption of transaction accounts in Madagascar – including as a store of value and as stepping stone for the poor to more advanced financial services. Under component 2, the project supports banks and MFIs to supply credit to MSMEs, while encouraging credit demand by productive businesses – directly enabling the growth of participating enterprises and the creation of jobs. Supported by a stronger enabling environment, these measures also aim to make banks and MFIs more experienced and better equipped (beyond the lifetime of the project) to lend to Madagascar's often poorly documented and collateralized enterprises – while making formal credit more accessible and familiar among Madagascar's community of micro entrepreneurs. Component 3 supports project management through the establishment of a project implementation unit (PIU) and through an impact evaluation of selected project interventions. Component 4 is a Contingent Emergency Response Component. Activities under each component are further described in Annex 1.

Component 1: Digitalization of transactions to increase usage of transaction accounts (SDR 17.9 million; US$25.5 million equivalent)

29. **Component 1 supports the usage of transaction accounts, digital finance and cashless transactions.** Subcomponents 1.1 and 1.2 support the move from cash to transaction accounts for (i) selected payments to and from the government and (ii) selected payments to and from MFIs. Particularly in rural areas, this will allow individuals and enterprises to benefit from significantly lower transaction costs by eliminating or reducing travel time and expenses, while making payments safer. The Government and the participating MFIs will benefit from lower cash handling costs, while reducing the scope for fraud as well as increasing the reach and effectiveness of their services. Supported by a financial education campaign and improvements to the national payments infrastructure, these measures aim to contribute to the wider socialization of digital finance and the adoption of transaction accounts in Madagascar – including as a store of value and as stepping stone for the poor to more advanced financial services.

Subcomponent 1.1: Digitalization of Government Payments (G2P)[22](US$9.5 million)

30. **Digitalization of teacher salaries and scholarships**: As of mid-2017, cash payments were received by around 11 thousand active civil service teachers, 11 thousand retired civil service teachers, 15 thousand active auxiliary "FRAM" teachers and 90 thousand scholarship recipients, based on the data provided by the Authorities. In rural areas, teachers sometimes need to travel for days to collect their cash salary, contributing to teacher absenteeism. The project will support the digitalization of FRAM teacher salaries, the launch of the digitalization of civil servant teachers salaries, and the digitalization of scholarships for university students, moving from cash payments to transaction accounts. This activity will start with local pilots, to then be extended nationally. The transaction accounts providers

[22] This activity will be closely coordinated with the parallel Madagascar Public Sector Performance Project (P150116). It will also be closely complemented by the financial capability / education and impact evaluation activities of this project (see below).

(banks, microfinance institutions and e-money issuers) willing to participate to the project will extend their network of agents to ensure that all teachers and students are close to a cash-out point. They will offer favorable conditions for transaction accounts for teachers and students. This activity will particularly benefit women. The majority of Madagascar's teachers are female. These stand to gain particularly from increased privacy and control over their finances within their household, as salaries and resources they earn are transferred to an account instead of paid in cash.

- Funded interventions:(i) an IT platform that will enable the Treasury to interface with the National Payments System and payment services providers; (ii) the transaction fees charged by providers to execute the payments (with gradually decreasing support over the project lifetime); (iii) technical assistance to the Treasury to review internal processes, implement the new payment procedures as well as update the regulatory framework for Government payments; (iv) the mapping of all national and local government payments and major employers' payment streams, developing an action plan to extend the digitalization of government payments beyond teacher salaries and students scholarships to other Government expenses.

31. **Digital collection of taxes:** In Madagascar, cash payment of taxes remains widespread. For instance, as of mid-2017, 94 thousand people paid the synthetic tax (impôt synthétique) for small business owners. The Government of Madagascar has already started pilots on the collection of the impôt synthétique, collected at the level of the national government, and the local market tax (taxe de marché), collected at local level. The project will support the digitalization of the impôt synthétique at the national level and, potentially, the extension of the market tax pilot to another major city.

- Funded interventions:(i) the technical developments for the connection between the Directorate General of Taxation (Direction Générale des Impôts) and the single technical platform and, potentially, the database and interface for the municipality (taxe de marché); (ii) the transaction fees charged by payment services providers (with gradually decreasing support over the lifetime of the project); (iii) the technical assistance to the Direction Générale des Impôts to review internal processes, implement the new tax collection procedures as well as update the regulatory framework for tax collection.

Subcomponent 1.2: Digitalization of MFIs (US5.5million)

32. **Front office: integration of MFIs' mobile services**: The traditional microfinance business model based on physical branches generates important transaction costs both for the institution (e.g physical infrastructure, operating costs) and for the customer (e.g. transport costs, waiting time in the agencies). The project therefore aims to digitalize MFIs, using mobile phones to deliver financial services (savings and credit) and related services (financial education).The aim is to lower transaction costs, improve MFI governance by making transactions more transparent and broaden the reach of the existing physical MFI branch network to service segments of the country that have been excluded so far. Digitalizing accounts can reduce MFI costs by between 80 percent to 90 percent for selected services (McKinsey Global Institute (2016) flagship report on Digital Finance).Capacities to be supported through the project include (i) the integration of MFIs with mobile money platforms to offer account-to-wallet services to clients; (ii) the digitalization of the process for registering new clients; (iii) the digitization of loan applications, and (iv) the use of push SMS (text and audio) to

interact with clients.

- Funded interventions: cost-sharing technical assistance and hardware/software for the digitalization of 3-4 promising MFIs[23](that are not already supported by TA in this domain) selected through a call for interest.

33. **Back office: mutualized management information system (MIS):** the lack of automated and performing MIS limits the ability of MFIs to integrate mobile services and to advance with digitization. It also contributes to the limited reach of internal controls as well as reporting to the CSBF, partially explaining some of the governance challenges experienced by the sector in recent years. Yet, without external support, most MFIs cannot afford to upgrade their MIS. As the sector is currently undergoing a restructuring, many MFIs are also dissuaded from committing to significant hardware/software investments as long as there is no clarity on the future of their institution. Therefore, the project will fund a mutualized MIS, housed at a common structure, that can be used remotely by participating MFIs.

- Funded interventions: (i) the establishment of a shared-use MIS for small and medium MFIs that will be jointly managed by the CSBF, APIMF, CNFI and the adhering MFIs; (ii) operating costs for the shared-use MIS for two years; (iii)hardware/software/Technical Assistance (TA) needs for MFIs joining the mutualized Management Information System MIS, including capacity development in internal controls and financial management

Subcomponent 1.3: Enabling environment for increased use of transaction accounts (US$10.5 million)

34. **National Payments System Infrastructure (NPS):** The NPS is the foundation for the emergence of digital finance, facilitating transactions between accounts at different financial institutions. In Madagascar, key elements of the NPS infrastructures were established in 2009. However, they require upgrading.

- Funded interventions: (i) the update of the existing real-time gross settlement system (RTGS) and the Automated Clearing House system (ACH) hardware; (ii) the support to the design and implementation of a platform providing interoperability for the clearing and settlement of retail (card and e-money) payments. The private sector has expressed the need for an increased interoperability to promote electronic payments, and will have a leading role in the design of the operating, governance and pricing rules for the platform; (iii) a survey of payment behaviors and payment costs in Madagascar.

35. **Financial capability:** Financial capability/education allows Malagasy individuals and businesses to become familiar with financial services and to make informed decisions about their finances. The project will include activities aimed at accompanying existing and potential users of digital financial services, particularly those users impacted by the measures on digitalization of government payments and MFIs under sub-component 1.1 and 1.2. A particular focus will be on behavioral nudges for female teachers, that can help them to transition to mobile accounts, increase savings, and gain greater

[23] If participating MFIs have an average customer base of 200,000 clients, the project could unlock digital services for around 600,000 to 800,00 participants.

financial autonomy.[24]

- Funded interventions: (i) a financial education campaign (delivered through mobile phones, local radios, and TV) focusing on features, usage and benefits of transaction accounts and electronic money transactions (e.g. information on the availability of redress mechanisms) – specific campaigns will be targeted to the beneficiaries of the activities under sub-components 1.1. and 1.2.; (ii) a behavior-change campaign for teachers benefiting from digitalized payments under subcomponent 1.1 to ensure use of e-money accounts as store of value (i.e., not all the money is withdrawn upfront upon the receipt of the salary) and as means to make electronic payments.

Component 2: Access to Credit for MSMEs (SDR 11.6 million; US$16.5 million equivalent)

36. **Component 2 supports access to credit for MSMEs.** Subcomponent 2.1 encourages credit supply by banks and MFIs, offering (i) credit guarantees and (ii) Fintech solutions to manage the credit risk associated with lending to the many Malagasy MSMEs that have limited conventional credit information and collateral. Subcomponent 2.2 aims to strengthen credit demand, by (i) offering business development services (BDS) to MSMEs to make them more bankable and (ii) encouraging MFIs to establish a physical presence and reach out to the underserved rural areas of Madagascar. Supported by a collateral registry and measures to strengthen consumer protection, these measures will directly benefit those MSMEs that receive credit facilitated through the project interventions, allowing them to scale-up and create new employment opportunities. A specific focus will be on products and services that meet the needs of women-owned MSMEs, such as loans with reduced collateral requirements, and business development services that address female-specific constraints to accessing finance. Beyond these direct beneficiaries however, as banks and MFIs learn-by-doing and become more confident in managing the risk of lending to smaller, less established and more remote enterprises, the project also aims to contribute to structural changes in the business models of Malagasy lenders and to encourage a culture of lending to MSMEs that lasts beyond the specific project interventions itself.

Subcomponent 2.1: Strengthening credit supply (US$11.5 million)

37. **Scale-up of the credit guarantee fund for MSMEs:** Strengthening access to finance for MSMEs requires encouraging commercial lenders to supply credit to traditionally underserved market segments, including MSMEs that may lack standard collateral or credit information. In the case of Madagascar, since many lenders have high liquidity ratios, a risk-sharing facility, such as a partial portfolio credit guarantee (PPCG), is a particularly cost-effective and suitable instrument to mobilize credit – as has been demonstrated by the previous PASEF project of the World Bank (see annex 5). The PPCG has so far catalyzed over US$46 million in private sector lending (cumulatively) using a capital of only US$4 million to issue guarantees. To safely further grow the volume of loans guaranteed, the PPCG needs to increase its capital. The new project will therefore continue support for this existing successful initiative, increasing the endowment of the PPCG from 4 million to US$12 million. Annex 6 assesses the scale-up of guaranteed credit that will become sustainable through this endowment increase. In addition, the existing steering committee is replaced by three committees

[24] As the CNFI will take a leading role in coordinating the design of these financial capability activities, the project will also fund capacity building of CNFI staff, including relevant study tours to learn from experiences abroad.

to strengthen the governance of the Fund. A supervision committee, meeting twice a year, will ensure that Solidis Garantie implements its terms of reference. The committee will be composed of (but not exclusively) the Ministry of Finance and Budget and the Central Bank An orientation committee, meeting twice a year, will have the mandate to suggest, if needed, changes to the orientations of the Fund and to the terms of reference of Solidis Garantie. Any proposed change will have to be submitted to the non-objection of the World Bank. This committee is composed (not exclusively) of the Ministry of Finance and Budget, the Central Ban the professional association of banks, the professional association of microfinance and two experts chosen for their knowledge of financial sector issues. Finally, a remuneration committee composed of the Ministry of Finance and Budget, the professional association of banks and one of the above mentioned two experts will validate SOLIDIS Garantie requests for an increase in honorarium. All proposed increases will have to be submitted to the non-objection of the World Bank.

- Funded interventions: (i) a capital increase of the PPCG; (ii) TA to support the seamless integration of the PPCG into the business processes of participating financial institutions.

38. **Innovation fund (Fintechs):** Financial technologies ('Fintech'), which use new (and existing) sources of data to appraise borrowers in innovative ways, can be a powerful tool to increase access to credit, making it possible to manage the credit risk of MSMEs that may otherwise be un-bankable.[25]This technology can have outsized impacts for female borrowers, by reducing collateral constraints which are often especially difficult to meet by collateral-poor female borrowers, and by introducing digital products which enhance privacy and financial autonomy for women. An innovation fund can create incentives and provide funding for banks and MFIs to pilot some of these Fintech solutions in Madagascar. The demonstration effects of successful pilots could help encourage the broader adoption of these technologies across the country, beyond the pilot institutions supported by the innovation fund. To complement this innovation fund, a World Bank SME Launchpad grant "Fintech Frontiers" will work with financial institutions in the country to identify specific fintech credit screening innovations and firms that they could partner with.

- Funded intervention: matching-grant innovation fund to support 1-2 Fintech pilots for appraisal and underwriting, development of new digital products and other technologies that demonstrate a strong potential impact on financial inclusion.

Subcomponent 2.2: Enhancing credit demand (US$2.5 million)

39. **Business development services (BDS) for MSMEs:** Financial institutions in Madagascar cite lack of capacity to develop bankable business plans and poor quality of financial statements and records as some of the central reasons preventing them from lending to more micro and informal firms. Women-owned firms in particular often face greater constraints around bankability, and need services to assist

[25] For example, an IDA lending operation in Ethiopia piloted the use of a psychometric test that predicts the likelihood of an entrepreneur repaying a loan. If female applicants with the pilot MFI scored highly on the psychometric test, they became eligible to access a large loan without asset collateral. The pilot is demonstrating that fintech can be a viable and profitable mechanism for reaching collateral-constrained borrowers. Other alternative sources of data for making credit decisions, such as data drawn from social media profiles, mobile phone usage, and data across groups of previous borrowers can also be harnessed to help lenders improve appraisal and lower collateral requirements (Wolkowitz and Parker, 2016).

in strengthening both hard skills, such as preparing financial statements, and soft skills, such as strengthening entrepreneurial mindsets. Helping firms to develop better business plans, and improving the presentation of financial statements, could therefore enable previously unbanked firms to become bankable in the eyes of lenders. The project will support a pilot of bankability services, with a focus on the distinct needs of both male-owned and female-owned firms. Firms would be referred to the bankability service by participating financial institutions. Nominal fees could be charged to participating MSMEs, not as a cost-recover mechanism, but as a commitment mechanism.

- Funded intervention: bankability service for entrepreneurs.

40. **MFI rural network expansion:** Bank and MFI branch networks remain scarce in rural areas, often because financial institutions do not want to bear the risk of attempting to run a profitable business in poor and sparely populated territories. The previous PASEF project therefore cost-shared the expansion of three MFI branches into two regions of Madagascar at a cost of around US$1 million. As these branch expansions attracted around 20.000 customers and demonstrated viability of business in these areas, other financial service providers have since made the leap to establish branches in these regions without project support

- Funded intervention: matching grant program to cost-share the equipment (not the purchase or lease of new properties) of new MFI branches in under-serviced regions. The matching-grant would cover one-off equipment costs and staff trainings for a limited period.

Subcomponent 2.3: Enabling environment for access to credit for MSMEs (US$2.5 million)

41. **Collateral registry:** There is currently no structured secured transaction system in Madagascar. This creates uncertainty about the enforceability of collateral rights in case of default – and deters lending in the first place. The International Finance Corporation (IFC) is, therefore, supporting the authorities with undertaking a broad based secured transactions reform. This project will fund the development of a centralized electronic, web based registry for security interests in movable property, in line with international accepted practices.

- Funded interventions: (i) hardware; (ii) software; (iii) technical assistance to set up a centralized electronic, web based collateral registry.

42. **Consumer protection:** Financial consumer protection is fundamental to increasing trust in formal financial services and encouraging financial inclusion. It also ensures that consumers benefit from extended financial access and do not become the victim of fraud or other market abuse, including predatory lending practices. Recognizing this, the CSBF has already included some financial consumer protection measures in the recently issued e-money law and draft MFI and banking laws. It has also begun developing financial consumer protection regulations, focusing on disclosure and dispute resolution for payment services and products.

- Funded interventions: (i) TA to strengthen financial consumer protection regulation and supervision at the CSBF; (ii) software to centrally collect key information (e.g. consumer complaints data).

Component 3: Project Management and Impact Evaluation (SDR 2.1 million; US$3 million equivalent)

43. **Project Management:** Drawing from the experience of the previous PASEF project, the project will establish a dedicated PIU composed of members that can work full time on the project's implementation. To ensure proper coordination and supervision of the project, a Project Steering Committee (PSC) will be established, composed of major stakeholders in the project. Section IV expands on implementation arrangements.

- Funded intervention: salaries and other operating costs of the PIU.

44. **Impact evaluation:** Key project interventions, including the digitalization of government payments and the financial education campaign, will benefit from extensive impact evaluation, comparing treatment and control groups before and after the intervention to measure impact, with a focus on impacts on women, and differential impacts between women and men. This will help to strengthen the case for further financial inclusion measures in Madagascar and beyond. By demonstrating the impact of the activities, it will help make a case for Madagascar to sustain these efforts beyond the immediate lifetime of this investment project. A DFID-funded impact evaluation trust fund (TF072809) has been secured for the project, via a call for proposals from the World Bank's Gender Innovation Lab. Project funds will support data collection, while the trust fund will support design and coordination of rigorous randomized evaluations, as well as analysis of the data.

- Funded intervention: data collection for impact evaluations.

Component 4: Contingent Emergency Response Component (US$0.0 million)

45. **Following an eligible crisis or emergency, the Borrower may request the World Bank to re-allocate project funds to support emergency response and reconstruction.** This component would draw from the uncommitted credit resources under the project from other project components to cover emergency response.

B. Project Cost and Financing

Project Components	Project cost	IBRD or IDA Financing	Trust Funds	Counterpart Funding
Total Costs	US$45 million	IDA	-	-
Total Project Costs	US$45 million			
Front End Fees	-			
Total Financing Required	US$4 5 million			

C. Lessons Learned and Reflected in the Project Design

46. **Many project activities, including the partial portfolio credit guarantee (PPCG), directly benefit from lessons learned under the previous PASEF project in Madagascar.** First, strong government ownership proved key for the successful implementation of the PASEF project. The new project has therefore been aligned to Madagascar's financial sector strategy and coordinated closely with key government counterparts (including BCM, MoF and CNFI). Second, key elements of the PASEF project have been proven to work well in Madagascar. These activities, including the PASEF PPCG fund (combined with TA in the participating financial institutions), financing of state-of-the-art MIS for MFIs and cost-sharing the branch expansion of MFIs to underserved rural areas, are therefore expanded under the new project. Third, over its lifetime, the PASEF project had to continuously adapt to the rapidly evolving political, economic and financial sector landscape of Madagascar. The new project is therefore designed keeping in mind the need for flexibility to adapt to changing conditions during project implementation.

47. **The design of the partial portfolio credit guarantee (PPCG) under the project also reflects the findings of the 2015 World Bank-FIRST report on "Principles for Public Credit Guarantee Schemes for SMEs".** The report outlines 16 key principles in the areas of legal and regulatory environment, corporate governance and risk management, operational framework and monitoring and evaluation. The PPCG supported by this project is consistent with all these principles (see Annex 5).

48. **The design of the project component on usage of transaction accounts is consistent with the 2016 findings of the international task force on Payment Aspects of Financial Inclusion (PAFI).** This task force was led by the CPMI (Committee for Payments and Market Infrastructures) and the World Bank. A resulting report (2016) recommended that all individuals and businesses should be able to have access to and use at least one transaction account operated by a regulated payment service provider to perform most, if not all, of their payment needs, to safely store some value, and to serve as a gateway to other financial services. In order to achieve this objective, the PAFI report identified three critical foundations (financial and ICT infrastructures, legal and regulatory framework, public and private commitment) and four catalytic pillars to drive access to/and usage of transactions accounts (transaction account and payment products design, access points, financial literacy and leveraging large recurrent payment flows such as Government payments).

49. **The BDS component of this project builds on extensive previous international experience.** Business trainings are a common intervention to support SMEs. However, global evidence suggests that traditional curricula, which aim to impart only hard skills such as book-keeping and marketing, have been largely ineffective (McKenzie and Woodruff, 2013)[26], particularly so for women. The design of the BDS component for this project therefore recognizes the limitations of traditional BDS and builds on promising new research in Ethiopia, Togo and Mexico. This new research has shown that mindset-oriented entrepreneurship training, emphasizing gains in psychological attributes such as confidence, grit and personal initiative, can have much larger impacts on catalyzing business growth (Frese and

[26] McKenzie, David and Woodruff, Christopher 2013. "What Ae We Learning From Business Training and Entrepreneurship Evaluations?" IZA Discussion Paper 6895, IZA, Bonn.

Glaub (2014)[27], Alibhai et al (2016)[28] Campos et al 2017[29]) and improving access to finance. The project will therefore incorporate non-cognitive skills development into the approach to BDS, alongside training aimed at improving financial practices. The design of the BDS component also takes into account lessons learned from previous and ongoing World Bank Group engagements in Madagascar, such as the IFC's SME Solutions Centre, and the Integrated Growth Poles and Corridor Project 2 (P113971), and from lessons learned from consultations with local BDS providers, such as the Centre de Gestion Agree and the Chambers of Commerce.

50. **The inclusion of a dedicated impact evaluation component within the project is based on lessons learned in generating rigorous evidence on the impact of project interventions and approaches.** The inclusion of an impact evaluation component builds on successful collaboration between the Finance & Markets GP (F&M) and the Gender Innovation Lab (GIL) on the impact evaluations embedded in an MSME support project in Ethiopia, the Women Entrepreneurship Development Project (WEDP). The partnership in Ethiopia has enabled F&M and GIL to pilot several innovative models for financing and supporting women entrepreneurs, which are now being replicated in other countries across the F&M portfolio also. Experience to date suggests that a separate impact evaluation component, with dedicated external funding, and a team of research specialists, is the ideal approach for generating evidence on the impact of project interventions. Based on this lesson learned, a DFID-supported Trust Fund has been secured to incorporate the support of the World Bank's Gender Innovation Lab and a core impact evaluation team has been assigned to this project.

51. **International good practices suggest that in order to increase users' capability to utilize financial services and products, as they learn in different ways, it is important to recur to multiple messages.** In fact, if a message is repeated several times using different sources, the beneficiaries are more likely to understand and remember such message.[30]International good practices also suggest it is important to take advantages of teachable moments to ensure that the message is absorbed and retained by the beneficiary.[31]Further, evidence shows that associating traditional messages and channels (e.g., in person trainings, sketches, etc.) to non-traditional channels it can assist improving the overall financial capability of financial services users. Finally, more recent evidence also shows that specific type of messaging (i.e., nudges) can not only make users more financially capable but also induce them to live healthier financial lives: (i) In the Philippines, it was found that reminders received by consumers from their bank increased the likelihood of clients reaching a savings goal and increased the total amount saved. Reminders that referred to the client's pre-stated savings goal were even more effective in

---

[27] Frese, Michael and Glaub, Matthias (2014). "A critical review of the effects of entrepreneurship training in developing countries, Enterprise Development & Microfinance (EDM), Volume 22, Issue 4.

[28] Alibhai, Salman, Niklas Buehren, and Sreelakshmi Papineni (2016). "From Learning to Earning: An Impact Evaluation of the Digital Opportunity Trust (DOT) Entrepreneurship Training". Gender Innovation Lab Policy Brief Issue No. 17. World Bank Group.

[29] Campos, F., Frese, M., Goldstein, M., Iacovone, L., Johnson, H. C., McKenzie, D., & Mensmann, M. (2017). Teaching personal initiative beats traditional training in boosting small business in West Africa. Science, 357(6357), 1287-1290.

[30]J. Chien et al, "Good practices for financial consumer protection: 2017 edition", available at *http://documents.worldbank.org/curated/en/492761513113437043/Good-practices-for-financial-consumer-protection-2017-edition*

[31] J. Chien et al, "Good practices for financial consumer protection: 2017 edition", available at *http://documents.worldbank.org/curated/en/492761513113437043/Good-practices-for-financial-consumer-protection-2017-edition*

increasing the client's savings.[32](ii) In Nigeria, a national marketing campaign along with a lottery promoted savings and resulted in improvements in savings behavior and the use of financial products over the short-term.[33] (iii) In Colombia, Bancolombia customers were targeted with messages after opening an account, this messages allowed for increased in activity levels (active new accounts increased by 32.5 percent) and amount saved in accounts (average account balances by 50 percent).[34]

52. **The project is closely connected to other World Bank activities in Madagascar.** As discussed, the project concept builds strongly on the analytical work completed in the course of the 2015 FSAP. The project also builds on the implementation of the two technical assistance projects funded by FIRST Trust Fund related to microfinance supervision (P153761) and the strengthening of the National Payment System (P160684). The collateral registry activities of this project build on the findings of an ongoing IFC TA engagement in Madagascar.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

53. **The Ministry of Finance and Budget (MFB) will be the signatory of the IDA Credit.** The main government entities with overall responsibility for project implementation will be the MFB and the Central Bank of Madagascar (BCM).

54. **A Project Implementation Unit (PIU) will be established as a dedicated unit in the MFB.** The PIU will have full fiduciary responsibility for project implementation. The PIU's responsibilities will include procurement of hardware, software, business development services, capacity building related equipment and other consultancies as needed, as well as overall coordination between the component activities. It will ensure monitoring and evaluation (M&E) activities and ensure financial reporting obligations associated with the project. PIU staff should include at all times during project implementation, at a minimum, a Project Coordinator, a financial officer, an accounting specialist, a procurement specialist, an M&E specialist and an environment focal point. The PIU will extend to hire other specialists and support staff, as needed to perform its functions. The Project Coordinator will be responsible for management of the PIU and overall project coordination. The Procurement Specialist and Financial Management (FM) Specialist will provide regular support on all project procurements and financial management processes.

55. **A Project Steering Committee (PSC), chaired jointly by the Secretary General of the Ministry of Finance and Budget and the Governor of the Central Bank, will meet at least bi-annually to provide policy guidance and oversight for the project.** It will comprise representatives from all the relevant project stakeholders involved in the project's implementation. This includes the MFB (including the CNFI and Direction Générale de la Dette Publique- DDP), the BCM (including the CSBF), the Ministry

---

[32] D. Karla et al, "Getting to the Top of Mind: How Reminders Increase Savings," available at http://www.povertyaction.org/sites/default/files/publications/getting-to-the-top-of-mind.pdf.
[33] Lundberg and Mulaj,, "Enhancing Financial Capability and Behavior in Low- and Middle-Income Countries."
[34] M. Valenzuela, "Juntos Finanzas – A Case Study", available at *https://www.cgap.org/sites/default/files/Working-Paper-Juntos-Finanzas-A-Case-Study-Oct-2015.pdf*

of Justice (MoJ), the Ministry of Industry and Private Sector Development, the Association of Banks (APB) and the Association of Microfinance Institutions (APIMF).The Committee will be in charge of: (i) approving annual work programs and budgets; (ii) reviewing project reports including progress reports, audits, the mid-term review and implementation completion reports; and (iii) addressing any major problems affecting project implementation. If needed, participants of the PSC can delegate their responsibilities for specific PSC meetings to relevant staff.

56. **Three inter-related committees will govern the PPCG.** A PPCG Supervision Committee (SSC) shall be responsible for oversight of SOLIDIS Garantie to ensure that it implements its terms of reference defined on the basis of the 2014 Convention signed between the Recipient and SOLIDIS Garantie. The SSC shall include, inter alia, representatives from the MFB (or BCM) and shall meet at least bi-annually. A PPCG Orientation Committee (OC) shall be responsible for providing policy guidance on the operations of the Fund and proposing changes to the terms of reference of SOLIDIS as necessary. It shall include, inter alia, representatives from the MFB, (or BCM), the professional association of banks, the professional association of micro finance institutions, and two experts chosen for their knowledge of financial sector issues and meet at least bi-annually. Finally a PPCG Remuneration Committee (RC), responsible for validating SOLIDIS requests for increases in honoraria which will then be submitted for non objection to the Association. The RC shall include, inter alia, representatives from the MFB, the professional association of microfinance institutions, the professional association of banks.

57. **A Project Implementation Committee (PIC), consisting of director-level staff of the main implementing organizations, will meet every second month to coordinate the implementation of the project.** The project will need to ensure that planning, implementation, and monitoring are adequately coordinated across key stakeholders. The project will address this through the establishment of a Project Implementation Committee that will meet every second month and ensure a smooth implementation and coordination on the basis of a common action framework. The committee will include representatives from each relevant stakeholder and PIU[35].

58. **Working groups will coordinate the progress on subcomponents of the project.** The CNFI, Ministry of Finance and the Central Bank are expected to establish a working group to coordinate the financial education activities. The Ministry of Finance, the Central Bank and the APIMF are expected to establish a working group to prepare and follow-up on an action plan for a mutualized MIS for MFIs. Other working groups can be proposed and established by project stakeholders, as needed.

59. **A project preparation advance (PPA) and retroactive financing (RF) will be used to advance with project preparation, including a Project Operations Manual (POM), ahead of project effectiveness and ensure timely implementation.** The PPA will be used to establish the PIU at the MFB, start analytical studies and preparation of the POM, ahead of project effectiveness. The POM will include all periodic reporting, monitoring and evaluation arrangements throughout the life of the project including annual independent operational audits, which will provide impact assessment of the various project components. The RF will fund a first tranche capital increase for the PPCG (US$ 2.5 million)

[35] The Project Implementation Committee (PIC) will include the PIU Coordinator, representatives from the World Bank Project Team as well as one representative for each of the main government counterparts that will support the project’s implementation. The World Bank will be the Secretariat of the PIC.

and the upgrade of the Real Time Gross Settlement /Automated Clearing House (RTGS/ACH) systems (US$2.9 million).

B. Results Monitoring and Evaluation

60. **The monitoring and evaluation (M&E) system will be based on the agreed Results Framework and monitoring arrangements.** The framework is meant to measure project activities using the indicators described in Section VII. Project design has been guided by a result framework intended to be useful for both project management and World Bank supervision. A set of additional indicators will then be collected for monitoring purposes during project implementation, including the additional indicators reported in Annex 8. The results framework focuses on the project development objective (PDO) to be achieved and the intermediate outcomes expected. The PIU will be responsible for conducting M&E activities, and a dedicated M&E Specialist will be hired for this task at effectiveness. Baseline data for all the agreed indicators will be verified and confirmed by the PIU in partnership and collaboration with the designated technical staff in each implementing agency within the first six months of project implementation.

61. **The PIU will remain responsible for the data collection, management, and monitoring of the agreed project development outcome indicators.** The primary monitoring mechanism will be quarterly reports and annual reports prepared by the Project Coordinator and presented to the Steering Committee. These reports will assess achievements against the Project Implementation Plan (PIP) and overall project progress using the indicators defined in the results framework. All reports will be submitted to the World Bank and shared with other development partners when needed. A mid-term review will be carried out at the half way point of the project. An Implementation Completion Report (ICR) will be undertaken after completion of the project. The project will incorporate a citizen engagement feedback loop, as described below.

62. **The project's impact evaluation will conduct rigorous, randomized evaluations of two specific project components: the digitization of teacher salaries, and financial capabilities.** Data collection for these studies will be conducted separately from and in addition to regular project data collection, and will be in the form of beneficiary surveys administered by a local survey firm. Design of the impact evaluation studies and data analysis will be supported through a separate impact evaluation trust fund. These studies will provide evidence on the impact and key lessons in increasing utilization of transaction accounts and digital financial services.

C. Sustainability

63. **The project is using existing structures and institutions to deliver services and support.** Considerable time and effort has been invested in ensuring the involvement and commitment of all implementing agencies, and none of the components contain any costly interventions that cannot be financed by the Government of Madagascar after the project ends.

64. **Several design features aim to ensure sustainability of the development impact of project component 1 on increasing "usage of transaction accounts".** To ensure that the digitalization of government payments is continued beyond the lifetime of the project, project funding for e-money

transaction fees will be gradually reduced during project implementation – helping the government to develop the habit to budget and pay for these services. Key equipment purchased by the project (including the mutualized MIS and the NPS infrastructure) are expected to be maintained by project stakeholders after project implementation. Beyond these, sustainability of development impact will be ensured by (i) the additional socialization of digital finance and e-money accounts that will be generated by project activities, including financial education, and (ii) the technical know-how gained by the Government and MFIs, including through TA financed by the project and the development of a modus-operandi between the Government, MFIs and e-money providers.

65. **The development impact of project component 2 "access to credit for MSMEs" is also expected to be sustained.** The project will encourage banks and MFIs to lend and gain experience handling currently underserved customers, Madagascar's MSMEs. This learning-by-doing effect will support the growth of a nascent market – socializing both lenders and borrowers. The PPCG is designed to maintain its capital and it is hoped that it will become a permanent feature of Madagascar's financial market. The Fintech adoption subsidized by the project, if successful, will be maintained by participating institutions beyond the project – and possibly eventually be replicated by other market participants. The provision of BDS to MSMEs will strengthen the capacity of local training providers as well as participating businesses. If the training proves effective, it could catalyze a scale-up of the program by the Government. To ensure sustainability of the MFI network expansion, the project will only offer limited cost-sharing and allow MFIs to select which underserved region to enter. The aim is to finance branch expansion into underserved areas in which there is a reasonable business case for MFI activity (even once project support ends). The centralized collateral registry, once set up, will be maintained and sustained by the Government. Finally, the CSBF is expected to maintain consumer protection measures put in place with support of the project.

D. Role of Partners

66. **The proposed operation is part of a program of coordinated reform dialogue on financial sector development with other development partners.** The *Cadre de Partenariat*, co-chaired by the Ministry of Finance and Budget and the World Bank, provides a forum for collaboration among development partners. The AFD has ongoing projects related to agent banking and access to finance for SMEs through a credit guarantee scheme. The team has coordinated closely with AFD during the project's preparation to exploit possible synergies. Moreover, parallel development policy operations of the World Bank, coordinated with all development partners, are supporting, among other reforms, important interventions on the regulatory framework for the microfinance sector, the e-money and the establishment of a private credit bureau.

V. KEY RISKS

A. Overall Risk Rating and Explanation of Key Risks

67. **The overall risk for this project is substantial.** Key risks and mitigation measures are discussed below.

68. **Political tensions and weak governance represent a high risk for this project.** Madagascar has a long history of disruptive political transitions and governance challenges. With the relative stability of recent years, the country has been able to make significant progress and initiate important reforms. However, the upcoming election, planned toward the end of 2018/early 2019, may intensify some of these drivers of fragility. Should fragility re-emerge, this may slow down or prevent project implementation.

69. **Macroeconomic risks are substantial, and are closely related to the political situation.** Madagascar's current positive macroeconomic developments rely on the continued access to development partner funding to finance the scale-up of infrastructure spending. Political events could, as they have in the past, disrupt these financing flows. Also, the budget could be disrupted by delays in the reform of key state-owned enterprises, including JIRAMA and Air Madagascar, or a major natural disaster, including hurricane or flood. In case macroeconomic and fiscal risks materialize, the development of the financial sector will be affected. If the macroeconomic environment deteriorates drastically, participating banks and MFIs, as well as the PPCG, may experience financial difficulties, which could put at risk project outcomes. Mitigating these risks, the IMF and the World Bank are continuing their support to Madagascar's fiscal framework through ongoing budget support operations. Madagascar's banks and the PPCG have strong capital buffers.

70. **This project is complex - risks linked to the technical design and stakeholder coordination are substantial.** This project contains a significant number of activities, many of which are complex and innovative. However, a range of factors help manage these risks. First, some of the project sub-components are designed as continuations of successful activities under the previous PASEF project. Second, the Government has demonstrated high implementation capacity under the previous PASEF project. Third, innovative activities (such as the digitalization of selected government payments) will be preceded by pilots to mitigate risk. Fourth, the project has been set up following a modular structure - so that components do not all depend on each other. Fifth, for those activities that require significant coordination between multiple stakeholders, the project has agreed to set up preparatory working groups to facilitate open channels of communication from the start. Sixth, the project has included substantial TA components to assist implementation.

71. **Institutional capacity is weak and represents a significant risk.** Weak capacity, particularly at the technical level, poses the risk that the actions supported by this program might not be implemented as successfully as expected or in the agreed timeframe, or that the capacity constraints prevent the attainment of the expected results. This operation mitigates these risks by building into the project intensive TA components throughout.

72. **Fiduciary risks remain substantial, despite the ongoing implementation of PFM reforms.** While there has been progress in implementing PFM reforms, the remaining fiduciary weaknesses are significant. They are partially mitigated by continued donor assistance in public financial management and public administration reforms, including the World Bank Public Sector Performance project. The appraisal summary below details key project-specific mitigation measures.

VI. APPRAISAL SUMMARY

A. Economic and Financial Analysis

73. **A strong public sector rationale has been established for all project interventions.** The project description in section III has already reviewed the costs and benefits of all project components. This section highlights the rationale for public sector intervention and the value-added of World Bank support.

Table: Rationale for Public Sector Intervention by Component
Component 1: Increasing usage of transaction accounts
Digitalization of government payments: yields significant benefits (lower transaction costs, transparency, socialization of transaction accounts, expansion of transaction accounts service points) that can only be unlocked by government action.
Digitalization of MFIs: Government funding is needed, given the tight liquidity situation faced by many MFIs, as well as the learning externalities (for the rest of the MFI community) generated by adopting digital finance in a few pilot MFIs.
Payments infrastructure: Government involvement is needed, since this infrastructure represents a public good used by all and is requested by the private sector.
Financial capability: Government involvement is needed, since messages from private companies are often interpreted as advertisement and financial education is a public good.
Component 2: Increasing access to credit for MSMEs
Capital increase for the Partial portfolio credit guarantee (PPCG): Poor credit information and creditor protection heighten adverse selection problems in Madagascar – excluding productive companies from access to credit and growth opportunities. Private credit markets alone do not achieve efficient economic outcomes. Given the considerable under-used liquidity of Malagasy banks, a guarantee can cost-efficiently incentivize lending and partially overcome these market frictions. In addition, the PPCG creates learning externalities – allowing banks and MFIs to learn how to adapt their business model to reach out to micro enterprises (including through the TA that accompanies the PPCG), while allowing MSMEs to learn to trust and understand how to use formal financial services to grow their business.
Innovation fund for Fintech adoption: Public involvement and funding creates an incentive for banks and MFIs to take the risk and explore how to integrate these new lending technologies in their business model – generating learning externalities for all.
Business development services (BDS): Public sector intervention is needed, since the private sector generally under invests in education (due to cash constraints or lack of foresight). A successful BDS pilot, funded through the Government, could catalyze further adoption of BDS by the private sector in Madagascar.
MFI branch expansion: Public sector funding is needed, since branch expansion gives access to basic financial services in remote areas. Many MFIs face liquidity constraints, which prevent branch expansion without additional funding.
Centralized electronic collateral registry: Public funding is needed, since this registry is a public good – allowing lenders to share information on collateral.

Consumer protection: Consumer protection is a public good enjoyed by all

74. **The World Bank can contribute to these interventions** through (i) funding support, (ii) technical assistance given its extensive previous experience on financial sector interventions in Madagascar and the world and (iii) its convening power, since many of the activities listed above require close coordination between different government entities and various private sector actors.

75. **Extensive simulations have been prepared to calibrate the size of the capital increase of the PPCG under this new project (see annex 6).** The capital increase has been designed to ensure that (i) the guarantee fund can continue its uninterrupted growth over the coming years, (ii) the guarantee fund remains sustainable and preserves its capital beyond the lifetime of the project and (iii) capital buffers remain large enough to be credible relative to the volume of loans guaranteed. Under the baseline scenario, increasing the capital endowment of the PPCG from US$4 million to US$12 million (as envisaged under this project) will allow for continued growth of the PPCG guaranteed loan portfolio by 30 percent annually until 2022 (in line with the envisaged growth in demand for the guarantee).

B. Technical

76. **The technical merits of the project design have been examined by World Bank staff over the course of project preparation and are considered to be sound and in line with international standards.** The design is grounded in a series of analytical diagnostics over the past few years, including the analysis and recommendations from the FSAP, implementation of the two TA FIRST funded activities related to microfinance supervision and the strengthening of the National Payment System, and the IFC TA funding on Collateral Registry Reforms in Madagascar. A number of detailed technical assessments have been conducted by the project team to inform the preparation of the project, including analyses of the microfinance and banking sectors, a pre-assessment of the context for implementing a national transaction processing platform (SWITCH) and simulations to evaluate different scenarios for a PPCG capital increase. Some of these additional technical analyses are included as annexes to the project document.

C. Financial Management

77. **The overall risk for the Project is rated substantial, due mainly to the inherent country-level fiduciary risk, but also partly due to the lack of experience with respect to project management of the Financial Operations Department (DOF) within the Treasury General Directorate of the Ministry of Finance, which will implement the project.** It is considered that PIU financial management arrangements will meet the World Bank's minimum requirements under World Bank Policy and Directive once the mitigation measures are implemented. The mitigation measures will be mostly implemented with the Project Preparation Advance and are comprised of: (a) the recruitment of qualified and experienced FM staff composed of one Financial Manager and one Accountant for the PIU, (b) the development and adoption of a FM procedures manual as part of the POM, (c) the purchase of an adequate accounting system for the PIU. Annex 9 expands on the financial management assessment for this new project.

D. Procurement

78. **The procurement assessment revealed limited capacity and little prior experience in managing World Bank funds by the DOF.** These risks will be mitigated by an early recruitment of a qualified and experienced project Procurement Specialist using the project preparation advance. This risk will also be mitigated by the preparation of a Financial Procedures Manual including procurement procedures and appropriate complaint resolution system in accordance with the Regulations. Appropriate fiduciary arrangements will be in place to ensure smooth implementation of the project. Continued close monitoring and mitigation of any potential risks will be made possible by regular progress and fiduciary reports, the World Bank's supervision and continued capacity building.

79. **Ahead of project implementation, a Project Procurement Strategy for Development (PPSD) has been elaborated with the collaboration of DOF and BCM and, at the end, an acceptable procurement plan covering the first 18-months of project implementation has been prepared.** World Bank procurement rules and procedures will be applied. Continuous monitoring and mitigation of any potential risk will be made possible through regular reporting on the progress and implementation of fiduciary activities, regular supervision, and further capacity-building, as necessary. Finally, the World Bank's fiduciary team will provide additional support for the implementation of the project. The DOF and the BCM will be trained and use the World Bank's online procurement planning and tracking tools (STEP) for preparing, clearing, updating Procurement Plans and conducting all procurement transactions for the Projects.

80. **Madagascar's national procurement procedures are widely used for local World Bank projects.** The Financing Agreement includes the obligation of suppliers to respect the World Bank's Anti-Corruption guidelines (art 4- III of the national Code) and the right for World Bank audits. Other elements of paragraph 5.4 of the Procurement Regulations for World Bank Borrowers are already under implementation by the Borrower. However, in accordance with paragraph 5.6, it is not evident that the quality of procurement is taken into account. To ensure compliance with the Procurement Regulations for IPF Borrowers, assistance from World Bank staff is therefore forecast during implementation, including through training and procurement clinics.

E. Social (including Safeguards)

81. **The project will have positive social benefits for beneficiaries mainly through improved financial infrastructure, financial education and consumer protection; no negative social impacts are expected to result from this project.** The project will not involve any activities that will result in land acquisition, physical displacement, economic displacement or any other form of involuntary resettlement as defined by OP 4.12. No civil works will be scheduled under the project.

82. **The project will incorporate a citizen engagement feedback loop by surveying a sample of beneficiaries.** Citizen engagement feedback will be collected annually by surveying a sample of project beneficiaries. A citizen engagement questionnaire will be provided to a sub-set of beneficiaries and designed to assess overall satisfaction of services (including ease of access, quality, process, disclosure, responsiveness of needs, etc). In addition, the project will also develop a grievance redress mechanism (GRM) which will allow beneficiaries to raise their concern related to project actions.

These actions will be led by independent third parties or NGOs recruited by the project. The results of the survey and information related to the GRM will be analyzed and assessed in a report, which will also contain proposed recommendations for project adjustments informed by citizen feedback. The survey results and the report will be shared by the PIU and will inform the overall project implementation, as appropriate.

F. Environment (including Safeguards)

83. **Since the Partial Portfolio Credit Guarantee (PPCG) under the project will provide guarantees to finance activities which will only be identified in the course of project implementation, an Environmental and Social Management Framework (ESMF) has been prepared.** This project has been classified as Category FI and an Environmental Assessment OP 4.01 is triggered owing to the activities of sub-borrowers who will benefit from credit guarantees under the Partial Portfolio Credit Guarantee (PPCG) Program (Component 2.1 of the project). However, the sub-borrowers who benefit from the guarantees under the program are not identified in advance. The PPCG is an existing program under the previous PASEF project and will be expanded under the current project. Based on PASEF data and consultation done with the Participating Financial Institutions (PFIs) during project preparation, sub-borrowers are MSME's who are engaged in a variety of sectors including trade, services, transport, constructions, and agriculture. The sub-borrowers covered under the PPCG vary in size from "micro" to "medium" and the environmental impacts vary from moderate to low and may be mitigated with generic mitigation measures. Under PASEF, 3 Category B projects were covered, and the rest were Category C. The PPCG is managed by a private Malagasy guarantee fund manager SOLIDIS Garantie, ensuring that it can quickly respond to claims by PFIs and that sustainable arrangements are in place that allow the Fund to continue operating without World Bank support. SOLIDIS Garantie is licensed, regulated and supervised by the financial sector supervisor. The guarantee is flexible and adapted to the needs of PFIs. The PFIs determine with the Fund manager the maximum volume of loans they can enter in the guarantee. The guaranteed loans are made with private funds by private banks and MFIs.

84. **The ESMF has been elaborated in consultation with key existing stakeholders**, including local banks, MFIs and the recipients of micro-finance. The ESMF is an update of the framework successfully used for the PPCG under the previous PASEF project. The PFIs' environmental and social responsibilities has been clarified and reinforced. The environmental and social screening process at PFIs and SOLIDIS Garantie has been improved. Overall, the procedures put in place under the PASEF project are strong and implemented in compliance with the PASEF ESMF[36], the project operational manual and the principles in the agreements signed with the PFIs. Under the current PPCG, the Project Coordination

[36]The proposed screening has two levels. In a first screening, sub-projects will not be further considered if they are part of an Exclusion List of Activities (ELA). Ineligible activities include the following: (i) activities classified as Category A, according to World Bank OP 4.01; (ii) all activities/subprojects that could trigger World Bank OP 4.12 on Involuntary Resettlement and OP 4.04 on Natural Habitats; and (iii) activities that are prohibited for World Bank Group lending, including IFC's exclusion list. In a second level of screening, eligible activities are selected as follows: (i) activities classified as Category B, according to World Bank OP 4.01, where the proposed subproject/activity presented by the PFIs to be registered under the PPCG has received an environmental license delivered by the Malagasy Environmental Authority (National Environmental Office (NOE) and has been implemented in a manner satisfactory to the Environmental and Social Management Framework (ESMF), and monitored by the Malagasy Environmental Authority with conformity certificate delivered by NEO; (ii) activities classified as Category C according to World Bank OP 4.01(i.e. negligible or no environmental and social impacts).

Unit, SOLIDIS Garantie and a part of existing PFIs have a good experience in implementing the ESMF. During the preparation of this new project, most PFIs say that the environmental rules do not represent a constraint. PFIs should verify that loans are compliant with the environmental and social specified in the ESMF, requesting necessary information from the end-borrower on the detailed implementation of ESMF. If the PFI submits a claim to the PPCG for a delinquent loan, the PFI needs to demonstrate to the guarantee fund manager that the underlying loan is compliant with the environmental and social due diligence specified in the ESMF.

85. **The World Bank Safeguard team will provide training to help key stakeholders implement the ESMF under the new project.** The safeguard team will assist and train the PIU and the PPCG guarantee fund manager to build up their capacity to manage the environmental and social risks described in the ESMF. For the PFIs, completion of an ESMF training and adoption of social and environmental responsibility standards through the agreement with the PPCG will be a precondition for adhering to the PPCG.

86. **To ensure compliance with the ESMF, the PIU will include an environment focal point full time to support the PFIs and SOLIDIS Garantie.** PFIs have the main responsibilities to ensure that the sub-borrower/credit meets all the eligibility criteria (including the environmental and social requirements, using the process outlined in the ESMF, to conduct environmental and social due diligence of individual sub-borrowers and their activities). They need to request necessary information from the sub-borrower and submit completed files to SOLIDIS Garantie. When a claim for a delinquent loan has been submitted by a PFI, SOLIDIS Garantie reviews the request and ensures that the claim meets all eligibility criteria included the environmental requirements. For Category B projects, SOLIDIS Garantie, with the support of the environmental consultant at the PIU level, will carry out a document review of the implementation of the sub-project's ESMF through conformity certificate delivered by NEO. SOLIDIS Garantie can reject the payment of a claim if the environmental requirements have not been met. In the PFIs, Credit officers are operational to review environmental and social compliance with Malagasy National Environmental Law. The PIU within the MFB will be responsible to implement the ESMF and an environmental and social specialist will be a key and integral part of the team. Progress Reports (PR) shall document the progress of ESMF implementation. The ESMF implementation budget is included in the project operational cost. The World Bank safeguard team will continue to assist and train the PIU and SOLIDIS Garantie to build up their capacity on the management of environmental and social risks described in the ESMF.

87. The updated ESMF has been elaborated in consultation with key existing stakeholders, including local banks, MFIs and the recipients of micro-finance. The Borrower's updated ESMF has been submitted to the World Bank's review and approval at the World Bank's Regional Safeguards Advisor (RSA). The cleared ESMF has been disclosed in the country on December 21, 2017 and in the Infoshop on December 22, 2017.

G. Other Safeguard Policies

Gender

88. **The project will aim to address key constraints faced by women-owned enterprises and female-**

headed households, in line with the World Bank Madagascar SCD (2015) and CPF (2017). Gender-related disparities in access to finance in Madagascar affect women's ability to cope with shocks, save for the future and operate higher productivity enterprises. More than two thirds of women are in a low-skilled activity against one third of men. Female entrepreneurs are also less likely to own and operate a multi-worker micro-enterprise, and more likely than men to own and operate a less profitable single-worker activity.[37] According to the 2013 Enterprise Survey, women relied on credit as much as men, but they were more likely to report access to credit as a problem. The Survey also indicated that only 20 percent of firms have majority female ownership and 28 percent of firms have a female top manager.

89. **The project will specifically target female-headed households, and female entrepreneurs.** Through component 1, the project will digitalize salary payments to teachers. A large majority of teachers in Madagascar are women. The component 2 BDS offerings will include modules specifically tailored for women entrepreneurs. Mind-set oriented trainings, in particular, have been shown to be effective for female entrepreneurs.[38]Through the innovation fund in component 2, the project will explore piloting innovative mechanisms that could help increase access to finance for women-owned SMEs, such as fintech collateral alternatives, or innovative appraisal tools. The centralized registry for moveable collateral will particularly benefit women, which tend to be more dependent on this type of collateral. In a follow-up project, a new window within the PPCG for women small entrepreneurs might be considered

90. **An impact evaluation embedded into the project, and designed by the World Bank's Gender Innovation Lab, will also aim to capture heterogeneous impacts of the project, particularly by gender.** Impact evaluation survey samples will be stratified by gender to ensure that representative data is captured on female-owned firms.

H. World Bank Grievance Redress

Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit *http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service*. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

[37]World Bank (2014). "Face of Poverty in Madagascar: Poverty, Gender, and Inequality Assessment."
[38]Campos, F., Frese, M., Goldstein, M., Iacovone, L., Johnson, H. C., McKenzie, D., & Mensmann, M. (2017). Teaching personal initiative beats traditional training in boosting small business in West Africa. Science, 357(6357), 1287-1290.

VII. RESULTS FRAMEWORK AND MONITORING

Click here to enter text.

Results Framework
COUNTRY : Madagascar
Madagascar Financial Inclusion Project

Project Development Objectives

The development objective of this project is to promote the financial inclusion of individuals and MSMEs in Madagascar.

Project Development Objective Indicators

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: Number of currently unbanked (i) FRAM teachers/students that receive their government salary/scholarship and (ii) businesses that pay the "impot synthetique" through a transaction account		Number (Thousand)	0.00	130.00	Biannual	Ministry of Finance payroll data	PIU
Description:							
Name: Number (cumulative) of MSME borrowers that banks and MFIs have		Number (Thousand)	0.00	5.00	Quarterly	Guarantee fund manager database	PIU

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
registered under the partial portfolio credit guarantee since effectiveness of the project							
Description:							

Intermediate Results Indicators

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: The number of MFIs that allow loan repayment through a mobile money account ("wallet-to-account")		Number	0.00	2.00	Annual	MFI survey	PIU
Description:							
Name: Shared MIS developed and operational		Yes/No	N	Y	Annual	APIMF survey	PIU
Description:							

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: National Switch developed and operational		Yes/No	N	Y	Annual	APB and APIMF survey	PIU
Description:							
Name: Number of consumers reached by the financial education campaign via mobile phone messages		Number (Thousand)	0.00	60.00	Quarterly	Survey of firm contracted with financial education campaign	PIU
Number of female consumers reached by the financial education campaign via mobile phone messages		Number (Thousand)	0.00	30.00	Quarterly	Survey of firm contracted with financial education campaign	PIU
Description:							
Name: Percentage of loans extended to MSMEs registered under the portfolio guarantee that are non-performing		Percentage	1.70	3.00	Quarterly	Guarantee Fund Manager	PIU
Description:							

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: Number of enterprises reached with BDS		Number	0.00	500.00	Quarterly	BDS provider database	PIU
Number of women-led enterprises reached with BDS		Number	0.00	250.00	Quarterly	BDS provider database	PIU
Description:							
Name: Number of clients of the new MFI branches established through the project		Number (Thousand)	0.00	20.00	Biannual	MFI's selected for branch expansion	PIU
Number of female clients of the new MFI branches established through the project		Number (Thousand)	0.00	8.00	Quarterly	MFIs selected for branch expansion	PIU
Description:							
Name: Banks and MFIs report data to a centralized electronic collateral registry		Yes/No	N	Y	Quarterly	Collateral registry management unit	PIU
Description:							

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
Name: Percentage of banks and microfinance institutions reporting data to the CBSF on financial consumer complaints		Percentage	0.00	30.00	Quarterly	CSBF	PIU
Description:							
Name: Report drafted annually on Citizen Engagement Survey		Yes/No	N	Y	At target date	Citizen Engagement Survey	PIU
Description:							
Name: Number of currently unbanked female (i) teachers/students that receive their government salary/scholarship and (ii) businesses that pay the "impot synthetique" through a transaction account		Number (Thousand)	0.00	65.00	Biannual	Ministry of Finance payroll data	PIU
Description:							

Target Values

Project Development Objective Indicators

Indicator Name	End Target
Number of currently unbanked (i) FRAM teachers/students that receive their government salary/scholarship and (ii) businesses that pay the "impot synthetique" through a transaction account	130.00
Number (cumulative) of MSME borrowers that banks and MFIs have registered under the partial portfolio credit guarantee since effectiveness of the project	5.00

Intermediate Results Indicators

Indicator Name	Baseline	End Target
The number of MFIs that allow loan repayment through a mobile money account (“wallet-to-account”)	0.00	2.00
Shared MIS developed and operational	N	Y
National Switch developed and operational	N	Y
Number of consumers reached by the financial education campaign via mobile phone messages	0.00	60.00
Number of female consumers reached by the financial education campaign via mobile phone messages	0.00	30.00
Percentage of loans extended to MSMEs registered under the portfolio guarantee that are non-performing	1.70	3.00

Indicator Name	Baseline	End Target
Number of enterprises reached with BDS	0.00	500.00
Number of women-led enterprises reached with BDS	0.00	250.00
Number of clients of the new MFI branches established through the project	0.00	20.00
Number of female clients of the new MFI branches established through the project	0.00	8.00
Banks and MFIs report data to a centralized electronic collateral registry	N	Y
Percentage of banks and microfinance institutions reporting data to the CBSF on financial consumer complaints	0.00	30.00
Report drafted annually on Citizen Engagement Survey	N	Y
Number of currently unbanked female (i) teachers/students that receive their government salary/scholarship and (ii) businesses that pay the "impot synthetique" through a transaction account	0.00	65.00

ANNEX 1: DETAILED PROJECT DESCRIPTION

COUNTRY : Madagascar
Madagascar Financial Inclusion Project

91. **This annex elaborates on the project structure and details the activities contained under each component.** It thus expands on the project components introduced in Section 2 of the main document.

Component 1: Digitalization of transactions

Subcomponent 1.1: Digitalization of Government Payments (G2P/P2G)

Digitalization of teacher salaries and scholarships

92. **Today, 10,782 teachers and 15,408 auxiliary teachers (maitres FRAM) receive their salary in cash, and 90,252 students receive their scholarship in cash.** Many of these teachers work in rural areas without proximity to a bank branch or earn too low incomes to justify the relatively high fees charged by bank accounts. Every month, these teachers therefore undertake the often time-consuming - and sometimes dangerous - journey to local government offices to collect their salaries in cash. Children are left without teachers for several days every month. The scholarships are distributed to the students by each of the 6 universities, a fastidious and unsecured process. Enabling salary and scholarship payments to transaction accounts could save time, encourage take-up of digital financial services and limit fraud. Enabling account payments will particularly benefit women. The majority of Madagascar's teachers are female. These stand to gain particularly from increased privacy and control over their finances within their household, as salaries and resources they earn are transferred to an account instead of paid in cash.

93. **The project will support the digitalization of FRAM teachers' salaries (and the initiation of the digitalization process for civil servants teachers, for which exact data were not immediately available) and of scholarships for university students, with a pilot phase and a national roll-out.**[39]The pilot phase will include about half of the teachers payments and three out of the six universities for scholarship payments for a duration of six months, to allow for an impact evaluation. The activities will be as follows:

- the financing of the required technical platform at the level of the Treasury, allowing a single interface between the Treasury and the National Payments System and payment services providers;

- the fees paid to payment services providers by the Treasury, and the cost of one withdrawal (cash-out) per month for each recipient (to make the digitalization cost-free for the recipient to allow for familiarization and awareness of the benefits of digitalization). It has been estimated that the payment services providers will charge 6 percent of the total value of the payments they will make on behalf of the Treasury, to deploy the network required to reach teachers in rural, remote areas. The level of

[39] The national roll-out would exclude areas without mobile phone coverage.

fees will be reassessed on a yearly basis between the Treasury and the payment services providers, with the progressive amortizing of the cost of the network deployment and the growth of the ecosystem. The support of the WB will be progressively phased out over the lifetime of the project, as the cost of cash management for the Treasury will decrease and the cost of the service provided by payment services providers should be progressively included in the national budget.[40]

- the technical assistance to the Treasury to (i) review internal processes and implement the new payment procedures; (ii) review and complement the regulatory framework for Government payments.

- the cost of the design and roll-out of accompanying measures to educate teachers and students on the access to and use of transaction accounts and electronic payments through project subcomponent 1.3.

- in addition, the project will finance a mapping of all national and local government payments and major employers' payment streams, developing an action plan to extend the digitalization of government payments beyond teacher salaries and students scholarships to other Government expenses.

Digital collection of taxes

94. **Government collections can also be leveraged for financial inclusion purposes, as individuals and businesses without access to transaction accounts have to make payments to government entities.** From a broader perspective, P2G experiences in an increasing number of countries show that robust e-government programs foster the use of electronic payments, boosting the efficiency of public administrations, businesses and individuals, and that of the National Payments System. The Government of Madagascar has already started pilots on the collection of the synthetic tax for small businesses (*impôt synthétique*), collected at the level of the national government, and the local market tax (*taxe de marché*), collected at local level. A city (Mahajanga) has implemented the collection via e-money of the tax paid by the merchants to occupy a spot in the market, to increase transparency, traceability and efficiency of local tax collection, limit the misappropriation of local resources, familiarize small merchants with transaction accounts and electronic transactions. The project will replicate the experience of Mahajanga in another city, where the municipal team is interested in and committed to the digitalization of local taxes.

95. **The project will support the digitalization of a national tax (impôt synthétique) and the extension of the market tax pilot from Mahajanga to another major city.** This will include:

- The financing of the technical connection between the *Direction Générale des Impôts* (impôt synthétique) and the payment services providers, or the database and interface for the municipality (*taxe de marché*);

- the fees paid to payment services providers (estimated at 3 percent) the cost of the disbursements

[40] E-money providers are working on a common proposal, at the request of the local administration.

billed by the payment services providers. The support of the WB will be progressively phased out over the lifetime of the project, as the cost of cash management for the DGI will decrease and the cost of the service provided by payment services providers should be progressively budgeted.

- the technical assistance to the *Direction Générale des Impôts* to (i) review internal processes and implement the new tax collection procedures; (ii) review and complement the regulatory framework for taxes collection.

Subcomponent 1.2: Digitalization of MFIs

96. **Madagascar's MFIs play a key role in bringing financial services to poor and remote individuals and businesses, but they require support to leverage the power of digital finance.** In contrast to e-money providers, which offer transfer, cash-in and cash-out services, MFIs promote a broader set of financial products, including savings, credit, insurance and financial education. In contrast to banks, MFIs focus on reaching smaller and more remote customers that often have limited formal documentation and collateral. As such, MFIs fulfill a key role in Madagascar's financial landscape. Nonetheless, their network of 4.6 points of service per 100,000 adults remains limited (though already larger than the branch network of banks). This project subcomponent aims to broaden the reach of MFIs by helping them to leverage the power of digital finance. It consists of activities to strengthen the front office and back office of MFIs:

- Front office: digitalize front office operations of MFIs (clients/members' registration, loans disbursement and collection, financial education)

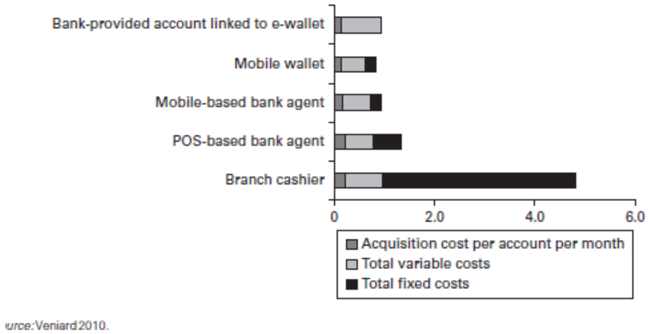
- Back office: Build the foundations for digitalization through the improvement of the back office, especially the MIS.

Front office: integration of MFI's mobile services

97. **Madagascar's population predominantly lives in rural areas, often far from MFI branches.** and is characterized by a low density with 41.7 people per km2 (2015). At the same time, seven (out of twenty-one) regions in the country (i.e. Analamanga, Vakinankaratra, Alaotra Mangoro, Analanjirofo, Atsinanana, Sava and Itasy) host more than 65 percent of microfinance points of service.

98. **In this environment in particular, the business model of microfinance services based on the traditional system of physical branches generates important transaction costs.** Currently, MFIs require customers to travel to their branches in order to make or withdraw deposits, request or repay credits. Transaction costs are high both for the institution (e.g. physical infrastructure, operating costs) and for the customer (e.g. transport costs, safety concerns of moving cash physically, waiting time in the agencies, etc.). In summary, the provision of financial services via branches is one of the most expensive methods of distribution as illustrated in the following figure.

Figure 5: Monthly cost in dollar associated with transaction accounts



Source: Microfinance Handbook (2016)

99. **This project therefore supports the digitization of MFIs operations, referring to the use of mobile phones to deliver financial services (savings and credit) and non-financial services (financial education) to microfinance clients.** The aim is to reduce transaction costs for the institution and its current clientele, to secure transactions and to increase the reach of MFI services to include remote regions and customer segments. Madagascar's mobile phones recorded strong growth. Forty-six percent[41] of the Malagasy population has mobile phones, far exceeding Internet access, which covers less than 4 percent of the population. The mobile phones market comprises three major players Orange (approximately 6 million subscribers), Airtel (3.5 million), Telma (3 million)[42].

100. **The digitalization of MFIs will encompass a range of potential functionalities (to be agreed with each participating MFI):**

- the integration of MFIs with mobile money platform to offer account-to-wallet services to their clients: the wallet-to-account link will offer the possibility to make the transactions at any time (no more limitation to the opening hours of the MFI branch).

- the digital processing of new clients and loan applications: loans officer will be equipped with mobile devices and digital applications allowing them to perform transactions in the field. Devices and applications will be functional in off-line (with synchronization once in an internet zone) and online mode.

- the use of push SMS (text and audio): the use of SMS to carry out reminders to customers of repayment schedules thus enabling them to avoid penalties for delay in reimbursement. The SMS will also be used to encourage good financial behavior including the savings.

101. **Key activities under this project sub-component are:**

- Selection of partnering MFIs: a call for expressions of interest to select a maximum of three to four MFIs for digitalization pilots. Key selection criteria will include: (i) being involved in a microfinance activity; (ii) institutional stability and governance; (iii) compliance with prudential requirements of

[41] http://donnees.banquemondiale.org/pays/madagascar
[42] Enclude, 2017: Rapport projet Banque à Distance

CSBF; (iv) having an automated and updated MIS; (v) financial performance; (vi) priority to institutions that have already initiated reflections / actions on the digitization of their services to rural or excluded segments (individual and MSMEs); (vii) focus on institutions that have a capacity for rapid growth in the years to come to serve a greater number of excluded users in a cost-effective way.

- MIS audits to fully assess the existing capacity of MFIs to integrate with mobile network operator (MNOs) electronic money platforms and offer wallet-to-account services: the integration will allow a customer to access anytime his account in the MFI as well as allow the collection of savings and disbursement of credit. This link requires a high level of integration between the MIS of the MFI and the MNO platforms. To this end, an audit of selected MFI MIS will be conducted to determine the level of integration between their MIS and the operator's electronic money platform.

- Selection of the technology solutions provider: a call for tender will be launched for the acquisition of hardware and software, delivery, installation and configuration for the digitization of operations (e.g. client registration, credit process, application and equipment), integration with MNOs, technical assistance to MFIs on the use of the technology. The technological solution must be in French.

- Technical assistance at both institutional and operational levels to selected MFIs: The digitization of the operations recommended in this project will require assistance to MFIs in managing the change that the use of technology will bring in the business model. Assistance will be at two levels: institutional and operational. The digitization of the MFIs' operations involves a strategic partnership and collaboration with the MNOs, bringing a certain fear among MFIs over the possibility of not being able to negotiate a favorable partnership. Capacity development of partnering MFI staffs will be implemented on the use of the digital solution, its marketing and communication towards the customer, the design and / or refinement of digital products. Each partnering MFIs will have technical assistance.

Back office: Mutualized MIS

102. **Many Malagasy MFIs lack an automated and well performing MIS.** Very few of them work in real time (unified databases) and many of them still work on Excel. This poses enormous challenges for them to report to the supervisor, to the *Centrale des Risques* and, above all, limits their capacity to offer digital services to their customers. Without external support, most of medium and small MFIs cannot acquire an automated MIS and lack qualified human resources to manage it.

103. **The project therefore proposes to fund a mutualized MIS that can be used remotely by MFIs**. This proposed shared-use MIS will be open to all MFIs wishing to outsource this service and will be linked to a capacity building program in internal control and governance. The activities envisaged are:

- Establishment of a shared-use MIS for small and medium MFIs: an assessment of MFIs without an automated MIS will be conducted to determine the capacity and functionalities needed. From the results of this needs assessment, a call for tender will be launched for the establishment of a shared use MIS. The shared MIS will be jointly managed by with CSBF, APIMF, CNFI and the adhering MFIs as partners. Thus, MFIs that do not have an automated MIS can be a member and through the shared MIS computerize, process and secure their data without having to invest in a MIS specific themselves.

Through this shared-use MIS, MFIs will be able to manage in self-service mode, view data, record their transactions, draw monthly financial and management reports according to CSBF requirements. The services that will be offered by the center and the shared MIS include (i) the processing of all the data related to the clientele and accounting; (ii) preparation and generation of all financial reports required by law, in addition to a series of management reports; (iii) preparation and generation of a monthly bulletin board for the MFI; (iv) training in the use of the tools (software, etc.).

- Acquisition of equipment's and software for the shared MIS: A call for tender for the acquisition of the hardware and software, delivery, installation, configuration to the norms (CSBF, etc.) and technical assistance to adhering MFIs on the use of the solution and the pricing of the services will be launched. The software features will be defined in partnership with the CSBF to ensure that reports / documents / information provided by the shared MIS to its members (MFIs) comply with prudential standards. The shared MIS will be housed in the premises of APIMF for the first two years. The project will finance the equipment's, software, technical assistance to adhering MFIs on the use of the solution and the team in charge of the management and operationalization of the MIS during two years. The shared MIS will have a fully autonomous team within APIMF for the management and operationalization. The dedicated team will be composed of: IT manager and an operations officer. MFIs will have to pay membership and contributions fees to benefit from the services. The contribution fees of MFIs since the beginning will allow the center to constitute a reserve for supporting its activity beyond the lifetime of the project.

- **Capacity development in internal control and financial management to MFIs**. All MFIs using the shared MIS will benefit from technical assistance in internal control, governance and financial management. This technical assistance will be tailored to the needs of each MFI and implemented in partnership with the APIMF. Guidelines and factsheets for MFIs on internal control and financial management will be developed as well as on-site trainings.

Subcomponent 1.3: Enabling environment for increased use of transaction accounts

National Payments System Infrastructure

104. **The infrastructure components of the National Payments System are the necessary foundations for the emergence of digital finance.** Key infrastructures include (i) an interbank system for retail electronic funds transfers (i.e. an automated clearing house (ACH)); (ii) a mechanism or platform to allow for the interoperability of card and e-money payments ; (iii) a large-value interbank settlement system (i.e. a real-time gross settlement system (RTGS)); (iv) a robust communications infrastructure; and (v) an effective and efficient identification infrastructure. Absence of any of these infrastructure components hinders the national payment system from exploiting the potential benefits of modern payment instruments, and therefore adversely affects financial inclusion. In Madagascar, the foundations of the NPS infrastructures were established in 2009 with the implementation of the real-time gross settlement (RTGS) and automated clearinghouse (Télécompensation). However, they required upgrading. No incidents have been reported so far, but several hardware components needed to be renewed. In addition, there is a demand from the private sector to implement interoperability in order to support the uptake of electronic payments. The Central Bank has accepted to take the lead, with a strong involvement and cooperation of the stakeholders of Madagascar

financial sector, who will collectively agree on the governance structure and operating rules of the new platform. Activities supported by the project are:

- The renewal of the existing RTGS and ACH hardware as well as the hardware of the network supporting those systems (acquisition of hardware, delivery, installation and configuration of the hardware tocentral bank's main site and emergency site, update of documentation and procedures, migration of data and start-up of new hardware and support, technical and functional training);

- The support to the Central Bank and financial sector for the design and implementation of an interoperable platform for the clearing and settlement of retail payments -card and e-money payments- : acquisition of hardware and software, delivery, installation and configuration to BFM main site and emergency site, documentation and procedures, testing and start-up of the system, technical and functional training and support. The governance and rules of the structure will be agreed upon by the financial community under the leadership of the Central Bank;

- Technical assistance to support the central bank in the design, procurement, testing and implementation of the technical infrastructure of the platform;

- A survey on payments behaviors and costs: The survey will assess (i) on the demand side: individual and businesses payment flows and behaviors including the volume and value of payment flows, access points and uptake and use of a variety of payment instruments; (ii) on the supply side: payment services providers, with a geo localization of their network; and (iii) the costs associated with the use of retail payment instruments prevalent in Madagascar - cash, paper checks, debit cards, credit cards, prepaid cards, direct debit transfers, direct credit transfers, mobile money, paper vouchers , based on the methodology developed by the World Bank and their implications on individuals and businesses.

Financial capability

105. **Financial capability[43]has emerged as a priority area for financial inclusion, ensuring user's trust and understanding of formal financial services.[44]**Financial capability, defined as "the capacity of a consumer to make informed decisions and act in one's best financial interest, given socioeconomic and environmental conditions"[45]is key driver for financial inclusion.[46]In fact, it is fundamental to increasing trust in and use of formal financial services as well as in ensuring that consumers have access to products they understand and can use responsibly. This is even more important when new products and services are deployed. In fact, such services not only tend to be more complex in nature but also allow reaching a wider range of users with less familiarity with formal financial services.

---

[43] Financial Capability is generally defined as the capacity to act in one's best financial interest, given socioeconomic and environmental conditions. It encompasses knowledge (literacy), attitudes, skills and behavior of consumers with respect to understanding, selecting, and using financial services, and the ability to access financial services that fit their needs.
[44] See various guidance documents including: CPMI-WB, *Payments Aspects of Financial Inclusion;* WB, *World Bank Good Practices on Financial Consumer Protection;* G20, *Highly Level Principles for Financial Consumer Protection,* G20, *High Level Principles on Digital Financial Inclusion;* and several publications available at *http://responsiblefinance.worldbank.org/*
[45] World Bank Group. 2013a. "Financial Capability Surveys Around the World: Why Financial Capability is Important and How Surveys Can Help," World Bank, Washington, DC
[46] See generally: CPMI-WB, *Payments Aspects of Financial Inclusion.*

106. **Increasing consumers' financial capability has emerged as a key priority in Madagascar.** In fact, not only is it one of the key principles of the 2013-2017 National Financial Inclusion Strategy (NFIS) but also one of the key recommendations of the recent Making Access to Finance Possible roadmap (2016) as well as a key component of the forthcoming NFIS. At present, in Madagascar, as emerged from the data of the Finscope survey, adults are not using transaction accounts, as both a means to make transactions electronically and as a tool to store value. In fact, the majority of the existing accounts are being used to make 1 or 2 transactions a month with over 20 percent of them being dormant (i.e., no transaction in the past 90 days) and the majority of adults still prefer using informal mechanisms to store value as they do not yet have trust or do not understand the formal financial sector.

107. **International good practices and guidance suggest that it is important to ensure that there is a reasonable balance between programs which can be expected to generate some quick wins and programs which can be regarded as longer-term investments.** While the Coordination Nationale pour la Finance Inclusive is working on updating the NFIS which will also include a financial capability component expected to cover a broad range of interventions including longer terms ones such as school curricula, at present there are no activities ensuring that financial services consumers have adequate knowledge to use transaction accounts and make electronic payments. It is important to ensure that current constraints are addressed through timely interventions. In particular, such interventions need to be coordinated and complement the digitalization of government payments and MFIs, to ensure that impacted consumers understand, have trust in, and adequately use formal financial services.

108. **The project proposes to conduct financial education campaigns to complement the digitalization of government payments and MFIs under sub-component 1.1 and 1.2.** Such campaigns will consist of two different types of activities: the first activity will aim at increasing users' financial capability and trust in formal financial services; while the second one will aim at changing users' behavior. These activities will be delivery by procuring consulting services:

- **Based on similar campaigns which have been deployed in Madagascar[47]and other countries in the region, the first sub-activity will aim at improving users' financial literacy.**This first sub-activity will be deployed prior to and in parallel to the digitalization of government payments and of MFIs. It will consist of delivering short messages through different channels, including mobile phones (including a dedicate line which can be access by the consumer according to his/her needs), local radios, and TV based on experience which have proved to be successful in Madagascar and in other countries in the region. The messages will focus on the following issues: i) features, usage, and benefits of transaction accounts, (ii) features, usage, and benefits of electronic transactions, and (iii) users' rights and available means (including available recourse mechanisms) in case of problems and issues. They are expected to be delivered in the region where the digitalization pilots will be conducted as well as in other region. The radio and TV messages will deliver short educational messages over a period of six to twelve months. Such messages are expected to include details on a toll-free line

[47] Such initiatives have already been deployed in Madagascar and in Uganda on a wide variety of topics including: health, gender, agriculture, and usage of microfinance services. In Madagascar, a simple toll-free number has already been set up by to delivery different types of messages and has been used by over 3.5 million users. See *http://hni.org/what-we-do/3-2-1-service/*

which consumers can access when requiring more information. Further, an initial messaging campaign will be addressed at e-wallet holders which will begin to transact via e-wallet through the project components 1.1 and 1.2. Such messages will explain how they will be paid and will provide details on the telephone line which will be made available to all consumers. The toll-free line will provide information: i) usage, features, and benefits of transaction accounts, (ii) usage, features and benefits of electronic transactions, and (iii) users' rights and available means (including available recourse mechanisms) in case of problems and issues. The toll-free line is expected to be available for a period of minimum 6 months. All messages will be delivered under the patronage of public institutions (Ministry of Education, *Conseil Nationale pour la Finance Inclusive*, etc.). A National Financial Education Council comprising of all these institutions is expected to be created and technical assistance will be provided to design the contents of the campaigns.

- **Based on the experiences in other countries,[48] this sub-activity will send "nudge" messages to improve users' financial behavior.** This second sub-activity will be deployed after the G2P teachers' payments have been digitalized and will be only targeted to the users affected by such digitalization, taking advantage of these teachable moments. It will consist of behavioral nudge pilots aiming at improving financial behaviors of such teachers by ensuring that: (i) they use their account as a safe store of value (i.e., not all the money is withdrawn upfront upon the receipt of the salary); (ii) they conduct electronic transactions through the transaction account. It is envisaged that four different groups will receive four different types of messages: two sub-groups will receive messages aiming at increasing usage of transaction accounts as a safe mean to store value and two sub-groups will receive messages aiming at increasing usage of electronic transactions. Based on experience from other countries, within each of the two sub-groups some beneficiaries will also receive some of incentives (e.g., extra air-time if more than two transactions are conducted). A particular focus will be on behavioral nudges for female teachers, that can help them to transition to mobile accounts, increase savings, and gain greater financial autonomy.

Component 2: Access to Credit for MSMEs

109. **Madagascar has approximately 250,000 (formal) enterprises, of all sizes and sectors.** This figure is based on the latest survey of SMEs carried out by the Malagasy Statistical Institute (INSTAT 2004). Out of these, micro-enterprises (less than 10 employees) account for 96 percent of the total number of enterprises. A survey of the informal sector conducted in 2012 by INSTAT defines the informal sector as "all units of production that do not have a statistical number and / or do not have formal written accounts". According to this definition, there were 2.28 million "informal production units" in Madagascar (excluding agriculture, livestock, hunting and fishing) in 2012. On average, these informal micro-enterprises employed 1.5 persons per unit. Access to credit is a key constraint for these enterprises. According to the World Economic Forum Executive Opinion Survey 2016, access to finance was ranked 3rd most problematic factor for doing business in Madagascar (after political

[48] These types of campaigns have proven to be successful in increasing users' merchant transactions (http://juntosglobal.com/wp-content/uploads/2015/12/Tigo-Pesa-Juntos-Merchant-Payments-Partnership.pdf), users' savings, http://juntosglobal.com/bbva-bancomer-results-juntos/. See also generally https://www.cgap.org/sites/default/files/Working-Paper-Juntos-Finanzas-A-Case-Study-Oct-2015.pdf

instability and corruption). Madagascar ranks at 133th place (out of 190 countries) in terms of "Getting Credit" in the 2018 World Bank Doing Business (DB) report.

110. **Several factors, both on the supply and demand sides, contribute to limit MSMEs access to finance.** On the supply side, the lack of data on SMEs market and sectors complicates the risk assessment by financial institutions, thus affecting the requirement for important collaterals. Administrative burdens and delays in the legal system for the realization of collaterals also contribute to limit financial institution appetite to lend to MSMEs. On the demand side, the collateral requirement up to 120-150 percent of the credit amount is an important barrier for MSMEs. The high cost of credit with banks and MFIs (effective interest rate range from 11 to 127%)[49]in Madagascar hampers access as well. Finally, many MSMEs lack the capacity to develop and present bankable projects. Thus, the need for business development services and the guarantee scheme.

Subcomponent 2.1: Strengthening credit supply

Scale-up of credit guarantee for MSMEs

111. **Strengthening access to finance for MSMEs requires encouraging commercial lenders to supply credit to traditionally underserved market segments**, by providing risk-sharing facilities, such as a partial portfolio credit guarantee (PPCG), to incentivize financial institutions to reach out to new types of customers, extend access to credit and allow lenders as well as new customers to learn how to do business profitably together. This also requires technical assistance to help lenders integrate the PPCG into their internal systems and to develop tools, procedures and products tailored to the new market segment.

112. **The previous Madagascar Financial Services Project (PASEF) funded by the Africa Catalytic Growth Fund (ACGF) established a partial portfolio credit guarantee (PPCG) for credits extended by banks and MFIs to micro, small and medium-sized enterprises (MSMEs) in July 2014**–with an initial capital of 4 million US dollars. For participating financial institutions (PFIs), it covers 50 percent of credits meeting well-defined eligibility criteria, incentivizing credit issuance to MSMEs. It is characterized by automaticity as all credits meeting the eligibility criteria must be entered in the guarantee. It is managed locally by a Malagasy private firm (SOLIDIS Garantie) licensed by the central bank to offer guarantees and operating under its supervision. One important characteristic of the PPCG is that it is accompanied by technical assistance. Each PFI benefits from the presence of a resident technical assistant whose mandate is to improve internal procedures, assist in the analysis of risks, develop the MSME clientele and train staff. The PPCG-MSME has enjoyed rapid uptake and will require additional capital to satisfy increasing demand.

113. **As at end-September 2017, the volume of credit registered under the MSME window of the guarantee amounted to 73 billion MGA (24.5 million US dollars), close to six times the volume of 13.7 billion MGA registered in November 2015.** The number of borrowers grew by seven times, from 230 borrowers in November 2015 to 1731 borrowers in September 2017. In cumulative terms, a total amount of credit of 138 billion MGA (46 million US dollars) has been guaranteed as at the end of August 2017. With a capital of 4 million US dollars, the guarantee thus supported

[49] Étude sur les déterminants des taux d'intérêt, PASEF 2016

cumulatively 46 million US dollars in credit. The number of participating financial institutions (PFIs) was multiplied by eight in one year. Six banks and 2 MFIs participate in the PPCG. More financial institutions expressed their intention to partner with the PPCG. As of September 2017, the ratio of bad loans relative to the total volume of loans registered under the guarantee stood at 1.7 percent - an acceptable level, well below the average level of non-performing portfolio within the banks and MFIs. Sixty percent of the amount of credit entered in the guarantee are new credits and 75 percent the number of borrowers are new. Most of the credit guaranteed are of small size. Seventy-two percent of the number of credit guaranteed are smaller than 13,000 US dollars, 63 percent smaller than 10,000 US dollars and 47 percent smaller than 6000 US dollars. Guaranteed credits originate from all regions of Madagascar, with 45 percent of the number coming from the capital region. Many of the credits would not have been extended in the absence of the guarantee, because of insufficient collateral or would have required a much higher interest rate. MFIs use the PPCG to extend credit with less than 100 percent real guarantees.

114. **In view of the above, the new project will continue the PPCG activity, augmenting its capital and continuing the accompanying technical assistance.** All banks and MFIs met during project preparation expressed a strong support for the PPCG. New financial institutions have shown an interest in becoming PFIs and existing ones have requested an increase in the volume of credit they can register on the guarantee. Neither is currently possible, as the existing level of capital would not be sufficient to support an increase in activity. Simulations show that without an injection of new financing the PPCG is not sustainable in the long run and the volume of credits guaranteed will decline over time. On the other hand, with an additional external funding of 8 million US dollars, there will not be a need for replenishment of the endowment for a number of years. While the PPCG started with a multiplier of 2, the multiplier has been raised to 4 to accommodate a larger volume of credit guaranteed. This raises the level of risk of the Fund. The additional capital will permit a lowering of the multiplier to 3 and possibly to 2. The new endowment of 12 million US dollars will also allow an annual increase in the volume of credit guaranteed until at least 2022. Technical assistance will accompany the new PFIs and the Fund manager.

Innovation fund (Fintechs)

115. **Tight credit supply in Madagascar stems in significant part from information asymmetries.** Lenders have insufficient information to assess the creditworthiness of potential borrowers. Informal, micro, and women-owned firms are especially constrained in their access to credit, because they are less likely to own the kind of fixed assets, such as land or houses, that can be used as collateral for a business loan. Increasing access to credit for the most excluded firms in Madagascar therefore requires innovation around the collateral constraint.

116. **Financial technology (‘fintech’) which uses new sources of data (or mines existing data in innovative ways) to appraise borrowers can be a powerful tool to increase access to credit, particularly for women entrepreneurs.** For example, an IDA lending operation in Ethiopia (P122764) piloted the use of a psychometric test that predicts the likelihood of an entrepreneur repaying a loan. If female applicants with the pilot MFI scored highly on the psychometric test, they became eligible to access a large loan without asset collateral. Nearly 1,200 loans have been disbursed, and repayment stands at 98.6%. The pilot is demonstrating that fintech can be a viable

and profitable mechanism for reaching collateral-constrained borrowers. Other alternative sources of data for making credit decisions, such as data drawn from social media profiles, mobile phone usage, and data across groups of previous borrowers can also be harnessed to help lenders improve appraisal and lower collateral requirements (Wolkowitz and Parker, 2016).

117. **A presentation on fintech for financial institutions in Madagascar was held during the preparation mission.** The presentation focused on three examples of fintech: (i) generating new data on borrowers by administering psychometric testing, a technology pioneered by the Entrepreneurial Finance Lab; (ii) harnessing existing under-utilized data on borrowers by digitizing previous loan files and mining previous loan data to understand characteristics which predict credit-worthiness of new borrowers, a model pioneered by First Access; (iii) tapping into alternative data from smart phones and telecommunication operators (telcos) to understand loan applicants behaviors and trustworthiness, a model pioneered by Lenndo. Participating financial institutions expressed strong interest in the use of fintech to improve financial inclusion, through enhanced credit appraisal and lending techniques. In addition, the financial institutions highlighted that local tech companies are also developing fintech tools which look promising, and that international-local fintech partnerships might be particularly useful.

118. **Through an innovation fund, the project will test the effectiveness of various innovative approaches to expanding finance for MSMEs, in particular fintech solutions, which can introduce new lending techniques and reduce reliance on fixed asset collateral.** Financial institutions will be able to access the innovation fund to support fintech interventions that show promise for expanding access to finance to micro-enterprises, informal enterprises, and women-owned enterprises in particular. Financial institutions will be selected based on their commitment and organizational readiness to adopt new digital technology, and will be expected to cost-share some portion of the fintech investment. Fintech firms to provide services will be procured by the PIU on behalf of the financial institutions.

Subcomponent 2.2: Enhancing credit demand

Business development services for MSMEs

119. **Financial institutions in Madagascar cite lack of capacity to develop bankable business plans and poor quality of financial statements and records as some of the central reasons preventing them from lending to more micro and informal firms.** Helping firms to develop better business plans, and improve presentation of financial statements and records could therefore enable previously unbanked firms to become bankable in the eyes of lenders. Several private consulting firms – namely Price Waterhouse Coopers (PWC) and Ernst & Young (E&Y) – are already providing advisory services of this nature to firms to help them become more bankable. However, both PWC and E&Y provide these services mainly to large firms, and are interested to downscale to the much larger market of micro, small, and medium enterprises.

120. **The project would support a pilot of consulting services to MSMEs.** The business development services would not be classroom-style, but would instead be based on a service provision model, in which an outsourced firm provides services directly to firms. This would involve onsite support

directly to individual firms in preparation of credit applications. Firms would be referred to the consulting service after expressing interest in applying for a loan. Firms outside the guarantee scheme would still be eligible to participate in the consulting services. Nominal fees could be charged to participating MSMEs, not as a cost-recovery mechanism, but as a commitment mechanism. A focus would be on improving the bankability of micro, informal, and women-owned firms.

121. **A rigorous impact evaluation of the pilot will enable the project to determine how successful this type of BDS is in increasing access to finance for previously unbankable firms.** Based on the findings of the impact evaluation, the pilot could be scaled up in a future phase of the project. Consulting firms currently offer similar services to large firms. The project would work to bring consultancy costs down through economies of scale with large numbers of MSMEs participating, and would target reaching 2,000 MSMEs.

MFI rural network expansion

122. **Under the PASEF, two MFIs benefited from a support to the extension of their network in underserved regions through the rehabilitation of 19 points of service in two underserved regions (Bethisboka and Anosy).** These 19 service points have been set up through a cost-sharing mechanism (70:30). As of June 2017, service points were serving close to 20,000 clients, providing US$2.7 million in credits and close to US$295,000 in savings. Bank and MFI branch networks remain scarce in rural areas, often because financial institutions do not want to bear the risk of attempting to run a profitable business in poor and sparely populated territories. The project will cost-share the extension of MFI branch networks, selecting branches through a call for expression of interest. This will follow the approach taken by the original PASEF project.

S*ubcomponent 2.3: Enabling environment for access to credit for MSMEs*

Collateral registry

123. **There is currently no structured secured transaction system in Madagascar, the legal framework does not permit the consistency, the rationality and the visibility of secured transaction; and the institutional framework is not clear.** The authorities will undertake a broad based secured transactions reform, introducing a modern, highly accessible, notice based registry, aligned with international best practice. An IFC TA project will develop an appropriate legal framework for credit secured against movable assets and support the implementation of a web based secured transaction registry. The project will also build capacity and raise awareness of this new legal framework among judges, lawyers, financial institutions and other key stakeholders. The proposed reform has been discussed with all the stakeholders and market participants, which found that the concept of a reform is unanimously welcome, namely by The Minister of Justice and the Central Bank of Madagascar.

124. **The main objective of this activity is to support the development of a secured transactions law and develop a centralized electronic, web based registry for security interests in movable property, in line with international accepted practices.** The investment project will provide funding

for: (i) Hardware; (ii) Software; (iii) Technical assistance costs. More specifically, activities under this output will include: (i) Supporting the Government of Madagascar in the requirements definition, technical specifications and tender process as required for the selection of a quality technology solution to support the needs of the country context; the purchase of the software, hardware and any associated costs of the actual registry (technology procurement and technology development) ; (ii) Providing support to accompany the implementation of the software and the hardware to independently evaluate the robustness and security of the technology in preparation for launch and support operational governance of the registry (including technological and organizational governance arrangements); (iii) providing the training and awareness campaigns, to develop and deliver a stakeholder engagement, awareness and capacity building strategies and finally (iv) conducting market opportunity assessment for uptake in movable asset based lending and an enabling environment assessment to support the most effective implementation of a secured transactions reform (including for example prudential regulations review, secondary market assessment and associated roadmaps and support activities).

Consumer protection

125. **Financial consumer protection is fundamental to ensuring responsible and viable financial inclusion.** This is because, while increased access can result in significant economic and societal benefits, it can be neutral or even harmful if consumers are not able to: (i) exercise their rights as consumers; (ii) select the financial products that suit them best; and (iii) be protected from mis-selling, fraud and other market abuses. Moreover, the need for an appropriate consumer protection framework is becoming urgent where innovation is occurring, like in Madagascar. In fact, while the emergence of rapid growth of new financial service providers such as e-money issuers, as well as the use of alternative delivery channels, can help fulfill important financial inclusion objectives, it also brings risks to consumers, particularly those with low levels of financial capability.

126. **In Madagascar, there is no such framework and consumers are subject to malpractices from financial service providers.** At present in Madagascar, except for a few selected existing measures (e.g., obligation for banks to publish their main tariffs and conditions) and new obligations which have been introduced (i.e., obligations included in the e-Money Issuers Law) and which will be introduced (i.e., obligations included in the draft Banking and MFIs Laws) the overall regulatory framework lacks any sort of comprehensive measures ensuring that consumers are adequately protected. This results in abusive practices towards financial services consumers. Examples of such practices include: misleading advertisement, non-standardized disclosure of interest rates (e.g., certain financial institutions disclose the nominal interest per month while other annualize it), non-disclosure of the total cost of financial product through a single standardized formula, and lack of suitability and affordability assessments.

127. **Beyond the legal vacuum, there is not yet systematic supervision of commercial practices or of the correct application of existing measures.** While current measures are limited, even for such obligations there is an overall lack of supervision due to lack of available tools and human resources as well as the need to develop the necessary supervisory skills. This results in the fact that even existing regulatory obligations are not implemented or if applied this is not done in a standardized way. Considering that the new set of legislation now gives the CSBF an explicit financial consumer

mandate and introduces specific obligations, this will need to be addressed.

128. **Aware of the existing gaps and needs, the CSBF has already begun working on developing key financial consumer protection regulations on disclosure and transparency and internal redress mechanisms for payment services and products.** The project aims at gradually closing the gap by initially working on developing a sound regulatory framework for credit, savings, and deposit products and then focusing on developing supervisory capacity. To this extent, within the policy and regulation unit of the CSBF dedicated staff has already been assigned to work on developing a broader financial consumer protection framework, and gradually selected staff will be assigned to the relevant financial consumer protection supervision tasks.

129. **In terms of the activities, in order to address the regulatory gap, the project will provide:**

- Technical assistance for the development of an adequate regulatory framework ensuring that consumers are granted adequate levels of protection. The framework would cover credit and savings products[50]and would include: basic transparency requirements on format, manner, and timeliness of key disclosure documents; standardized disclosures requirements (Key Facts Statements); rules on customer mobility and fair treatment. For what concerns rules on internal redress mechanisms, the project will provide assistance to extend to all relevant providers the application of the current requirements being developed by the CSBF for institutions offering payment services and products.

- For what concerns financial consumer protection supervision, given the need to develop the necessary skills, the project will also provide capacity building for effective financial consumer protection supervision. To ensure a gradual approach, after the completion of the regulatory framework, the project will provide technical assistance to build capacity of relevant supervisors dedicated to financial consumer protection supervision. Such assistance would include: (i) general training on market conduct supervising and relevant supervisory techniques, (ii) on-the-job training including via the assistance of a resident consultant, on market conduct supervision, the development of supervisory manuals, and the development of a supervisory strategy; and (iii) an exposure visit to a selected jurisdiction.

- Finally, considering the limited human resources, the project will support the development of software to facilitate supervision. Through the resident consultant, the project will finance the design as well as finance the development of relevant software to assist in monitoring the application of financial consumer protection requirements as well as to inform the development of adequate risk-based supervision. In fact, technology-solutions are now assisting more and more supervisors through automating and streamlining administrative and operation procedures, digitizing data and working tools, and improving data analytics. The development of such tools is expected to substantially assist the CSBF, given the limited

[50] Issues relating to payment, credit and savings products have been identified as the most urgent and problematic ones in the recent FSAP and the diagnostic conducted through the FIRST Funded Payment Systems Technical Assistance. While the FIRST technical assistance is currently helping the Central Bank and CSFB in developing an adequate framework for payments products and services, the project will complement these efforts by assisting in developing a similar framework for credit and savings products.

human resources currently available. In fact, more frequent, granular and processed data can substantially ease and improve supervision. The project will finance relevant software for the submission and analysis of relevant complaints data and data on other relevant indicators, which will be developed through the technical assistance which the project will provide to facilitate data collection and supervision.

Component 3: Project Management & Impact Evaluation

Subcomponent 3.1: Project Management

130. **Drawing from the experience of the PIU that was established under the ACGF Madagascar Financial Services Project (PASEF), the project will have a PIU composed by members that can work full time on project's implementation.** The Government recognized the importance of a dedicated PIU. It was also recognized that in order to carry out its responsibilities and effectively implement the project, the PIU will work with several stakeholders in the Central Bank, CSBF, CNFI, APIMF, APB etc. To ensure proper coordination and supervision of the project, a Project Steering Committee (PSC) will be established and will provide policy guidance and oversight.

Subcomponent 3.2: Impact Evaluation

131. **Support for micro, small and medium enterprises is a popular policy option for governments all over the world.** A common pillar of support programs to MSMEs has been to facilitate access to credit, often in the form of microfinance. But can microfinance actually help enterprises to grow? A recent review of six randomized evaluations from four continents suggests that, while microcredit has some benefits, it has not led to the transformative improvements in business performance and poverty reduction widely expected. An impact evaluation component built into the project ex-ante will aim to test out promising, innovative approaches to financing and supporting MSMEs, and to rigorously measure impacts of project interventions in order to generate policy-relevant advice and evidence-based approaches for supporting MSMEs in Madagascar.

132. **The project team will explore randomization of specific project interventions, in order to enable rigorous impact evaluation.** Impact evaluations could be considered in up to two project interventions. Impact evaluations will focus in particular on understanding differential impacts for female and male beneficiaries. The World Bank's Gender Innovation Lab would partner with FCI to provide research support to conduct impact evaluations.

Component 4: Contingent Emergency Response Component (US$ 0.0m)

133. **Following an eligible crisis or emergency, the Borrower may request the World Bank to re-allocate project funds to support emergency response and reconstruction.** This component would draw from the uncommitted credit resources under the project from other project components to cover emergency response.

ANNEX 2: IMPLEMENTATION ARRANGEMENTS

COUNTRY : Madagascar
Madagascar Financial Inclusion Project

Project Institutional and Implementation Arrangements

134. **The Ministry of Finance and Budget (MFB) will be the signatory of the IDA Credit.** The main government entities with overall responsibility for project implementation will be the MFB and the Central Bank of Madagascar (BCM).

135. **A Project Implementation Unit (PIU) will be established as a dedicated unit in the MFB.** The PIU will have full fiduciary responsibility for project implementation. The PIU's responsibilities will include procurement of hardware, software, business development services, capacity building related equipment and other consultancies as needed, as well as overall coordination between the component activities. It will ensure monitoring and evaluation (M&E) activities and ensure financial reporting obligations associated with the project. PIU staff should include at all times during project implementation, at a minimum, a project coordinator, a financial officer, an accounting specialist, a procurement specialist and an environment focal point. The PIU will extend to hire other specialists and support staff, as needed to perform its functions. The Project Coordinator will be responsible for management of the PIU and overall project coordination. The Procurement Specialist and Financial Management Specialist will provide regular support on all project procurements and financial management processes.

136. **A Project Steering Committee (PSC), chaired jointly by the Secretary General of the Ministry of Finance and Budget and the Governor of the Central Bank, will meet at least bi-annually to provide policy guidance and oversight for the project.** It will comprise representatives from all the relevant project stakeholders involved in the project's implementation. This includes the MFB (including the CNFI and the DDP), the BCM (including the CSBF), the Ministry of Justice (MoJ), the Ministry of Industry and Private Sector Development, the Association of Banks (APB) and the Association of Microfinance Institutions (APIMF).The Committee will be in charge of: (i) approving annual work programs and budgets; (ii) reviewing project reports including progress reports, audits, the mid-term review and implementation completion reports; and (iii) addressing any major problems affecting project implementation. If needed, participants of the PSC can delegate their responsibilities for specific PSC meetings to relevant staff.

137. **A Project Implementation Committee (PIC), consisting of director-level staff of the main implementing organizations, will meet every second month to coordinate the implementation of the project.** The project will need to ensure that planning, implementation, and monitoring are adequately coordinated across key stakeholders. The project will address this through the establishment of a Project Implementation Committee that will meet every second month and ensure a smooth implementation and coordination on the basis of a common action framework.

The committee will include representatives from each relevant stakeholder and the PIU.[51]

138. **Working groups will coordinate the progress on subcomponents of the project.** The CNFI, Ministry of Finance and the Central Bank are expected to establish a working group to coordinate the financial education activities. The Ministry of Finance, the Central Bank and the APIMF are expected to establish a working group to prepare and follow-up on an action plan for a mutualized MIS for MFIs. Other working groups can be proposed and established by project stakeholders, as needed.

139. **A project preparation advance (PPA) and retroactive financing (RF) will be used to advance with project preparation, including a Project Operations Manual (POM), ahead of project effectiveness and ensure timely implementation.** The PPA will be used to establish the PIU at the MFB, start analytical studies and preparation of the POM, ahead of project effectiveness. The POM will include all periodic reporting, monitoring and evaluation arrangements throughout the life of the project including annual independent operational audits, which will provide impact assessment of the various project components. The RF will fund a first tranche capital increase for the PPCG (US$ 2.5 million) and the upgrade of the RTGCS/ACH systems (US$2.9 million).

Financial Management

140. **The overall risk for the Project is rated substantial, due mainly to the inherent country-level fiduciary risk, but also partly due to the lack of experience of the new Financial Operations Department (DOF) within the Treasury General Directorate of the Ministry of Finance, which will implement the project.** It is considered that PIU financial management arrangements will meet the World Bank's minimum requirements under World Bank Policy and Directive once the mitigation measures are implemented. The mitigation measures will be mostly implemented with the Project Preparation Advance and are comprised of: (a) the recruitment of qualified and experienced FM staff composed of one Financial Manager and one Accountant for the PIU, (b) the development and adoption of a FM procedures manual as part of the POM, (c) the purchase of an adequate accounting system for the PIU. Annex 9 expands on the financial management assessment for this new project.

Procurement

141. **The procurement assessment revealed limited capacity and little prior experience in managing World Bank funds by the new DOF.** These risks will be mitigated by an early recruitment of a qualified and experienced project Procurement Specialist during project preparation using the project preparation advance. This risk will also be mitigated by the preparation of a Financial Procedures Manual including procurement procedures and appropriate complaint resolution system in accordance with the Regulations. Appropriate fiduciary arrangements will be in place to ensure smooth implementation of the project. Continued close monitoring and mitigation of any potential risks will be made possible by regular progress and fiduciary reports, the World Bank's supervision and continued capacity building.

[51] The Project Implementation Committee (PIC) will include the PIU Coordinator, representatives from the World Bank Project Team as well as one representative for each of the main government counterparts that will support the project's implementation. The World Bank will be the Secretariat of the PIC.

142. **Ahead of project implementation, a Project Procurement Strategy for Development (PPSD) has been elaborated with the collaboration of DOF and BCM and, at the end, a procurement plan covering the first 18-months of Projects implementation was prepared.** World Bank procurement rules and procedures will be applied. Continuous monitoring and mitigation of any potential risk will be made possible through regular reporting on the progress and implementation of fiduciary activities, regular supervision, and further capacity-building, as necessary. Finally, the World Bank's fiduciary team will provide additional support for the implementation of the project. The DOF and the BCM will be trained and use the World Bank's online procurement planning and tracking tools (STEP) for preparing, clearing, updating Procurement Plans and conducting all procurement transactions for the Projects.

143. **Madagascar's national procurement procedures are widely used for local World Bank projects.** The Borrower agreement will include the obligation of suppliers to respect the World Bank's Anti-Corruption guidelines (art 4- III of the national Code) and the right for World Bank audits. Other elements of paragraph 5.4 of the Procurement Regulations for World Bank Borrowers are already under implementation by the Borrower. However, in accordance with paragraph 5.6, it is not evident that the quality of procurement is taken into account. To ensure compliance with the Procurement Regulations for IPF Borrowers, assistance from World Bank staff is therefore forecast during implementation, including through training and procurement clinics.

Environmental and Social (including safeguards)

144. **The project will have positive social benefits for beneficiaries mainly through improved financial infrastructure, financial education and consumer protection; no negative social impacts are expected to result from this project.** The project will not involve any activities that will result in land acquisition, physical displacement, economic displacement or any other form of involuntary resettlement as defined by OP 4.12. No civil works will be scheduled under the project.

145. **Since the Partial Portfolio Credit Guarantee (PPCG) under the project will provide guarantees to finance activities which will only be identified in the course of project implementation, an Environmental and Social Management Framework (ESMF) has been prepared.** This project has been classified as Category FI and an Environmental Assessment OP 4.01 is triggered owing to the activities of sub-borrowers who will benefit from credit guarantees under the Partial Portfolio Credit Guarantee (PPCG) Program (Component 2.1 of the project). However, the sub-borrowers who benefit from the guarantees under the program are not identified in advance. The PPCG is an existing program under the previous PASEF project and will be expanded under the current project. Based on PASEF data and consultation done with the Participating Financial Institutions (PFIs) during project preparation, sub-borrowers are MSME's who are engaged in a variety of sectors including trade, services, transport, constructions, and agriculture. The sub-borrowers covered under the PPCG vary in size from "micro" to "medium" and the environmental impacts vary from moderate to low and may be mitigated with generic mitigation measures. Under PASEF, 3 Category B projects were covered, and the rest were Category C. The PPCG is managed by a private Malagasy guarantee fund manager SOLIDIS Garantie, ensuring that it can quickly respond to claims by PFIs and that sustainable arrangements are in place that allow the Fund to continue operating without World

Bank support. SOLIDIS Garantie is licensed, regulated and supervised by the financial sector supervisor. The guarantee is flexible and adapted to the needs of PFIs. The PFIs determine with the Fund manager the maximum volume of loans they can enter in the guarantee. The guaranteed loans are made with private funds by private banks and MFIs.

146. **The ESMF has been elaborated in consultation with key existing stakeholders**, including local banks, MFIs and the recipients of micro-finance. The ESMF is an update of the framework successfully used for the PPCG under the previous PASEF project. The PFIs environmental and social responsibilities has been clarified and reinforced. The environmental and social screening process at PFIs and SOLIDIS Garantie has been improved. Overall, the procedures put in place under the PASEF project are strong and implemented in compliance with the PASEF ESMF[52], the project operational manual and the principles in the agreements signed with the PFIs. Under the current PPCG, the PIU, SOLIDIS Garantie and a part of existing PFIs have a good experience in implementing the ESMF. During the preparation of this new project, most PFIs say that the environmental rules do not represent a constraint. PFIs should verify that loans are compliant with the environmental and social specified in the ESMF, requesting necessary information from the end-borrower on the detailed implementation of ESMF. If the PFI submits a claim to the PPCG for a delinquent loan, the PFI needs to demonstrate to the guarantee fund manager that the underlying loan is compliant with the environmental and social due diligence specified in the ESMF.

147. **The World Bank Safeguard team will provide training to help key stakeholders implement the ESMF under the new project.** The safeguard team will assist and train the PIU and the PPCG guarantee fund manager to build up their capacity to manage the environmental and social risks described in the ESMF. For the PFIs, completion of an ESMF training and adoption of social and environmental responsibility standards through the agreement with the PPCG will be a precondition for adhering to the PPCG.

148. **To ensure compliance with the ESMF, the PIU will include an environment focal point full time to support the PFIs and SOLIDIS Garantie.** PFIs have the main responsibilities to ensure that the sub-borrower/credit meets all the eligibility criteria (including the environmental and social requirements, using the process outlined in the ESMF, to conduct environmental and social due diligence of individual sub-borrowers and their activities). They need to request necessary information from the sub-borrower and submit completed files to SOLIDIS Garantie. When a claim for a delinquent loan has been submitted by a PFI, SOLIDIS Garantie reviews the request and ensures that the claim meets all eligibility criteria included the environmental requirements. For Category B projects, SOLIDIS Garantie, with the support of the environmental consultant from the PIU, will carry out a document review of the implementation of the sub-project's ESMF through conformity certificate delivered by NOE. SOLIDIS Garantie can reject the payment of a claim if the

[52]The proposed screening has two levels. In a first screening, sub-projects will not be further considered if they are part of an Exclusion List of Activities (ELA). Ineligible activities include the following: (i) activities classified as Category A, according to World Bank OP 4.01; (ii) all activities/subprojects that could trigger World Bank OP 4.12 on Involuntary Resettlement and OP 4.04 on Natural Habitats; and (iii) activities that are prohibited for World Bank Group lending, including IFC's exclusion list. In a second level of screening, eligible activities are selected as follows: (i) activities classified as Category B, according to World Bank OP 4.01, where the proposed subproject/activity presented by the PFIs to be registered under the PPCG has received an environmental license delivered by the Malagasy Environmental Authority (National Environmental Office (NOE) and has been implemented in a manner satisfactory to the Environmental and Social Management Framework (ESMF), and monitored by the Malagasy Environmental Authority with conformity certificate delivered by NEO; (ii) activities classified as Category C according to World Bank OP 4.01(i.e. negligible or no environmental and social impacts).

environmental requirements have not been met. In the PFIs, Credit officers are operational to review environmental and social compliance with Malagasy National Environmental Law. The ESMF implementation budget is included in the project operational cost. The World Bank safeguard team will continue to assist and train the PIU and SOLIDIS Garantie to build up their capacity on the management of environmental and social risks described in the ESMF.

149. **The** updated ESMF has been elaborated in consultation with key existing stakeholders, including local banks, MFIs and the recipients of micro-finance. The Borrower's updated ESMF has been submitted for the World Bank's review and Approval to the World Bank's Regional Safeguards Advisor (RSA). The cleared ESMF has been disclosed in the country on December 21, 2017 and to Infoshop on December 22, 2017.

Monitoring and Evaluation

150. **The monitoring and evaluation (M&E) system will be based on the agreed Results Framework and monitoring arrangements.** The framework is meant to measure project activities using the indicators described in Section VII. Project design has been guided by a results framework intended to be useful for both project management and World Bank supervision. A set of additional indicators will then be collected for monitoring purposes during project implementation, including the additional indicators reported in Annex 8. The results framework focuses on the project development objective (PDO) to be achieved and the intermediate outcomes expected. The PIU will be responsible for conducting M&E activities, and a dedicated M&E Specialist will be hired for this task at effectiveness. Baseline data for all the agreed indicators will be verified and confirmed by the PIU in partnership and collaboration with the designated technical staff in each implementing agency within the first six months of project implementation.

151. **The PIU will remain responsible for the data collection, management, and monitoring of the agreed project development outcome indicators.** The primary monitoring mechanism will be quarterly reports and annual reports prepared by the Project Coordinator and presented to the Steering Committee. These reports will assess achievements against the Project Implementation Plan (PIP) and overall project progress using the indicators defined in the results framework. All reports will be submitted to the World Bank and shared with other development partners when needed. A mid-term review will be carried out at the half way point of the project. An Implementation Completion Report (ICR) will be undertaken after completion of the project. The project will incorporate a citizen engagement feedback loop, as described below.

152. **The project's impact evaluation will conduct rigorous, randomized evaluations of two specific project components: the digitization of teacher salaries, and financial capabilities.** Data collection for these studies will be conducted separately from and in addition to regular project data collection, and will be in the form of beneficiary surveys administered by a local survey firm. Design of the impact evaluation studies and data analysis will be supported through a separate impact evaluation trust fund. These studies will provide evidence on the impact and key lessons in increasing utilization of transaction accounts and digital financial services.

Role of Partners (if applicable)

153. **The proposed operation is part of a program of coordinated reform dialogue on financial sector development with other development partners.** The Cadre de Partenariat, co-chaired by the Ministry of Finance and Budget and the World Bank, provides a forum for collaboration among development partners. The AFD has ongoing projects related to agent banking and access to finance for SMEs through a credit guarantee scheme. The team has coordinated closely with AFD during the project's preparation to exploit possible synergies. Moreover, parallel development policy operations of the World Bank, coordinated with all development partners, are supporting, among other reforms, important interventions on the regulatory framework for the microfinance sector, the e-money and the establishment of a private credit bureau.

ANNEX 3: IMPLEMENTATION SUPPORT PLAN

COUNTRY: Madagascar
Madagascar Financial Inclusion Project

Strategy and Approach for Implementation Support

154. The objective of the Madagascar Financial Inclusion Project is to promote financial inclusion in Madagascar by increasing usage of transaction accounts and access to credit for MSMEs, focusing on results. Key institutions responsible for preparation of the project are the Ministry of Finance and Budget (MFB) and the Central Bank of Madagascar. The team will rely on the lessons learned from the implementation of the PASEF project to design and implement the Financial Inclusion Project. Support to implementation by the World Bank will include at least two regular support missions each year. The World Bank's staff may carry out additional technical missions as required. Results and progress will be shared withthe Government, the steering committee of the project (Ministry of Finance and the Central Bank) and different stakeholders through regular Aide Memoires.

155. A midterm review will be undertaken jointly with the Government to review overall project implementation.

Implementation Support Plan and Resource Requirements

156. **Overall.** This implementation support plan (ISP) describes how the World Bank will support the risk mitigation measures and provide the technical advice necessary to help the client achieve the PDO. This ISP also identifies the minimum requirements to meet the World Bank's fiduciary obligations. It has been developed based on the nature of the project and its risk profile. Formal implementation support visits and field visits will be carried out semi-annually and focus on the areas detailed below.

157. There will be strong coordination between the World Bank and the PIU, the party responsible for day-to-day administrative project management. The World Bank task team will bring a comprehensive set of instruments and expertise to advise on project activities. It will work closely with the PIU to ensure project success and take a flexible approach to ensure that it meets client needs as circumstances evolve. The team will conduct at least two implementation support visits per year, as well as maintain an ongoing dialogue via audio conferences and email.

158. In addition to implementation support visits and ongoing engagement, the World Bank project team will carefully monitor the progress of project implementation and achievement of results via formal and informal reporting channels. Formal reporting channels include ISRs, and results monitoring reports supplied by the PIU. Informal channels include interaction with direct beneficiaries of the project, reports from local media, and country economic analysis.

159. Moreover, the World Bank project team will establish a Project Implementation Committee

composed by one representative for each key implementing partner. The committee will meet once a month and will work on the basis of an action matrix outlining a detailed set of tasks to be completed within the coming month to allow for a smooth implementation.

160. **Financial Management.** The project will have on-field supervision at least twice a year. This is in addition to regular implementation support, desk assessments, quarterly IFR reviews and annual audit report reviews. After each supervision, the risk will be measured and recalibrated accordingly. Supervision activities will include: the compliance with the agreed upon FM arrangements, review of quarterly IFRs; review of annual audited financial statements as well as timely follow-up of issues arising; transaction review; participation in project supervision missions as appropriate; and updating the FM rating in the ISR.

161. **Procurement.** Procurement for the Madagascar Financial Inclusion Project under the IDA Credit shall be carried out in accordance with the World Bank's 'Guidelines for Procurement of Goods, Works, and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by World Bank Borrowers', dated January 2011 and revised in July 2014 (the 'Procurement Guidelines'); 'Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers', dated January 2011 and revised in July 2014; 'Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants, (the Anti-Corruption Guidelines)', dated October 15, 2006 and revised in January 2011; and the provisions stipulated in the Legal Agreement. The Project Implementation Manual of the Project, shall describe the basic guiding principles, the established methods, procedures and commercial practices, contract forms, and the main responsibilities of the financial intermediary institutions and entities applicable to the Project. As part of implementation support visits, the World Bank will undertake procurement supervision.

162. **Monitoring and Evaluation.** The monitoring and evaluation (M&E) system will be based on the Results Framework and will be used to track and monitor progress and impact. The framework is meant to measure project activities using the monitoring arrangements described in Section VII.In order to leverage preexisting structures and institutions, the PIU will be responsible for establishing, managing and reporting the M&E system. This will include data collection, compilation and reporting from relevant stakeholders and implementing agencies for all components. An M&E Framework will be established and detailed in the Project Implementation Manual. The PIU will provide bi-annual and annual progress reports. The project will also undertake an impact evaluation to assess outcomes. It will support rigorous empirical analysis based on a quantitative comparison of a treatment and control groups before and after access to specific project interventions.

Implementation Support Plan

163. **The tables below detail the key areas of focus of the implementation support activities for the duration of the project's term.** These have been determined based on an understanding of the priority activities to be implemented over the life of the project. Future updates will be based on progress on project activities, timing of major new activities, and the expertise required to address any issues that arise, among other things.

Time	Focus	Skills Needed	Resource Estimate	Partner Role
Year 0 before project effectiveness and first twelve months	Following completion of baseline and launch of key project activities	Senior Financial Sector Economist, Economist, Operations Officer, Senior Financial Sector Specialist, Procurement specialist, Financial Management specialist, M&E specialist, Social Safeguard Specialist.	US$200,000	Mixed team missions to support design and launch of specific project components, and ensure compliance with relevant policies and procedures
12-48 months	Technical support and oversight to specific project components, and to project-wide financial management, procurement, and safeguards	Senior Financial Sector Economist, Economist, Operations Officer, Senior Financial Sector Specialist, Procurement specialist, Financial Management specialist, M&E specialist, Social Safeguard Specialist.	US$450,000	Two Implementation Support Missions per year, attended by full project team. Regular in-country support.

Skills Mix Required: Bank staff and consultants who worked on the project included

Skills Needed	Number of Staff Weeks	Number of Trips	Comments
Sr Financial Economist (TTL)	36	8	2 trips per year (for 4 years) depending on the progress status.
Economist (co-TTL)	36	8	
Operation Officer	18	8	
Sr Financial Sector	18	8	

Specialist		
Sr Financial Sector Specialist	18	Country-based
Sr. Procurement Specialist	6	Country-based
FM Specialist	6	Country-based
Sr. Social Safeguard Specialist	6	Country-based
Sr. Environmental Safeguard Specialist	6	Country-based
Sr. Legal Counsel	6	0
Team Assistant	36	Country-based

Partners

Name	Institution/Country	Role
Francesco Strobbe	WB Head Quarter	Sr. Financial Economist (TTL)
Christoph Ungerer	WB Head Quarter	Economist (co-TTL)
Sylvain Rambeloson	WB Madagascar	Sr. Procurement Specialist
Maharavo Harimandimby Ramarotahiantsoa	WB Madagascar	Financial Management Specialist
Aly Salman Alibhai	WB Head Quarter	Operation Officer
Andre Ryba	WB Head Quarter	Consultant
Andrianjaka Rado Razafimandimby	WB Madagascar	Social Development Specialist
Brinda Devi Dabysing	WB Mauritius	Sr. Financial Sector Specialist
Dorothee Delort	WB Head Quarter	Sr. Financial Sector Specialist
Honglin Li	WB Head Quarter	Operations Analyst

Marco Traversa	WB Head Quarter	Financial Sector Analyst
Maria Eileen Pagura	WB Head Quarter	Consultant
Noro Aina Andriamihaja	WB Madagascar	Sr. Financial Sector Specialist
Tenin Fatimata Dicko	WB Head Quarter	Young Professional
Paul Jean Feno	WB Madagascar	Sr. Environmental Safeguard Specialist
Peter Lafere	WB Head Quarter	Sr. Social Development Specialist
Siobhan McInerney-Lankford	WB Head Quarter	Sr. Legal Counsel
Landy Angelina Rakotonalina	WB Madagascar	Team Assistant

ANNEX 4: Overview of Madagascar's Financial Sector

164. Financial intermediation in Madagascar is very shallow. By the end of 2015, total financial sector assets represent 34.8 percent of the GDP in 2015, of which nearly three quarters are banking sector assets. The banking sector is composed of 11 commercial banks, including 8 subsidiaries of international groups, 2 subsidiaries of Mauritian banks and one private Malagasy bank. Four banks (BOA, BNI, BMOI, BFV) dominate the market. Indeed, these four banks hold over four fifths of deposits and loans. The government retains a minority stake in three of these banks. In 2015, the banking sector penetration rate is below 5%, relatively low compared to the CEMAC zone (7%) and the UEMOA (15%)[53]. Three banks Microcred, SIPEM and Accès Bank operated in the microfinance sector. These microfinance banks intervene mainly in urban areas, with the exception of the latter, where 19 percent of the credit portfolio is rural. BOA has a microfinance directorate and direct and indirect intervention in the microfinance sector.

165. As MFIs, banks also invested and expanded their network of branches and ATMs. Between 2013 and 2015, the number of branches increased by 33.49 percent and the number of ATMs by 31.68%[54]to reach 291 and 320 respectively. BOA is the number one bank in Madagascar, in terms of coverage and clientele with 80 branches and 123 ATMs.

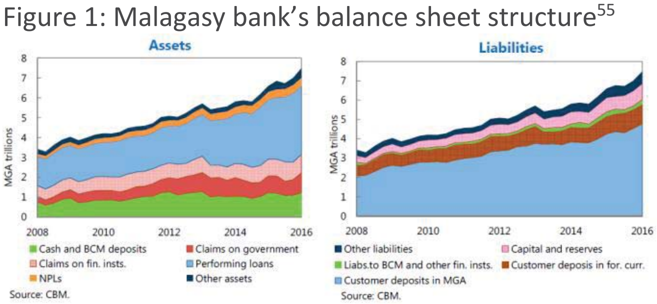
Table 1: overview of the banking sector

Description	2015
Number of bank	11
Number of branches	291
Number of ATMs	320
Assets (billion Ar)	7,010

Source: APB, 2016

166. In absolute terms, banking assets slightly exceed US$2 billion. Bank resources are almost exclusively composed of deposits (79%). The bulk of the deposits is in local currency, as well as a significant part of the loans. The majority of loans are short-term (51.79%) and long-term financing represents only 12 percent of the credit portfolio.

Figure 1: Malagasy bank's balance sheet structure[55]



[53]ABP, 2017
[54]APB, 2017
[55]IMF, 2016: Financial System Stability Assessment

167. The quality of banks credit portfolio is improving with an NPL which went from 11.6 percent in 2014 to 10.5 percent in 2015. The risk level associated with the loan portfolio may be underestimated. Indeed, banks are rapidly reclassifying restructured loans as performing loans. The sector also recorded good profitability, resulting from the large difference between lending and deposit rates and commissions gains on foreign currencies. The solvency ratio is relatively adequate, although it has declined recently.

168. The liquidity of the sector is abundant, with a marked seasonal character. For the sector as a whole, resources are largely made up of deposits, with the outstanding amount far exceeding the credit portfolio. Banks hold large amounts of treasury bills as well, which give them access, if necessary, to refinancing facilities with the BCM.

Table 2: Financial indicators of the banking sector

Financial ratio of banking sector (%)	2013	2014	2015
Assets quality			
Credit growth	17.9	20.7	18.5
NPL	13	11.6	10.5
Provisioning rate	62.1	62.2	61.3
Profitability			
Operating ratio	54.6	49.4	48.7
Net interest margin	5.5	5.9	6
Return on Assets (ROA)	2.4	3.3	3.7
Return on Equity (ROE)	26.1	34	47.6
Liquidity			
Loans/Deposit	63	68	70
Liquidity coverage ratio	63.9	59.2	55.3

Source: BCM (2016) and APB (2017)

169. The microfinance sector is composed of 22 active institutions and experienced a rapid growth with a household penetration rate which rose from 19.5 percent in 2011 to 30.4%[56] in June 2016. The number of members /clients almost doubled between 2011 and 2016 (844,340 to 1,451,072 with 48 percent of women). The sector recorded between 2010 and 2015, an average annual increase of 6.43 percent in the number of service points. In June 2016, the country had 949.

[56]Data provided by CNFI (2016)

Table 3: Overview of the microfinance sector						
	2011	**2012**	**2013**	**2014**	**2015**	**2016**
Number of points of service	739	784	820	890	937	949
Penetration rate	19.50%	22.69%	24.60%	28.10%	29.60%	30.40%
Number of clients/members	844 340	984 683	1 098 075	1 288 428	1 395 868	1 451 072
% of women clients/members	45.91%	45.92%	47.03%	48.33%	48.51%	48.88%
Outstanding loans (million Ar)	246 925	314 791	387 682	444 144	506 946	562 322
Outstanding savings (million Ar)	195 492	233 530	309 434	382 182	487 462	510 473

Source: CNFI (2016)

170. The country is adopting a new law on microfinance which will be promulgated later this year. Within the new microfinance law, MFIs categorization (see table 4 below) will change, there will be only two categories of microfinance institutions: those that collect deposits and grant credits designated as "Deposit and Credit MFIs"; and microfinance institutions that provide credit only called "MFIs of Credit".

Table 4: MFIs current categorization

Characteristics	**Category 1**		**Category 2**		**Category 3**	
	Mutualist[57]	Non-mutualist	Mutualist	Non-mutualist	Mutualist	Non-mutualiste
Nb of members/clients	≤ 1000 members	unlimited	unlimited	unlimited	unlimited	unlimited
Savings	Maximum of 500 000 Ar[58]	Not authorized	Deposit from members only	Deposit from the public	Deposit from members only	Deposit from the public
Loan maturity	Short term ≤ 1 year		Short and medium term: 1 to 5 years		Short, medium: 1 to 5 years and long term ≥5 years	
Indvidual loans	Up to 1,5 million Ar	Up to 3 million Ar	For at least 30% of the credit volume, individual amount ≤ 5 million Ar		For at least 30% of the credit volume, individual amount ≤ 15 million Ar	
			For up to 10% of the volume of credit, individual amount ≥ 15 million Ar		For up to 10% of the volume of credit, individual amount ≥ 60 million Ar	

[57] Mutualist institution: is a financial institution that is owned by its members who subscribe to a common fund. Profits after deductions are shared between the members. The members own the business.
[58] 1$= 3200 Ar

Group loans	Up to 6 million Ar	Up to 12 million Ar	Non –applicable	
Number of institutions	11		9	3

Source: CSBF (2016)

171. The microfinance sector in Madagascar has been growing fast, but the financial performance has been mixed. The total outstanding loans and deposits of all MFIs increased dramatically in the past 6 years, the deposits and loans from MFIs have almost tripled and in 2016 reached with respective amounts of MAG 562 322 million and MGA 510 473 million as illustrated in table 3. However, the activity remains concentrated within a small number of institutions at the end of 2015 with three MFIs accounting for 26 percent of the clientele, 54 percent of the credit portfolio and 22 percent of the deposits. Regarding the financial performance, the overall quality of the credit portfolio is moderate with a PAR 30 at 6%[59] knowing that the standard is set at 5%. The profitability of the sector is low and uneven. Indeed, the spell out of the sector is very low (0.9 percent given the reference in the sector is 3.5%). The low level of profitability is likely linked to higher operating ratio of the sector 111.9%.

Table 5: Financial erformance of MFIs in Madagascar

Financial Performance indicators	Overall sector (2015)
PAR30	6.0%
PAR90	4.8%
Provisioning rate	86.2%
Solvency ratio	51.2%
Operating ratio	111.9%
ROA	0.9%
ROE	4.5%

Source: information's collected with CSBF (2015)

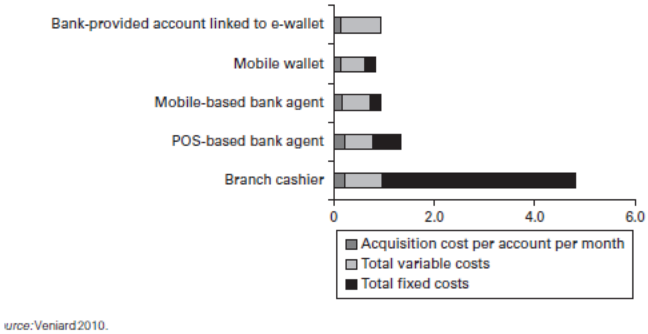
172. Madagascar is characterized by high level of rurality of its population, with 65 percent living in rural areas and a relatively low population density with 41.7 people per km2 (2015)[60]. MFIs current business model requires that customers come into their branches to make or withdraw deposits, request or repay credit. This rurality combined with weak transport infrastructure and increased insecurity of people and goods increases the costs of providing financial services in rural areas and increases the difficulties for formal financial institutions to develop products to meet the specific needs of rural segments. Indeed, seven of the 21 regions in the country (Analamanga, Vakinankaratra, Alaotra Mangoro, Analanjirofo, Atsinanana, Sava and Itasy) host more than 65 percent of microfinance points of service.

173. This business model of microfinance services based on a traditional system of branches (see table

[59] All financial ratios and data of the entire sector are provided by CSBF (2015)
[60] Banque Mondiale, Indicateurs du Développement dans le monde, 2015

3: MFIs points of services) generates important transaction costs both for the institution (physical infrastructure, operating costs) and for the customer (transport costs, waiting time in the agencies), etc.). The provision of financial services via branches is one of the most expensive methods of distribution as illustrated in the following figure.

Figure 2: Monthly cost in dollar associated with transaction accounts



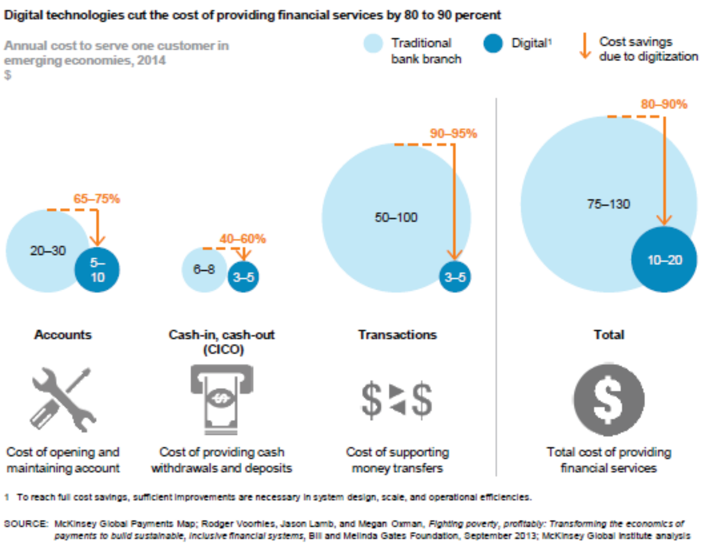
Source: Microfinance Handbook (2016)

174. MFIs in Madagascar are exposed to increasing insecurity, especially in rural areas. There are more and more branches robbery cases, which endangers the staff of the MFIs and their clients. With this insecurity, more and more clients / members of MFIs limit their visit to branches and transact with the institution. Indeed, mutual MFIs which dominate the sector have large number of "inactive" deposit accounts, particularly in rural areas. According to their analysis, this situation result from the transport fees and insecurity their members face.

175. Digital technologies for the provision of financial services or digital finance consists of the use of the internet and mobile phone with little use of cash and traditional channel branches to offer financial services. By introducing disbursement and collection capabilities through e-money, MFIs can leverage the wider network of e-money providers to broaden their reach and limit cash handling or fraud by MFI agents. According to a study by McKinsey & Company (2016), digital technologies cut the cost of providing financial services by 80-90 percent while allowing existing MFI clients to save time, money, manage their cash flows more flexibly (see figure 3: below). SMS can be used to send reminders of repayment deadlines, encouraging savings (a recent study[61]by CGAP showed that clients receiving encouraging savings SMS could save 5 times more than those who don't receive SMS)[62]communicating on new products, and especially having an ongoing financial education program.

[61] http://www.cgap.org/blog/interactive-sms-drives-digital-savings-and-borrowing-tanzania
[62] The financial capability sub-component of the project will include behavioral programs (e.g., nudges) to promote healthier consumers' financial behaviors.

Figure 3: Cost savings due to digitization



Source: McKinsey & Company (2016)

176. In this project framework, the digitization of MFIs' operations refers to the use of mobile telephony to deliver financial services (savings and credit) and non-financial services (financial education) to microfinance clients in order to meet the need to reduce transaction costs for the institution and its current clientele, to secure transactions and increase customer base by reaching out to excluded segments. The selection of mobile technology to provide financial services in this project is based on the fact that in Madagascar mobile telephony recorded a strong growth and more important than the Internet. Indeed, 46 percent of the Malagasy population have a mobile phone, far exceeding Internet access which is less than 4 percent of the population. The mobile market comprises three major players; Orange (approximately 6 million subscribers), Airtel (3.5 million), Telma (3 million).

177. In 2010, mobile operators have been authorized to operate as intermediaries in banking (IOB) to deploy the Mobile Money, which is offered by the three operators (Airtel money, orange money and Mvola). The country has 76.3 service points per 100,000 adults with 2,067,145[63] users. The offer of mobile money service consists of: deposits and withdrawals through an electronic wallet, transfer of money, mainly between people (P2P), purchase of communication credit, payment of invoices (ex : Jirima). The second generation of services offered in partnership between MNOs and financial institutions are emerging. There are two types of services available on the market, one is only available for the banks. Indeed, the banking sector has stronger partnership[64] with MNOs and is more advanced in this field with the "Account to Wallet" which link the customer accounts in the bank with its mobile wallet. The second type of second generation services available for both MFIs

[63] MAP Results (2016)

1. [64]BOA Madagascar en partenariat avec Airtel Money, la BMOI avec Orange Money et la BFV-SG avec MVola

and banks on the Malagasy market is the collection of credit repayments and use of push SMS. Moreover, there is a growing interest of MNOs in offering nano credit, however this practice is not authorized by the CSBF.

178. To date, three MFIs (CECAM, ACEP, CEFOR) have experiences on digital finance in partnerships with MNOs. They use push SMS to their clients on financial or health education. SMS is used by some MFIs to remind customers of their credit repayment terms. In addition, exchanges with MFIs indicate that their clients / members are demanding faster and more rapid services, particularly in relation to the analysis, validation and disbursement of loans. They use the mobile channel for credit repayments and even sometimes credit disbursements (CEFOR). MFIs are not offering the account-to-wallet services to their clients due to the capacity of their MIS which will require some (MFIs with upgrade and update MIS) minor adaptation for integration with MNOs, and for others due to the lack of automated MIS. Thereby, the mobile transactions by a client are not reflected in real time on the MFIs MIS. The successful implementation of digital finance solutions is based on the existence of an efficient MIS. Through the PASEF project six MFIs[65]benefited from an automated MIS. MNOs in Madagascar offer three levels of integration between the MFI's MIS and their e-money platform: web interface, file transfer protocol (FTP), interface application programming (API). The latter is the one recommended by the CGAP because it allows to follow in real time the transactions thus mitigating the risks for customers and the MFIs.

[65]The PASEF installed MIS for 5 MFIs (four MFIs of category 2: OTIV Tana, OTIV Diana, Fivoy, Vola Mahasoa; and one MFI of category 3: ACEP) and one microfinance bank: SIPEM

ANNEX 5: Structure of the Partial Portfolio Credit Guarantee (PPCG) established by the PASEF project

179. The Partial Portfolio Credit Guarantee (PPCG) for loans extended by banks and MFIs to micro, small and medium-sized enterprises (MSMEs) was established in July 2014. Its establishment was one of the activities under the recently closed World Bank project Madagascar Financial Services Project (PASEF). The PASEF project endowed the PPCG with a capital of 4 million US dollars.

180. As of September 2017, the PPCG included eight participating financial institutions (PFIs). This included six banks and two MFIs. Credit outstanding registered under the guarantee was 73.8 billion AR (US$24.5 million) linked to 1731 borrowers. The default rate stood at 1.7%. Around 77 percent of registered credit had maturity below 2 years, around 50 percent of credit went to commerce and around 44 percent were investment loans. Seventy-five percent of borrowers registered under the guarantee were new borrowers who could not have received a credit without the guarantee.

Institutional setup

181. The PPCG is managed by a private Malagasy guarantee fund manager SOLIDIS Garantie. This ensures that the PPCG is well adapted to the local environment in Madagascar, that it can quickly respond to claims by PFIs and that sustainable arrangements are in place that allow the Fund to continue operating without World Bank support. SOLIDIS Garantie is licensed, regulated and supervised by the financial sector supervisor. The PPCG operates through dedicated deposit accounts, strictly separated from other SOLIDIS Garantie operations. As indicated above, the original steering committee has been replaced by three committees to reinforce the governance of the Fund. External audits are regularly performed for the PPCG and the PFIs.

182. An important feature of the PPCG is that the PFIs and SOLIDIS Garantie receive accompanying technical assistance (TA). Each PFI benefits from a technical assistant whose responsibilities include assistance with the PPCG, developing the links between the PFI and SOLIDIS Garantie, improving internal procedures, developing risk analysis of MSMEs, developing the clientele of the PFIs and training staff. A resident technical assistant at SOLIDIS Garantie helps with the internal procedures and the MIS.

183. The guarantee is flexible and adapted to the needs of PFIs. The PFIs determine with the Fund manager the maximum volume of loans they can enter in the guarantee. The guaranteed loans are made with private funds by private banks and MFIs.

Payout of the guarantee

184. The PPCG automatically guarantees 50 percent of credit losses for all qualifying loans extended by the PFIs. Each PFI agrees with SOLIDIS Garantie on the characteristics of qualifying loans (size of loan, size of borrower, sector of borrower, etc.). All kinds of financing are eligible, including overdrafts, investment credits and operating credits; - however loan renewals are only eligible with a decrease in the collateral or an increase in the loan amount. The PFI analyzes each loan request and decides to extend or not the loan. Once granted, any loan that falls within the defined characteristics must be registered on the guarantee (up to an aggregate credit amount agreed with

SOLIDIS Garantie). By automatizing and keeping this process nimble, the PPCG reduces administrative burden for all participants and ensures quick settlement of claims.

185. The design of the PPCG aims to minimize moral hazard and adverse selection. Because the guarantee is partial, the PFI keeps an interest in screening loan applications and selecting viable borrowers. Because the guarantee is applied to the entire portfolio of qualifying loans, the PFIs cannot limit the guarantee to their selection of most risky loans. Because the guarantee is applied to credit extended from PFIs to borrowers, borrowers are not aware that their loan is partially guaranteed by a quasi-public Fund (the PPCG is "silent"). This avoids moral hazard and high delinquency rates when loans are known to be insured by public funds.

186. If a loan registered in the guarantee defaults, the PFI submits a claim to SOLIDIS Garantie. SOLIDIS Garantie then has thirty days to review the claim on behalf of the Fund and pay the claim. The PFI is in charge of the recovery and the proceeds are shared equally with the Fund. The quick payment is an important benefit for PFIs who receive cash immediately without having to wait for a lengthy settlement.

Fees structure

187. The PFIs pay commission for coverage through the PPCG. The commission is set at 2 percent as long as the ratio of their non-performing portfolio to the total portfolio registered under the guarantee remains below 4%. Above that level, the commission increases to 3%. When the non-performing portfolio reaches 7 percent of the total, the PFI can no longer enter loans on the guarantee. Claims will be paid by the Fund only if the ratio of bad loans to the total volume of loans in the guarantee is less than 25%. These are stop loss measures intended to protect the Fund from difficulties experienced by a few PFIs.

188. There is no direct subsidization in the MSME window - commissions paid by PFIs and the returns on investments of the endowment should cover the administrative costs of SOLIDIS Garantie and net losses related to the payments of claims. This design should contribute to maintaining the capital endowment of the window at its original level. In 2016, the revenues of the Fund were able to cover all the costs.

Eligibility and selection process of financial institutions

189. PFIs were chosen through calls for expression of interest. To qualify, PFIs have to meet a number of criteria:

- Meets the prudential norms established by the CSBF
- Has a reasonable ratio of bad loans to total loans
- Has reasonable ROA and ROE
- Has a good presence in the country through branches
- Is engaged in lending to MSMEs or has expressed an interest to develop lending activities towards MSMEs; it has obtained all the authorizations to that effect from its Board of Directors and has the necessary means to conduct such activity

- Has a dedicated staff for the management of a MSME clientele or is determined to hire such dedicated personnel who will be trained by a technical assistant
- Has credits procedures covering analysis of loan requests, loan granting, loan monitoring and loan recovery or commits to establish such procedures with the help of a technical assistant
- Has computer tools for the management of credits or commits to acquire such tools
- Has the capacity to categorize the credits according to the classification established by CSBF
- Has a reporting system on credits by type of borrowers, sector of activity, geographic zone, or will be able to adapt its existing system to develop such reporting.
- Has a rating system for borrowers or commits to put in place such a system
- Has the capacity to achieve the performance indicators agreed upon in the convention
- Has (or commits to put in place) anti-money laundering and anti-terrorists policies as well as a policy of social and environmental responsibility in conformity with similar policies at the World Bank and will integrate these policies in the operational procedures of the institution
- Commits to abide by the procedure manual of the PPCG
- Commits to maintain a financial management system and to prepare financial statements in conformity with usual accounting norms; these financial statements must be audited and certified by licensed auditors.
- Has accepted and signed a convention with SOLIDIS Garantie

Selection Process of the fund manager

190. SOLIDIS Garantie was chosen to manage the PPCG Fund under the PASEF project because: (a) its capital is 100 percent privately owned; (b) it is licensed and supervised by the CSBF (a regulatory requirement to manage a guarantee scheme); (c) it has the capacity to manage a guarantee Fund; (d) it has experience in the management of guarantees; (e) its fee is competitive; and (e) it shows great interest in developing the PPCG. There is only one other institution licensed to manage guarantees in Madagascar. The Government owns 49 percent of the capital of this other institution and it has not been successful in developing its own guarantees.

191. Over the past three years, SOLIDIS Garantie has been quite efficient and effective in managing the PPCG, ensuring its growth and development. It has paid claims within the set 30 days and PFIs are satisfied with its performance. SOLIDIS Garantie is therefore expected to continue to act as PPCG Fund manager going forward.

The PPCG (MSME window) meets all the 16 principles defined in 2015 by an international task force under the leadership of the World Bank and FIRST Initiative.

Principle 1: *The Credit Guarantee Scheme (CGS) should be established as an independent legal entity on the basis of sound and clearly defined legal and regulatory framework to support the effective implementation of the CGS' operations and the achievement of its policy objectives.*

MET: The PPCG has been established as an independent Fund with its own policy objectives. A legal expert has reviewed the structure and the operations of the Fund. The Fund Manager is a fully privately owned institution licensed and supervised by the Commission de Supervision

Bancaire et Financiere (CSBF).

Principle 2: *The CGS should have adequate funding to achieve its policy objectives, and the sources of funding, including any reliance on explicit and implicit subsidies, should be transparent and publicly disclosed*

MET: The World Bank provides the endowment (capital) to support the guarantees. The endowment is paid in tranches that are disbursed as needed according to the volume of business.

Principle 3: *The legal and regulatory framework should promote mixed ownership of the CGS, ensuring equitable treatment of minority shareholders*

MET: While the PPCG Fund is owned by the State, the existing regulatory framework does not prevent mixed ownership. The Fund steering committee that defines the policies and global approaches of the Fund is composed of Government and the private sector (see composition of the steering committee below). The Fund manager is fully private.

Principle 4: *The CGS should be independently and effectively supervised on the basis of risk-proportionate regulation scaled by products and service offered*

PARTIALLY MET: The Fund is supervised by the World Bank project and the CSBF

Principle 5: *The CGS should have a clearly defined mandate supported by strategies and operational goals consistent with policy objectives*

MET: The PPCG has a clearly defined mandate and clearly defined strategies. Policies are defined by its Steering Committee.

Principle 6; *The CGS should have a sound corporate governance structure with an independent and competent board of directors appointed according to clearly defined criteria*

MET: The PCG Fund has an independent and competent steering committee that plays the role of a board of directors. The Steering Committee is composed of a representative from the Ministry of Finance, the Central Bank, the Professional Association of Banks, the Professional Association of Microfinance Institutions and two individuals chosen for their knowledge of banks and Microfinance institutions. The Fund manager and the World Bank project coordinator attend the steering committee meetings without a voting right.

Principle 7: *The CGS should have a sound internal control framework to safeguard the integrity and efficiency of its governance and operations*

MET: The Fund manager, SOLIDIS Garantie is subject to sound internal controls. In addition an external auditor conducts quarterly audits of the Fund, its manager and participating financial institutions (PFIs).

Principle 8: *The CGS should have an effective and comprehensive enterprise risk management framework that identifies, assesses and manages the risks related to CGS operations*

MET: There are clear limits to losses acceptable to the Fund and stop loss measures are in place. In addition, the claims on the Fund by PFIs are closely monitored triggering, when warranted the intervention of the Fund manager.

Principle 9: *The CGS should adopt clearly defined and transparent eligibility and qualifications criteria for SMEs, lenders and credit instruments*

MET: The criteria are clearly spelled out in the conventions signed between the PFIs and SOLIDIS Garantie. The criteria refer to the eligibility of SMEs and credit instruments. Eligibility criteria are also clearly defined for PFIs.

Principle 10: *The CGS's guarantee delivery approach should appropriately reflect a trade-off between outreach, additionality and financial sustainability, taking into account the level of financial sector development of the country*

MET: Such a trade-off drives the operations of the PPCG Fund

Principle 11: *The guarantee issued by the CGS should be partial, thus providing the right incentive for SME borrowers and lenders and should be designed to ensure compliance with the relevant prudential requirements from lenders, in particular with capital requirements for credit risk*

MET: The guarantee covers only 50 percent of the amount of the credit; prudential requirements are met by the Fund. Only lenders who meet all prudential norms are admitted as PFIs.

Principle 12: *The CGS should adopt a transparent and consistent risk-based pricing policy to ensure that the guarantee program is financially sustainable and effective for both SMEs and lenders*

MET: there is a transparent risk-based policy based on the portfolio at risk acceptable to the Fund.

Principle 13: *The claim management process should be efficient, clearly documented and transparent providing incentives for loan loss recovery, and should align with the home country's legal and regulatory framework*

MET: There is a clear and efficient process to deal with claims within thirty days. PFIs are tasked with proceeding with loan recovery. A justified claim is paid by the Fund within thirty days and the PFI shares 50-50 with the Fund the proceeds of loan recoveries.

Principle 14: *The CGS should be subject to rigorous financial reporting requirements and should have its external financial statements audited externally.*

MET: The Fund provides quarterly reporting. As indicated earlier it is subject to quarterly external audits

Principle 15: *The CGS should periodically and publicly disclose nonfinancial information related to its operations*

MET: Through its manager, SOLIDIS Garantie, there are weekly reports on the operations of the Fund which cover financial as well as non-financial operations.

Principle 16: *The performance of the CGS- in particular outreach, additionality and financial sustainability – should be systematically and periodically evaluated, and the findings form the evaluation publicly disclosed*

MET: The performance of the PPCG is indeed evaluated periodically globally and for each lender. These evaluations lead at times to a review of the conventions signed between the lender and the Fund manager. The form of public disclosure is being assessed to protect confidentiality.

ANNEX 6: Simulations for the capital increase of the Partial Portfolio Credit Guarantee (PPCG) under the new project

192. The volume of credits that can be guaranteed depends on the level of capital of the Fund and the multiplier applied to the capital. The multiplier has been fixed at three, a conservative but a safe level. The level of capital depends on the initial and subsequent endowment and on the interaction of revenues (commissions received from PFIs and investment revenues) and expenses (administrative expenses and net losses attributable to claims). The question arises as to whether the initial endowment of four million US dollars will permit the Fund to continue to operate and to grow. In the negative, what level of endowment will allow the Fund to grow at a 30 percent annual rate (its current growth rate) for many years to come.

193. Simulations were made to assess how the program will perform with and without an increase in the Fund's endowment (capital). In one set of simulations, there is no increase in external financing. Other simulations were run with different external increases in the endowment. Particularly, in one set of simulations, external financing was gradually increased by 8 million US dollars starting in mid-2017. The simulations were run with different rates of net claims (net claims of 2%, 3-4 percent and 7-8%). A summary of the results follows

1. *Simulations with no injection of new external financing*

(a) With a net claim of 2 percent of the volume of credits registered under the guarantee, the level of capital remains stable. But sometime between March and June 2018, the Fund reaches its maximum capacity (a multiplier of 3) and credits can no longer be registered. The Fund will continue to operate but without growth.

(b) With a net claim of 3 to 4 percent in 2018, the Fund registers an operating loss and the capital starts a slow declining trend in the second quarter of 2018. As a result, the amount of credit that can be registered under the guarantee will slowly decline over time.

(c) In a pessimistic simulation with 4-5 percent net claim on the volume of credits benefitting from the guarantee in 2017 and a 7-8 percent net claim in 2018, the capital engages on a steeper decline, despite an increase in the fee paid by the PFIs. This scenario is non-sustainable in the longer run. The multiplier reaches 3 in December 2017.

In summary, without an injection of new financing, the PPCG is not sustainable in the long run and the volume of credits guaranteed will decline over time.

2. Simulations with new external financing of 8 million US dollars in three installments

(a) With a maximum net claim of 2 percent of the volume of credit registered under the guarantee, in 2018, the Fund is sustainable in the long run. There are no net losses and the multiplier remains below 3 percent for a number of years. The improvement over the equivalent simulation without the additional external financing (simulation 1.a) is the additional return on the investment of the increased capital. This provides a net benefit to the Fund over the years.

(b) With a maximum net claim of 3-4 percent, the results are quite similar to the previous simulation (2.a). The Fund exhibits some long run stability and could function for 5 years (including 2017) before it reaches a multiplier of 3.

(c) With a net claim on credits of 5-6 percent in 2017 and 7-8 percent in 2018, the capital is sufficient to cover the losses for about three years. The multiplier remains below 3 for a little less than 4 years.

The conclusion is that with an additional external funding of 8 million US dollars, there will not be a need for a replenishment of the endowment for a number of years. The new endowment of 12 million US dollars would allow a 30 percent annual increase in the volume of credit guaranteed until at least 2022. At that time the volume of credit guaranteed under the SME window would have reached 280 billion ariary (85 million US dollars).

The table below gives the details of the simulation 2 (b) as an example:

	Units	2017	2018	2019	2020	2021	2022
Capital	ARY mill	11 450	24 200	31 371	38 543	39 395	39 996
Volume of credit portfolio under the guarantee	ARY mill	81 795	105 300	136 890	177 950	231 940	280 000
Amount of credit guaranteed	ARY mill	40 897	52 650	68 445	88 975	115 670	140 000
Multiplier		3.57	2.17	2.18	2.30	2.93	3.5
Commissions	ARY mill	717	935	1 211	1 574	2 046	2 556
Revenue from investment	ARY mill	1 030	1 604	2 501	3 150	3 507	3 572
Cash inflow	ARY mill	1 747	2 539	3 712	4 724	5 553	6 128

Fees paid to the Fund manager	ARY mill	634	709	874	1 048	1 258	1 510
Cost of audits	ARY mill	51	61	71	71	71	80
Fees for MIS	ARY mill		114.7	110	120	120	140
Other charges	ARY mill	3	5	6	7	7	8
Payments to members of steering committee	ARY mill	26	26	26	26	26	26
Payments of claims	ARY mill	371	1 053	2 053	2 600	3 470	4 200
Cash outflow	ARY mill	1 085	1 968	3 140	3 872	4 952	5 964
Net cash inflow (+) ouflow (-)[66]	ARY mill	662	571	572	852	601	164

Source: World Bank and SOLIDIS Garantie staff

Hypotheses
Increase in capital: 4 million US dollars in 2018, 2 million US dollars in 2019, 2 million US dollars in 2020
Rate of claims: 2 percent in 2018. 3 percent in 2019-2022

ANNEX 7: Impact Evaluation Proposal[67]

Madagascar – Project d'Appui aux Services Financiers (PASEF 2)
Impact Evaluation Outline - GIL Steering Committee
July 2017

I. Background

A large majority of teachers in Madagascar are women, and digital payments represent a shift towards more regular, reliable, and secure incomes. This IE would explore how this increased regularity and reduced liquidity of income impacts women's intra-household bargaining power, intra-household cooperation, saving behavior, access to other financial services, and exposure to redistribution pressure from their financial network.

II. Design and Outline of Impact Evaluation: Digital Payments to Teachers

Government payment programs form an integral part of the Finance and Markets (F&M) Global Practice's approach to financial inclusion. Globally, F&M is beginning to pilot government payment programs as a tool for accelerating financial inclusion, and helping unbanked borrowers gain access to transaction accounts and a broader suite of financial services.[68] Efforts to target women are at the forefront of F&M's

[66] Simulations are based on internal exchange rate projections.
[67] This annex contains the outline of the impact evaluation proposal that was submitted to the World Bank's Gender Innovation Lab for funding in July 2017. The proposal has been approved in October 2017.
[68] "The Importance of Government Payments", in *General Guidelines for the Development of Government Payment Programs*, Payment Systems Policy Research Series, World Bank Group, Finance & Markets Global Practice, 2013.

financial inclusion strategy. By providing evidence on the impact of digital payment programs on women's financial inclusion and women's economic empowerment, this impact evaluation could play a critical role in informing and expanding F&M digital payments interventions in a broad range of countries.

a. Scope of the Intervention

Digital Payments: In Madagascar, there are 170,000 government employees and of this 45,000 are paid in cash. Out of the 170,000 government employees 30,000 are teachers employed by the Ministry of Education. Additionally, there are 70,000 non-civil servant teachers hired by local communities which makes the total teacher target intervention population 100,000. Many of these teachers work in rural areas without proximity to bank branches and earn very low incomes (and thus could not justify opening bank accounts). This project, depending on performance, might be followed by another project allowing to extend from teachers to health care workers, which will cover most government workers.
The team is working to select geographic areas for the roll out of the digital payments to teachers. The city of Mahajanga has been identified by the project team for a pilot but this is still under discussion with the government. The project/government will then work with payment services providers and these providers will make a proposal for how to set up access points for teachers to open transaction accounts. In the pilot phase the project will be rolled out in a municipality and then there will be a phased roll out at a national level.

Financial Literacy Campaigns: The digitization of payments would be accompanied by financial literacy campaigns, aimed at influencing behaviors. There are two types of campaigns under discussion. The first is a broad campaign about how to open transaction accounts etc. The second campaign is proposed to be a targeted campaign to influence behavior in two senses, i) influence their savings – leave money in the account after they are paid and ii) a campaign to encourage people to access a broader range of financial services. There is scope to add financial innovation to these campaigns. One idea now is to influence the population through text messages campaigns using different messaging for different people.

b. Roll out and Randomization

The digital payments intervention will be rolled out by commune level (over 1,000 communes in the country). It would impact all teachers that are paid out of that commune. The mobile money providers will want to start with urban populations and move to rural populations, and areas will need reliable phone coverage to participate. The project team is open to generating a control group by randomizing communes that meet certain pre-selection criteria, such as network coverage and level of urbanization

c. Gender Angle

The majority of teachers are women and this project will pay their salaries on mobile money accounts. This will reduce delays in payment, reduce how far they have to travel to get paid, provide them with a way to store funds and get access to other financial services. In addition, these teachers aren't being paid regularly because the government is not sending the money to the payment agent, and the agent is not delivering the full amount that is due.

III. <u>Research questions/learning potential</u>

This intervention is a unique opportunity to observe the impact of an exogenous variation in the level of certainty and the regularity of income of a population. We could learn how digital payments, by decreasing uncertainty, increasing regularity of income, and decreasing the liquidity of payment impact women's intra-household bargaining power, saving behavior, intra-household cooperation and exposure to redistribution pressure from their social network. This would contribute to answer to some of GIL's priority research questions on saving behavior and mobile savings accounts.

The impact evaluation could also answer some important questions, beyond the GIL priority questions, which are relevant to both GIL and the F&M project team. This would include understanding the impact of digital payment accounts on access to other financial services (the 'gateway' effect), and the impact on teacher's absenteeism as a result of reduced travel time to receive payments.

IV. Next steps

The PASEF 2 scoping mission will take place in September and the project team will further discuss the target municipalities and roll out strategy then.

ANNEX 8: Additional indicators for analytical purposes[69]

Area.	Indicators
Digitalization of government payments	- number/value of transfers initiated by teachers* - number/value of bill payments initiated by teachers* - number/value of electronic transactions (other than cash withdrawals) initiated by students* - number/value of transfers initiated by merchants* - number/value of bill payments initiated by merchants* (*for which a new e-money account is created through the project)
MFI interventions	- % of MFIs clients using mobile phone to transact (disaggregated by gender and rural/urban) - Volume of mobile based transactions - Savings mobilized by new MFIs branches - Credit extended by new MFIs branches

[69] Information on these indicators will be regularly collected by the team during official Implementation Support Missions and used as an additional tool to help project's management and implementation. Actual baseline and targets will be defined by the team in the Project Implementation Manual.

PPCG	- Number (cumulative) of MSME loans that banks have registered under thepartial portfolio credit guarantee since effectiveness of the project - Average size of MSME and MFI loans that banks have registered under the partial portfolio credit guarantee since effectiveness of the project - Percentage of MSME loan applications not eligible for the PPCG due to safeguard measures
Business Development Services	- Number and % of firms satisfied with business development services received
Financial Capability	- % of beneficiaries who have been using their account as a store of value following the behavioral campaigns % of beneficiaries who conduct more than 2 transactions a month following the behavioral campaigns
Financial Consumer Protection	- Number of yearly supervisory inspections conducted - Number of complaints received by financial institutions

ANNEX 9: Financial Management Assessment Report

Executive Summary

194. A dedicated unit (PIU) will be established within the Ministry of Finance and Budget (MFB) for the implementation of the project.

195. The overall risk for the Project is rated **substantial** due mainly to the fiduciary risk inherent at country level, but also to some extent to the lack of experience of the PIU in project management. It is considered that PIU financial management arrangements will meet the World Bank's minimum requirements under World Bank Policy and Directive once the mitigation measures are implemented. The mitigation measures will be mostly implemented with the Project Preparation Advance and are comprised of: (a) the recruitment of qualified and experienced FM staff composed of one Financial Manager and one Accountant for the PIU, (b) the development and adoption of a FM procedures manual as part of the POM, (c) the purchase of an adequate accounting system for the PIU.

Project Description and institutional arrangements

196. The development objective of this project is to promote the financial inclusion of individuals and MSMEs in Madagascar. This project proposes to finance activities to support financial inclusion in Madagascar over four years for US$45 million through 4 components: (i) Digitalization of transactions to increase usage of transaction accounts (US$ 25.5m); (ii) Access to Credit for MSMEs (US$ 16.5m); (iii) Support Project Management and Impact Evaluation (US$ 3m); (iv) Contingent Emergency Response (US$ 0m).

197. The previous World Bank-funded project in financial sector PASEF (P109607) was successfully implemented by an Association comprised of representatives of the MFB and the Central Bank of Madagascar supported by external technical assistants. As the Government has demonstrated good implementation capacity under the previous project and, as some of the project sub-components are designed as continuation of activities under the previous PASEF project, this project will be implemented by a Project Implementation Unit (PIU) to be established as a dedicated unit in the MFB. The PIU will have full fiduciary responsibility for project implementation.

Country Issues

198. The overall country fiduciary risk including fraud and corruption risk is high. The 2014 PEFA self-assessment indicated significant PFM constraints and noticed that limited progress had been made on improving the credibility of the budget, the transparency of the budget, timeliness and availability of financial reporting. Per PEFA 2014 report, 24 Indicators were scored C or D out of a total of 29 indicators scored. A PFM strategy was developed in 2015 and reforms have been ongoing to address the identified weaknesses. Achievements to highlight include the regular and timely publication of the Budget on the MFB website and the publication of a citizen budget from 2015 translated in Malagasy (local language) to reach wider audience. The Cour des Comptes published its first report covering the year 2014 in May 2016. Moreover, the audited final accounts of the State Budget from 2009 to 2012 were approved by the Parliament in 2015 and 2016. The World Bank- funded Public Sector Performance Project (P150116), effective in March 2017, is supporting some PFM reforms to improve revenue management, service delivery in the education sector in Selected Regions including controls, and performance monitoring. A 2017 PEFA self-assessment is currently underway.

199. Given the weaknesses in the PFM system, the project will opt for the gradual use of the country PFM systems using a risk-based approach disbursement process, designated account opened at the Central Bank, relaying in MFB departments for the implementation of the project. The overall fiduciary risk rating of the project is assessed as Substantial and mitigation measures have been proposed (see FM Action Plan).

Financial Covenants

200. The borrower shall establish and maintain a financial management system including records, accounts and preparation of related financial statements in accordance with accounting standards acceptable to the World Bank.

201. The financial statements of the project will be audited in accordance with international auditing standards. The audited financial statements for each period shall be furnished to the Association not later than six (6) months after the end of the project fiscal year.

202. The Interim Unaudited Financial Statements will be established in accordance with format agreed with the World Bank and will be transmitted within 45 days after the end of each quarter.

Detail of financial management arrangements

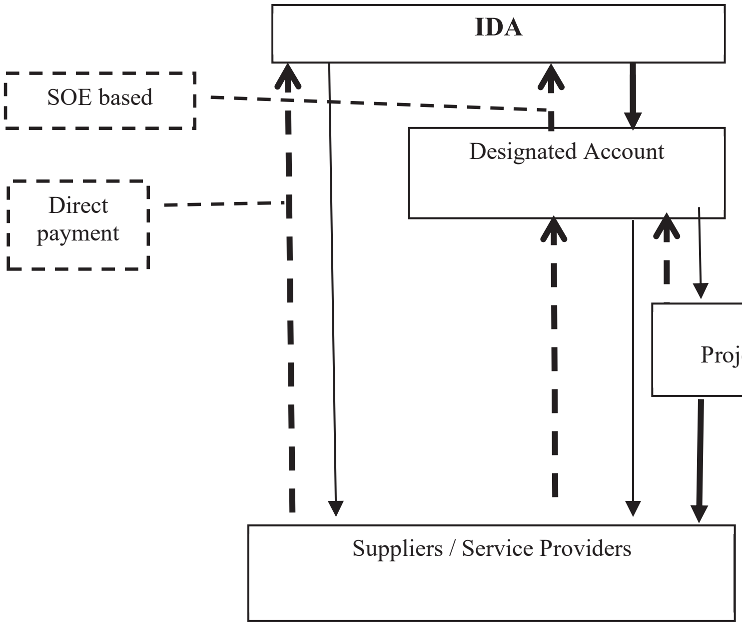
Staffing. The PIU will be staffed with one (1) Finance Officer and one (1) Accountant recruited on a contractual basis, in accordance with the TOR agreed with the World Bank.
The World Bank will provide the project's fiduciary staff with trainings on the World Bank financed project financial procedures if required.

Budgeting. The PIU will prepare the project annual work plan and budget, in line with the regular Government annual budget preparation cycle. The budget execution will be monitored on a monthly and a quarterly basis. The budget execution report will be part of the Interim Financial Report and any variances will be explained and remedial measures indicated. The procedures governing the budget preparation, execution and monitoring cycle will be developed in the project's financial and administrative procedures manual.

Funds flow and Disbursement arrangements.

203. Disbursements will be made in accordance with the *World Bank Disbursement Guidelines for Projects,* dated February, 2017. The financing proceeds will be disbursed using the disbursement methods as per Disbursement and Financial Information Letter (DFIL). One designated account (DA) denominated in US$ will be opened at the Central Bank. A secondary US$ account will be opened at an acceptable commercial bank to enable payment of eligible expenditures.The DA will receive an initial advance equivalent to four months of forecasted expenditures and will be replenished regularly through monthly Withdrawal Applications (WA) supported with Statements of Expenditures (SOEs). Direct payments may be made to service providers at the request of the Recipient. The Project Operations Manual (POM) will broadly describe the disbursement process.

Funds of Flow



Legend	*Transfers of funds* *Flow of documents* *Payment to suppliers*	

Disbursements by category: The table below sets out the expenditure categories to be financed out of the Credit proceeds. This table takes into recognition the prevailing Country Financing Parameter for Madagascar in setting out the financing levels, which shows there will be no counterpart funds in the sense to share the project expenditure.

Category	**Amount**	**Percentage of Expenditures to be Financed**
1) Goods, civil works, non consultant services, consultant services, Component1	25.5 m	100%
2) Goods, civil works, non consultant services, consultant services, Component 2	16.5 m	100%
3) Goods, civil works, non consultant services, consultant services, Component 3	3 m	100%
4) Goods, civil works, non consultant services, consultant services, Component 4	0 m	100%
5) Non-allocated		
Total	45 m	

204. Retroactive financing. The Borrower requested retroactive financing to fund a first tranche capital increase for the PPCG(US$ 2.5 million) and the upgrade of the RTGCS/ACH systems (US$2.9 million). In accordance with the World Bank policies, retroactive financing is permitted under the following conditions: (a) the activities financed are included in the project description and are procured in accordance with the applicable World Bank procurement rules; (b) such payments do not exceed 20 percent of the loan amount; and (c) the payments were made by the Borrower not more than 12 months before the expected date of the Loan Agreement signing. In this context, the Government may make withdrawals up to the approved RF amount for payments made prior to the date of the Loan Agreement but on or after the retroactive financing date to be specified in the financing agreement, for Eligible Expenditures under agreed categories.

Internal controls and Internal audit. Internal controls will comprise, but not be limited to the following: clear segregation of duties, monthly reconciliation of accounting, frequent reporting, contract management and internal audit plan. The internal controls system and procedures will be detailed in the POM. The Directorate in charge of the internal audit within the Ministry of Finances will include the project in its work program.

Accounting and Reporting. The project accounting system will be maintained on a modified accruals cash basis with disclosure of commitments and will comply with the Malagasy General chart of accounts (Plan Comptable Général 2005) which is broadly in line with the International Accounting Standards IAS/IFRS.

All information on the budget execution will be entered ex post in the Government IFMIS. To that end, the PIU will send the budget execution report to the Ministry of Finance and Budget. An accounting software will be purchased to enable the project's accounting, budget follow-up and reporting. The detailed procedures governing the budget execution report preparation and monitoring will be developed in the POM.

The Project will submit the IFRs to the World Bank within 45 days after the end of each reporting period.

External financial Audit. The external audit of the project financial statements will be carried out by independent audit firms to be appointed per TOR agreed with the World Bank. The audit will comply with the International Standards on Auditing and the audit report. In line with the new access to information policy, the project will comply with the World Bank disclosure policy of audit reports (e.g. make publicly available, promptly after receipt of all final financial audit reports (including qualified audit reports)).

Implementation support and Supervision plan:

Considering the current overall residual FM risk level, the following describes the supervision plan:

Action	Description	Frequency
Desk reviews	Interim financial reports review; Review of the audit report on the financial statements of the project; Review of other relevant information such as internal audit reports.	Quarterly Annually Continuous as they become available
On site visits	Review of overall operation of the FM system; Monitoring of actions taken on issues highlighted in audit reports, auditors' management letters, internal audit and other reports, Transaction review (if needed)	Twice a year As needed As needed
Capacity building support:	FM training sessions for regional and central staff provided by the World Bank and regular FM meetings	During implementation and as and when needed

FM actions plan

Action	Responsible party	Deadline and conditionality
1- Development and adoption of the POM including FM manual	PIU/MFB	No later than 3 months after

		effectiveness
2- Recruitment of a qualified FM staff (One FM Manager and One Accountant)	PIU/MFB	No later than 2 months after effectiveness
3- Purchase and installation of an adequate Accounting system for the entity	PIU/MFB	No later than 3 months after effectiveness
4- Recruitment of an Independent external auditor	PIU/MFB	No later than 6 months after effectiveness

The FM risk assessment and mitigations measures are summarized in the table below:

Risk	Risk	Risk Mitigating Measures Incorporated into Project Design	Conditionality	Residual Risk Rating
Inherent risk	H			H
Country level PFM reform is experiencing implementation delays and weaknesses identified by the PEFA 2014 in PFM cycle generate the risk if lack of transparency and accountability in the use of public funds.	H	Implement the PFM reform agenda with the support of the World Bank and other donors (AFDB and EU). The World Bank financed project (P150116, Public Sector Services Delivery and Accountability Project) is supporting the improvement of the Madagascar public sector and PFM system	N	
Entity level The PIU has no previous experience in financial management of IDA projects	S	Recruit one qualified Finance Manager and one Accountant for the PIU.	N	S

Project level Misunderstanding of the responsibility as the project involve several stakeholders and due to the lack of experience in project implementation especially project financed by the World Bank	S	A POM including FM procedures and a clear description of the roles and responsibilities of the various stakeholders will be developed with appropriate trainings.	Y	S
Control Risk				**S**
Budgeting Delay in preparing annually budget and inappropriate monitoring of budget execution resulting in delay in achieving project's objectives.	S	Follow strictly budget procedures and timeline as per the POM. Tools and system will be set up to enable preparation and execution of the project	N	S
Accounting Weak capacity and lack of experience in managing World Bank financed projects which may result in delay and inaccuracies of accounting data	S	Recruit qualified FM staff. Install an adequate accounting information system that enables budget follow-up, accounting, reporting.	N	M
Internal Controls and Internal audit Ineffective audit function Risk of ineligible expenditures	 S S	The staff of the Directorate in charge of the internal audit within the Ministry including the project will benefit from trainings on WB FM Procedures. Design a comprehensive POM covering FM aspects. Monitor the risk on non-compliance of the expenditures by using risk based	N Y N N	 S S

		approach for internal audit. Provide support and sensitize on the risk of ineligible expenditures during the World Bank supervision mission.		
Funds Flow Risk of delay in the disbursement of the funds because the designated account is opened at the Central Bank.	S	Provide support to the Government to identify and mitigate the risk of the transfer of the funds to the Central Bank (dedicated unit for donors funded projects at the Central Bank).	N	S
Financial Reporting and Monitoring Unreliable IFRs and delay in submitting the IFRs	S	Accounting software to be set up Qualified FM staff recruited	N	M
External Auditing Audit not in compliance with internationally acceptable standards Delay in submitting the audit report	S	Qualified and independent external auditors under TOR satisfactory to the World Bank. Project financial statement timely available.	N	M
Fraud & Corruption Risk of fraud & corruption in the contracts management	S	Ensure that the grievance redress mechanism is part of the project.	N	S
Overall Risk	S			S

Conclusions of the FM Assessment: The overall residual FM risk is considered **Substantial**. The proposed financial management arrangements for this project are considered adequate subject to the implementation of the mitigation measures, and meet the World Bank's minimum fiduciary requirements under World Bank policy and directive.