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R2019-0050/1

March 11, 2019

Closing Date: Thursday, March 28, 2019 at 6:00 p.m.

FROM: Vice President and Corporate Secretary

Mexico - Expanding Rural Finance Project

Additional Financing

Project Paper

Attached is the Project Paper regarding a proposed additional loan to Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero (FND) with the guarantee of Mexico for the Expanding Rural Finance Project (R2019-0050), which is being processed on an absence-of-objection basis.

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The World Bank

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Report No: PAD3120

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT PAPER

ON A

PROPOSED ADDITIONAL LOAN
AND RESTRUCTURING

IN THE AMOUNT OF US$ 400 MILLION

TO THE

FINANCIERA NACIONAL DE DESARROLLO AGROPECUARIO, RURAL, FORESTAL Y PESQUERO

FOR THE

EXPANDING RURAL FINANCE PROJECT
WITH A GUARANTEE OF THE UNITED MEXICAN STATES
MARCH 7, 2019

Finance, Competitiveness And Innovation Global Practice
Latin America And Caribbean Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective March 7, 2019)

Currency Unit =	Mexican Pesos (MXN)
MXN 19.28 =	US$ 1

FISCAL YEAR

January 1 - December 31

Regional Vice President:	Axel van Trotsenburg
Country Director:	Pablo Saavedra
Global Director:	Alfonso Garcia Mora
Practice Manager:	Zafer Mustafaoglu
Task Team Leader(s):	Steen Byskov, Daniel Ortiz del Salto

ABBREVIATIONS AND ACRONYMS

AF	Additional Financing
AGROASEMEX	Mexican Agricultural Insurance Company *(Aseguradora Agropecuaria Mexicana)*
CNBV	National Banking and Securities Commission *(Comisión Nacional Bancaria y de Valores)*
CONDUSEF	Commission for the Protection of Users of the Financial System *(Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros)*
CONAPO	National Council for Population (*Consejo Nacional de Población*)
CPS	Country Partnership Strategy
CSA	Climate-smart agriculture
EMF	Environmental Management Framework
ERR	Economic Rate of Return
FAO	Food and Agriculture Organization
FIRA	Trust Funds for Rural Development *(Fideicomisos Instituidos en Relación con la Agricultura)*
FIRCO	Trust Fund for Shared Risk *(Fideicomiso de Riesgo Compartido)*
FOCIR	Capitalization and Investment Fund for the Rural Sector *(Fondo de Capitalización e Inversión del Sector Rural)*
FND	Rural Financial Development Agency *(Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero)*
GDP	Gross Domestic Product
GNI	Gross National Income
GP	Global Practice
GRS	Grievance Redress Service
IBRD	International Bank for Reconstruction and Development
INAH	National Institute of Anthropology and History (*Instituto Nacional de Antropología e Historia*)
IP	Indigenous Peoples
IPPF	Indigenous Peoples Planning Framework
LCR	Latin America and the Caribbean Region
MSME	Micro, Small, and Medium Enterprise
M&E	Monitoring and Evaluation
NBFI	Non-Bank Financial Institution
NPL	Non-performing Loan
NPV	Net Present Value
PCG	Partial Credit Guarantee
PDO	Project Development Objective
PFI	Participating Financial Intermediary
PIU	Project Implementation Unit
ROA	Return on Assets
ROE	Return on Equity
SHCP	Ministry of Finance *(Secretaría de Hacienda Y Crédito Público)*
WB	World Bank

MEXICO

Expanding Rural Finance Project

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BASIC INFORMATION – PARENT (MX: Expanding Rural Finance - P153338)

Country	Product Line	Team Leader(s)		
Mexico	IBRD/IDA	Steen Byskov		
Project ID	**Financing Instrument**	**Resp CC**	**Req CC**	**Practice Area (Lead)**
P153338	Investment Project Financing	GFCLC (9281)	LCC1C (447)	Finance, Competitiveness and Innovation

Implementing Agency: Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero

Is this a regionally tagged project?	

Bank/IFC Collaboration

No

Approval Date	Closing Date		Original Environmental Assessment Category	Current EA Category
24-Nov-2015	31-Dec-2020		Financial Intermediary Assessment (F)	Financial Intermediary Assessment (F)

Financing & Implementation Modalities

[ ] Multiphase Programmatic Approach [MPA]	[ ] Contingent Emergency Response Component (CERC)
[ ] Series of Projects (SOP)	[ ] Fragile State(s)
[ ] Disbursement-Linked Indicators (DLIs)	[ ] Small State(s)
[✓] Financial Intermediaries (FI)	[ ] Fragile within a Non-fragile Country
[ ] Project-Based Guarantee	[ ] Conflict
[ ] Deferred Drawdown	[ ] Responding to Natural or Man-made disaster
[ ] Alternate Procurement Arrangements (APA)	

Development Objective(s)

The project's development objective is to expand the availability of finance to the rural economy.

Ratings (from Parent ISR)

	Implementation					Latest ISR
	11-Mar-2016	24-Oct-2016	08-May-2017	19-Dec-2017	21-May-2018	21-Nov-2018
Progress towards achievement of PDO	S	S	S	S	S	S
Overall Implementation Progress (IP)	S	S	S	S	S	S
Overall Safeguards Rating	S	S	S	S	S	S
Overall Risk	M	M	M	M	M	M

BASIC INFORMATION – ADDITIONAL FINANCING (Expanding Rural Finance Project - P169156)

Project ID	Project Name	Additional Financing Type	Urgent Need or Capacity Constraints
P169156	Expanding Rural Finance Project	Restructuring, Scale Up	No
Financing instrument Investment Project Financing	Product line IBRD/IDA	Approval Date 28-Mar-2019	
Projected Date of Full Disbursement 31-Dec-2023	Bank/IFC Collaboration No		
Is this a regionally tagged project? No			

Financing & Implementation Modalities

[ ] Series of Projects (SOP)	[ ] Fragile State(s)
[ ] Disbursement-Linked Indicators (DLIs)	[ ] Small State(s)
[✓] Financial Intermediaries (FI)	[ ] Fragile within a Non-fragile Country
[ ] Project-Based Guarantee	[ ] Conflict
[ ] Deferred Drawdown	[ ] Responding to Natural or Man-made disaster
[ ] Alternate Procurement Arrangements (APA)	
[ ] Contingent Emergency Response Component (CERC)	

Disbursement Summary (from Parent ISR)

Source of Funds	Net Commitments	Total Disbursed	Remaining Balance	Disbursed
IBRD	400.00	320.61	79.39	80 %
IDA				%
Grants				%

PROJECT FINANCING DATA – ADDITIONAL FINANCING (Expanding Rural Finance Project - P169156)

FINANCING DATA (US$, Millions)

SUMMARY (Total Financing)

	Current Financing	Proposed Additional Financing	Total Proposed Financing
Total Project Cost	405.00	400.00	805.00
Total Financing	405.00	400.00	805.00
of which IBRD/IDA	400.00	400.00	800.00
Financing Gap	0.00	0.00	0.00

DETAILS - Additional Financing

World Bank Group Financing

International Bank for Reconstruction and Development (IBRD)	400.00

COMPLIANCE

Policy

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

[ ] Yes [✓] No

Does the project require any other Policy waiver(s)?

[ ] Yes [✓] No

INSTITUTIONAL DATA

Practice Area (Lead)

Finance, Competitiveness and Innovation

Contributing Practice Areas

Agriculture

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

PROJECT TEAM

Bank Staff

Name	Role	Specialization	Unit
Steen Byskov	Team Leader (ADM Responsible)	Senior Financial Sector Economist	FABBK
Daniel Ortiz del Salto	Team Leader	Operations Officer	GFCLC
Gabriel Penaloza	Procurement Specialist (ADM Responsible)	Procurement Specialist	GGOPL
Daniel Chalupowicz	Financial Management Specialist (ADM Responsible)	Financial Management Specialist	GGOLF
Dorothee Georg	Social Specialist (ADM Responsible)	Social Safeguards	GSU04
Susana Toledo Camacho	Environmental Specialist (ADM Responsible)	Environmental Safeguards	GENLC
Anita Tarce	Team Member	Program Assistant	GFCLC
Christian Rodriguez Torres	Team Member	IT Consultant	CF1A7
Diana Martinez Ramirez	Team Member	Program Assistant	LCC1C
Fabiola Altimari Montiel	Counsel	Senior Counsel	LEGLE
Federico Alfonso Diaz Kalan	Team Member	Financial Sector	GFCLC
Maria Virginia Hormazabal	Team Member	Finance Officer	WFACS

Extended Team

Name	Title	Organization	Location

I. BACKGROUND AND RATIONALE FOR ADDITIONAL FINANCING

A. Original Project Objectives and Performance Status

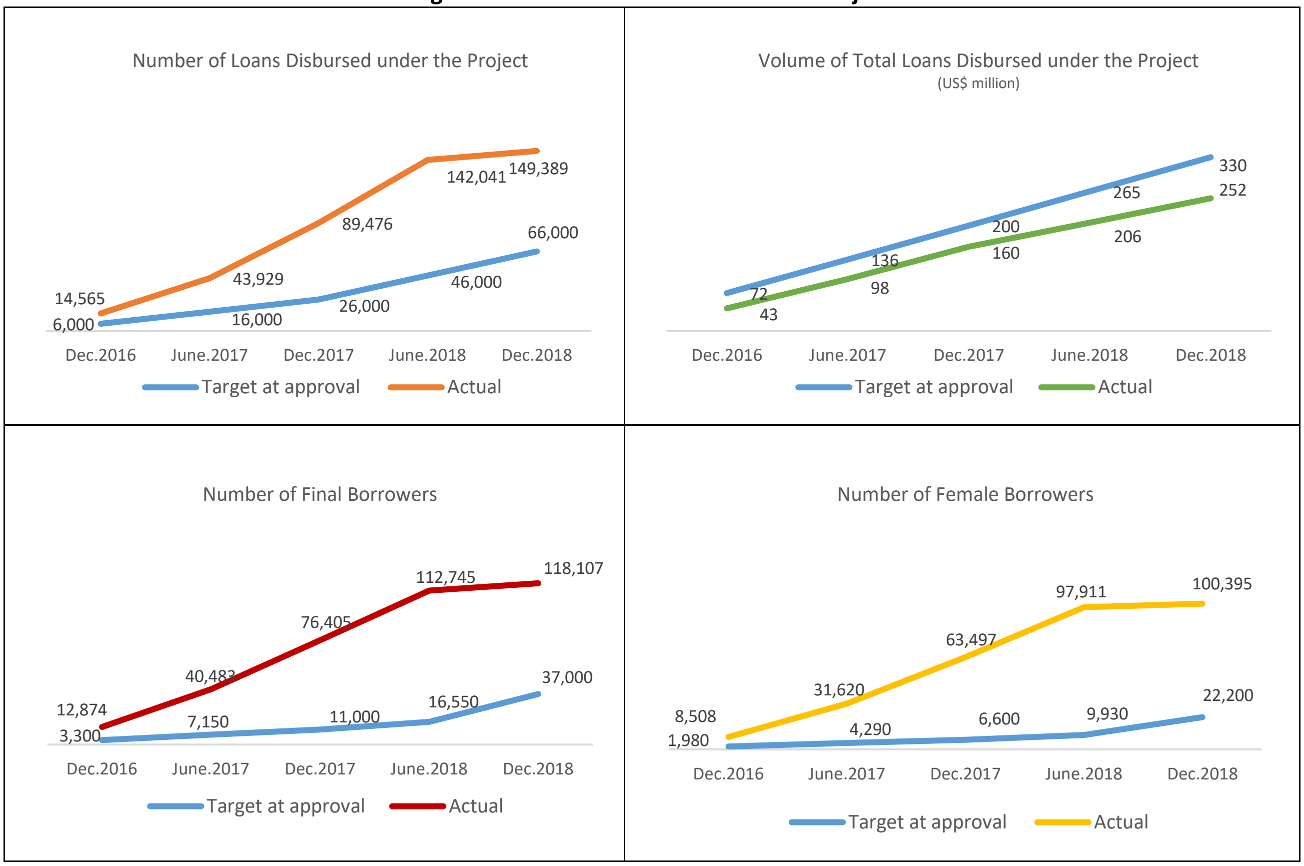
1. **The Expanding Rural Finance Project (P153338) was approved by the World Bank (WB) Board on November 24, 2015 with the development objective of expanding the availability of finance to the rural economy.** The Project is supporting the borrower and implementing agency, *Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero* (FND), to: (i) expand credit for rural micro, small, and medium enterprises (MSMEs); and (ii) strengthen the institutional capacity of the implementing entity and the participating financial intermediaries (PFIs). The Project became effective on July 13, 2016, and its current closing date is December 31, 2020.

2. **The overall Implementation Progress (IP) has been satisfactory throughout the life of the Project.** The Project has been disbursing on schedule. Eighty percent of the loan has been disbursed (US$320 million) as of December 31, 2018. Satisfactory performance on project management, financial management, counterpart funding, procurement, and monitoring and evaluation (M&E) have contributed to the achievement of Project results. The Project is also complying with both the legal covenant and applicable safeguards. Project progress reports and financial reports have been submitted appropriately. Moreover, the overall risk rating remains moderate.

3. **The Project has also made satisfactory progress towards achieving the PDO which is also critical development objective for Mexico, in supporting inclusion, jobs and poverty reduction in the poorer states in the South.** The Project has been effective and efficient in achieving its objectives, and it is central to new government's goal of reducing regional inequalities and supporting the income of rural people in the poorer states of the south (and center) of the country. Lack of access to finance has been a bottleneck for growth and poverty reduction across the country, but particularly affects marginalized and rural areas of lower income states (predominantly in the south of the country), and specific population groups like women—all directly targeted by this Project. The Project is performing well against both the PDO and intermediate target indicators. The reach to the targeted MSMEs in rural areas in poorer states and women entrepreneurs is performing beyond expectations. The institutional capacity building to FND, including as regards to the framework for lending to rural MSMEs, and to the participating financial intermediaries (PFIs) has also been successful. These efforts would need to continue, as they would enable sustainability in rural finance. The detailed progress on the Project's subcomponents can be summarized as follows:

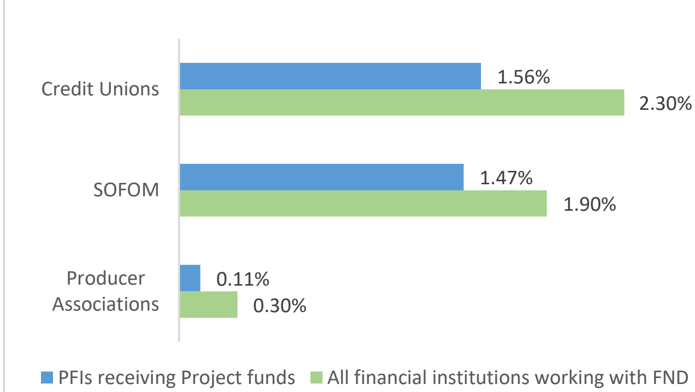
4. **Subcomponent 1A - Credit Line through PFIs to MSMEs:** Under this subcomponent, a credit line is being intermediated by FND through participating financial intermediaries (PFIs) serving rural MSMEs. FND on-lends to eligible PFIs. The PFIs in turn on-lend to eligible rural MSMEs. US$252 million has been disbursed through credit lines with 152 eligible PFIs, which in turn have provided 150,000 credits to 118,000 rural MSMEs with an average loan size of US$1,700. Eighty-five percent of credit recipients are women, 10 percent are located in communities classified as marginalized or highly marginalized by the National Council for Population (CONAPO), and 10 percent are first-time borrowers from formal financial institutions. The number of loans and number of final beneficiaries exceed the original target of the Project because more microfinance institutions were included as PFIs than anticipated.

Figure 1. Loans Disbursed under the Project



5. **PFIs, including both regulated and unregulated institutions, have been lending without compromising the quality of their loan portfolios**. The Project seeks to create sustainable rural credit provision through small rural financial institutions. It is important both for the viability of the PFIs and for the impact on MSMEs that funds are lent to borrowers with the ability to repay. Repayment by the final borrowers has been good across PFI types as evidenced by moderate levels of non-performing loans (NPLs) (Figure 2). On average, NPLs amount to 1.29 percent for the Project, and the ratio is particularly low for the unregulated producer associations (*dispersoras*). Of the 152 eligible PFIs that have provided credits in rural areas, about 50 percent are *dispersoras*.

Figure 2: NPLs by Financial Institution Type

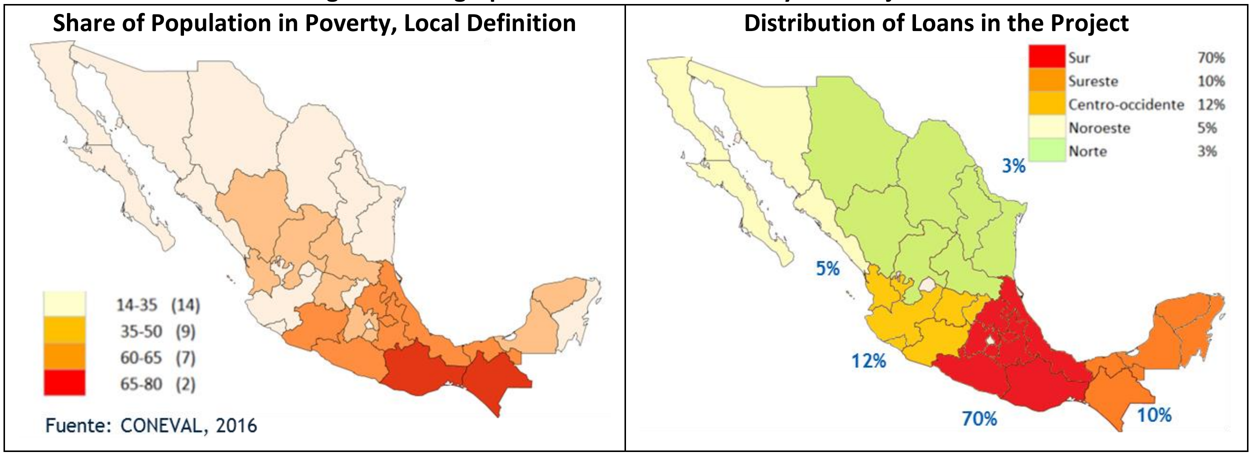


Source: FND, as of June 2018

6. **The Project has been effective in reaching areas with high poverty rates and marginalized communities (Figure 3).** With the model of using small rural financial intermediaries as PFIs, the Project has

successfully reached not only rural areas, but parts of the country where poverty rates are high. 80 percent of the 150,000 credits were provided in the southern states with the highest levels of poverty in Mexico. The Project has provided 127,000 microcredits (less than US$1,000) with an average loan size of US$300 and 23,000 credits for SMEs with an average loan size of US$9,500. Of the US$252 million disbursed, 62 percent was directed to credits for the agricultural sector, 20 percent to commerce, 11 percent to livestock, and 7 percent to other sectors.

Figure 3: Geographic Distribution of Poverty and Project Loans



7. **Subcomponent 1B - Supporting FND Pilots for Rural Finance:** This subcomponent aims to pilot solutions for financial product serving rural borrowers with potential to be scaled up. The Project is currently piloting a price hedge financial product – *coberturas* – to small-scale agricultural producers. The producers purchase an option that effectively provides a minimum price on their outputs, and the Project lends the funds needed to purchase the option. This activity is progressing with US$750,000 disbursed to provide approximately 2,000 *coberturas* through eligible PFIs to hedge the price of about 200,000 tons of sorghum, cotton, coffee and corn worth approximately US$50 million.

8. **Subcomponent 2A - Modernization of FND's Core Banking Information Technology System:** This subcomponent supports the modernization of FND's core banking platform and related systems. The new system will support better risk management, financial service delivery, and performance monitoring. After an initial delay, the first phase of reengineering FND's processes was completed in August 2018. Subsequently, the Government that took power on December 1, 2018 is planning to merge FND with three other rural finance related institutions: *Fondo de Capitalización e Inversión del Sector Rural* (FOCIR), *Fideicomiso de Riesgo Compartido* (FIRCO), and *Aseguradora Agropecuaria Mexicana* (AGROASEMEX). This potential change will have moderate implications for the IT system; the scope of the activity would need to be adjusted. FND remains strongly committed to the IT project and has expressed an interest in financing the implementation of the IT system with own funds, as an option, to be able to extend the scope of the activity by complementing the diagnostic and technical design of the IT project according to the planned new institutional structure.

9. **Subcomponent 2B - Strengthening Rural Financial Institutions:** Under this subcomponent, FND, with counterpart funds, partially finances capacity building activities to PFIs to support the development of a sound rural financial sector. The objectives are to help manage FND's risks and to develop strong rural financial institutions. During the first two years of Project implementation, FND has provided 393 grants to 226 rural

financial intermediaries (about US$3 million). A WB Policy Research Working Paper[1] studied the impact of this Program on the interest rates and outreach of credit unions between 2003 and 2012. The study found that the support provided to PFIs to finance technical assistance increased the survival rate for credit unions by 16 percent and raised the value of their loan portfolio by 50 percent without leading to a higher NPLs. It also increased operating efficiency and lowered the interest rate charged to borrowers as much as 2.6 percentage points.

B. Rationale for Additional Financing

10. **As evidenced by the new government's own assessment and that of the Bank, limited access to finance is a bottleneck for growth and poverty reduction in the country**. This shortcoming is even more pronounced in the poorer states of the country (in the south and central areas), in rural areas, and among certain groups of the population like women. The new government is emphasizing further the development of poorer states in the south as a way to generate jobs and accelerate poverty reduction. The Project already aims at alleviating this bottleneck and focuses on the geographic areas and population groups targeted by the new government, and thus, it is a well-structured and on-going vehicle that can be easily scaled up.

11. **Despite the progress, the rural finance gap remains large**. Credit depth at around 40 percent of gross domestic product (GDP) in Mexico remains below that of its regional and middle-income peers. Recent data by the Findex shows that only 10 percent of the rural population has obtained a loan or used a credit card in the past 12 months, posting a decline relative to the previous survey from 2014, when credit reached 14 percent of the rural population. It also contrasts with the regional averages for credit in rural areas in Latin America & the Caribbean (LAC), East Asia & the Pacific (EAP), and Europe & Central Asia (ECA), all of which stand at approximately 20 percent[2], as well as the OECD (44 percent). Ninety percent of credit is given in urban areas, although more than 20 percent of the adult population lives in rural areas. The unequal access to credit also has a regional dimension (Figure 4), with the poorer states in the south being particularly under-served.

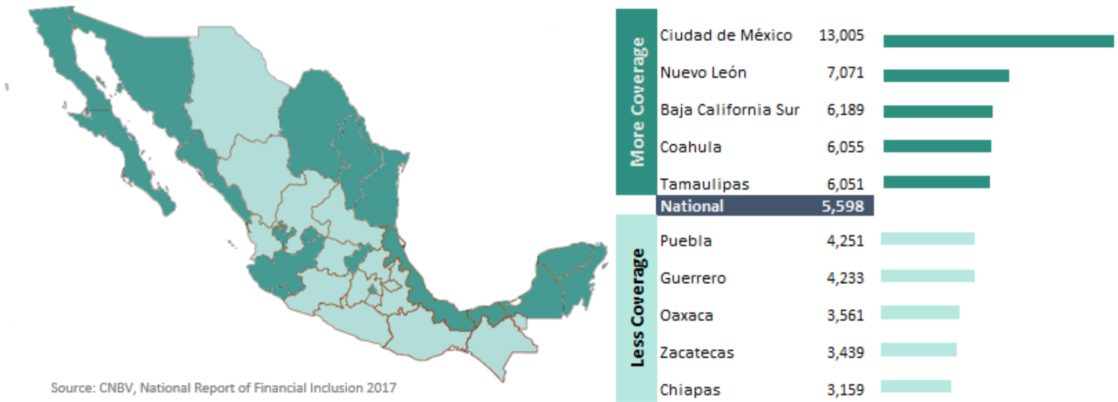
12. **Cross-country comparisons show that Mexico has significant opportunities to improve access to finance**. Findex data shows that while LAC, EAP and ECA regions have seen account ownership at a financial institution grow to 53, 70 and 65 percent of the population, respectively, Mexico has exhibited a 4-percentage points contraction to 35 percent between 2014 and 2017. This places Mexico as the country with the lowest account ownership ratio among OECD countries, where median account ownership reached 95 percent of the population. Moreover, only 25 percent of the poor[3] in Mexico have an account at a financial institution, relative to 41, 59 and 56 percent in LAC, EAP and ECA, respectively. The ratio of the second OECD country with the lowest account ownership among the poor, Turkey, doubles that of Mexico, stressing the material scope for improvement in this area.

[1] *http://documents.worldbank.org/curated/en/591351529583939227/pdf/WPS8483.pdf*

[2] The shares of the rural population that obtained a loan or used a credit card are 19.2, 19.8 and 21.4, for Latin America & the Caribbean, East Asia & the Pacific, and Europe & Central Asia, respectively. (Findex 2017)

[3] This indicator refers to the poorest 40 percent of the population. (Findex 2017)

Figure 4: Number of Bank Loans per 10,000 adults



13. **The AF will allow for a scaling up of the Project's impact in terms of volume, number of loans and number of beneficiaries, including women and the population in marginalized areas, and it will allow for testing new pilots for effective development finance solutions.** The AF will scale up Component 1 by US$400 million and thereby deepen the impact of the proven mechanism for successfully reaching rural communities and marginalized areas. The AF will also include a Level 2 restructuring to modify the results framework in line with the scale up, and a three-year extension of the closing date to December 31, 2023, which will provide the time needed to implement the scaled up Project. The results targets will be scaled up to reflect in part the additional funds available and in part the lessons learned during implementation regarding the Project's ability to reach the targeted population. The closing date extension will also allow more time for testing new development finance solutions, including the pilot discussed below. This pilot will test a solution that mobilizes private commercial finance to the PFIs aligned with the Maximizing Finance for Development agenda.

14. **The institutional capacity building aspect of the Project will continue and be deepened.** The institutional support to FND and to PFIs is a mechanism to make rural finance self-sustaining over the medium term. The systems, approaches, training, and the structure of the Project itself, have positive externalities well beyond the Project, for Mexico and other countries. It lays a comprehensive approach to reach rural and marginalized areas with financing mechanisms for the productive sector that can be sustained. It establishes criteria and institutional frameworks to make these mechanisms successful in reaching a difficult segment of the market with the support of private sector agents.

15. **In addition, the AF will bring important climate co-benefits**. The rural sector is highly vulnerable to climate hazards. In the southern states such as Guerrero, Chiapas, and Oaxaca, among other, farmers face severe climate risks, such as floods and draughts. In addition, rural smallholders face high climate vulnerability due to: (i) lower than average crop yields (e.g., average maize yields are less than half those of commercial farmers); (ii) small land tenure size (73 percent of farmers own less than 5 ha); (iii) reliance on rain-fed systems (90 percent of subsistence farmers, in comparison to 63 percent of commercial farmers) and thus dependence on regularity of environmental conditions for production; and (iv) fewer resources (finances, savings healthcare, subsidies, tools, and inputs) available to help cope and adapt to climate impacts (World Bank, 2014). The lack of financial intermediaries is a key bottleneck in accessing finance, which is crucial to protecting farmers against/and adapting their practices to climate risks, while achieving higher productivity and market integration to also further their resilience. Availability of finance under the Project could potentially support rural population's move towards use of equipment for low tillage farming and micro irrigation, investments to

improve post-harvest processing to reduce energy and wastage and use of improved seed varieties all of which could provide environmental benefits due to increased productivity and higher resilience to climatic risks. In addition to the climate co-benefits of the Project as a whole, the AF requires that a percent of Project funds is solely and directly targeted for climate-smart adaptation measures, which will reduce vulnerabilities to changing weather conditions.

16. **The AF contributes to the ambitious climate change mitigation and adaptation strategy of the Government as reflected in its Nationally Determined Contribution (NDC) under the United Nations Framework Convention on Climate Change (UNFCCC).** Mexico's NDCs recognize the important role of rural development in enhancing resilience and the AF intents to reduce the climate vulnerability of the rural sector, especially in the poorer more-susceptible to climate shock southern states where the Project has been active. Due to the high climate risk to the economic development of the rural sector in the Project areas, the Project will help ensure that vulnerable populations have access to finance that will naturally incentivize a more climate-proof rural development path. In addition to climate co-benefits of the Project as a whole, the additional earmarking of funds for climate smart investments (at least 5 percent of the funds) is expected to help develop capacity and proactive approaches in financial intermediaries working under the Project and among rural population for channeling more financial resources towards climate resilient activities. Hence, the total impact of the Project on climate adaptation and mitigation measures is expected to grow during the lifecycle of the Project and expand well-beyond the Project life.

17. **The AF is well aligned with the country's development priorities and the Bank's current Country Partnership Strategy (CPS)**. The CPS 2014-2019[4] for Mexico, discussed by the Board of Directors on December 12, 2013, considers the need to increase access to finance and improve financial inclusion a key aspect under Theme 1 "Unleashing Productivity". It supports the Sustainable Development Goal 8 "Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all", which aims at strengthening the capacity of domestic financial institutions to encourage and expand access to banking, insurance and financial services for all. In addition, the Project is aligned with the National Policy on Financial Inclusion, especially Pillar 4 "Greater supply and use of formal financial services for the underserved and excluded population". The emphasis on the rural sector is also well aligned with the priorities of the new government.

18. **A planned merger of FND with three other rural finance institutions aims to provide a comprehensive offer of rural finance solutions.** The four institutions will be jointly managed, and their services coordinated. AGROASEMEX is a national insurance and reinsurance company offering a range of products for the rural sector including catastrophic crop and weather insurance thus complementing the credit products by FND. FOCIR is a private equity fund providing to the rural sector offering a solution for riskier projects. FIRCO is a trust for agribusiness and fishery development that offers technical support and risk sharing. The merger will not include *Fideicomisos Instituidos en Relación con la Agricultura* (FIRA), which offers development banking for rural finance with an emphasis on guarantees. As the merger is completed, the Project may need to be amended to accommodate the revised rural financial services offering.

[4] Report Number 83496 *http://documents.worldbank.org/curated/en/819661468051245938/pdf/834960WP0P12700Box0382091B00PUBLIC0.pdf*

II. DESCRIPTION OF ADDITIONAL FINANCING

19. **Two changes are envisaged:** (i) Adjustments to the Results Framework and Monitoring; and (ii) extension of the closing date by 3 years to December 31, 2023.

20. **The Project indicators in the Results Framework and Monitoring will be revised.** A set of indicators will be revised to adjust both the annual and end targets to reflect: (i) the current progress of each indicator; (ii) the allocated amount of the additional financing; and (iii) the new closing date. Another set of indicators will be adjusted to clarify its definitions and to improve the projected annual targets. Finally, a new indicator will be added to reflect the share of loan recipients under Component 1 that are first-time borrowers (See Section VIII).

21. **The Project will extend the closing date by 3 years to December 31, 2023.** The extension of the closing date will provide the time needed to implement the scaled up Project. It will also provide time to gather more information about the results generated by the existing pilot of price hedging for agricultural commodities, and the new pilot to mobilize private commercial finance to eligible PFIs.

22. **In addition, aligned with Maximizing Finance for Development agenda, a pilot activity under Subcomponent 1B is being planned to mobilize commercial funding for the PFIs in the Project.** The pilot will serve the same project-level development objective "to expand the availability of finance to the rural economy". Rather than FND lending directly to the PFIs, a Partial Credit Guarantee (PCG) will be offered by FND to encourage private lenders to finance PFIs. The pilot will leverage the capacity FND has developed in assessing the credit risk of PFIs, while encouraging private sector lenders to develop their capacity to do the same. The tool is not intended to replace FND's 2nd tier lending, but rather as a complementary tool for those PFIs that are mature enough to access private capital but need initial support. The pilot may be initiated with FND own funding to accommodate legal restrictions on FND's loan financed activities.

23. **The AF will scale up the development effectiveness of the Project.** The additional US$400 million will be allocated to Component 1: (i) US$391 million for Subcomponent 1A, and (ii) US$9 million for subcomponent 1B. The total Project cost will be US$805 million, including US$5 million from counterpart funds that are used to implement Subcomponent 2B (Table 1). As with the parent Project, retroactive financing will be allowed under the AF up to a maximum of US$80 million (20 percent of the AF) made one year before the loan signing date.

Table 1: Project Cost

Components	Original Amount (US$)	AF Amount (US$)	Total (US$)
Subcomponent 1A: Line of Credit	364,000,000	390,000,000	754,000,000
Subcomponent 1B: Pilots	10,000,000	9,000,000	19,000,000
Subcomponent 2A: Core Banking System	25,000,000	0	25,000,000
Subcomponent 2B: Capacity Building for PFIs	5,000,000	0	5,000,000
Front-end fee	1,000,000	1,000,000	2,000,000
Total	405,000,000	400,000,000	805,000,000

24. **Implementation arrangements remain unchanged.** FND will remain the Borrower and responsible for the implementation of the Expanding Rural Finance Project. The Bank will enter into a Loan Agreement with FND. The United Mexican States will guarantee the obligation of the Borrower in respect to the AF. For implementation of Component 1, the Borrower (FND) will enter into a Subsidiary Financing Agreement with new eligible PFIs to on-lend to rural MSMEs through loan agreements. The Project Implementing Unit (PIU) within FND will continue as the Bank's main counterpart. No additional safeguards policies will be triggered, there will be no changes in the environmental FI category, and the Project's Environmental Management Framework (EMF) and Indigenous Peoples Planning Framework (IPPF) were updated and will continue to be implemented. No additional risks have been identified and the overall safeguards risk remains Moderate.

25. **The AF will make significant contributions to climate mitigation and adaptation.** In addition to climate co-benefits that come, the AF will target at least five percent of Project funds to finance a range of adaptation measures in the rural sector as identified in the Food and Agriculture Organization Climate-smart agriculture (FAO CSA) Sourcebook, that will reduce vulnerability, inter alia, to drought, pests, disease and other shocks. The FAO CSA Sourcebook (2017)[5] is the latest exhaustive resource for adaptation measures in the rural sector. The AF will also improve the capacity to adapt and grow in the face of longer-term stresses like shortened seasons and erratic weather patterns by providing access to finance. Lastly, the AF has important mitigation co-benefits by directing rural economic activity towards a lower-emission growth path. The updated Environmental Management Framework[6] for the AF has set out stringent exclusions and regulations for rural activities that in the business as usual cause large GHG emissions. In the business as usual scenario, agriculture and cattle ranching are not only a primary source of greenhouse gas (GHG) emissions in Mexico but are the third most rapidly growing source of emissions[7]. Land use change contributed 6.3 percent of the total GHG emissions. The AF will fund lower-carbon emission activities by requiring that any approved loan meets stringent low-carbon standards as outlined in the EMF including no change of land use of forest areas, following qualified technical advice for the development of sustainable livestock projects (intensive systems, increase tree planting for shade, live fences, protection of channels, and promotion of biological corridors), the use of forest management plan, and application of best environmental practices.

III. KEY RISKS

26. **The overall Project risk rating remains Moderate.** The risk rating reflects the commitment of the new government to the Project, the financial strength and experience of FND in operating in the rural finance segment and the strong performance of FND during the first years of Project implementation.

27. **Political and Governance risk rating is Moderate.** A change of Government and the FND management team present risks to continuity of priorities and implementation. The new Government's request for AF confirms its commitment to the Project. The new Government has also signaled strong support for access to finance and financial inclusion in rural areas and for marginalized communities.[8] The newly appointed General Manager of FND and several senior management team members bring development banking experience from

[5] http://www.fao.org/climate-smart-agriculture-sourcebook/en
[6] https://www.gob.mx/cms/uploads/attachment/file/433917/Marco_de_Gesti_n_Ambiental__MGA_.pdf
http://documents.worldbank.org/curated/en/569421468057233879/pdf/SFG1257-REVISED-EA-SPANISH-P153338-PUBLIC-Disclosed-2-1-2019.pdf
[7] FAO: Agricultural emissions come mainly from methane enteric fermentation (representing 63.87 percent of all agricultural emissions), followed by manure management (17.13 percent), soil management (16.58 percent), rice (0.47 percent), burning of agricultural residues (0.27 percent), and others (1.68 percent).
[8] Financial inclusion is one of the 5 components of the recently announced *Programa de Impulso al Sector Financiero*.

other institutions in Mexico and projects confidence in their commitment to the scaled up Project including a strengthened emphasis on second-tier lending. The Bank team had close and productive collaboration with the new counterpart team.

IV. APPRAISAL SUMMARY

A. Economic and Financial (if applicable) Analysis

28. **The Project has overperformed the original expectations from the original economic and financial analysis**. The Project was initially estimated to have an economic rate of return (ERR) of 19.8 percent, based on projections of 74,000 loans receiving an average loan of US$5,000. An updated assessment of the Project from an economic and financial perspective estimated the ERR at 23.2 percent over the term of the loan (15 years). Sensitivity analysis suggests that the Project would remain desirable even if MSMEs' growth boost was half the amount estimated or when microcredits had no effect on income. The Project is particularly cost efficient because it leverages FND's existing staff and institutional infrastructure thus containing administrative costs. At the same time, the use of permanent FND resources for Project implementation underpins sustainability of the activities beyond the life of the Project.

29. **The economic analysis of component 1A was updated to reflect improved data availability and experience with loan implementation including dividing the analysis between MSMEs and micro-borrowers**. Under Component 1A, microcredits are now assumed to have an average size of about US$300 and a 1-year term. The beneficiaries are assumed to have an annual income of MXN25,000, which places them between the second and the third decile in the income distribution.[9] The credit has a significant though short-lived impact in terms of lifting the individual credit constraint: income is projected to rise 25 percent for one year (jumping one decile in the income distribution) and then return back to its baseline level. MSME loans are assumed to have an average size of about US$10,000 and a 1-year term. The beneficiaries are assumed to have an annual income of MXN76,000 and have the ability to grow faster with the loan. After loans are granted, beneficiaries' income is expected to grow at a 6 percent annual rate for 5 years and then return to their normal rate of 2 percent. Beneficiaries are also expected to generate new jobs during the 5-year high-growth period. Most additional funds will be allocated to Component 1A for rural MSMEs. Using the set of assumptions from the updated assessment, the ERR for the additional finance would increase to 28.6 percent. (see Annex 1)

B. Technical

30. **The Project's technical design remains as originally approved given the Project's successful track.** Key principles underlying the Project design include: (a) transparent eligibility criteria for PFIs developed based on available domestic (National Banking and Securities Commission (CNBV) and Microfinance Information Exchange Market data) and international data to benchmark sector performance; (b) adherence to market principles for interest rates to final borrowers; (c) establishment and monitoring of clear indicators tracking project performance; and (d) examination of FND's financial strength and its processes for accreditation of PFIs to receive funds under the Project. The envisaged pilot brings in private finance with a risk sharing mechanism leveraging FND's ability to underwrite PFI credit risk. A planned merger of FND with other rural finance

[9] http://www.inegi.org.mx/saladeprensa/boletines/2017/enigh/enigh_08.pdf

institutions would require adjustments in the scope of the IT project according to the new institutional structure.

31. **The Project contributes to Maximizing Finance for Development through the development of sustainable rural financial institutions.** The PFIs in the Project are being reviewed as part of the credit appraisal process for good internal organization, operational processes and risk management. Where gaps are identified, technical advice is provided under Subcomponent 2B. The financing provided under Subcomponent 1A supports PFI growth, and the associated monitoring by FND provides ongoing assessment of risk management and financial strength of the PFIs. Product development by PFIs is supported by Component 1B including a price hedge for borrowers, which not only helps the borrowers manage their risk, but also reduces credit risk for the PFI. Lastly, aligned with Maximizing Finance for Development agenda, a planned new pilot funded by FDN with own funds, will test a solution that mobilizes private commercial finance to the PFIs as substitute for FND's lending to PFIs.

C. Financial Management

32. **The Project will continue with the existing fiduciary implementation arrangement, which had satisfactory financial management performance supervisions and unqualified audit report opinions.** The PIU's organizational structure includes a Project Coordinator and three staff who are directly responsible for the administrative tasks related to the Project financed by the World Bank, namely managing loan's disbursements and presenting the Project's financial reports. This unit has experience working with the World Bank and with the Inter-American Development Bank.

33. **The Project uses country systems which in general operate under an adequate internal control environment with sound financial and operational systems and well-defined procedures used by the entities within the Federal Government in Mexico.** In addition, the World Bank conducts regular Financial Management supervisions and provides periodic training aimed at building capacity. The Project will be annually audited in accordance with terms of reference acceptable to the Bank.

D. Procurement

34. **Procurement will be governed by the World Bank's Procurement Regulations for IPF Borrowers dated July 2016 and revised on November 2017 and August 2018.** A Project restructuring, processed in December 2016, migrated Component 1 to the WB Procurement Regulations. The AF will only support Sub-components 1A (Line of Credit) and 1B (Hedge pricing and other pilots) through loans made by eligible financial intermediaries where the Procurement Regulations do not apply. All activities that involve procurement processes remain under the parent Project and will continue following the original Procurement arrangements.

E. Social (including Safeguards)

35. **Social Safeguards Performance of the parent Project is Satisfactory**. The PIU has responded diligently to the World Bank regarding GRM implementation, the development of Indigenous Peoples Funds Business Plans, and gender-disaggregated Indigenous Peoples (IP) beneficiaries. Since the beginning of the Project: (i) The PIU has hired a social development specialist who is responsible for the implementation of the IPPF and available to respond to any project-related questions, travel to the Project areas and supervise the sub-projects when needed. (ii) 85 percent of the total Project beneficiaries are women and 10 percent of the credits go to

highly marginalized or marginalized regions. Out of all the beneficiaries, 405 are indigenous (156 women and 259 men; 40 percent/60 percent ratio). 5 States are covered through IP beneficiaries. (iii) Regional indigenous funds have successfully developed business plans for their IP beneficiaries, in line with the IPPF. (iv) The GRM was culturally adapted to the regional entities and is accessible via email, phone and with the local entities. Despite a wide dissemination, no grievances were emailed to the PIU.

36. **The parent Project, in compliance with OP/BP 4.10, Indigenous Peoples, developed an IPPF.** Social Safeguards Risk is considered Moderate due to the complexity of social safeguards monitoring of the many financial intermediaries and the sub-projects to ensure social inclusion. The IPPF for the parent Project will remain valid under the AF, and its implementation will continue while the Project is active. Some census data was updated, and lessons learned included in the document for the AF, but the overall content remains the same. The parent Project's IPPF was developed by the PIU and consulted prior to appraisal of the parent Project to ensure wide buy in. A new consultation will not be necessary. The updated IPPF was published on FND's and WB's website on January 31, 2019[10]. Involuntary resettlement OP/BP 4.12 is not triggered for this Project. All sub-projects to be financed will be carried out on private land owned or leased by the ultimate beneficiaries. In order to avoid potential impacts on third parties, the EMF, through an exclusion list, screens against activities that may result in resettlement impacts.

37. **The Project has several entry points for citizen engagement**. These include FND's web-based client feedback form, an email address, a dedicated telephone number, the internal control office within FND, about 100 regional branches, and the use of public information from Mexico's Commission for the Protection of Users of the Financial System (CONDUSEF) for collecting and addressing complaints from PFI clients (included as an indicator in the Results Framework), and the role of Regional Indigenous Funds in empowering marginal communities with resources and decision-making powers. In addition, FND and the WB conduct periodic site visits to obtain direct feedback from Project beneficiaries.

38. **The Project will continue to have a positive impact on women's access to finance**. Mexico has made good strides in financial inclusion, increasing the share of both men and women with financial accounts. In 2011, 33 percent of men and 22 percent of women had an account, and in 2017, these figures increased to 41 percent for men and 33 percent for women. For accounts at a financial institution, the 2017 figures are 39 percent for men and 33 percent for women. Despite these improvements, gaps between men and women persist. Disparities are even wider in rural areas: In 2017, 29 percent of people in rural communities had an account; 10 percent borrowed from a financial institution or used a credit card; and 7 percent borrowed from financial institution. The parent Project set a 60 percent target for female borrowers, with a baseline of zero. The target was surpassed with 85 percent of borrowers being women. The AF aims to continue this trajectory and contribute to closing gaps in financial inclusion in Mexico. This would help reduce the gender gap observed from adults that borrowed from a financial institution or used a credit card (14 percent of men, 10 percent of women) [11]. The Project will continue tracking progress using the "share of female beneficiaries (borrowers)" indicator.

[10] *https://www.gob.mx/cms/uploads/attachment/file/433909/Marco_de_Planificaci_n_de_los_Pueblos_Ind_genas__MPPI_.pdf*
http://documents.worldbank.org/curated/en/359201468303243306/pdf/SFG1281-REVISED-IPP-SPANISH-P153338-PUBLIC-Disclosed-2-1-2019.pdf
[11] Source: Findex 2017

F. Environment (including Safeguards)

39. **The Project is classified as Environmental Risk Category FI (Financial Intermediary Assessment), and environmental safeguard policies triggered remain the same as in the parent Project. Environmental risks are considered low.** Safeguards triggered include Environmental Assessment (OP/BP 4.01), Natural Habitats (OP/BP 4.04), Pest Management (OP 4.09), and Forests (OP/BP 4.36). The AF does not trigger additional safeguard policies. The Concept Memorandum for this AF was approved on September 27, 2018.

40. **Environmental safeguards performance is satisfactory in the parent Project.** The OP/BP 4.11, Physical Cultural Resources, is not triggered for this AF Project. However, a chance finds procedure has been included as an annex in the EMF. The updated EMF was published on FND's and WB's website on January 31, 2019[12]. Areas where the sub-projects are located, have been used traditionally for agricultural and livestock activities. No significative environmental changes are expected. A National cultural and historic legislation is active, and the National Institute of Anthropology and History (INAH) has a data base in place with locations identified and potential sites for chance finds along the country. In the parent Project, the Environmental Impact Assessment (EIA) does not report locations with physical and cultural resources. As part of the screening process for the sub-projects, the specific location is confirmed on site by the PFI and FND personnel.

41. **No significant environmental negative impacts are expected due to the small size of the loans and the application of environmental screening and exclusion list as stated in the Environmental Management System of the parent Project, which continues to be valid for the AF.** In the updated EMF, most common eligible activities have been identified (agricultural, livestock, forestry, and fishery sectors), and their environmental impacts and mitigation measures described, including environmental, health, and safety practices for use by the beneficiaries. Recommendations for best practices by sector have been developed and will continue to be distributed to beneficiaries through brochures as part of the implementation of the EMF.

42. **The EMF implementation by PFIs at local level is monitored by FND.** An exclusion list including protected areas and ecologically sensitive habitats is included. As part of the Subsidiary Agreement among FND and the PFIs, a clause is included regarding compliance with environmental safeguards through the Environmental Management System. FND verifies that PFIs apply the screening process and exclusion list as stated in the Operational Manual.

G. Other Safeguard Policies (if applicable)

43. N/A

V. WORLD BANK GRIEVANCE REDRESS

44. 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

[12] *https://www.gob.mx/cms/uploads/attachment/file/433917/Marco_de_Gesti_n_Ambiental__MGA_.pdf*
http://documents.worldbank.org/curated/en/569421468057233879/pdf/SFG1257-REVISED-EA-SPANISH-P153338-PUBLIC-Disclosed-2-1-2019.pdf

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*

VI. SUMMARY TABLE OF CHANGES

	Changed	Not Changed
Results Framework	✔	
Components and Cost	✔	
Loan Closing Date(s)	✔	
Disbursements Arrangements	✔	
Implementing Agency		✔
Project's Development Objectives		✔
Cancellations Proposed		✔
Reallocation between Disbursement Categories		✔
Safeguard Policies Triggered		✔
EA category		✔
Legal Covenants		✔
Institutional Arrangements		✔
Financial Management		✔
Procurement		✔
Other Change(s)		✔

VII. DETAILED CHANGE(S)

COMPONENTS

Current Component Name	Current Cost (US$, millions)	Action	Proposed Component Name	Proposed Cost (US$, millions)
			1. Expanding Credit for Rural MSMEs	
			2. Strengthening Institutional Capacity for Sustainable Rural Finance	

TOTAL	0.00			0.00

LOAN CLOSING DATE(S)

Ln/Cr/Tf	Status	Original Closing	Current Closing(s)	Proposed Closing	Proposed Deadline for Withdrawal Applications
IBRD-85550	Effective	31-Dec-2020	31-Dec-2020	31-Dec-2023	30-Apr-2024

DISBURSEMENT ARRANGEMENTS

Change in Disbursement Arrangements
Yes

Expected Disbursements (in US$)

Fiscal Year	Annual	Cumulative
2016	0.00	0.00
2017	142,229,095.30	142,229,095.30
2018	87,497,734.06	229,726,829.36
2019	95,760,382.00	325,487,211.36
2020	99,512,788.64	425,000,000.00
2021	100,000,000.00	525,000,000.00
2022	100,000,000.00	625,000,000.00
2023	135,000,000.00	760,000,000.00
2024	40,000,000.00	800,000,000.00

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Latest ISR Rating	Current Rating
Political and Governance	Moderate	Moderate
Macroeconomic	Moderate	Moderate
Sector Strategies and Policies	Moderate	Moderate
Technical Design of Project or Program	Moderate	Moderate

Institutional Capacity for Implementation and Sustainability	● Moderate	● Moderate
Fiduciary	● Moderate	● Moderate
Environment and Social	● Moderate	● Moderate
Stakeholders	● Moderate	● Moderate
Other		
Overall	● Moderate	● Moderate

LEGAL COVENANTS – Expanding Rural Finance Project (P169156)

Sections and Description
No information available

Conditions

VIII. RESULTS FRAMEWORK AND MONITORING

Results Framework
COUNTRY: Mexico
Expanding Rural Finance Project

Project Development Objective(s)

The project's development objective is to expand the availability of finance to the rural economy.

Project Development Objective Indicators by Objectives/ Outcomes

Indicator Name	DLI	Baseline	Intermediate Targets					End Target
			1	2	3	4	5	
Expand the availability of finance to the rural economy.								
Number of loans disbursed under project (cumulative) (Number)		0.00	150,000.00	200,000.00	240,000.00	280,000.00	320,000.00	400,000.00
Action: This indicator has been Revised	***Rationale:*** ***This indicator will revise both the annual and end targets to reflect: i) the current progress; ii) the additional financing; and, iii) the new closing date.***							
Volume of total loans disbursed under project (cumulative), US$ million (Amount(USD))		0.00	252.00	345.00	436.00	527.00	618.00	773.00
Action: This indicator has been Revised	***Rationale:*** ***This indicator will revise both the annual and end targets to reflect: i) the current progress; ii) the additional financing; and, iii) the new closing date.***							
Average non-performing loans ratio for PFIs receiving		0.00	6.00	6.00	6.00	6.00	6.00	6.00

Indicator Name	DLI	Baseline	Intermediate Targets					End Target
			1	2	3	4	5	
project funds (Percentage)								
Action: This indicator has been Revised	***Rationale:*** ***This indicator will not change. It is adjusted to the new format of the Operations Portal and revised to reflect the new closing date.***							

Intermediate Results Indicators by Components

Indicator Name	DLI	Baseline	Intermediate Targets					End Target
			1	2	3	4	5	
1. Expanding Credit for Rural MSMEs								
Volume of Bank Support: Lines of Credit - Microfinance (cumulative), US$ million (Amount(USD))		0.00	37.00	53.00	68.00	83.00	98.00	123.00
Action: This indicator has been Revised	***Rationale:*** ***This indicator will revise both the annual and end targets to reflect: i) the current progress; ii) the additional financing; and, iii) the new closing date. During Project preparation a split between volume of micro and SME lines of credit was not available for this core indicator so a 50 percent split for each one was used as proxy, following the guidelines. Using the results reached so far in the Project, it is estimated that at least 15 percent of the allocated amount would be directed to microcredit.***							
Volume of Bank Support: Lines of Credit - SME (cumulative), US$ million (Amount(USD))		0.00	214.00	290.00	360.00	440.00	515.00	632.00
Action: This indicator has been Revised	***Rationale:*** ***This indicator will revise both the annual and end targets to reflect: i) the current progress; ii) the additional financing; and, iii) the new closing date. During***							

Indicator Name	DLI	Baseline	Intermediate Targets					End Target
			1	2	3	4	5	
	project preparation a split between volume of micro and SME lines of credit was not available for this core indicator so a 50 percent split for each was used as proxy, following the guidelines. Using the results reached so far in the Project, it is estimated that about 75 percent of the allocated amount would be directed to SME credit.							
Number of final beneficiaries with loans financed with project funds (cumulative) (Number)		0.00	118,000.00	150,000.00	190,000.00	225,000.00	260,000.00	315,000.00
Action: This indicator has been Revised	***Rationale:*** ***This indicator will revise both the annual and end targets to reflect: i) the current progress; ii) the additional financing; and, iii) the new closing date.***							
Number of final microfinance beneficiaries financed with project funds (cumulative) (Number)		0.00	100,000.00	130,000.00	160,000.00	190,000.00	220,000.00	260,000.00
Action: This indicator has been Revised	***Rationale:*** ***This indicator will revise both the annual and end targets to reflect: i) the current progress; ii) the additional financing; and, iii) the new closing date.***							
Female beneficiaries as a share of total beneficiaries financed by the project. (Percentage)		0.00	60.00	60.00	60.00	60.00	60.00	60.00
Action: This indicator has been Revised	***Rationale:*** ***This indicator will not change. It is adjusted to the new format of the Operations Portal.***							
Share of loan recipients from marginal municipalities financed by the project. (Percentage)		0.00	15.00	15.00	15.00	15.00	15.00	15.00

Indicator Name	DLI	Baseline	Intermediate Targets					End Target
			1	2	3	4	5	
Action: This indicator has been Revised	***Rationale:*** ***This indicator will not change. It is adjusted to the new format of the Operations Portal.***							
Share of loan recipients that are first-time borrowers (Percentage)		10.00	10.00	10.00	10.00	10.00	10.00	10.00
Action: This indicator has been Revised	***Rationale:*** ***This new indicator is added to reflect the share of loan recipients under Subcomponent 1A and 1B that are first-time borrowers. This indicator has been monitored by FND as part of the additional indicators that are part of the Operations Manual.***							
Average NPL rate for FND lending to PFIs under the project-funded credit line (Percentage)		0.00	5.00	5.00	5.00	5.00	5.00	5.00
Action: This indicator has been Revised	***Rationale:*** ***This indicator will not change. It is adjusted to the new format of the Operations Portal***							
2. Strengthening Institutional Capacity for Sustainable Rural Finance								
Percentage of FND branch offices using the new core banking system. (Percentage)		0.00	0.00	0.00	0.00	10.00	50.00	70.00
Action: This indicator has been Revised	***Rationale:*** ***This indicator will be revised to adjust the targets based on the current progress and to reflect the new closing date.***							
Number of PFIs that receive capacity building from FND (Number)		145.00	200.00	220.00	260.00	280.00	300.00	300.00

Indicator Name	DLI	Baseline	Intermediate Targets					End Target
			1	2	3	4	5	
Action: This indicator has been Revised	***Rationale:*** ***This indicator is revised to clarify its definition and to adjust the projected annual targets accordingly. The revised indicator will take into account unique PFIs (counted only once). The Operational Manual will keep monitoring the total number of Capacity Building Support (Apoyos) provided by FND to PFIs.***							
Submission of operational tracking data (Yes/No)		No	Yes	Yes	Yes	Yes	Yes	Yes
Action: This indicator has been Revised	***Rationale:*** ***This indicator will not change. It is adjusted to the new format of the Operations Portal and revised to reflect the new closing date.***							
Number of PFIs registered to receive client feedback on Financial Consumer Protection Agency's (CONDUSEF) website (Number)		107.00	130.00	150.00	180.00	200.00	200.00	200.00
Action: This indicator has been Revised	***Rationale:*** ***This indicator will not change. It is adjusted to the new format of the Operations Portal and revised to reflect the new closing date.***							

Monitoring & Evaluation Plan: PDO Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Number of loans disbursed under project (cumulative)	Cummulative number of loans disbursed under the project for Subcomponents 1A and 1B to the rural economy. This is the sum	Semi-annual	Semi-annual Project Progress Report.	FND has in place the Second Tier Information System (SICI)	Project Implementation Unit at FND

	of two intermediate results indicators disaggregated that measure the number of microfinance and SME loans disbursed. Beneficiary MSMEs include both individuals and firms.				
Volume of total loans disbursed under project (cumulative), US$ million	This indicator is a cumulative measure of the total volume of funding disbursed by PFIs to SMEs under the credit line in Subcomponent 1A and the funds disbursed under Subcomponent 1B. This is the sum of two intermediate results indicators disaggregated that measure the microfinance credit volume and SME credit volume.	Semi-annual	Semi-annual Project Progress Report.	FND has in place the Second Tier Information System (SICI) to collect Data for this indicator.	Project Implementation Unit at FND
Average non-performing loans ratio for PFIs receiving project funds	NPL ratio = loans overdue for between 30 and 90 days / gross loans reflecting portfolio at risk of lending of PFIs to final beneficiaries. The expected target is less than 6 percent (< 6 percent)	Semi-annual	Semi-annual Project Progress Report.	Financial statements of the participating financial intermediaries as December 31 and June 30 for each year.	Project Implementation Unit at FND

Monitoring & Evaluation Plan: Intermediate Results Indicators					
Indicator Name	**Definition/Description**	**Frequency**	**Datasource**	**Methodology for Data Collection**	**Responsibility for Data Collection**
Volume of Bank Support: Lines of Credit - Microfinance (cumulative), US$ million	A line of credit is classified ‘microfinance’ if the supporting sub loans (a) have an average outstanding balance (gross loan portfolio / number of active borrowers) <300% of the latest per capita GNI or (b) are less than US$1,000. Either circumstance triggers classification as microfinance. A split by microfinance and SME is estimated based on the first years of Project implementation.	Semi-annual	Semi-annual Project Progress Report.	FND has in place the Second Tier Information System (SICI) to collect Data for this indicator.	Project Implementation Unit at FND
Volume of Bank Support: Lines of Credit - SME (cumulative), US$ million	A line of credit is ‘SME finance’ if the supporting sub loans have an average outstanding balance > microfinance cut-off, but no more than US$300,000. A split by microfinance and SME is estimated based on the first years of Project implementation.	Semi-annual	Semi-annual Project Progress Report.	FND has in place the Second Tier Information System (SICI) to collect Data for this indicator.	Project Implementation Unit at FND
Number of final beneficiaries with loans financed with project funds (cumulative)	This indicator is a cumulative measure of the	Semi-annual	Semi-annual Project	FND has in place the Second Tier Information	Project Implementation Unit at FND

	total number of unique MSME beneficiaries provided under the credit line in Subcomponent 1A and the unique beneficiaries under Subcomponent 1B.		Progress Report.	System (SICI) to collect Data for this indicator.	
Number of final microfinance beneficiaries financed with project funds (cumulative)	This indicator is a cumulative measure of the total number of unique microfinance beneficiaries provided under the credit line in Subcomponent 1A and 1B. A line of credit is classified 'microfinance' if supporting subloans (a) have an average outstanding balance (gross loan portfolio ÷ number of active borrowers) <300% of the latest per capita GNI or (b) are less than US$1,000.	Semi-annual	Semi-annual Project Progress Report.	FND has in place the Second Tier Information System (SICI) to collect Data for this indicator.	Project Implementation Unit at FND
Female beneficiaries as a share of total beneficiaries financed by the project.	Percentage of female unique beneficiaries (counted only once)	Semi-annual	Semi-annual Project Progress Report.	FND has in place the Second Tier Information System (SICI) to collect Data for this indicator.	Project Implementation Unit at FND
Share of loan recipients from marginal municipalities financed by the project.	The National Council on Population classifies municipalities according to their level of marginalization (social and	Semi-annual	Semi-annual Project Progress Report.	FND has in place the Second Tier Information System (SICI) to collect Data for this indicator.	Project Implementation Unit at FND

	economic disadvantage), based on the 2010 census. This indicator will track the percentage of final borrowers (unique beneficiaries, first loan, and first disbursement from project funds) from municipalities with high and very high levels of marginalization.				
Share of loan recipients that are first-time borrowers	Share of unique loan recipients under Subcomponent 1A and 1B that are first-time borrowers.	Semi-annual	Semi-annual Project Progress Report.	FND has in place the Second Tier Information System (SICI) to collect Data for this indicator.	Project Implementation Unit at FND
Average NPL rate for FND lending to PFIs under the project-funded credit line	NPL rate = loans overdue for more than 90 days / gross loans reflecting lending from FND to PFIs (average)	Semi-annual	Semi-annual Project Progress Report.	FND - *Dirección Ejecutiva de Enlace y Evaluación con las Coordinaciones Regionales (DECEER)*	Project Implementation Unit at FND
Percentage of FND branch offices using the new core banking system.	Percentage of FND branch offices that have installed the new banking system and are at least in the testing phase of using it.	Semi-annual	Semi-annual Project Progress Report.	IT Department at FND	Project Implementation Unit at FND
Number of PFIs that receive capacity building from FND	Number of unique PFIs financed through Subcomponent 2B. This includes both PFIs receiving funds through the credit	Semi-annual	Semi-annual Project Progress Report.	FND - *Dirección Ejecutiva de Promoción de Negocios con Intermediarios Financieros Rurales*	Project Implementation Unit at FND

	line and PFIs that are not yet eligible for or not yet participating in the credit line. (counted only once).				
Submission of operational tracking data	FND presents information on additional tracking indicators as indicated in the Operational Manual.	Semi-annual	Semi-annual Project Progress Report.	FND has in place the Second Tier Information System (SICI) to collect Data for this set of indicators.	Project Implementation Unit at FND
Number of PFIs registered to receive client feedback on Financial Consumer Protection Agency's (CONDUSEF) website	Data available on CONDUSEF's website. This includes all PFIs working with FND, not just those financed by the project.	Semi-annual	Semi-annual Project Progress Report.	CONDUSEF	Project Implementation Unit at FND

Annex 1: Economic and Financial Analysis

1. Introduction

The Mid-Term Review determined that the Expanding Rural Finance Project has overperformed relative to the original economic and financial analysis. The Project was initially estimated to have an economic rate of return (ERR) of 19.8 percent. An updated assessment of the Project from an economic and financial perspective estimated the ERR at 23.2 percent.

The analytical framework for Component 1 is revised to reflect the improved understanding of beneficiaries served by the Project based on the initial years of Project implementation.

The analysis assesses the expected benefits and costs associated with the activities financed by the Project. It is grounded in a framework linking project activities (including lending small amounts to credit-constrained borrowers in poor rural areas as well as rural MSME, which can also benefit from a subcomponent that gives them access to put options) to targeted outcomes (allow for a significant though short-lived relief from the credit constraint, enable the onset of a higher growth phase, or increase output due to a fall in revenue uncertainty). The full incremental value added is considered in the analysis. Some of the incremental income will accrue to the invested capital, some of the incremental income will accrue to the incremental labor applied, and some income with accrue to the Government through taxes. The considered rationale for public investment is the existence of a market failure reflected in the credit constraint and lack of access to finance by the poor as well as MSMEs in rural areas of Mexico.

The scope of the analysis includes the benefits accrued to the final beneficiaries, PFIs, and to the Government. The final beneficiaries benefit through higher revenue due to the loosening of their credit constraints. In the case of rural MSMEs, they also create new jobs and achieve higher growth rates in the first years, leading to an income that remains higher than the baseline for the projected horizon. Moreover, the use of put options unleashes part of the MSMEs potential, thanks to a more predictable revenue stream. The PFIs benefit from an increase in their funding availability, which enables them to scale up their operations and increase their reach in this underserved segment of the population. The Government benefits through increased tax collection. The Project is particularly cost efficient because it leverages FND’s existing staff and institutional infrastructure thus containing administrative costs.

The assumptions on the impact of loans to the different final beneficiaries’ income are based on anecdotal evidence collected by the task team over the life of the Project. As it is necessary with the large number of and diverse nature of beneficiaries, it relies heavily on assumptions about how final beneficiaries respond to the access to credit offered by the Project. Economic impact assumptions were validated with the FND team. Moreover, the framework is robust to changes in the assumptions as suggested by sensitivity analysis. According to the latter, the Project would remain desirable even if MSMEs’ growth boost was half the amount estimated or when microcredits had no effect on income.

The analysis considers only the initial loan granted to final beneficiaries and not new lending of funds that have been repaid. The loan granted from IBRD to FND has a maturity longer than the original loan granted from FND to PFIs, which in turn are longer than the maturities granted to final beneficiaries. Notwithstanding the fact that when loans are repaid, they are relent to new PFIs and sub-borrowers, our approach is consistent with what the Bank considers Project activities. If re-lent funds were considered, the estimated impact would be higher.

The following paragraphs details how the analysis was performed and guides future users of the model. The analysis of the Project was done in excel, structured in three sections:

- Subcomponent 1A (AF400): Refers to Subcomponent 1A (Credit Line through PFIs to MSMEs).
- Subcomponent 1B (AF400): Refers to Subcomponent 1B (Supporting FND Pilots for Rural Finance).
- Overall (AF400): Consolidation of both flows.

This updated assessment was also applied to the parent Project using a similar structure. The differences introduced by the additional disbursements will be discussed in each relevant section.

2. Subcomponent 1A - Credit Line through PFIs to MSMEs

This section analyzes the Project's subcomponent that funds the credit line intermediated by FND through PFIs serving rural MSMEs. It is structured around three main blocks that lay out how the Project flows are projected:

1. Starting from a set of assumptions at the aggregate level, the annual outstanding WB-financed loan to FND and the number of individual loans is projected
2. With that input and with beneficiary level assumptions, the annual incremental value added, and number of new jobs are projected
3. The flows from both sets of final beneficiaries, as well as FND's interest payments, disbursements and amortizations, are put together to present the overall subcomponent cash flow.

The aggregate level assumptions are introduced first. Then the calculations are presented bottom-up: beneficiary level assumptions are presented for MSMEs and microcredit beneficiaries, and those inputs are later used as part of the Subcomponent cash flow. The need to distinguish two types of beneficiaries arises from the Project implementation data: up to June 2018 the Project has provided 124,659 microcredits (less than US$1,000) with an average loan size of US$293 and 17,382 credits for SMEs with an average loan size of US$9,492.

This analysis assumes that the entire AF is allocated to Subcomponent 1A. This means that the component will change relative to the parent Project, both in terms of disbursement amounts and term (5 versus 7 years). The fact that the AF is disbursed two years later than initially projected means that the maturity is extended to 2038 (15 years after the last disbursement). At the business level, the number of end borrowers' projection had to be adjusted so it linearly grew until the funds available for lending were exhausted. Average loan size was projected to remain constant.

2.1) Aggregate level assumptions

This section comprises the budget allocation (US$770M), number of years for disbursement (7 years), interest rates used in the model, and annual impairments and average loan term for each kind of beneficiary. The disbursement detail presents the totals that were actually disbursed up to 2018, and subsequent disbursements are assumed to spread equally over the remaining years. Finally, business level assumptions are denominated in MXN. As for the number of end borrowers, these are based on the number of loans that have been disbursed up to June 2018 (estimated at 150,000 by the end of the year). Average loan size is assumed to remain constant both for microcredits and MSME. Assuming that the proportion of microcredits/MSME remains constant, the number of end borrowers is projected to grow linearly until the funds available for lending are exhausted. Finally, MSME are expected to create jobs at a constant revenue to wage ratio.

2.2) Beneficiary level assumptions – Microcredit

Beneficiaries of this group are assumed to earn an average revenue of MXN125,000 and income of MXN25,000 which places them between the second and third decile of the income distribution (based on official data from INEGI). The microcredit is expected to lift the credit restriction for that person, increasing his/her revenue by 25 percent over one period, moving him/her to the third to fourth decile of the income distribution. A generic microcredit borrower income and revenue paths are depicted, showing the impact of the Project on both. After that, total incremental revenue generated by the Project is presented for each vintage: the number of new credits of that year comes from the business level assumptions from section 2.1, which then follow the evolution of the generic borrower. Income and loans outstanding are presented in a similar fashion. No new jobs are assumed to be created by microcredits. The main outputs are the total incremental value added (income), loans outstanding, and interest payments to PFIs by end-borrowers.

2.3) Beneficiary level assumptions – MSME

Beneficiaries of this groups belong to a different income group, with average revenue at MXN380,000 and income at MXN76,000. This set of MSMEs is expected to increase its annual revenue growth rate from 2 percent to 6 percent for a period of five years and then return to the previous growth rate. MSMEs are assumed to employ three workers, with an average salary of MXN66,500 (based on FAO data), and 80 percent of the borrowing MSMEs are expected to create new jobs. Based on those assumptions, a generic MSME loan is laid out. The fact that beneficiary MSME go back to grow at benchmark rates implies that a positive (revenue and income) gap is kept against the benchmark for the foreseeable future (until the loan matures in 15 years). As in the case of Microcredits, the incremental revenue and income is presented for each loan vintage. In contrast with Microcredits, the fact that the positive revenue and income gaps persist is reflected in each vintage, which shows positive incremental income until the end of the Project. Job creation is assumed for 80 percent of the borrowers (percentage of farms showing revenue additionality) during the 5 years of high growth for each vintage. The number of jobs is based on the constant revenue to wage ratio established in the aggregate level assumptions (at the business level).

2.4) Cash Flows

The Subcomponent 1A cash flow includes as an inflow the additional income generated both by microcredit recipients as well as MSMEs. New jobs from MSMEs are monetized at an average salary of MXN66,500 (and adjusted for wage inflation). Interest due to World Bank from FND is also considered an inflow. Finally, the cash flow includes World Bank disbursements (-) / amortizations (+).

3. Subcomponent 1B - Supporting FND Pilots for Rural Finance

This section analyzes the Project's subcomponent that pilots solutions for financial product serving rural borrowers with potential to be scaled up, including a price hedge financial product – *coberturas* – to small-scale agricultural producers. As with Subcomponent 1A, it is structured around three main blocks that lay out how the Project flows are projected: starting from a set of assumptions at the aggregate level, the annual outstanding WB-financed loan to FND and the number of individual put options are projected; with that input and with beneficiary level assumptions, the annual incremental value added and number of new jobs are projected; the flows from the final beneficiaries, as well as FND interest payments, disbursements and amortizations, are put together to present the overall subcomponent cash flow. The aggregate level assumptions are laid out first. Then the calculations are presented bottom-up: beneficiary level assumptions (MSME *Coberturas*) build on the aggregate assumptions, and those inputs are used as part of the Subcomponent cash flow.

3.1) Aggregate level assumptions

This section comprises the budget allocation, number of years for disbursement, interest rates used in the model, annual impairments and average loan term for each kind of beneficiary. The disbursements are then assumed to spread equally over five years. Finally, business level assumptions are denominated in MXN. As for the number of put options ("*coberturas*"), these are based on the number of contracts granted up to June 2018 (estimated at 1,460 by the end of the year). Average contract size is assumed to remain constant at about MXN10,000. The number of contracts is projected to grow linearly until the funds available for the subcomponent are exhausted. Finally, MSME are expected to create jobs at a constant revenue to wage ratio.

3.2) Beneficiary level assumptions – MSME *Coberturas*

The beneficiary MSMEs have the same profile as those in Subcomponent 1A: average revenue at MXN380,000, income at MXN76,000 and similar job creation potential. This set of MSMEs are expected to benefit from put options due to the removal of price uncertainty on revenue. The increase certainty is assumed to enable a 10 percent increase in revenue for one year. The generic MSME *Cobertura* is projected to have both revenue and income enhanced for one period. Below, the incremental revenue and income is presented for each contract vintage. Job creation is assumed for 80 percent of the borrowers (percentage of farms showing revenue additionality) during the year in which revenue is boosted. The number of jobs is based on the constant revenue to wage ratio established in the aggregate level assumptions.

3.3) Cash Flows

The Subcomponent 1B cash flow includes as an inflow the additional income generated by MSMEs that benefited from the removal of price uncertainty. New jobs from MSMEs are monetized at an average salary of MXN66,500 (and adjusted for wage inflation). Interest due to World Bank from FND is also considered an inflow. Finally, the cash flow includes World Bank disbursements (-) / amortizations (+).

4. Overall Economic and Financial Analysis of the Project

The framework concludes by aggregating the cash flows from the previous sections and presents an aggregate rate of return and net present value (using a discount rate of 15 percent). The different timeline for the parent Project relative to the current version (which includes additional financing) of Subcomponent 1A is also reflected in the time horizon.

5. Conclusion

This annex presented a detailed layout of the economic and financial framework that was used to update the assessment of the Project, which concluded that the ERR of the parent Project would increase to 23.2 percent, from an initial estimation of 19.8 percent. The framework was also used to perform a sensitivity analysis which suggests that the Project would remain desirable even if MSMEs' growth boost was half the amount estimated or when microcredits had no effect on income. Finally, the analysis of the Project including the additional financing and assuming that most additional funds will be allocated to Component 1A for rural MSMEs, yielded an ERR of 28.6 percent.