# ADMINISTRATION AGREEMENT

**between**

**THE INTER-AMERICAN DEVELOPMENT BANK**

**and**

**THE GOVERNMENT OF SWITZERLAND**

**represented by the Swiss Agency for Development and Cooperation**

**regarding**

**Project Specific Grant to the Inter-American Development Bank for Project RG-M1222/RG-X1214 titled "Institutional Governance and Greater Financial Inclusion "**

**ADMINISTRATION AGREEMENT**

**THIS ADMINISTRATION AGREEMENT** is entered into between the Inter-American Development Bank (the "Bank") and the Government of Switzerland, represented by the Swiss Agency for Development and Cooperation (the "Donor"). The Bank and the Donor are referred to collectively in this Administration Agreement as the "Parties".

**WHEREAS,** the Bank is a public international organization, the purpose of which is to contribute to the acceleration of the process of economic and social development of its regional developing member countries in Latin America and the Caribbean, individually and collectively;

**WHEREAS,** the Multilateral Investment Fund II (hereinafter referred to as the "MIF") was established by the Agreement Establishing the Multilateral Investment Fund II, dated April 9, 2005 with the purpose of supporting economic growth and poverty reduction in the regional developing member countries of the Bank and the developing member countries of the Caribbean Development Bank by encouraging increased private investment and advancing private sector development;

**WHEREAS,** the Bank is the administrator of the MIF, pursuant to the Agreement for the Administration of the Multilateral Investment Fund II, dated April 9, 2005;

**WHEREAS**, the Bank has designed Project RG-M1222/RG-X1214 titled "Institutional Governance and Greater Financial Inclusion " (the "Project") as described in the attached project document (the "Project Document"), which forms an integral part of the present agreement;

**WHEREAS**, the Donor wishes to support the execution of the Project by providing a project specific grant to be administered by the Bank; and

**WHEREAS**, the Bank is prepared to receive and administer the contribution funds to be made available by the Donor.

**NOW, THEREFORE**, the Parties hereby agree as follows:

1. The Contribution will be solely for the purposes indicated in the Project Document. Any material deviations from the objectives and activities of the Project described in the Project Document will require the Donor's written approval.

2. The Donor will make available to the Bank a grant contribution in the maximum amount of US$2,394,737 (Two Million Three Hundred Ninety-four Thousand, Seven Hundred Thirty-seven United States Dollars) (the "Contribution") (the Contribution includes the administrative fee referred to in Section 6 below) to be administered by the Bank to co-

finance the Project. The Donor shall transfer the Contribution to the Bank in a total of five (5) disbursements and in accordance with the following payment schedule:

| No | Date: | Amount: |
| --- | --- | --- |
| 1) | Upon signature of this Administration Agreement by the Parties: | $500,000 (five hundred thousand Dollars) |
| 2) | No later than September 31, 2016: | $500,000 (five hundred thousand Dollars) |
| 3) | No later than March 31, 2017: | $500,000 (five hundred thousand Dollars) |
| 4) | No later than March 31, 2018: | $500,000 (five hundred thousand Dollars) |
| 5) | No later than March 31, 2019: | $394,737 (three hundred ninety four thousand, seven hundred and thirty seven Dollars) |

Contribution disbursements 2) through 5) shall be transferred by the Donor to the Bank upon the Donor's receipt of a Project Status Report, further described in Article 3.2 of the Project Document as well as the previous year's unaudited financial statements of the Project. The Project Status Report and the financial statements of the Project shall be sent by the Bank at least thirty (30) days in advance of each disbursement date, as established in Section 2 of this Administration Agreement.

3. Upon signature of this Administration Agreement by the Parties, and following the Bank's written request, the Donor will transfer the Contribution to account #04404221 "Inter-American Development Bank - Cofinancing Account" opened by the Bank at Deutsche Bank America Trust, New York (swift #BKTRUS33XXX) (the "Account"). The Contribution will be administered in the Account without distinction from other donors' contributions.

   The Bank will administer the Contribution in accordance with the provisions of this Administration Agreement and the Bank's applicable policies and procedures. The Bank will exercise the same care in the discharge of its functions, as described in this Administration Agreement, as it exercises with respect to the administration and management of resources from other donors.

4. The Contribution will be accounted for separately from the Bank's assets, and will be administered together with other contributions received by the Bank. The Bank may freely exchange the Contribution funds into other currencies as may facilitate their

administration and disbursement. The Bank will not be responsible for foreign exchange risk in the receipt, conversion or administration of Contribution funds. Further, the Bank may at its discretion invest and reinvest the resources of the Contribution pending their disbursement in connection with the Project.

5. To assist in the defrayment of the administrative costs in relation to the Contribution, the Bank will charge and retain:

   (a) a fee of U.S.$119,737 (One Hundred Nineteen Thousand Seven Hundred Thirty-seven United States Dollars), which is equal to five percent (5%) of the total amount of the Contribution at the time the Contribution is deposited by the Donor; and

   (b) any investment income generated by the Contribution pending its disbursement towards the Project.

6. The Bank's procurement policies and procedures will be applicable to the procurement of goods and services, as well as the contracting of consulting services, carried out with the Contribution, as required by the different components of the Project. Further, the Donor accepts that:

   (a) the resources of the Contribution will be completely untied; and

   (b) any consultancy services financed with the Contribution may be provided and executed by companies, specialized institutions or individuals from any Bank member country.

7. The Donor will not be responsible for the activities of any person or third-party engaged by the Bank as a result of this Administration Agreement, nor will the Donor be liable for any costs incurred by the Bank in terminating the engagement of any such person.

8. A final operational and financial project report will be submitted covering the entire project duration, no later than 120 days after project end. The Donor may also request a non-audited financial expense report of the Contribution. In addition, the Donor may request an "agreed upon procedures" report issued by an external auditor on the use of the Contribution resources. The cost of such auditor's report will be borne by the Donor and will not be deducted from the Contribution. The Donor will reimburse the Bank for the cost of this report promptly after receiving a written request from the Bank. The Bank will not provide audited financial statements for the Account.

9. The Bank will invite the Donor to participate in Project supervision missions as well as in the Project mid-term review mission. The Donor may participate in those missions and meetings either through the Donor's own staff or by designating a competent representative.

10. The Bank will endeavor to maximize opportunities to highlight the Donor's Contribution to the Project (e.g., by including the logo of the Swiss Agency for Development and Cooperation in documentation and other public information), and invite the Donor to participate in key events related to the Project.

11. The Donor will be responsible for its own costs with respect to any participation in missions, meetings or events.

12. As soon as possible upon completion of the Project, the Bank will return to the Donor any remaining uncommitted Contribution funds (meaning those that have not been committed towards Project activities), unless otherwise agreed to in writing by the Parties.

13. The Parties agree that neither of them shall offer a third person nor seek, accept or get promised directly or indirectly for itself or for another party any gift or benefit which would or could be construed as an illegal or corrupt practice.

14. Following consultations between the Parties, either Party may determine that if the purposes of this Administration Agreement can no longer be effectively or appropriately carried out, either Party may give notice of termination of this Administration Agreement. Such termination shall enter into effect three (3) months after notice has been received, subject to the settlement of any outstanding obligations made prior to the notice being received. If in the Donor's written, reasonable and justified opinion, the Contribution is not being used or has not been used for the purposes of this Administration Agreement, the Donor shall have the right to suspend any undisbursed and uncommitted funds to the Bank and/or terminate this Administration Agreement with immediate effect. In the event of termination by either Party, both Parties shall cooperate to ensure that all arrangements made hereunder are settled in a fair and orderly manner.

15. The offices responsible for coordination of all matters and receiving any notice or request in writing in connection with this Administration Agreement or the Project are as follow:

    (a) <u>For the Bank</u>:

        i. All communications pertaining to donor relations and resource mobilization will be directed to:

        Inter-American Development Bank
        1300 New York Avenue, NW
        Washington, D.C. 20577
        UNITED STATES OF AMERICA
        Attention: Manager, Office of Outreach and Partnerships (ORP)
        Tel.: +1 (202) 623-1583
        Fax: +1 (202) 623-2543
        E-mail: partnerships@iadb.org

ii. Day-to-day communications regarding the implementation of this Administration Agreement will be directed to:

Inter-American Development Bank
1300 New York Avenue, NW
Washington, D.C. 20577
UNITED STATES OF AMERICA

| | |
|---|---|
| Attention: | Chief, Grants and Co-financing Management Unit<br>Office of Outreach and Partnerships (ORP/GCM) |
| Tel.: | +1 (202) 623-2018 |
| Fax: | +1 (202) 623-3171 |
| E-mail: | orp-gcm@iadb.org |

(b) For the Donor:

Swiss Agency for Development and Cooperation
Freiburgstr. 130
3003 Bern
Switzerland

| | |
|---|---|
| Attention: | Latin America Division, Dr. Peter Beez |
| Tel.: | +41 58 46 23571 |
| E-mail: | peter.beez@eda.admin.ch |

16. This Administration Agreement will come into force on the date of its signature by each of the Parties and covers the period from January 1, 2015 to December 31, 2018 or until all parties have fulfilled their obligations arising from it. Such expiration will not affect commitments already entered by the Bank with third parties in accordance with this Administration Agreement. Unless otherwise agreed to in writing, any outstanding uncommitted balance of the Contribution will be returned to the Donor, in accordance with Section 15 above.

17. The Parties may amend any provision of this Administration Agreement in writing.

18. Subject to their respective policies and procedures with respect to the disclosure of information, the Parties may make this Administration Agreement publicly available.

19. Nothing in this Administration Agreement may be construed as creating an agency relationship between the Parties.

20. The Parties will seek to settle amicably any disputes that may arise from or relate to this Administration Agreement.

**IN WITNESS THEREOF**, the Inter-American Development Bank and the Government of Switzerland, represented by the Swiss Agency for Development and Cooperation, each acting through its duly authorized representative, have signed this Administration Agreement in two (2) originals in the English language as of the dates indicated below.

| **INTER-AMERICAN DEVELOPMENT BANK** | **GOVERNMENT OF SWITZERLAND represented by the Swiss Agency for Development and Cooperation** |
|---|---|
| Bernardo Guillamon<br>Manager, Office of Outreach and Partnerships | Sybille Suter<br>Head Latin America and Caribbean Division and Employment and Income |
| Date: JANUARY 7, 2015 | Date: Jan. 9th 2015 |

ANNEX A

PUBLIC

INTER-AMERICAN DEVELOPMENT BANK
MULTILATERAL INVESTMENT FUND

# REGIONAL

# INSTITUTIONAL GOVERNANCE AND GREATER FINANCIAL INCLUSION

## (RG-M1222)

## DONORS MEMORANDUM

This document was prepared by the project team consisting of: Claudia Gutiérrez (MIF/DEU); Karen Fowle (MIF/DEU); Gyoung Joo Choe (MIF/KSC); Trang Ho (MIF/KSC); Anne Marie Lauschus (LEG/NSG); Paula Auerbach (COF/CEC); Fernando Catalano (COF/CBO); Ana Cecilia Sánchez (COF/CNI); Alberto Bucardo (COF/CME); Gladis Gómez (COF/CHO); Carmen Mosquera (COF/CPE); Armando Chamorro (CMF/CNI); Rebecca White (IIC/IIC); and Miguel Aldaz (ORP/ORP). Omar Villacorta (MIF/ATF) and Sergio Navajas (MIF/ATF) were the Project Team Leaders.

# Contents

Project Summary
Executive Summary

I. Background and Rationale ........ 1

A. Diagnostic assessment of the problem to be addressed ........ 1
B. Project beneficiaries ........ 9
C. Contribution to the MIF mandate, Access Framework, and IDB strategy ........ 9

II. Project Description ........ 10

A. Objectives ........ 10
B. Description of the intervention model ........ 11
C. Executing agency ........ 12
D. Components ........ 14
E. Project governance and execution mechanism ........ 21
F. Sustainability ........ 22
G. Lessons learned in project design from the MIF and other institutions ........ 22
H. The MIF's additionality ........ 23
I. Project impact ........ 23
J. Project outcomes ........ 24
K. Systemic impact ........ 24

III. Monitoring and Evaluation Strategy ........ 24

IV. Cost and Financing ........ 25

V. Project Risks ........ 27

VI. Environmental and Social Impact ........ 27

VII. Fulfillment of Milestones and Special Fiduciary Arrangements ........ 28

VIII. Access to Information and Intellectual Property ........ 28

## PROJECT SUMMARY

## INSTITUTIONAL GOVERNANCE AND GREATER FINANCIAL INCLUSION (RG-M1222)

Financial services can be delivered in the long term only with sound, healthy financial institutions. Good governance practices make a contribution on this front, since they have a direct positive impact on institutional performance. In Latin America and the Caribbean, however, the adoption of governance standards and practices is still limited and insufficient, particularly at microfinance institutions (MFIs) and credit unions that serve poor and low-income populations, comprised mainly of women and individual clients in rural areas with difficult access to the financial system. The project is a joint effort between the Swiss Agency for Development and Cooperation (SDC) and the MIF to improve governance at these institutions, thereby promoting the expansion of quality financial services to those clienteles. The project's intervention model is based on the generation of state-of-the-art instruments for assessing the MFIs and credit unions and launching processes to reform and change their systems of governance, through external technical support and training for their governing bodies and managers. The project will also promote the development of advisory service offerings by working with local training centers and a group of consultants with specialized qualifications and knowledge. The project will pursue partnerships with regulators, investors, associations of financial institutions, and risk rating agencies, in order to have an impact on incentives for better governance systems. As a result, the institutions participating in the process will be in a position to make better decisions for strategic and operational management and, ultimately, to advance financial inclusion in the region.

## ANNEXES



| | |
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| Annex I | Logical Framework |
| Annex II | Itemized Budget |
| Annex III | Quality for Effectiveness in Development (QED) Matrix |



## APPENDICES

Proposed resolution

## OTHER AVAILABLE ANNEXES



| | |
|---|---|
| Annex IV | Selection of the coexecuting agency: Request for expressions of interest and general guidelines for the submission of proposals by finalists |
| Annex V | Report on project supervision, fulfillment of milestones, fiduciary agreements, and institutional integrity |
| Annex VI | Preliminary list of milestones |
| Annex VII | Schedule of activities |
| Annex VIII | Procurement plan |

## ABBREVIATIONS

| | |
|---|---|
| CFI | Center for Financial Inclusion |
| CGDF | Corporate Governance Development Framework |
| CGTF | Corporate Governance Task Force |
| CMF | Capital Markets and Financial Institutions Division |
| CONAMI | Comisión Nacional de Microfinanzas [National Microfinance Commission] |
| DNA | Diagnostic needs assessment |
| FCA | Full capital adequacy |
| MFI | Microfinance institution |
| MIX | Microfinance Information eXchange |
| NGO | Nongovernmental organization |
| PSR | Project status report |
| SDC | Swiss Agency for Development and Cooperation |

# REGIONAL
# INSTITUTIONAL GOVERNANCE AND GREATER FINANCIAL INCLUSION
# (RG-M1222)

## EXECUTIVE SUMMARY

| | | | |
|---|---|---|---|
| **Country and geographic area:** | Regional, all IDB member countries are eligible | | |
| **Executing agency:** | The Bank, acting through the Office of the MIF and an international coexecuting agency to be selected through a competitive process | | |
| **Access area:** | Access to Financing | | |
| **Agenda:** | Financially inclusive ecosystems | | |
| **Coordination with other donors/Bank operations:** | Cofinancing from the Swiss Agency for Development and Cooperation (SDC) | | |
| **Direct beneficiaries:** | Approximately 54 financial institutions | | |
| **Indirect beneficiaries:** | Approximately 162,000 individuals from poor or low-income populations who are clients of the project financial institutions | | |
| **Financing:** | Technical cooperation: | US$1,725,000 | 37% |
| | Investment: | US$0 | 0% |
| | Loan: | US$0 | 0% |
| | **Total MIF Contribution** | US$**1,725,000** | 37% |
| | SDC cofinancing: | US$2,394,737 | 52% |
| | Local counterparts: | US$ 500,000 | 11% |
| | **Total Budget** | **US$4,619,737** | 100% |
| **Execution timetable:** | Execution period: | 48 months | |
| | Disbursement period: | 52 months | |
| **Environmental and social impact review:** | This operation has been preevaluated and classified in accordance with the IDB's Environment and Safeguards Compliance Policy (Operational Policy OP-703). Since the impacts and risks are limited, the proposed classification for the project is Category "C." | | |

**Unit with disbursement responsibility:** MIF Access to Finance Unit

# I. BACKGROUND AND RATIONALE

## A. Diagnostic assessment of the problem to be addressed

1.1 **Governance as a key element in financial institutions.**[1] Concern over implementing good governance principles and practices in financial institutions has become highly visible in recent years. At the global level, the 2008 international financial crisis showed, for example, how failures and mistakes in calculating risk exposure, the exercise of shareholders' rights, the practices of boards of directors, and even executive pay can cause financial conglomerates to collapse.[2] At the level of financial institutions serving poor and low-income populations, such as microfinance institutions (MFIs) and credit unions, the perception that governance problems pose an increasing risk was emphatically confirmed by the results of recent surveys. The Center for the Study of Financial Innovation in its annual publication *Microfinance Banana Skins* ranked governance fourth in 2011 and second in 2012 among factors generating the most risk in the microfinance industry around the world. Recent specific studies on crises, bankruptcies, and reorganizations at Latin American MFIs and credit unions have concluded that the survival of troubled institutions ultimately hinged on the quality of their governance.[3]

1.2 **Greater financial inclusion with better institutional governance.** The role of MFIs and credit unions working on behalf of poor and low-income populations is crucial because those institutions are typically their sole point of access to the financial system. However, MFIs and credit unions with weak governance systems do not meet the conditions required to offer quality services adapted to this segment, and their bankruptcy and closure could cut off the source of financing for microentrepreneurs, small farmers, and rural dwellers in general. The disappearance of savings deposited in those institutions is also a latent risk in the presence of poor governance, which, although it may not have a systemic impact, does have repercussions on equal opportunity for access to formal savings. A general consensus exists that good governance practices are a factor with a positive impact on the performance of MFIs and credit unions, as well as on their growth and the deepening of access to, and use of, financial services.

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1 The word "governance" is used in this document to refer generically to "governability," "corporate governance," "cooperative governance," and/or "governance system."

2 Kirkpatrick, G. (2009): Corporate governance lessons from the financial crisis (vol. 1). OECD.

3 The studies presenting robust evidence include:

- Marulanda, B. et al. (2010): *Lo bueno de lo malo en microfinanzas. Lecciones aprendidas de experiencias fallidas en Latinoamérica* [The good of the bad in microfinance: Lessons learned from failures in Latin America]. MIF, Calmeadow & IAMFI.
- Rozas, D. (2011): Weathering the storm. Hazards, beacons and life rafts: Lessons in microfinance crisis survival from those who have been there. Center for Financial Inclusion.
- Rozas, D. (2009): Throwing in the towel: Lessons from MFI liquidations. Microfinance Gateway.

Research on access to financing and good governance principles and practices at financial institutions shows a positive correlation between the two variables.[4]

1.3 **Generation and adoption of good governance tools.** The good governance principles and standards prevailing in the region's financial systems are generally designed for large, traditional financial institutions such as banks, not for MFIs or credit unions, although these are frequently the most committed to the financial inclusion of poor and low-income populations. In addition wider dissemination of the few materials available, there is an urgent need to create practical, applicable tools that can guide MFIs and credit unions in the initial assessment of their governance systems and to continue external support for implementing reforms that mitigate weaknesses such as overconcentration of functions in a single person, the absence of a transparent accountability system, or the lack of independent oversight bodies to detect administrative mismanagement or fraud, among other typical problems. Moreover, the materials available do not have specific features for measuring progress in making recommended changes or improvements in the governance of institutions at the end of the intervention cycle.[5]

1.4 **Awareness and incentives for changing systems of governance**. Recognition of the positive impact of a good system of governance is increasing, but still insufficient at financial institutions. It should be kept in mind that the practical application of good governance concepts demands changes in the behavior of governing bodies and substantive decisions that often require time and specialized guidance. It is a challenge to find incentives to surmount obstacles related to opposition to change from stakeholders at MFIs and credit unions (owners, executives, managers), who in certain circumstances may be ensconced in comfort zones, may be biased, or may cultivate unilateral interests. The absence of awareness at financial institutions of the need to consider a process that includes monitoring and external support over the long term saps the motivation to institute internal changes that are valid responses to their needs.

1.5 **Diversity of regulatory environments, financial institutions, and needs.** The main findings of the project analysis mission to Ecuador, Bolivia, Nicaragua, Peru, Mexico, and Jamaica by a combined team of specialists and consultants

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[4] Analistas Financieros Internacionales (AFI) (2010): "Corporate Governance and Access to Finance." Perspectives 62. World Savings Banks Institute.

[5] The very few publications focus almost exclusively on a description of general principles. Some of them are listed below:

- Rock, R., Otero, M., Saltzman, S. (1998): Principles and practices of microfinance governance. Development Alternatives, Inc.
- Fundación Microfinanzas BBVA (2011): The practice of corporate governance in microfinance institutions. Fundación Microfinanzas BBVA.
- Fundación Microfinanzas BBVA (2011): Universal Corporate Governance Code For Microfinance Institutions. Fundación Microfinanzas BBVA.
- CMEF (2012): Guide for the adoption of good governance principles in microfinance institutions. Consensus statement. Council of Microfinance Equity Funds.

from the MIF and the Swiss Agency for Development and Cooperation (SDC) concluded that there are at least three factors determining the diversity of institutions and needs in the region that should be taken into account to improve governance:

(i) The legal and regulatory framework being modified in the countries as a consequence of national strategies for social and financial inclusion, the establishment of a new institutional framework for financial regulation, and the recognition or creation of new legal constructs to bring all or a majority of financial institutions under the regulatory and supervisory umbrella make it imperative for financial regulators to work together, since it is they who set the standards and principles for good governance and are tasked with overseeing their proper implementation.

(ii) Financial institutions in the region differ widely owing to their: (a) legal structure, (b) ownership structure, (c) stage of development, (d) size of operations, and (e) organizational structure, among other features, which gives rise to differing issues for institutional governance at the national, sector, and subsector levels in the different countries. Initiatives for the adoption of standards and principles for good governance practices should take all these differences into account so that changes can be brought about effectively and efficiently. The differing natures of the financial institutions makes it necessary to segment the market niche to which a support initiative is directed.

(iii) Demand for governance improvements is high in the countries consulted and has been voiced clearly by all types of financial institutions interviewed, as well as by financial regulators, external financiers, networks of institutions, and others, which indicates that an initiative to adopt good governance standards and principles would be welcomed in the region. However, it is crucial to learn more about needs, in order to target efforts to the groups with better changes of achieving reforms.

The analysis mission also made the following findings by county visited:[6]

(iv) *Ecuador:* The new Superintendencia de la Economía Popular y Solidaria (SEPS) [Superintendency of Cooperative Associations and Low-income Groups] is in the process of bring some 1,000 credit unions under regulation and supervision. The majority are very small, and although they need to improve certain aspects of governance, in the

[6] The information was obtained from a sample of countries in the region in order to substantiate progress in governance and interest in working together among financial institutions and regulatory and supervisory bodies. It does not in any way imply a preference for implementing the project in any of the countries listed.

short term they are focusing on attaining a minimum of financial sustainability. Meetings with SEPS and with credit union sector and second-tier entities made it possible to identify credit unions with assets of over US$10 million and no fewer than 5,000 clients as a potential niche for the project. Attention to this group of institutions does not preclude work with larger credit unions, MFIs regulated by the Superintendencia de Bancos y Seguros [Superintendency of Banks and Insurance Companies], or microfinance nongovernmental organizations (NGOs) that operate outside the sphere of government regulation, which have also expressed their interest in working with the project to improve governance.

(v) *Bolivia*: The Autoridad de Supervisión del Sistema Financiero [Financial System Supervision Authority] (ASFI) has also identified institutions in the process of adjustment to become regulated as a priority sector for the project, i.e. 51 limited membership credit unions and 15 NGOs. Between 2011 and 2012 a number of credit unions were taken over and closed as a result of governance problems, among other issues, which alerted the regulatory agency to the need to embark on a process to prevent future crises. Since then, ASFI has issued guidelines to enable institutions in the process of obtaining operating licenses, particularly the credit unions, to make a start on improvements. Fundación para el Desarrollo Productivo y Financiero [Foundation for Productive and Financial Development] (PROFIN), in coordination with ASFI, launched pilot projects in mid-2013 at three credit unions, to assess their systems of governance and recommend good practices. ASFI has expressed its interest in supporting the MIF's activities to improve the governance of the institutions it regulates.

(vi) *Nicaragua*: The new sector regulatory agency, Comisión Nacional de Microfinanzas [National Microfinance Commission] (CONAMI), has a mandate under Law 769 on the Promotion and Regulation of Microfinance to promote governance at the MFIs under its jurisdiction. Accordingly, it is preparing a specific set of regulations to support the adoption of good practices. Thus far, it regulates 26 MFIs, mostly NGOs and corporations, and plans to increase the number to 30 by the end of 2014, also including some credit unions. After Nicaragua's microfinance crisis in 2008-2010, the sector in general has become aware of the importance of having an efficient, high-quality system of governance. The MFIs that continue operating in the market and CONAMI itself have explicitly approached the MIF to indicate their interest in participating in initiatives and processes for better governance.

(vii) *Peru*: Peruvian financial institutions in general are working on various internal initiatives to improve governance. The Superintendencia de

Bancos y Seguros [Superintendency of Banks and Insurance Companies] (SBS) actively promotes the adoption of standards and good practices among the institutions it regulates and has expressed interest in continuing with awareness-raising activities and training in this area. Institutions operating outside the jurisdiction of the SBS, NGOs belonging to the Consorcio de Organizaciones Privadas de Promoción al Desarrollo de la Pequeña y Microempresa [Consortium of Private Organizations Promoting the Development of Small Business and Microenterprise] (COPEME), and credit unions tied to second-tier institutions want to work with the MIF on implementing tools to assess governance and monitor improvements in a group of selected affiliates.

(viii) *Mexico*: The size of the market for low-income financial institutions in terms of the number of operators and the different legal and structural options they have adopted make it impossible to identify a group of institutions with specific needs for better governance. A more detailed study of demand is required, although governance is a prevalent issue in the market, which is highly interested in working on it. In interviews with the MFI trade association and different sector experts, requests have been received for pilot projects to introduce tools for the introduction of good governance practices.

(ix) *Jamaica:* The Development Bank of Jamaica (DBJ) includes governance standards in its requirements for licensing MFIs, and the government is preparing microcredit legislation that contains elements related to safeguarding the quality of their governance. Many microfinance players in the country recognize the need to strengthen the governance of MFIs not just in Jamaica, but in the Caribbean as a whole, on account of the relative youth of microfinance in the region and the lack of knowledge of international standards and good practices.

1.6 **Shortage of consulting services and specialized training centers.** The specialization required to take action and assess the governance systems of MFIs and credit unions working with poor and low-income populations is insufficient in the region's financial industry, particularly in the case of independent experts but also in the case of employees of regulatory agencies, risk rating agencies, international financiers, etc. Although different centers that provide training in governance exist in the region, they do not specialize in finance, so no specific material on training in governance has been created for MFIs and credit unions with a social vocation.[7] When training centers have decided to prepare and offer governance courses, they have not been in depth or designed to scale.[8] In any event, the training service offerings are geared toward the theory of governance, principles, and good practices, but not toward practical implementation and making changes at MFIs and credit unions.

1.7 **Divergent efforts to improve governance.** Private and public organizations have taken initiatives in the region to improve governance. Global initiatives such as the Program for Corporate Governance of the World Bank's International Finance Corporation or the Global Corporate Governance Forum are important, but they are targeted to large, sophisticated institutions such as traditional banks. Others such as the Corporate Governance Development Framework (CGDF) encourage multilateral and bilateral financing institutions to improve their assessments of the governance of the companies in which they invest.[9] As far as microfinance, the Swiss Agency for Development and Cooperation (SDC) included a pilot initiative to assess governance in one of its old projects in Nicaragua, which is the sole experience in the region to date with the potential to be scaled up. In terms of credit unions, initiatives such as the Corporate Governance Task Force (CGTF)[10] have been established, and the Social Performance Task Force (SPTF)[11] as well as the Council of Microfinance Equity Funds have also been making efforts to work on this issue, but they are relatively recent and have focused on disseminating existing knowledge.

1.8 **Experience of the IDB Group in supporting better governance.** The MIF and the IDB have supported initiatives with a diagnostic approach or for the production of documents establishing general guidelines, which has failed to close

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7 The Institute Argentina para el Gobierno Corporativo [Argentine Corporate Governance Institute], Instituto Brasileiro de Governança Corporativa [Brazilian Corporate Governance Institute], Centro de Gobierno Corporativo y Desarrollo de Mercados de Chile [Chilean Center for Corporate Governance and Market Development], and the Centro de Excelencia en Gobierno Corporativo de Mexico [Mexican Center of Excellence in Corporate Governance] are some examples of centers dealing with the subject of governance that take a general approach for companies of all kinds.

8 Microfinance governance courses such as those offered by the Consorcio Latinoamericano para Capacitación en Microfinanciamiento [Latin American Consortium for Microfinance Training] (COLCAMI) in Mexico, last for just one or two days. Although the Boulder Microfinance Institute offers longer and more in-depth courses, their cost is higher, making access more difficult.

9 The CGDF was established in 2011 by 30 development finance institutions to coordinate reforms that reaffirm their commitment to transparency, accountability, and good business governance practices. The member institutions include the Inter-American Investment Corporation, the Andean Development Corporation, the Asian Development Bank, the African Development Bank, and the International Finance Corporation.

10 The CGTF was established in 2010 by institutions from different parts of the world, but has been active since 2012 at the Center for Financial Inclusion of ACCION. The MIF has been a member of the CGTF since late 2013.

11 The SPTF is a group that has been operating since 2005 and has more than 1,500 member institutions around the world. It promotes the implementation of the Universal Standards on Social Performance Management at microfinance institutions.

the gap in knowledge and action to address the processes of assessment and implementation of specific reforms needed today by MFIs and credit unions. The most representative governance projects are:

(i) MIF project RG-M1148, "Human and Institutional Capital in the Microfinance Sector," approved in 2009 and executed by Fundación Microfinanzas BBVA. The objective of component II, "Strengthening of good corporate governance in microfinance," was to prepare and disseminate a manual of good corporate governance practices and provide training in good corporate governance for microfinance to specialized instructors, executives, and board members of the region's MFIs.

(ii) MIF project RG-M1146, "Strengthening Banking Supervision for Improved Access to Financial Services in the Americas," approved in 2009 and executed by the Association of Supervisors of Banks of the Americas. One of the outcomes of Component II, "Financial stability and institutional and market strengthening," is a "proposal for strengthening supervision rules for corporate governance."

(iii) MIF programs RG-M1106, "Caribbean Microfinance Capacity-building Project, CARICAP I," approved in 2008, and RG-M1208, "Caribbean Microfinance Capacity-building Project, CARICAP II," of 2012, were designed with training activities in good governance practices for beneficiary MFIs in the Caribbean.

(iv) MIF project EC-M1036, "Central Finance Facility and Financial and Technological Services for Ecuadorian Savings and Loan Cooperatives," approved in 2008 and executed by Financoop, a second-tier cooperative institution. Subcomponent I of Component I on improvement of risk management processes provided for the production of a technical guide on good corporate governance practices adapted for credit unions, which was distributed to Financoop's members after production.

(v) IDB project NI-T1138, "Program to Support Microfinance and Financial Inclusion in Nicaragua," approved in 2010 and executed by the Capital Markets and Financial Institutions Division (CMF) at the IDB Country Office in Nicaragua. The objective of component II is to support the Association of Microfinance Institutions in readying its members to comply with Law 769 of 7 July 2011 on Microfinance Promotion and Regulation, entailing a number of activities to strengthen the governance of Nicaraguan MFIs that range from assistance in complying with the governance regulations to pilot projects to test assessment tools.

Also noteworthy is the work of the Inter-American Investment Corporation (IIC), whose principal expertise lies in analysis and support for better governance in family businesses and small and medium-sized enterprises. The IIC also has specific processes for evaluating the governance of the institutions in which it invests, and provides funding to enable them to make progress.

1.9 **Scaling up of the SDC's experience in Nicaragua.** As mentioned earlier, a relevant pilot project was sponsored by the SDC in Nicaragua between 2011 and 2013 to develop an innovative tool for assessing governance, which trained a group of independent consultants to work within MFIs and credit unions on improving their governance. The evaluation of the project was positive overall, and, with relevant recommendations for improvements, it was subsequently replicated at several MFIs and credit unions in Honduras and Bolivia using funds from sources other than the SDC. The factors of success in this experience include:

(i) Creation of a practical guide as a tool for assessing governance at MFIs that was also applied to credit unions.[12]

(ii) Language in the guide adapted for easy understanding of the technical terminology by the institutions' executives.

(iii) Intensive training for local consultants to implement the guide and monitor its implementation.

(iv) Partial subsidization of the cost of the assessments and monitoring of the proposed reforms.

The following lessons learned can also be drawn from evaluation of the SDC's experience:

(v) Implement guidelines that promote compliance with the regulatory frameworks of local regulators and international governance standards.

(vi) Take a demonstrative approach in a medium term of at least six months.

(vii) Work with senior consultants, so that their recommendations are high-impact and persuasive for the decision-making bodies of the MFIs and credit unions.

(viii) Establish a promotion strategy to attract more interest and a larger number of participating institutions.

Given the SDC's operating restrictions in other countries of the region, efforts to extend this first initiative have not succeeded thus far.

1.10 **Funds committed by the SDC and pre-project activities.** The SDC is interested in pursuing governance issues at MFIs and credit unions. Its head office in Berne, Switzerland, has committed 3.5 million Swiss francs (about US$3.8 million) to carry out a project on a regional scale together with the MIF. The proposed

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12 Vita, M., Vega, J. (2011). "Evaluation and development of good governance in microfinance institutions." SDC.

project has been formulated with the idea of scaling up the SDC's previous experience in this area and enhancing it with the lessons learned from initiatives supported by the MIF and other private and public organizations. As a preparatory activity, the SDC is financing a consulting engagement entitled, "Baseline: Governance at MFIs and credit unions in Latin America and the Caribbean," to make headway in establishing the baseline that will be the starting point for the project, and to lay the groundwork for implementing the system for monitoring and supervision the outcome and impact indicators. The consulting engagement is expected to conclude in the second quarter of 2014.

## B. Project beneficiaries

1.11 The project will work with financial institutions, primarily MFIs and credit unions that wish to undertake a process of improvement and adjustment to comply with the good governance requirements and standards issued by the financial supervision and regulatory authorities of their countries. The project institutions will be financially and operationally sustainable and have a social commitment to serve poor and low-income populations, particularly women and individuals living in rural areas with difficult access to the financial system. In terms of size, the project will be directed to institutions with loan portfolios between US$5 million and US$20 million, although requests from institutions outside this range may also be considered. The project will primarily support institutions in the process of becoming regulated, as well as regulated institutions wishing to improve their governance practices following the guidelines of the local financial regulator. A priori, it is estimated that at least 54 MFIs and credit unions in three countries of the region will benefit from the project, with an indirect impact on about 162,000 borrowers.[13]

## C. Contribution to the MIF mandate, Access Framework, and IDB strategy

1.12 The project will contribute to the MIF's objectives of promoting private sector development and reducing poverty. First, through work inside the MFIs and credit unions it will help to improve: (i) the roles, responsibilities, and membership of boards of directors, (ii) management information systems, (iii) supervision, control, and decision-making; and (iv) conflict management. This will provide more solid grounding for institutional transparency, make internal crises less likely, and contribute to financial performance and therefore to solvency and transparency. Second, thanks to better institutional performance, the MFIs and credit unions will be able to expand their services in the countries where they operate and serve a larger number of individuals from impoverished social strata who lack access to quality, formal financial services. In addition, this project will help to narrow knowledge gaps by generating information and lessons learned about how to gauge and surmount the challenges in governance in the region, the factors that promote good practices, and their direct and indirect impact in favor of financial inclusion. Lastly, the process to improve governance at the project

[13] The calculation is based on an average of 3,000 borrowers at MFIs and credit unions in the region.

beneficiary MFIs and credit unions will be implemented with the assistance of local training centers and consultants, leaving behind installed capacity in the countries where the project will be implemented.

1.13 **Connection to the agenda.** The project will contribute to the objectives of financially inclusive ecosystems agenda of the MIF's Access to Finance Unit, which will work to improve, test, and adopt tools and standards for transparency, client protection, and corporate governance of financial institutions.

1.14 **Collaboration with the IDB Group.** The project design team included participants from the Capital Markets and Financial Institutions Division (CMF) of the IDB's Institutions for Development Sector and a corporate governance specialist from the IIC. CMF contributed its experience with the design and implementation of IDB project NI-T1138, "Program to Support Microfinance and Financial Inclusion in Nicaragua," approved in 2010 and executed by the IDB Country Office in Nicaragua. The project team also established cooperative ties with the IIC with the joint objective of designing a standard method for the IIC and the MIF to analyze governance in the due diligence and supervision processes used at institutions that seek financing and execute projects.

1.15 **Geographic scope.** The project will be implemented in at least three countries of the region. Selection of these countries is open and will be based on the results of the requests for expressions of interest emerging from implementation of the components planned for the project. The no objection of each country's government will be obtained before proceeding.

## II. PROJECT DESCRIPTION

### A. Objectives

2.1 The expected impact of the project is to contribute to the soundness and sustainability of the microfinance institutions (MFIs) and credit unions working for the financial inclusion of clients from poor and low-income populations, reflected in improvement of the quality of these institutions' financial and social performance indicators. The expected outcomes are to improve the governance of MFIs and credit unions serving poor and low-income population segments by implementing standards and adopting good practices in governance.

2.2 Annex I (Logical Framework), Annex II (Itemized Budget), and Annex III (Quality for Effectiveness in Development (QED) Matrix) present supporting information on the relevance of the above-mentioned objectives. The following sections contain a detailed description of the project and references to other annexes and technical documents.

## B. Description of the intervention model

2.3 The key elements of the intervention model are:

(i) *Adaptation of existing tools for implementing good practices*: Tools developed previously by the Swiss Agency for Development and Cooperation (SDC), the MIF, and others to improve governance system practices provide a solid foundation for defining a development plan and monitoring its implementation. The project will revise and adapt those tools to the different legal forms and the different extents to which governance has been developed at the MFIs and credit unions. It is also strategically important to customize the tools so that, from a procedural standpoint, they meet the specific requirements of the different regulatory frameworks.

(ii) *Development of tools for ex ante and ex post assessment:* The project will develop these tools to be implemented at the institutions. They will be pragmatic, fast and easy to introduce, and capable of measuring progress in implementing governance standards and good practices qualitatively and quantitatively at a specific point in time. These assessments are important because: (i) they can trigger a reform process within the institutions by showing the governing bodies which aspects are priorities; and (ii) they make it possible to quantify progress by comparing the initial and final assessments of a governance strengthening plan.

(iii) *Intensive work with local training centers and consultants:* Introduction of the tools at the MFIs and credit unions would not be possible without a group of governance experts to work inside the institutions. Since the supply of consulting services for governance enhancement is scarce in the region, the project will contract local training centers and consulting firms after a regional public competition, to initially train consultants on the tools created by the project, and then organize them to assist MFIs and credit unions interested in undertaking a process of change. Working with local entities to build capacity will contribute to the project's future sustainability.

(iv) *Financial incentives to introduce the tools:* The project will provide temporary partial subsidies for MFIs and credit unions to introduce the tools for the assessment and implementation of good governance practices described in the preceding paragraphs. The MFIs and credit unions will be selected based on the results of a public request for expressions of interest. The subsidies for the cost of the consulting services necessary for the intervention will help to kindle interest among the institutions in joining the project. Initiatives of this kind, at more accessible cost, will not only attract a larger number of individuals for training, but lay the groundwork for the future sustainability of the project since the market will inherit human capital that can apply this knowledge in the long term.

(v) *Support for the MFIs and credit unions during the entire intervention process:* The consulting services financed by the project for governance assessments and for the implementation of good practices will be performed by experts during the period of time determined in the strengthening plans, with an average duration of one year. Changes in governance systems require multiple, systematic steps that are difficult to achieve and cannot feasibly be taken in a short time, even at less sophisticated institutions. The consultants in charge of implementing the processes will work inside the institutions with their owners, board members, and executives, guiding the necessary changes and overseeing progress to ensure that the changes do not interfere with their day-to-day managerial and operational activities.

(vi) *Maturation of the results after the intervention:* Experience in implementing good governance practices indicates that the results are not felt immediately after a technical intervention ends at the institutions, but rather materialize over a period of time that can vary greatly depending on the depth of the reforms necessary to bring about change. In some cases, the MFIs and credit unions may show signs of weakness or crisis during the intervention process as a consequence of the internal transformations required by a better system of governance. Typical examples of these temporary anomalies are: (i) a reduction in the institution's returns in the short term as a result of a prudential directive ordering higher provisioning; (ii) a rise in the at-risk portfolio indicator owing to a transparency mandate calling for its recalculation; or (iii) an increase in write-offs as a consequence of guidelines for cleaning up the unrecoverable portfolio.

## C. Executing agency

2.4 This project will be executed by the IDB, acting through the Office of the MIF and a coexecuting agency to be selected through an open competitive process. The selected coexecuting agency will ensure that the installed capacity created by the project remains in the region over the long term, and to that end it will sign a technical-cooperation agreement with the MIF to execute components I, II, IV, and V, which focus on activities with local technical subexecutors who provide specialized technical assistance adapted to the needs of their country's MFIs and credit unions.[14] The coexecuting agency will assign full-time and part-time professionals to form an administrative and technical team consisting of a

[14] As stated in paragraphs 1.6 and 1.7, there is no provider of governance training and consulting services offering services on a regional scale. Consequently, the coexecuting agency represents a valid response to this constraint, since it will work in coordination with the local training centers and consulting firms whose initiatives are currently fragmented.

technical coordinator, a fiduciary and administrative specialist (both full-time), and a part-time accountant and communications specialist, to be contracted at the appropriate time. The MIF, for its part, will execute all the activities of component III relating to the generation of systemic knowledge and partnerships to bring about governance reforms at the regional level.

2.5 At the time the present document was written, the MIF had published a request for expressions of interest by potential coexecuting agencies on its website and in *United Nations Development Business*, to ensure open and transparent competition. Annex IV (Selection of the coexecuting agency: Request for expressions of interest and general guidelines for the submission of proposals by finalists), contains the guidelines for submitting proposals and the evaluation criteria. Importantly, the request for expressions of interest welcomed cooperative efforts and consortia combining different skills to establish a solid management team, able to efficiently and effectively assign and manage the project.

2.6 The MIF and the SDC will review the expressions of interest received from potential coexecuting agencies and select a minimum of three proposals for the final selection phase. The finalists will be invited to participate in a second round to provide more detail on their proposals, following the general guidelines described in Annex IV. As part of the selection process, an analysis will be performed of the financial management and procurement capacity of the three finalists, applying the MIF's diagnostic needs assessment (DNA). The results of the DNA for each of the finalists will be a key consideration in the final selection. Once the final proposals have been received, the companies may make formal presentations at MIF offices in Washington, D.C. or via teleconferencing from their home countries, to make clarifications or answer questions.

2.7 The selected coexecuting agency will be responsible for complying fully with the fiduciary and administrative requirements that arise from the activities executed and will be responsible for delivering regular status reports on project implementation. The details on status report requirements are presented in Annex V (Report on project supervision, fulfillment of milestones, fiduciary agreements, and institutional integrity), which is available in the technical files for this document. Annex IV contains guidelines to ensure that the coexecuting agency is in a position to subcontract local firms as the subexecutors of activities in components II and III, through local competitive processes. In such cases, the coexecuting agency will include express clauses in the contracts entered into with the local subexecutors whereby they agree to comply with the fiduciary and administrative requirements on the same terms as the MIF requires of the coexecuting agency. Notwithstanding, the coexecuting agency will bear sole responsibility for supervision and full compliance with the commitments agreed upon with the subexecutors.

## D. Components

The project has five components: (i) generation of state-of-the-art tools; (ii) transfer of technical skills to the market; (iii) better governance in institutions; (iv) systemic knowledge and partnerships for reform; and (v) learning, communication, and exchange of knowledge. As mentioned earlier, components I, II, III, and V will be carried out by the coexecuting agency since they involve field work with MFIs and credit unions in each country selected, while component IV will be executed by the MIF since it involves knowledge generation and partnerships at the regional level. The following paragraphs offer a detailed description of each component.

**Component I: Generation of state-of-the-art tools (MIF: US$29,000; SDC: US$94,500)**

2.8 The objective of the first component is to map and revise tools existing on the market that can be used to produce a new range of instruments capable of identifying the main governance problems at MFIs and credit unions and offering them practical and efficient opportunities for reform in different stages. The three activities of this component, described below, will be executed by the coexecuting agency:

- **Activity 1: Mapping and improvement of existing tools for governance assessment and development.** The project will examine the tools already developed by the MIF, the SDC, and other agencies with the goal of adapting them in form and substance to the specific regulatory frameworks in the different countries involved and the types of institutions with which work will be done. This is not a matter of reformulating concepts already developed by the MIF, the SDC, or other agencies, but of adapting them to the different specific characteristics of each country, without resulting in the proliferation of different tools having the same purpose.
- **Activity 2: Tool for ex ante and ex post assessment of governance.** The project will create a simple, innovative tool that can be used to quickly assess, ex ante and ex post, the extent of compliance with governance principles and standards. This new tool is one of the project's innovations and will complement the tool developed in activity 1 since it can be used to measure changes in governance at the MFIs and credit unions. No such tool exists today in the region's financial markets. Importantly, the ex ante and ex post assessment tool is also a centerpiece of the project's control system because it will help to monitor attainment of project objectives.
- **Activity 3: Strengthening of tools to support the development of governance.** To create a toolkit that can be used by consultants to guide implementation of the reforms, the project will support the development of instruments such as the following: (a) by-laws; (b) regulations governing elections; (c) internal regulations; (d) regulations governing fees; (e) code of conduct; (f) management reports; (g) board of directors' reports; (h) oversight

committee reports; (i) succession plan; (j) information transparency policy; (k) plan of operations for internal audits; (l) presentations for training courses for executives; (m) self-evaluation format for boards of directors; and (n) financial assessment guide for executives (nonfinancial). These tools can vary depending on the degree of sophistication of the MFIs and credit unions.

2.9 These activities will be implemented in parallel with the start of the project. Since in the majority of cases, the goal is to fine-tune materials that the SDC and the MIF have already produced in earlier undertakings, the outputs and outcomes are expected to be available in the first six months of project execution.

**Component II: Transfer of technical skills to the market (MIF: US$79,500; SDC: US$185,500)**

2.10 This component focuses on the creation of capacity to offer technical expertise in good governance. The activities will be conducted by the coexecuting agency in countries where training centers and suitable groups of consultants for working on this subject are identified.

- **Activity 1: Local training centers or firms for education in governance.** The project will take advantage of the existing institutional infrastructure for training and consulting services in finance, microfinance, and cooperative enterprise in the countries of the region. The coexecuting agency will issue at least two regional requests for expressions of interest during project implementation to enable local training centers or consulting firms to apply, resulting in award of the execution of different activities in their respective countries. The winners of these competitions will enter into agreements with the coexecuting agency to act as project subexecutors. Some of the criteria that may be included in the terms of the requests for expressions of interest are:
  - (i) A minimum of three years' experience in training local consultants;
  - (ii) A preliminary list of the team of consultants to be trained in governance;
  - (iii) A tentative list of local MFIs and credit unions eligible for project activities and support;
  - (iv) Capacity for promotion and ability to attract more consultants in future;
  - (v) Capacity to absorb the training materials with a view to offering them in the long term and making the activity sustainable; and other criteria.

The coexecuting agency will be responsible for adjusting the above selection criteria based on the findings of the study "Baseline: Governance at MFIs and credit unions in Latin America and the Caribbean," which will include an explicit section on technical assistance service offerings.

- **Activity 2: Development of consultants' skills in the use of project tools.** This activity will mitigate the market weakness of not having enough expert consultants to guide the MFIs and credit unions in a practical process of improving their governance. The project will coordinate measures to establish a training and certification program with the local training centers and consulting firms that win the competitions held under activity 1 of this component. The training program will consist of various modules focusing on application of the tools generated by the project under component I. Training will be provided by instructors who must necessarily have previously applied governance tools at financial institutions. Ideally, the instructors will be consultants who have already applied the SDC's tools or have participated in the process of producing the project's new tools. Activities to support the training processes will include roundtables at the country level, where the consultants to receive training present the findings of their work with MFIs and credit unions. The training program will also invite an international expert to describe the lessons learned from applying the tools in other countries, during one or more sessions. To ensure the sustainability of this activity, the local training centers and consulting firms are expected to adopt the training program and offer it regularly after the project has ended. Although at least 80 local consultants are projected to start the training programs, about 25% are expected to complete them and actually work with the MFIs and credit unions on change processes after the project.

**Component III: Improved governance at MFIs and credit unions (MIF: US$464,250; SDC: US$1,083,250)**

2.11 The objective of this component is to rate, assess, and develop governance in at least 54 MFIs and credit unions in three countries of the region. The total may also include MFIs and credit unions from other countries of the region that request project support and are selected after a public competition. The activities will be executed by the coexecuting agency and are described in detail below:

- **Activity 1: Selection of beneficiary MFIs and credit unions.** The project plans to issue at least one regional request for expressions of interest each year for MFIs and credit unions wishing to improve their governance systems to apply for nonreimbursable technical assistance funding. The coexecuting agency will be responsible for all operating procedures, under the direction and supervision of the Steering Council. Some of the main beneficiary selection criteria will be:

  (i) Size in terms of assets and loan portfolio;

  (ii) Number of borrowers, savers, and users of other financial services;

  (iii) Positive average operating sustainability for the last two years;

  (iv) Mandate to serve poor and low-income populations;

  (v) Commitment of governing bodies to work to improve governance.

The number of institutions to be selected will grow each year during project execution, to a total of 54. The following table estimates the number of institutions to be selected each year:

| Year > | 1 | 2 | 3 | 4 | Total |
|---|---|---|---|---|---|
| Country 1 | 2 | 5 | 5 | 6 | 18 |
| Country 2 | 2 | 5 | 5 | 6 | 18 |
| Country 3 | 2 | 5 | 5 | 6 | 18 |
| Institutions per year | **6** | **15** | **15** | **18** | **54** |
| Cumulative institutions | | **21** | **36** | **54** | |

Anticipating that the institutions selected in each competition will not necessarily be located in the countries where the local training centers and consulting firms that will train governance consultants under component II are located, component III includes funds to cover the travel costs of consultants trained by the project to the countries where the supply of services is insufficient.

- **Activity 2: Ex ante assessment and rating of governance.** The MFIs and credit unions selected each year under activity 1 of this component will have to coordinate with an external consultant trained under component II to apply the evaluation tool developed under component I (activity 2). This assessment will be performed over a period of about two weeks and will produce a rating that will be used as the institutional baseline for the IMF or credit union. This activity is important since the assessment will identify the main governance weaknesses that need to be examined by the MFIs and credit unions and their main bodies, so that they can decide whether they wish to address them and commit to a reform process in the medium term. The average cost of an assessment has been estimated as US$3,000, with the institution covering half.

- **Activity 3: Development and improvement of governance.** Under the guidance of the consultants trained by the project under the component II activities, the MFIs and credit unions will establish a plan for strengthening and implementing the improvement process over the short and medium term. At each institution, the areas to be strengthened will be identified, and guidance and monitoring of implementation of the reforms will last for about 12 months. This activity will transfer and make intensive use of the toolkit developed under activity 3 of component I. One of the most important aspects of the control structure for this activity is receipt by the coexecuting agency of the governance development plans signed by the board of directors of each MFI or credit union. After the reform stage begins, each institution will have to negotiate and approve a governance development plan, committing to carry out the reforms designed with the consultant. The results of the intervention will become visible after the second year of implementation, since on average a reform takes 12 months. The estimated cost of the activity is US$12,000 per institution, with the institutions covering 40%.

- **Activity 4: Ex post rating of governance.** Once activity 3 has concluded at each MFI or credit union, its governance will be evaluated a second time by an external consultant different from the one who performed the ex ante assessment, to independently measure the improvements made. The MFI or credit union will be aware from the outset of the areas and the weight to be attached to them in the rating, so that they can focus on the areas to be improved during the entire consulting process. As in activity 2, the unit cost of the evaluations has been estimated as US$3,000, with the institutions covering 50%.
- **Activity 5: Training for board members, executives, and key personnel.** This is another important element of the project inside the MFIs and credit unions. The project methodology will be peer-to-peer exchanges of experience, involving cases prepared in advance whereby participants discuss the governance problems actually faced by their institutions and the measures taken to address them. The project will tap the experience of the Center for Financial Inclusion (CFI) for training in this methodology, drawing on its experience on a pilot project involving similar activities with MFIs.[15] Peer-to-peer exchanges will be held at least once a year in parallel with the sessions of events such as the Inter-American Forum on Microenterprise (FOROMIC), taking advantage of its power to attract board members, executives, and staff from MFIs and credit unions around the region.

**Component IV: Systemic knowledge and partnerships for reform (MIF: US$408,500; SDC: US$283,500)**

2.12 The activities of this component will be executed by the IDB, acting through the Office of the MIF. The objective is to produce systemic knowledge, so as to directly raise awareness among a number of actors with links to the MFIs and credit unions and establish partnerships to bring about governance reforms at the regional level. Each of the activities is described below:

- **Activity 1: Generation of regional knowledge.** To meet the need for knowledge of project audiences, the following regional studies will be conducted: (i) the first will identify the micro-variables for measuring the relationship between good governance and institutional performance results, and will test their impact on access to, and use of, financial services by MIF and credit union clients. (i) the second will study the behavior of MFI and credit union executives, their propensity to change, and the impact on the results of their institutions through the application of organizational behavior

[15] In October 2013 in Mexico City, the IFC held a pioneering training event attended by 27 executives from 14 MFIs from 11 countries in the region. The course, "Leadership and Governance in a Competitive World," was very highly rated by those attending and is the only event involving the peer-to-peer training methodology targeted to MFIs anywhere in the world.

analysis techniques. The results of both initiatives are expected to be disseminated through the channels of the IDB, the MIF, the SDC, and the channels created by the project itself. Dissemination of the documents will also be promoted at local and international events where the project obtains exposure.

- **Activity 2: Partnerships with regulatory and supervisory agencies.** Partnerships with regulators and supervisors will provide an opportunity for them to reinforce their requirements for standards compliance and implementation of good practices. The project will pursue partnerships with at least two regulatory and supervisory agencies in the region, and will finance the following expenditures for them: (i) consulting services to improve the governance regulatory framework; (ii) in-house training of staff for better supervision of governance at regulated institutions; and (iii) consulting services to create specific governance supervision tools for financial regulators. Regulatory and supervisory bodies wishing to obtain this cooperation will sign a strategic partnership document committing to providing a local counterpart contribution of at least 30% of the total to be cofinanced. The project will benefit, given that the need for MFIs and credit unions to comply with the regulatory requirements may be one way of directly speeding up implementation of component III and of indirectly spurring the other four components. The partnerships and joint work with regulators will have an impact on the actions of institutions already subject to regulation, as well as those in the process of becoming regulated.

- **Activity 3: Partnerships with other international actors.** Social investors, cooperation agencies, rating agencies, and other institutions that promote governance or financial inclusion are important for the project. The ties these organizations have with MFIs and credit unions are varied and can serve to leverage incentives in the promotion of governance. For example, since social investors and cooperation agencies are providers of funding and technical assistance, they focus on institutions with strong administrative capacity and, consequently, good governance practices. Activities planned with this group of players include the cofinancing of pilot projects at MFIs and credit unions and the development and testing of new tools. This activity also plans to support a process of aligning standards for measuring governance in due diligence processes, by designing a proposed tool and submitting it for approval to the different actors such as cooperation agencies, risk rating agencies, development finance institutions, and investors. In terms of knowledge generation and project promotion, partnerships are expected to be established with institutions such as the CGDF, the CGTF, the SPTF or the Microfinance Information eXchange (MIX),[16] which have a special interest in narrowing the gaps in understanding the subject and promoting good practices

[16] MIX is a not-for-profit organization established in 2002 that specializes in providing market information and financial data on the microfinance sector.

around the world, and events may be sponsored to disseminate the project outcomes of interest to them. Lastly, considering that the SDC is the most important strategic partner in this project, resources have been allocated for a consulting engagement to help develop its relationship with the IDB and the MIF. The objective of this consulting engagement will be to perform an independent external review of the coexecuting agency's fiduciary and operational compliance.

**Component V: Learning, communication, and exchange of knowledge (MIF: US$203,500; SDC: US$193,500)**

2.13 The objective of this component is to harness all the learning from implementation of the project activities through the systematization and documentation of know-how and the exchange of findings, using an efficient communication strategy. Since this is a regional project with a number of actors from the financial systems in which the MFIs and credit unions operate, the project's audiences have been identified as: (i) associations of financial institutions; (ii) financial regulators and supervisors; (iii) social investors; (iv) cooperation agencies; (v) risk rating agencies; and (vi) research centers. The coexecuting agency will be responsible for execution, and will keep the above in mind when implementing four activities:

- **Activity 1: Preparation of a communication strategy and platform.** Creation of an image and a communication and promotion strategy is crucial for the success of the project since, generally speaking, it should be strong enough not simply to capture the attention of the audiences to which is it targeted, but to help raise awareness and be persuasive about the need for changes in their behavior. Therefore, a communications consulting firm will be contracted to define the project's branding and help to establish the best channels for reaching the target audiences and presenting the knowledge products and outcomes of the program, etc. The communication plan to be developed under this component will also include a website and identification of the most efficient awareness-raising events.
- **Activity 2: Documentation of progress.** This activity has been planned to examine the experiences of the MFIs and credit unions that participated in the project, documenting the most efficient processes for improving governance. It includes the production of 54 infographics, one for each institution in the project. Preliminarily, the plan is to design one audiovisual output on the project outcomes.
- **Activity 3: Dissemination and exchange of knowledge.** This activity involves attending and organizing events and activities for the exchange of knowledge among the MFIs and credit unions. The project launch and closing will take place at regional conferences or seminars organized by third parties, providing financing in order to steer the main topic toward governance and place project activities in the forefront. However, the coexecuting agency will

also organize an event to exchange knowledge with actors from the region prior to the close of operations. This activity will also finance attendance at events that are not sponsored and visits to project beneficiary MFIs and credit unions to learn first-hand about lessons that can contribute to the advance of the project. Lastly, a budget item has been set aside for associations of MFIs and credit unions to promote the project.

- **Activity 4: Project fact sheet.** Annually, the coexecuting agency will update a project fact sheet, a standard document furnished by the MIF containing basic information on the project. It is a concise, practical communication tool that serves to show the challenges, intervention strategy, and results achieved.

## E. Project governance and execution mechanism

2.14 The project's governance structure comprises three levels: (i) Steering Council; (ii) the MIF as technical supervision leader; and (iii) the coexecuting agency.

- The first level is reserved for the Steering Council, a body to which the MIF and the SDC will each appoint one regular member and one alternate to represent them from project start to end. The Steering Council may also include up to three independent members invited to serve *ad honorem* by the MIF and the SDC. It will provide strategic direction, guidance, and support in meeting the project's challenges. The Steering Council will: (i) define the strategic vision of the project in the implementation stage; (ii) lead the process of selecting and contracting the coexecuting agency; (iii) support the requests for expression of interest to select the local subexecutors and the project beneficiary MFIs and credit unions; (iv) help to establish partnerships between key interested parties from the public and private sectors and civil society; (v) review the six-monthly project status reports; and (vi) recommend whatever adjustments are necessary to make the project a success. During the first year of project implementation, the Steering Council members will meet quarterly, or as deemed necessary, using virtual meeting tools. They will also meet face-to-face at least once a year.
- The second level is the MIF, which will be responsible for systematic supervision and control of the project. The MIF will have two types of objectives: (i) informative, to ensure that the Steering Council is up-to-date on progress, challenges, and problems; and (ii) consultative, to provide the coexecuting agency with operational guidance and obtain the greatest possible efficiency in project implementation. It is important to note that at no time will the consultative function replace the role assigned to the Steering Council. The MIF will designate one of its staff as project supervisor, who will continuously monitor and evaluate the coexecuting agency.
- A third level corresponds to the coexecuting agency, which will follow the guidance of the Steering Council through the MIF's recommendations. The coexecuting agency will create systems to assure project promotion and efficient implementation. It must also be able to produce timely and accurate

reports and communications for the MIF and the Steering Council to perform their work of supervision and direction, respectively. The coexecuting agency will implement the components and activities with the features of a MIF regional project, using its formats and internal operating processes.

2.15 The SDC will provide the resources committed for the project to the IDB, and the MIF will be responsible for disbursements to execute the component under its responsibility. The MIF will also disburse resources to the coexecuting agency for the components under its responsibility against the fulfillment of milestones, as shown in Annex VI (Preliminary list of milestones). The project execution period will be 48 months, and the disbursement period will be up to 52 months, to leave room for an audit and a final evaluation.

## F. Sustainability

2.16 The project will provide nonreimbursable technical-cooperation resources for MFIs and credit unions that meet the selection criteria to be defined in the regional requests for expressions of interest under component III. The selection criteria will be strict enough to guarantee that the beneficiary institutions continue to operate after the end of the project intervention, and that with the governance improvements, they improve their financial and social performance in the medium and long term. The subsidies received by the MFIs and credit unions will be partial and temporary, so that the institutions can demonstrate their commitment to invest in improvements. The capacity created by the project will be internalized by the beneficiary institutions, so that it can be applied periodically over the long term, either by themselves or with the assistance of consultants who have become specialized with the help of the project. The local partners—whether associations of financial institutions or the subexecutor training centers—will integrate the material generated by the project into their regular academic offerings, so that, in the long term, other interested parties can receive training in the subject. Lastly, the financial regulators will approve regulatory measures that will have a lasting systemic impact in their countries.

## G. Lessons learned in project design from the MIF and other institutions

2.17 The MIF has a tradition of support through microfinance and access to finance projects, but has never addressed the subject of governance, over and above some specific component or activity dedicated to producing guidelines or universal standards. This will be the first comprehensive, regional project to improve governance with a practical approach that promotes the implementation of best practices to achieve results in the medium term. Thus, learning from past experience has been essential in formulating the project. As mentioned earlier, the project specifically takes into account the experience of earlier SDC and MIF initiatives to improve governance. Paragraphs 1.8 and 1.9 provide a detailed description of those experiences, and section II.B, describing the intervention model, sets forth the key elements that are a direct response to the problems encountered, and have been used as inputs for the formulation of this project.

## H. The MIF's additionality

2.18 **Nonfinancial additionality.** The MIF's role is important for the success of the project in terms of coverage and future scalability, particularly if it is decided to include a larger number of beneficiary countries or prolong the project. Unlike the SDC, the MIF's influence extends to 26 countries of the region, enabling it to reach a larger number of direct and indirect beneficiaries and disseminate the knowledge generated by the project. The SDC focuses its efforts on Nicaragua and Honduras in Central America, and its operations elsewhere in the region are limited to Bolivia, Colombia, Cuba, and Haiti. The MIF's relationships with financial regulators and associations of financial institutions as a result of past and present projects in the financial sector is an intangible asset that can be capitalized on to launch and promote the project, which brings the benefit of attracting more participants from the audiences to which the project is targeted.

2.19 **Financial additionality.** The SDC resources would be insufficient without the MIF's involvement in the project, since there is a regional need to improve governance at MFIs and credit unions. In the SDC's past experience in promoting governance, additional funds were required to reach a larger number of beneficiaries. A more abundant source of funding is clearly required, given that (i) this is a regional project, (ii) it involves a more comprehensive and longer-term intervention model than previously had been used by the SDC, and (iii) it includes components for incentives and partnerships in activities to support regulators, associations, etc.

## I. Project impact

2.20 From the standpoint of impact, the 54 MFIs and credit unions participating in the project area expected to improve in terms of coverage and solvency ratios:

- *Increased capital adequacy:* The improved governance capacity of the institutions will be reflected in a sharper focus by all their governing bodies on meeting the main objectives of "institutional health." The indicator that will best represent this process is "full capital adequacy," which adds the difference between the portfolio over 30 days in arrears and the loan loss reserve to the balance in the capital account. To improve this indicator, the institutions will have to focus on three key factors: the quality of the portfolio, loan loss provisioning, and growth in equity. It is important to bear in mind that capital adequacy is both a financial and a social objective, as an indicator of both performance and support for members.

- *Growth in borrowers:* Institutions that have strengthened their governance systems will register growth in their portfolio of active borrowers. Increased awareness of goals and greater ability of the various governing bodies to supervise and control compliance will be reflected in better goal attainment, which includes the addition of new clients.

## J. Project outcomes

2.21 The project will have a direct impact on a minimum of 54 MFIs and credit unions, improving their governance systems in the medium and long term and, therefore, impacting their financial and social performance. These improvements will be visible in the results of the individual ex ante and ex post assessments of each of the interventions conducted, based on qualitative and quantitative indicators related to governance.

2.22 The other indicator is the number of consultants who are qualified as experts in governance, who put their expertise to work at the MFIs and credit unions. The project will finance a system to certify consultants who meet certain requisites and demonstrate their skills in the field. Not all the consultants who participate in the different training events will be certified; rather, such certification will be directed to identifying true experts who have completed at least once successful intervention.

## K. Systemic impact

2.23 The project will help generate knowledge on the assessment of governance systems at MFIs and credit unions, as well as on processes for implementing good practices. It will apply these tools to promote changes at those institutions, which will improve their performance, and will also disseminate them in the market as a "common good" that can be used by different types of audiences, including individual consultants, financial regulators, commercial investors, risk rating agencies, donors, social investors, etc. To assure scalability and future sustainability, the project will work in partnership with these players, particularly regulators and international actors, which will be instrumental in influencing the financial market in general and providing incentives for a larger group of institutions to adopt good governance standards and practices.

# III. MONITORING AND EVALUATION STRATEGY

3.1 **Baseline.** The coexecuting agency will use the information produced by the consulting study, "Baseline: Governance at MFIs and credit unions in Latin America and the Caribbean," to be funded by the SDC in the first half of 2014 with resources independent from the project (see paragraph 1.10). The study will gather information to adjust the logical framework indicators, particularly those directly related to improvements in governance at the MFIs and credit unions. The coexecuting agency will establish a system for gathering information to monitor all activities implemented under the project, which will enable the MIF and external evaluators to perform the corresponding analyses of development impact. Some key features to be included in the system are: (i) the ratings of the institutions in the ex ante and ex post assessments; (ii) the operating, financial, and social position of the institutions targeted by the project; and (iii) training for consultants and experts. The coexecuting agency will also be tasked with preparing a monitoring and evaluation plan, as established in the contracting terms.

3.2 **Monitoring.** The recipients of project financing will report information to the coexecuting agency that can be aggregated to measure progress on activities and their contribution to achievement of the logical framework indicators. The coexecuting agency will prepare six-monthly project status reports (PSRs) and commission independent evaluations in each country to learn in greater detail about the project outcomes and impact during project implementation. The project will contribute directly to the indicators of the MIF's financially inclusive ecosystems agenda, and its development can be tracked through the agenda progress report (APR).

3.3 **Evaluations.** A midterm evaluation of the project will be performed 24 months after the first disbursement, or once 50% of the aggregate MIF and SDC resources have been disbursed, whichever occurs first. The evaluation will measure the following factors: (i) progress in obtaining results; (ii) difficulties encountered during project execution and corrective measures taken; (iii) soundness of the benchmark parameters and the monitoring and evaluation system; and (iv) lessons learned and recommendations arising from project implementation. The logical framework indicators will be used to measure these factors. The final evaluation of the project will be performed once 90% of the aggregate MIF and SDC have been disbursed, or three months prior to the last disbursement. It will synthesize the findings of the program and all the individual project evaluations, and answer important questions such as: To what extent and how have the beneficiary institutions improved their good governance practices? Which indicators best capture the changes in the governance system and in the financial and social performance of the institutions? What is the estimated maturation time to begin assessing changes and outcomes in governance systems? What impact have gains in governance had on the institutions' clients? Are board members and executives more aware of the benefits of good governance standards and practices? Did the project have an impact on creating awareness of good governance among other market players? Do specialized consulting service offerings exist in governance improvement?

## IV. COST AND FINANCING

4.1 The project has a total cost of US$4,619,737. Of that amount, US$1,725,000 (37%) will be contributed by the MIF, US$2,394,737 (52%) by the Swiss Agency for Development and Cooperation (SDC), and US$500,000 (11%) by the local partners. The execution period will be 48 months, and the disbursement period will be 54 months. Annex II (Itemized budget) and Annex VII (Schedule of activities) provide detailed information on activities, amounts allocated, and time frames. A summary budget by components, evaluations, audits, and project administration costs is presented below:

| Summary budget | MIF | SDC | Local counterpart | TOTAL |
|---|---|---|---|---|
| Component I. Generation of state-of-the-art tools | 29,000 | 94,500 | - | 123,500 |
| Component II. Transfer of technical skills to the market | 79,500 | 185,500 | 50,000 | 315,000 |
| Component III. Improved governance at MFIs and credit unions | 464,250 | 1,083,250 | 400,000 | 1,947,500 |
| Component IV. Systemic knowledge and partnerships for reform | 408,500 | 283,500 | 50,000 | 742,000 |
| Component V. Learning, communication, and exchange of knowledge | 203,500 | 193,500 | | 397,000 |
| Evaluations, audits, and other | 190,250 | 84,750 | | 275,000 |
| *Evaluations and audits* | 85,000 | 55,000 | | 140,000 |
| *Ex post evaluations* | 40,000 | 20,000 | | 60,000 |
| *Contingencies* | 10,250 | 9,750 | | 20,000 |
| *Contribution to the MIF Impact Account* | 40,000 | | | 40,000 |
| *Contribution to the Access to Finance Agenda* | 15,000 | | | 15,000 |
| Project administration | 350,000 | 350,000 | | 700,000 |
| Administration fee collected by the IDB from the SDC (5% of its contribution) | | 119,737 | | 119,737 |
| TOTAL | 1,725,000 | 2,394,737 | 500,000 | 4,619,737 |

4.2 The project resources contributed by the SDC will be administered by the IDB through a project-specific grant (PSG). The IDB administers such operations in the manner established in the "Report on COFABS, Ad-hocs and CLFGS and a proposal to unify them as project-specific grants (PSGs)" (document SC-114). As provided in these procedures, the SDC's commitment will be established through a separate administrative agreement. Under the agreement, the IDB will administer the resources of this project and charge an administrative fee of 5% of the contribution, which will be duly identified in the project's budget. The administrative fee will be collected after the contribution has been converted into U.S. dollars.

4.3 The MIF and SDC resources for this project will be autonomous, meaning that they can be approved and executed independently, adhering to the allocation of funds described in the budget table and in the description of the components.

4.4 If the resources committed by the SDC are not received in U.S. dollars, the final amount will depend on the exchange rate in effect on the date when the Bank receives the funds from the donor and converts them into dollars. If the exchange rate declines appreciably, and the SDC's contribution is reduced in size and the difference cannot be covered from the funds set aside for contingencies, the activities envisaged in the project will be scaled back, and the project team will adjust the budget accordingly.

## V. PROJECT RISKS

5.1 **Regulatory framework risk**. Financial regulation and its requirements for the implementation of good governance practices largely determine the incentives for institutions to make internal changes and improvements. A scenario in which the regulatory framework is indifferent to, or discourages, the adoption of good practices would have a negative impact on the project. **Mitigant:** The project will be implemented in countries where the regulatory framework is favorable to the implementation of good practices, preferably where partnerships can be established with the financial regulation and supervision authorities. Moreover, a substantial criterion for selecting the beneficiary institutions will be their appetite for adopting the regulatory agency's guidelines.

5.2 **Risk of lack of interest**. The expected number of institutions participating in the project is large. There is a risk that the request for expressions of interest will fail to attract the expected number, and that few institutions will join the project, adversely affecting its scope, outcomes, and impact. **Mitigant**: The project will adopt a dissemination and promotion strategy that guarantees the effectiveness of the requests for expressions of interest. The strategy will include demonstrative elements to inform potentially interested parties about the experience with the institutions participating in the early stages of the project. Annual requests for expressions of interest will be issued, so that institutions that do not participate from the outset of the project will have a chance to join later.

5.3 **Risk of aversion to change**. Reforms in the governance of an MFI or credit union require a will to change on the part of its key governing bodies. Even if the tools developed are efficient in spurring critical analysis and substantive changes in the governance system, the greatest obstacle may be related to a lack of will or resistance by the decision-making bodies of the institutions or some of their members, to modifying a power position. **Mitigant:** In addition to raising awareness among governing bodies, the main mitigant will be the involvement of different external actors who can incentivize the change process at the MFIs and credit unions. Regulators and financiers will play a leading role here, owing to the impact they can have by requiring the adoption of good practices.

## VI. ENVIRONMENTAL AND SOCIAL IMPACT

6.1 This operation was preevaluated and classified in accordance with the requirements of IDB's Environment and Safeguards Compliance Policy (Operational Policy OP-703) on 22 July 2013. Since the impacts and risks are limited, the proposed classification for the project is Category "C."

## VII. Fulfillment of Milestones and Special Fiduciary Arrangements

7.1 **Results-based disbursements and fiduciary arrangements.** The coexecuting agency will commit to the MIF's standard arrangements relating to results-based disbursements, procurement, and financial management specified in Annex VIII (Procurement plan). The Swiss Agency for Development and Cooperation (SDC), as cofinancing agency, will also adhere to the stipulations of that document.

7.2 The MIF will be responsible for preparation and submission to the SDC of progress on meeting the stipulations of the administrative agreement.

## VIII. Access to Information and Intellectual Property

8.1 **Access to information.** The information generated with project resources is not considered confidential, with the exception of the governance diagnostic and assessment reports on the MFIs and credit unions participating in component III. Nevertheless, information aggregated by country and type of institution may be disseminated by the project, the MIF, and/or the Swiss Agency for Development and Cooperation (SDC) to demonstrate progress and results.

8.2 **Intellectual property.** The IDB will retain intellectual property rights to all outputs financed with MIF resources. Since the Swiss Agency for Development and Cooperation (SDC) is contributing previously-acquired knowledge to the project, the MIF will ensure that it can be replicated throughout the region while maintaining intellectual property rights or licensing its use from the SDC.