AFIRMA QUARTERLY REPORT

PROJECT YEAR 2, QUARTER 2 – January-March 2006

The AFIRMA Project, managed by Development Alternatives, Inc. prepared this publication for review by the United States Agency for International Development.

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USAID Contractor

Cover Photos: Clients of AlSol in Chamula, Chiapas by Nathanael Bourns (left) and Fernando Fernandez (right)

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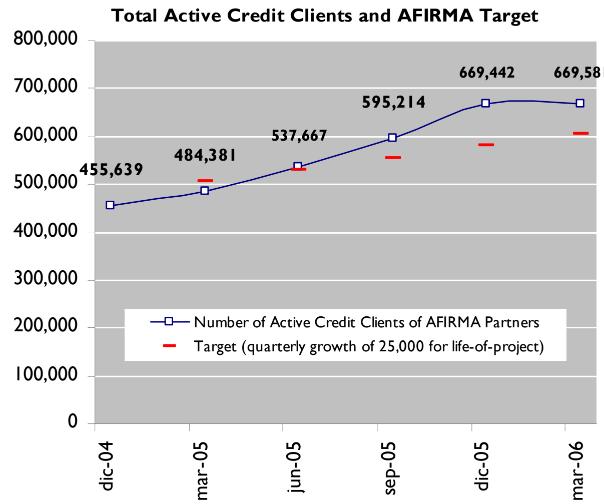
1. EXECUTIVE SUMMARY

The USAID/Mexico-funded AFIRMA Project, implemented by DAI, is designed to help build an inclusive, sustainable microfinance sector in Mexico as a means to increase access to a range of financial services and contribute to local economic development. Key results over the quarter included:



- ***Task 1: Strengthen MIF capacity.*** AFIRMA continued work with 12 partner MFIs, which continued to improve financial performance, and are now reaching a total of 669,581 clients, a 47% increase above the December 2004 baseline. However, there was little growth in early 2006, as some partners reported growing competition and slower demand, while others were focused (with project assistance) on internal transformations, or, for the first time, lacked the liquidity to expand more rapidly. AFIRMA is working with partners and external sources of funding to address the latter point and growth is expected to pick up again next quarter. The project has now supported re-design or development of 8 financial products, in an effort to help partners meet client needs. AFIRMA also planed support of Pronegocio, Grupo Banorte's finance company, to begin next quarter.

- ***Task 2: Develop a local, commercially-based MFI support services industry.*** AFIRMA worked with 3 local firms during the quarter on operational processes, information systems, and marketing, and contracted 6 local consultants, working in close coordination with international specialists. AFIRMA has examined the *supply* of and *demand* for support services to improve the supply of services. Training is slated for late 2006, in coordination with Mexican and international institutions.

- ***Task 3: Support innovations to expand access to rural finance.*** The project coordinated with USAID Development Finance Advisor Geoffrey Chalmers to adjust USAID's Rural and Agricultural Finance training materials to a Mexican practitioner audience. The workshop planned for June 21-23 will mark the launch of this task, to be followed closely by the final design of an innovation grant fund, and corresponding request for grant applications.

- ***Task 4: Build capacity to supervise microfinance.*** AFIRMA was in regular contact with new leadership for implementation of the Popular Savings and Credit Law (LACP) at the Banking Commission (CNBV) during the quarter. At the CNBV's request, AFIRMA has planned initial diagnostics for Federations that the CNBV has licensed to supervise the popular finance sector, in coordination with new personnel responsible for LACP implementation.

- ***Task 5: Improve the enabling environment for rural and microfinance.*** AFIRMA continued work on the credit information services component, coordinating with the Central Bank and one of the two private credit bureaus (following offers to both). AFIRMA supported strategic planning with the MFI association Prodesarrollo and its new leadership and design of a remunerations study for the sector. The project also continued to work closely with the microfinance program for the *Secretaria de la Economia*, Pronafim, to plan and deliver the Fifth National Encounter for Microfinance in late May, at which USAID is invited to present.

2. INTRODUCTION

The Access to Rural Finance for the Microenterprise (AFIRMA) Project, a USAID/Mexico-funded project implemented by Development Alternatives, Inc. (DAI), forms a central part of USAID/Mexico's Results Framework, under the new regional Strategic Objective 2 (SO 2) for Central America and Mexico – **Economic Freedom: Open, Diversified Expanding Economies.** Under SO 2 the Intermediate Result (IR) to which AFIRMA contributes is IR 3: ***Broader access to financial markets and services.*** AFIRMA is designed to help build an inclusive, sustainable microfinance sector in Mexico as a means to increase access to a range of financial services and the project's main goal can be summarized as:

> *"To contribute to the development of a dynamic, effective microfinance sector in Mexico that provides sustainable financial services to under-served urban and rural market segments, helping them manage risk and contribute to local economic growth."*

The AFIRMA Contract Scope of Work (SOW) and approved Year Two Work Plan outline five distinct, interrelated tasks:

1. Strengthen the institutional capacity of MFIs;
2. Develop a local, commercially-based MFI support services industry;
3. Develop innovative products and technologies that expand access to rural financial services and remittances;
4. Strengthen the capacity of the CNBV and federation committees to supervise RFIs and MFIs; and,
5. Improve the enabling environment for the rural and microfinance industry.

These tasks and their relationship to each other and to the ultimate goals of the project are further outlined in the Performance Monitoring Plan, updated in January 2006 to adjust to the Mission's new strategic objectives and intermediate results (above). Progress towards each of the five tasks over the second quarter of year 2 (January-March, 2006) and key priorities for quarter three of year 2 are presented in the next section. Following that is a description of project management over the quarter, including a summary of project finances.

3. AFIRMA WORK PLAN IMPLEMENTATION

Consistent with the year 2 work plan, activity during the quarter was most intense under Task 1 – *Strengthen MFI institutional capacity*, although the project team also undertook activities under tasks 2, 3 and 5. In quarter 3 of year two, the project will launch activities under task 4, and will hold a Rural and Agricultural Finance workshop to launch task 3 and inform the design of a Rural Innovation Fund.

3.1 TASK 1 – STRENGTHEN MFI INSTITUTIONAL CAPACITY

In AFIRMA's efforts to support increased outreach, it strives to strike a balance between the breadth of outreach, in terms of the number of new clients served, and the depth of outreach, in terms of the poverty level and geographic location of clients. The project strategy to work with institutions of various types, sizes and target markets, and the diverse institutional development needs of these institutions, illustrate the potential trade-offs between achieving the greatest number of new clients with access to service (project goal is 500,000) and working with poorer and rural clients, where total growth may be slower and where institutions may require substantial capacity-building before emphasizing growth. As a result, choosing the simplest path to achieve quantitative targets is not an option. Factors such as geographic market, marginalization of target clientele and outreach in terms of providing financial services where they are most difficult to deliver, as well as potential growth in the breadth of outreach are all factors that AFIRMA will continue to consider in prioritizing assistance.

Core principles of AFIRMA support of Partners

- **Respond to well-thought-out business plans,** owned by partners, addressing needs and capacity for sound growth and sustainability.
- **Demand-based approach** – respond proactively to the needs of each partner within the framework of business plans and project objectives,
- **Maintain flexibility** to respond to the changing market conditions and partner needs.
- AFIRMA consultants are **facilitators of change**, but partners themselves take ownership of the processes and changes.
- **Continue support based on results,** responsiveness, openness to change, and capacity to absorb assistance.

One of the primary goals for the quarter was to ensure that AFIRMA's planned assistance with each partner addressed the strategic priorities of that institution, consistent with AFIRMA goals.

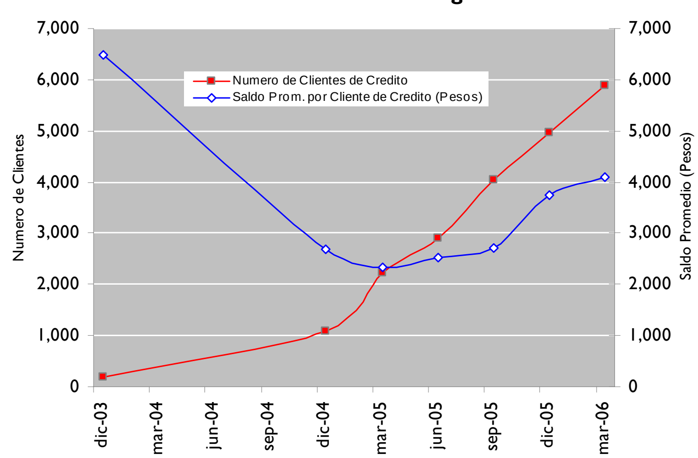
Below is a summary of AFIRMA support for each partner over the quarter. ***A complete set of performance indicators as of March 2006 are presented in Annex A***.

3.1.1 FIMEDER

FIMEDER has been granted a license to operate as a SOFIPO, regulated by the CNBV under the Popular Savings and Credit Law (LACP). It will join FinComun as one of the few institutions that has been able to meet all LACP requirements, which will allow FIMEDER to mobilize savings and offer other services in addition to credit.

FIMEDER continued to grow well over the quarter in terms of active credit clients (chart at right), and was able to improve its financial performance substantially (see chart on ROA & ROE below), primarily through growth of the loan portfolio, which has caused dramatic improvement of operating efficiency. The average balance has begun to increase as FIMEDER improves client retention (clients tend to increase loan size progressively if they stay with an MFI) and through individual lending targeting a niche slightly above the current methodology.

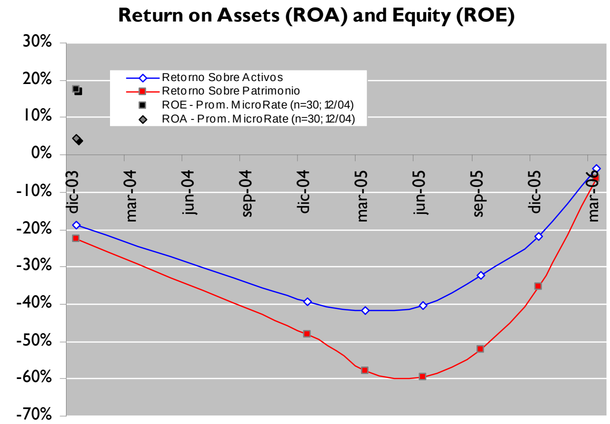
Active Credit Clients and Avg. Balance



During the quarter, AFIRMA supported FIMEDER with the following initiatives:

- ***Strategic Planning*** – In January, AFIRMA consultant Max Errazuriz completed his work (begun in late 2005) with FIMEDER in facilitating the strategic plan, which was coordinated with and later approved ratified by the Board of Directors.

- ***Individual lending*** – FIMEDER has had problems in the past with its individual loan product, but continues to view it as a vital future offering. Following a product diagnostic to determine areas for improvement in late 2005, AFIRMA consultant Vicente Avalos of Peru continued work during the quarter to prepare and deliver training courses for loan officers in individual lending, train internal trainers, redesign, pilot and begin roll-out of the adjusted product. He has worked with FIMEDER to develop new credit applications, identified pilot branches, train existing and new branch managers, and construct projections to examine how the product can contribute to FIMEDER's long-term sustainability.

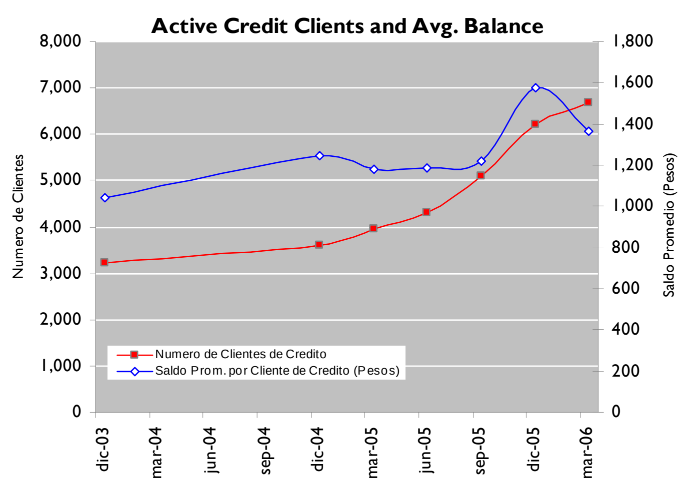


Upcoming priorities that AFIRMA has identified with FIMEDER are:

- Develop the "FIMEDER School" human resources and training program (a long-term activity)
- Study tour for the new Human Resources Director
- Present the AFIRMA institutional report to the Board of Directors, at the request of management
- Design Savings products and support office functions in line with the LACP

3.1.2 AlSol

AlSol began 2006 having completed, by far, its most successful year in 2005 terms of expanding outreach to rural clients in Chiapas, and in terms of steadily improving financial results including improved client retention and portfolio quality. In early 2006, AlSol has continued to grow both in terms of active clients (chart at right) and total loan portfolio, although the rate of growth has slowed, as the institution now lacks the necessary lending capital to continue to grow at the rate achieved in 2005. AlSol achieved Financial Self-Sufficiency[1] in early 2006 (see chart below), an important milestone since it signals that the institution can survive independent of additional donations. It also means that it can finance growth, in part, through retained



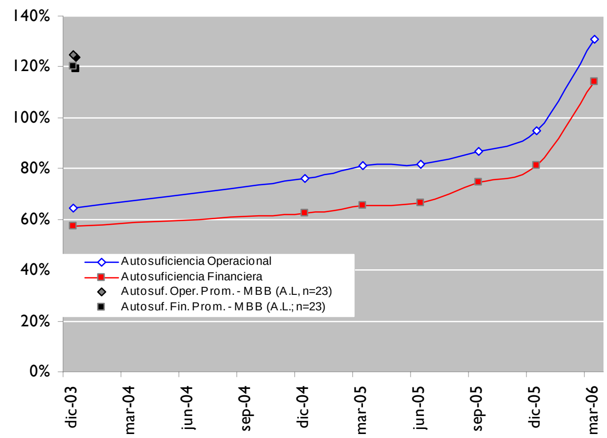
[1] The standard CGAP definition is used, as with all standard ratios that AFIRMA calculates. See Annex A for definitions and ratios.

earnings, although demand clearly outstrips the current rate of capitalization.

AFIRMA has advocated on behalf of AlSol with funds and investors interested in investing in the institution's sustainable growth.

With each area where AFIRMA has supported AlSol, the institution has taken full advantage of the assistance, and pro-actively worked to implement recommendations. During the quarter, Mr. Summerlin worked with AlSol to:

Financial and Operational Self-Sufficiency



- ***Conduct strategic and operational planning*** –Mr. Summerlin worked with AlSol to finalize the strategic and business planning begun in late 2005, and worked with the board of directors to re-think its role and level of commitment. Mr. Summerlin's work during the quarter focused on implementing simple monitoring tools to judge progress towards the business plan against the specific goals established for each unit and individual.
- ***Recommend operational adjustments*** – Mr. Summerlin, who also had as part of his SOW the review of operations, worked with AlSol in February to implement operational adjustments and support implementation of the business plan.

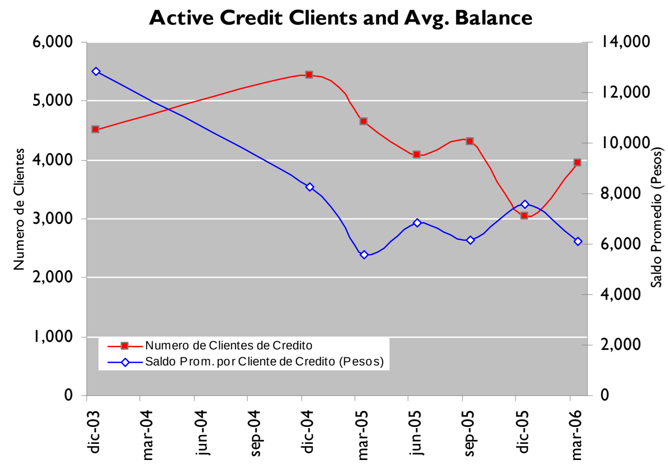
Upcoming priorities that AFIRMA has identified with AlSol are:

- Board Training (April 2006) by AFIRMA staff
- Audit standards and improvement of internal controls
- Continued operational adjustments and training of a new Manager of Financial Services (operations)
- Evaluation of the management information system
- Analysis of the appropriate future capital and legal structure for AlSol given the institutional priorities
- Creation of a Human Resources function within the Administrative area and training on human resources management.

3.1.3 DESPENO

Despeno has improve performance slightly in early 2006, as it continues a transition begun in 2005 from a dedicated Procrea credit distributor of funds from FIRA (the GoM trust fund for rural lending) to a more traditional MFI with continued interest in serving rural clients. Poor financial results at Despeno reflect the transition from highly subsidized rural lending operations with higher credit volume per client, to a higher cost structure relative to the smaller volume of the lending portfolio to urban and rural microenterprises. This change is reflected in the averaged balance per client (see chart at right).

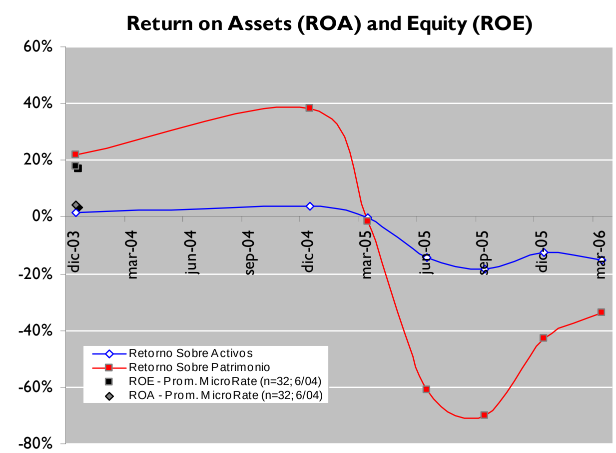
Following the difficult year in 2005, performance has begun to improve in early 2006 as reflected in the chart on ROA/ROE below. The chart also reflects decreasing leverage (the shrinking gap of difference between ROA and ROE), as Despeno moves from a credit distributor for FIRA, for which it could be undercapitalized (14 times debt to equity, for example), to a less leveraged structure that should attract investors and funds willing to lend to the institution. Despeno plans to reach a point of equilibrium in late 2006.



During the quarter, AFIRMA assistance focused on the following activities:

- ***Adjustments to the credit product*** – Due to Despeno's positive response to prior work of DAI microfinance specialist Claudia Ordóñez, AFIRMA expanded upon the scope of work to refine and re-launch the solidarity group microcredit product, which was completed during the quarter. Ms. Ordonez also completed field training on the product and methodology adjustments for operational staff (loan officers and branch managers). Despeno reports that the portfolio of clients served under the adjusted conditions and methodology is performing well, with improved client retention and lower risk in the new portfolio.

- ***Management Information Systems*** – AFIRMA Consultant Carlos Paredes began work Despeno to determine needs for a new management information system (MIS).



Bolivian consultant Eliana Otondo was denied a visa to return to Mexico to complete her work on human resources. AFIRMA and Despeno will examine the proper way to ensure that Ms. Otondo can return to complete her work.

Upcoming Priorities for AFIRMA support of Despeno include:

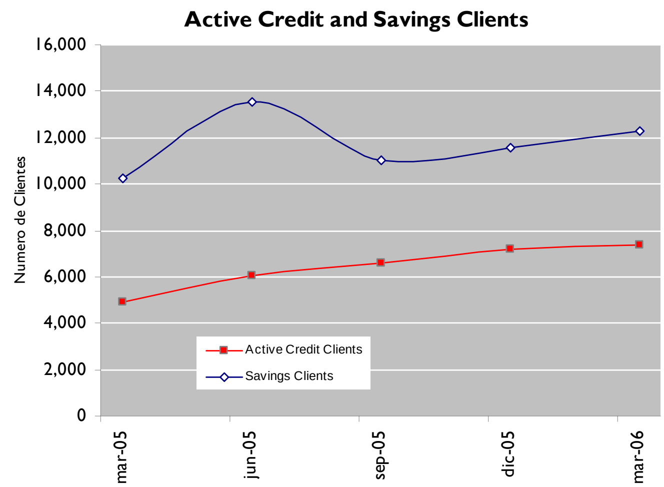
- Ongoing monitoring and follow-up assistance with the adjusted solidarity group loan product
- Study tour for the new Coordinator
- Develop and roll-out a new individual lending product
- Evaluate the current institutional image and assist with improvements

3.1.4 CADEMI

Last quarter, AFIRMA assistance was on hold following a review of CADEMI's tax situation as a non-profit *Asociacion Civil*. Next quarter, based on CADEMI's response, AFIRMA will work with USAID to determine whether to continue technical assistance with CADEMI. Financial and operational results are included in Annex A, along with the other partners.

3.1.5 AMUCSS

Last quarter AFIRMA work with AMUCSS continued to focus primarily on accounting and planning. The AMUCSS network has grown slowly over the past 12 months, in comparison to other AFIRMA partners, but has taken important steps to improving the flow and quality of management information within the network, and at individual *microbancos*.



- ***Accounting, Internal Control and Initial Compliance with LACP*** - First on the list of priorities with AMUCSS is the need to establish reliable accounting and internal control systems, and AFIRMA continued to support AMUCSS through local resident internal control specialist Martín Yedra, to improve accounting and control systems, and produce reports previously unavailable to management. AFIRMA also hired local accountants Alfonso Bustos and Juan Omar Flores, as well as local accounting consultant Rene Garcia for this effort. The team, which completed its work with AMUCSS in February, developed financial statements for the seven networks of *microbancos*, which although clearly preliminary in nature, allowed AMUCSS to affiliate with the FEDRURAL Supervisory Federation[2] and request an extension for legal conversion to a SOFIPO, an obligatory step under the LACP since AMUCSS mobilizes voluntary savings. Assistance fulfilled one of the high-priority objectives to allow the networks to continue operations.

- ***Management Information Systems*** – In January, following close coordination with the accounting assistance, AFIRMA completed support of implementation of the Rana MIS in two Micro-banks (Hueuetla and La Uno) that had not yet installed the software. This work was conducted through a purchase order with the local firm Consultants in Tecnologia Integral, S.A. (CTI). The assistance and related training was well received within the *microbancos* and in AMUCSS in general and has allowed for greater financial transparency where implemented.

- ***Strategic Planning and definition of the organizational structure*** – DAI Senior Microfiance Specialist John Magill completed his work on the planning process for 2006-2008 in January, along with the managers of the networks of *microbancos.* An important result of the support, in addition to the plan, was the formation of two internal work groups: one to analyze options for the ideal legal and organizational structure of AMUCSS, and the other to focus on improving the financial position of AMUCSS.

Future AFIRMA support for AMUCSS will be coordinated with USAID and conditioned based on a clear definition of the institution's administrative, operative and financial, situation and future priorities. Likely areas for further assistance that AFIRMA has identified with AMUCSS include:

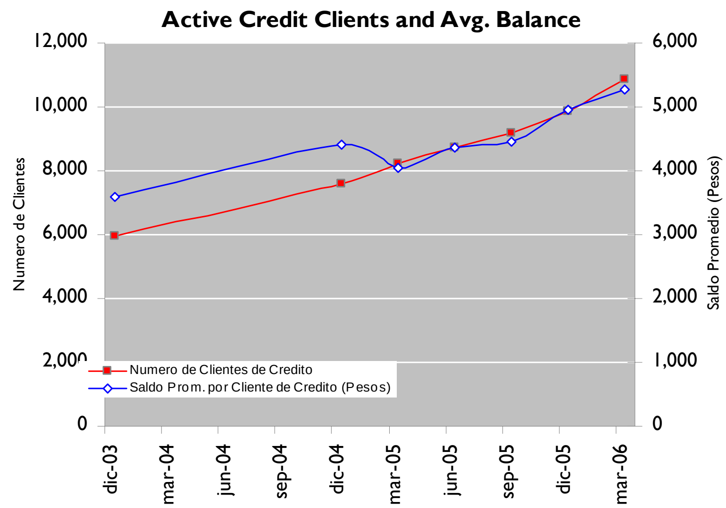
- Human resource management

[2] FedRural has been approved for delegated supervision under the *Ley de Ahorro y Credito Popular* (LACP – Popular Savings and Credit Law).

- Support with credit operations, possibly through a resident advisor
- Ongoing support to improve Internal controls and accounting

3.1.6 Fondo 5 de Mayo

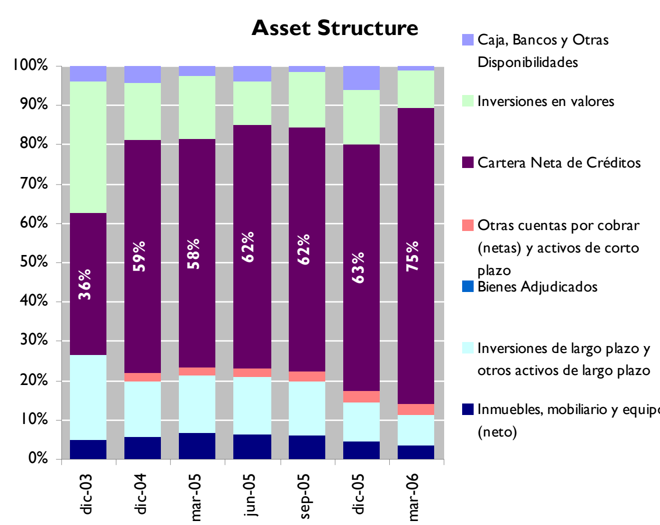
During the quarter, Fondo 5 de Mayo (F5M) continued the highly positive trajectory begun in 2005, growing more quickly than in the past and maintaining financial self-sufficiency established last year. The growth (see chart on active clients) has meant that F5M is dedicating a greater portion of its assets to the loan portfolio (now 75%, approaching international standards for successful MFIs), and thereby improving overall financial performance. Although both of these elements are highly positive, the growth is putting pressure on liquidity, for the first time in the institution's history, and is causing F5M to examine options for capitalizing the lending operations, (including the option of placing the lending operations from the multi-service NGO in a specialized, regulated entity).



F5M continued to take full advantage of AFIRMA support, as reflected in continuing positive results and aggressive future plans. During the last quarter AFIRMA supported F5M to:

- ***Implement adjusted solidarity group lending methodology*** – F5M implemented the adjusted product and product manual established through support from DAI Microfinance Specialist Robin Young. Ms. Young's efforts also laid the groundwork for the individual lending product to be developed in 2006.

- ***Develop Individual Lending Product –*** Based on progress begun with the adjustments to the solidarity group lending methodology, Ms. Young began working with F5M to develop an individual lending product in late March.



- ***Finalization of strategic and business plans*** – AFIRMA consultants Alex Silva (former manager of ProFund, the most successful regional microfinance investment fund) and Robin Young helped the F5M president and senior management determine the future direction of the institution. The F5M Board used inputs to take a formal decision on the long-term plan and institutional structure at their meeting on February 22, 2006, at which the State of Puebla indicated that it would support transformation and that the capital donated could be transferred, if the mission remained similar.

The board of directors requested establishment of an independent 3rd party commission to review options and invited Nate Bourns to participate. Mr. Bourns agreed to participate as an individual, on the condition that his positions and opinions would be his own, would not obligate USAID or the US Government in any way.

- ***Operational staff training*** – AFIRMA contracted microfinance specialist Hector Cisneros of El Salvador to train operational staff in the adjusted credit methodology and to improve the process of identification, orientation and training of loan officers. Mr. Cisneros began working with F5M in 2006 as a resident consultant, under the conditions for such assistance agreed upon with USAID in September 2005.

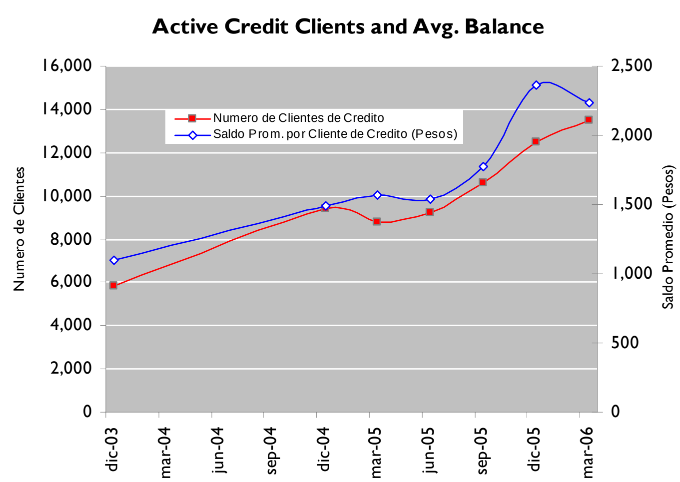
F5M has broken from a conservative path and developed an aggressive plan for 2006-2010, including separation of the lending operations from non-financial operations, with projected growth of nearly 100% for 2006. So far, F5M is on target with most aspects of its projections, but is seeing a potential squeeze on liquidity as growth continues. Going forward, F5M management an board of directors have identified the need to examine options for transformation in order to obtain the capital necessary to sustain lending operations growth.

AFIRMA plans to support the following activities during the rest of 2006:

- Train operational personnel in the adjusted credit methodology
- Develop, pilot-test and launch an individual lending product
- Support decisions on transformation of the lending operations to a regulated entity
- Define needs and options for a new management information system, depending on strategic decisions for transformation
- Study tour for middle managers to visit one or more large, successful, MFIs

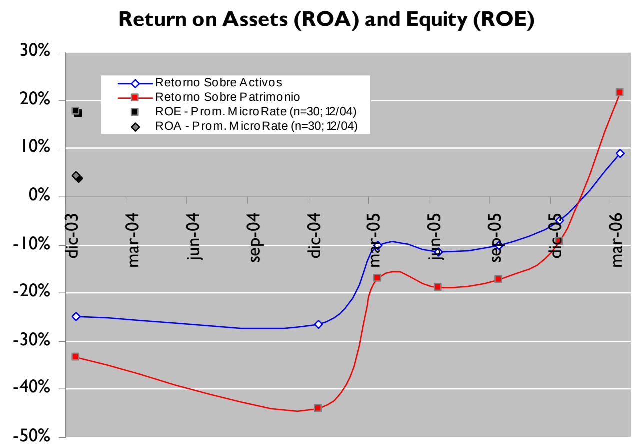
3.1.7 ProMujer Mexico

Early 2006 was a period of transition for ProMujer Mexico (PMM), as the previous General Manager Armando Laborde departed and Javier Vargas, formerly with the MFI Solfi, was identified to take over. During the transition, AFIRMA has been in close contact with President of the Board of Directors Maria O'Keefe. Having surmounted significant challenges in early 2005, PMM has grown well since June 2005 (see chart at right) and has begun 2006 attaining a positive return during the quarter, excluding donations, (see ROA/ROE chart below). Similar to other AFIRMA partners, PMM is now facing the need for increased lending capital to continue the current growth trend.



During the last quarter, work with ProMujer focused on finalizing the market study, implementing study results, and supporting the decentralization of operations, including improvement of internal controls in order to allow for decentralization of operations.

- ***Market Study*** - DAI microfinance specialist Hillary Miller-Wise, along with junior microfinance consultant Brooke Jones, collaborated closely with the local research firm, Serta (hired under a cost-shared purchase order), to ensure the quality of intermediary and final deliverables. In January 2006, Ms. Miller-Wise officially concluded the study with a presentation of the market analysis to ProMujer's management, president and to USAID and completed a marketing strategy for 2006.



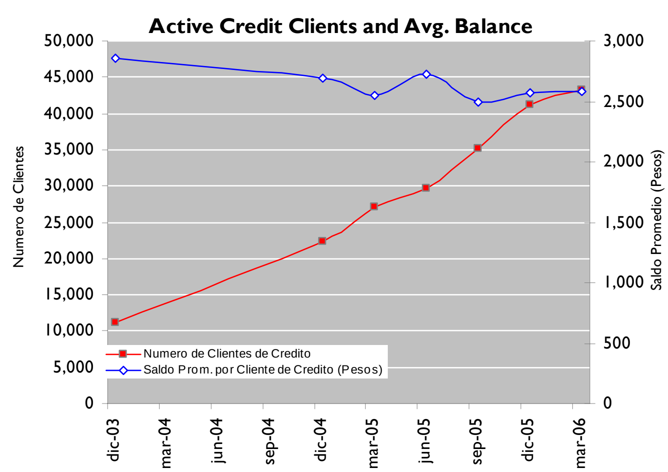
- ***Internal Control and Decentralization*** – AFIRMA supported PMM through assistance from Peruvian microfinance consultant Leopoldo de la Jara and local consultant María Olazábal to establish internal controls and a more appropriate structure given PMM's strategy to decentralize their operations. The consultants completed operations and internal control manuals, and will complete a credit manual next quarter to finalized the assignment.

Upcoming Priorities for AFIRMA support of PMM include:

- Training to implement the internal control system AFIRMA supported
- definition of needs for a new management information system
- Training middle management

3.1.8 FINCA Mexico

Following FINCA Mexico's outstanding performance in 2005, the institution has continued to grow profitably while also making investments and mobilizing funding necessary for future growth. Although the rate of growth in active clients (chart at right) and profitability (ROE/ROA chart below) have each declined slightly as lending slowed in late 2005 and early 2006 (see chart below showing the loan portfolio as a percentage of total assets). AFIRMA does not view the change as cause for concern, as FINCA maintains high profitability, even as it begins to lower lending interest rates in some of the more competitive markets in which it operates.

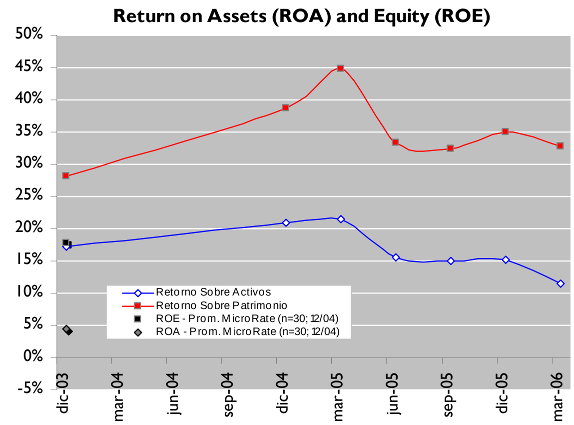


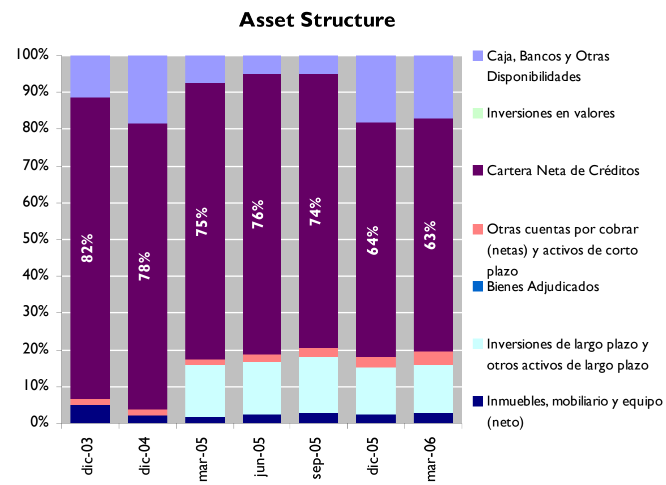
AFIRMA continued to provide intensive assistance in response to FINCA Mexico's needs during the quarter, and according to the FINCA Mexico General Manager, Gonzalo Puente, USAID assistance has played an important role in the positive results. The main activities supported in the last quarter were:

- ***Support of Operations*** – Johnny Velasco, a microfinance operations specialist from Bolivia continued his one-year scope of work as Resident Consultant. Mr. Velasco has focused on supporting FINCA in consolidating the operational area, improving operational efficiency and client retention. This work should translate to portfolio growth and improved portfolio quality and volume.

- ***Systematization of Administrative Procedures*** – AFIRMA continued to support systematization of administrative procedures through a third phase with the local firm SIN, (*Servicios Internacionales de Negocios*) led by SIN consultant Felipe Sandoval. This activity has resulted in the development of a set of manuals documenting and systematizing (in electronic format) each of FINCA Mexico's operational processes. In early 2006, work focused on training personnel on how to use and update the new manuals. This assistance is resulting in clear policies, procedures and forms for standardized operations and improved internal controls.

- ***Management Information Systems*** – AFIRMA continued to support analysis of the capability of its Management Information System (MIS) SIEM 7, to adapt to the administration and control necessary for the planned expansion. AFIRMA IT consultant Carlos Paredes worked with FINCA Mexico over the quarter to determine requirements for communication, control systems and reliability of data transmission. He also worked to improve overall security measures of the MIS.



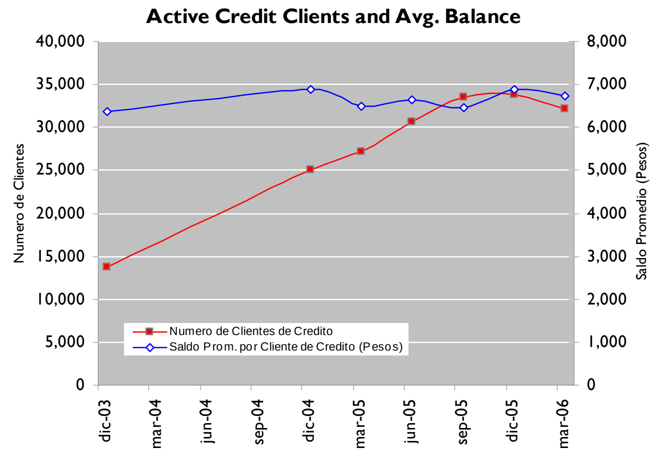


AFIRMA has also worked with FINCA Mexico and USAID-sponsored EMDAP Advisor Ivana Fertziger to determine the following priorities for 2006, based on FINCA's business plan:

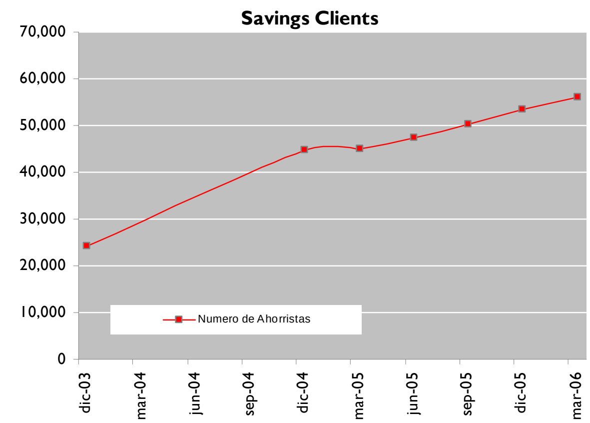
- Training in problem loan recovery (with AFIRMA Microfinance Specialist, Willy Escobedo)
- Finalize the Systematization of Operational and Administrative Procedures (ongoing with *SIN*)
- Develop individual lending product
- Strengthen Human Resources area, including a training program for middle managers
- Legal options to become a regulated MFI
- Study tour for leading loan officers
- Begin to develop savings products (late 2006)

3.1.9 FinComún

FinComún continues to be a leader in many ways within the microfinance subsector, but growth in credit clients has slowed in late 2005 and early 2006 (although growth in savings clients has continued steadily – see charts at right), as the institution focused on operational adjustments that AFIRMA is supporting related to the primary credit product. Although FinComun remains profitable (see ROA/ROE chart below), Profitability has declined as the net portfolio (after subtracting the portfolio reserve) has declined as a percentage of total assets due to portfolio quality challenges.

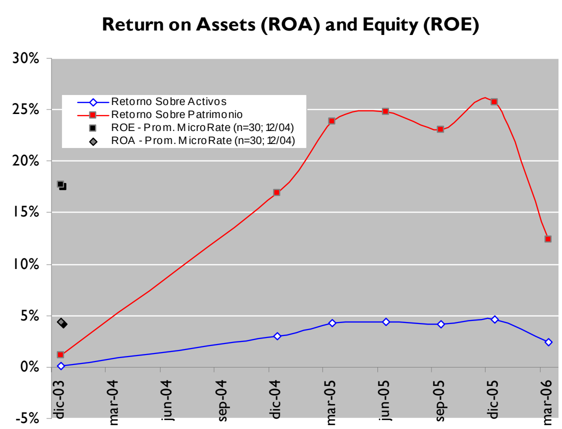


Last quarter AFIRMA held regular meetings with FinComún senior management to support decisions regarding loan portfolio performance (portfolio quality), discuss implementation of a risk management area (as recommended by AFIRMA consultant Max Errazuriz). AFIRMA also supported the following activities over the quarter:



- ***Final Strategic and Business Plan*** – in early 2006, AFIRMA consultant Luis Noel Alfaro finalized the Strategic Plan for 2006-2010. The final plan, developed with senior management, staff, and external advisors and approved by the Board of Directors clarifies objectives and establishes a long-term strategy for FinComún, and lays out financial and operational projections by product and by branch.

- ***Costing System*** – In order to help FinComún gain a better ongoing understanding of its cost structure and ultimately to improve efficiency, AFIRMA brought in Bolivian microfinance costing specialist Milagros Chiappe in late 2005. Ms. Chiappe completed her initial report in Janunary and will continue to consult with FinComun as it implements its new MIS. It is worth reiterating that *this work has had an impact beyond FinComún*, causing the MIS provider (supported through Bansefi's project with the World Bank, and planned to be replicated in other MFIs) to review the accounting software to ensure compatibility with a costing system that can help MFIs understand and better manage their own costs. Ms. Chiappe will continue work in late 2006 to support implementation of the costing system.



- ***Product and Methodology Adjustments*** – AFIRMA continued to support FinComún with needed adjustments to loan products and methodologies through technical assistance from credit specialist Michael Steidl, who reviewed the policies, operational procedures, and personnel aspects of the methodology, to propose client-focused improvements the administration of the product, in order to improve repayment incentives and decrease overall risk in the loan portfolio. The work revealed weaknesses in the credit analysis that is one of the main causes of deteriorating portfolio quality and last quarter AFRIMA and Mr. Steidl began a re-training plan for operational personnel, with particular emphasis on the individual loan product, and in problem-loan recovery.

FinComún Client Meets EGAT Director

In April, FinComún and AFIRMA hosted a visit from the **USAID/EGAT Director Jacqueline Schafer** to review the institution's progress to date, experience with the project, and to visit Maria Teresa Perez, a seamstress whose business has developed well due in part to loans from FinComún.

Based upon FinComún's priorities stemming from the business plan for 2006, AFIRMA plans to provide support in the following areas:

- Final implementation of a Costing System in the new MIS
- Training in credit analysis for individual lending and update FinComún training modules for all products
- Overall improvement program for training and human resource management

3.1.10 CAME

CAME's reporting to AFIRMA has been slower than with other partners, making it more difficult to judge performance and adjust programming on a timely basis. To date the project has not received audited results for 2005, nor has CAME turned in pro forma results for March 2006. AFIRMA has reiterated the importance of reporting on time as part of the partnership agreement and expects response time to improve going forward.

AFIRMA and CAME continued to hold regular meetings in early 2006, although support was less intense than in previous quarters:

- ***MIS Implementation*** – In late 2005 AFIRMA continued to support CAME with implementation of the FINMAS Management Information System through technical assistance from Bolivian systems consultant Miguel Garcia. Mr. Garcia's work last quarter focused on pilot testing FINMAS installation in two branches, which despite some deficiencies and obstacles, produced successful results. In 2006 AFIRMA is continuing to support CAME with full implementation of the MIS in all branches.

- ***Microfinance Operations –*** CAME requested assistance to improve functioning of the operational area, and strategic and operational planning of the growth of the credit portfolio, including growth and productivity goals. AFIRMA identified Bolivian microfinance expert Liliana Bottega, who recommended adjustments to the village banking methodology as implemented at

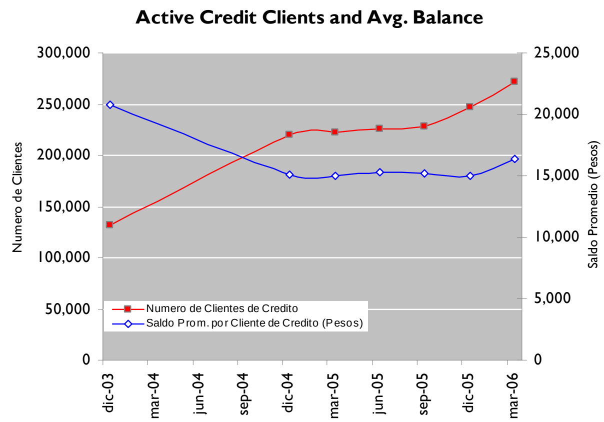
CAME. Based on this work, later in 2006 AFIRMA will build upon this work to examine possibilities for an individual lending product.

Based upon CAME's priorities for 2006, AFIRMA plans to support in the following areas:

- Full implementation of FINMAS
- Systematization of operational processes
- Develop individual loan product
- Analyze options for legal transformation to a SOFIPO
- Examine options for new sources of funding

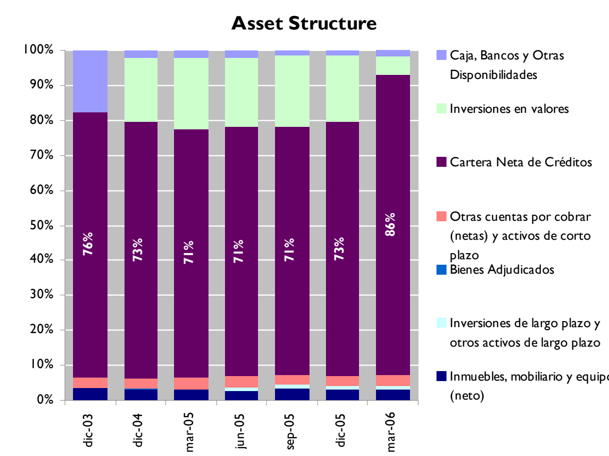
3.1.11 Caja Libertad

Caja Libertad has continued to grow, now serving over 270,000 active credit clients (see chart at right), with the bulk of clients in a niche above the rest of the AFIRMA partners (as evidenced by the average loan balance). Unlike other partners, the rate of growth of total credit clients for Caja Libertad increased last quarter, and the loan portfolio now represents 86% of the total assets, a much higher proportion than it has had in the past and a high figure for a credit union.



Work with Caja Libertad to design and launch a microcredit product moved forward during the quarter, following delays in internal decision processes. Assistance to Caja Libertad last quarter focused on:

- ***Microcredit Product Development*** – During the quarter, AFIRMA coordinated with Caja Libertad on the previous design (by DAI microfinance specialist Robin Bell) of a microenterprise loan product, and on building internal consensus within the Caja on the implications of a new loan product for the microenterprise segment. The deliverables were reviewed by Caja Libertad's board and management, which have expressed in writing the desire for AFIRMA assistance with a microcredit pilot in the second half of 2006.

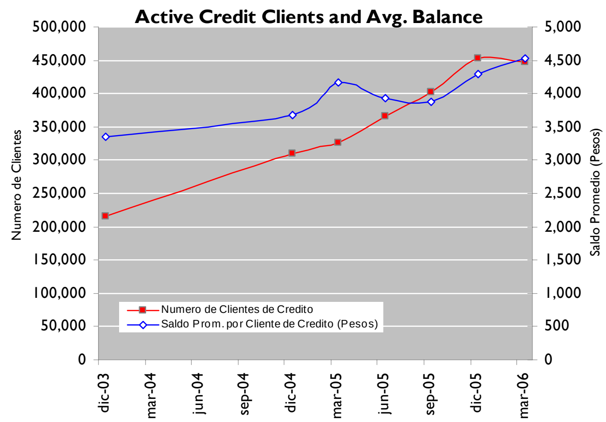


Additional assistance has been discussed with Caja Libertad and AFIRMA will consider supporting:

- Study tour for the main members of the board of directors and senior management to see credit unions that have been successful implementing microcredit products
- Implementation of a risk management area
- Systematization of processes and procedures for the individual lending product

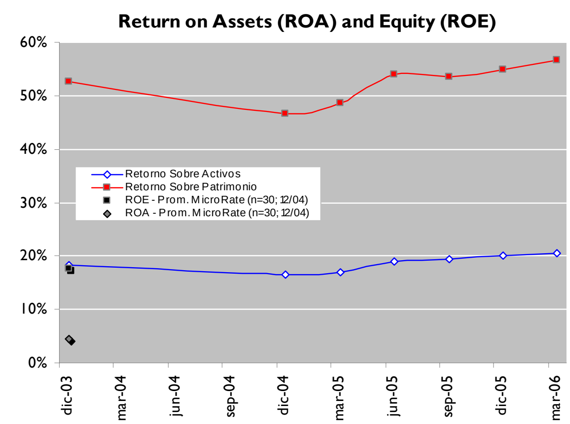
3.1.12 Compartamos

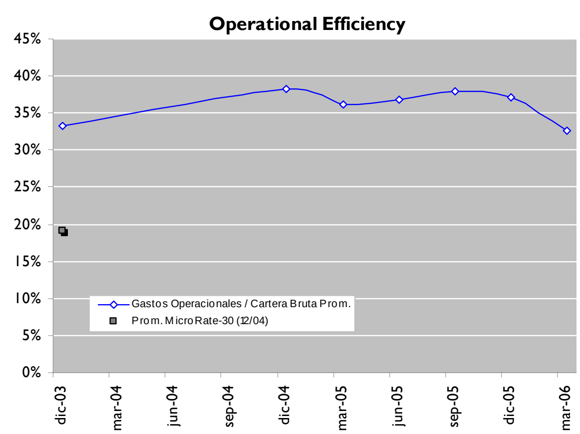
Compartamos showed a slight decline in total clients during the first quarter of 2006, following 2 years of rapid growth, but has continued to grow in the segments it is reaching with its individual and solidarity group loan products, now with over 30,000 active clients for these two products. Despite the slight decline in total clients, profitability continued to rise as efficiency improved and more profitable individual loans increased their share of the portfolio, keeping Compartamos *among the world's most profitable financial institutions of any type*. Compartamos has focused recently on completing its transformation to a regulated commercial bank from its current status as a SOFOL (finance company) and is likely to have a basic license in June 2006.



AFIRMA is supporting improved capacity for development and adjustment of new products and better efficiency through assistance led by partner **Acción International**.

Monica Brand, Vice President of Marketing and Product Development at Acción, continued to focus on developing internal capacity to develop products and services and on improving overall operational efficiency and productivity.





- ***Product Development*** – Following successful development of a prototype home improvement loan product, and field monitoring of the basic pilot microinsurance product, Acción delivered a draft Product Development Manual, including the steps and tools to be used for any product development process. In early 2006 Acción has worked with Compartamos to adjust the manuals based upon the pilot experiences with the home improvement loan product and the basic insurance product.

- ***Efficiency and Productivity*** – Acción Consultant Wilmer Guevara has developed tools and MIS reports necessary to manage individual and solidarity group loans; developed credit manuals for individual and solidarity group lending, assisted with restructuring the sales force and developed credit manuals, forms and analysis tools, and incentive structures. In order to transfer the new credit methodologies Mr. prepared a pilot training program, rolled-out of the methodology, trained managers and operational personnel, and trained personnel in the branches that administer the product, outlined follow-up activities for the full branch implementation, and formed an "efficiency and productivity" responsible for transferring and monitoring the implementation of the tools. Mr. Guevara also assisted the "*Area de Personas*" (Human Resources) with profiles, selection and training for loan officers. The "Efficiency and Productivity" initiative has contributed to more than doubling the individual and solidarity loan portfolios and increasing loan officer productivity by 50%. Last quarter, Mr. Guevarra focused more on addressing increasing delinquency rates in these two products which have contributed to very slightly higher overall portfolio-at-risk, but is far from being a major concern (the total value of loans at risk over 30 days was still below 1% of the total portfolio).

The two activities outlined above will continue into next quarter. AFIRMA, Acción and USAID have met with Compartamos to define follow-on work with Compartamos addressing key priorities to ensure the positive trends continue. Specific potential areas of support include:

- Continue supporting consolidation of the Efficiency and productivity program
- Support pilot and launch of products for housing improvement, insurance, and incorporate new products into the incentives schemes
- Brand management as Compartamos begins to offer a wider range of products
- Client retention
- Credit Scoring, focusing primarily on segmenting clientele and examining common characteristics of client desertion (2007)

3.1.13 ProNegocio

AFIRMA carried out negotiations with ProNegocio, the finance company (SOFOL) owned by Banorte, the largest Mexican-owned commercial bank, in close coordination with USAID/Mexico, following an in-depth diagnostic conducted in December 2005. The diagnostic was well received and ProNegocio participated in the January 27 AFIRMA meeting with partners. Mission Director Edward Kadunc and Development Finance Advisor Geoffrey Chalmers visited ProNegocio management in Monterrey, and the relationship may open a new avenue of coordination with USAID on the mission's municipal finance activity. AFIRMA has also coordinated the participation of ProNegocio in a regional workshop on the role of banks in microfinance to be held at INCAE in Costa Rica in late May.

ProNegocio has agreed in principle to fund half of a technical assistance program with AFIRMA and next quarter the project will begin supporting ProNegocio, most likely in the following areas:

- Strengthen the credit technology and develop new products for the microenterprise segment.
- Revise the organizational structure, human resource policies, and develop a training program.
- Develop specialized risk management, including internal audit for microcredit operations.
- Improve the marketing strategy, including market intelligence, and promotional campaigns.
- Expose directors to microfinance best practices and benchmarks and train directors and managers in planning and management techniques for successful microfinance operations.

3.2 TASK 2 – DEVELOP A LOCAL, COMMERCIALLY-BASED MFI SUPPORT SERVICES INDUSTRY

A local support services industry is critical to the growth of rural and microfinance in Mexico, and AFIRMA is working to build upon and improve the supply of training, technical assistance, audit, research, product development, and other services that MFIs demand. In year 1, in order to better understand the market for local services to MFIs, microfinance specialist Ricardo Calvo of Acción International and USAID/AFIRMA intern Virginia Brandon carried out a survey of the demand for local support services among partner MFIs and confirmed results with other industry stakeholders (see box below). OIn addition to identifying the services demanded, this activity highlighted that developing this industry will require focus on both supply and demand, in the sense that *MFIs will have to be more demanding of quality service* and design results-based contracts with service providers.

MFI Demand for Support Services
The areas of greatest **strategic importance**, according to AFIRMA partners, in order of importance:

- Planning and strategy
- Product design and adaptation
- Management Training
- Credit Analysis
- Legal Structure
- Operational Training

The primary services currently needed for **daily operations** were, in order of importance:

- Operational and Management Training
- IT Systems
- Product Design and Adaptation
- Credit Analysis
- Human Resource Management

During the AFIRMA retreat in December, participants reaffirmed the need for Task 2 activities to be linked with Task 1 support of MFIs partners, matching qualified local firms and consultants who would benefit from specialization in certain areas with international specialists on certain assignments.

The year 2 work plan lays out three lines of action: creating a consultant's database and developing two separate training programs for technical assistance and training providers (firms and individuals), progress and plans for each of which is described briefly below .[3]

3.2.1 Contracting Local Consultants and Firms

Task 2 was originally budgeted as a grant fund, but as indicated in the first AFIRMA contract modification, the activities will be run primarily through contracts with local firms and consultants. Activities with individual consultants contracted normally through SOWs with AFIRMA's Task 1 partners are outlined below in addition to the work contracted through local purchase orders. Main general results under this activity included:

- AFIRMA continued to build ties between MFIs and local firms and consultants, while simultaneously providing opportunities for local consultants to improve microfinance-specific skills through close consultation with the project and partnering with international specialists.
- AFIRMA has continued to provided good examples of how to contract firms, using clear terms of reference, competition (in compliance with good practice and USAID regulations) and technical and price criteria for selection. Results thus far have generally been good in terms of MFI satisfaction, quality of deliverables and timing compliance.
- AFIRMA has evaluated a selection of firms as part of the Microfinance Training of Trainers program design described below.

Work with each local firm or independent consultant is briefly described in the following table ordered by AFIRMA partner supported:

[3] A more complete description is provided in the AFIRMA Year 2 Work Plan.

Table 1 – AFIRMA use and development of local firms and consultants

MFI	Project	Local Firm or Consultant
AMUCSS	MIS implementation	**CTI**, a small firm based on Mexico City, provided TA to AMUCSS in MIS
AMUCSS	Team members in the accounting and systems work	Local consultants **Martin Yedra, Alfonso Bustos,** and **Juan Flores** worked with senior international microfinance consultant Rafael Tejeda. Next quarter, Juan Flores will begin work with MIS specialist Carlos Paredes at FINCA.
AMUCSS	LACP Compliance (financial statements)	**Rene García,** a consultant with experience providing technical assistance on the *Ley de Ahorro y Credito Popular* (LACP), has worked with AMUCSS and will begin work with AlSol in the next quarter.
CADEMI	Tax & Legal Advise	***Desarrollo Empresarial Anjona* (DEA)**, a small accounting, audit & tax advisory firm has worked with AFIRMA & completed tax analysis for CADEMI in January.
FIMEDER	Human Resources	**Vayda Sosa**, an HR specialist with over 10 years of experience working with banks, worked with FIMEDER to improve human resources management.
FINCA	Administrative Process systematization	***Servicios Internacionales de Negocio* (SIN)** provides TA and training on process systematization and has helped FINCA systematize administrative manuals and train staff
ProMujer	Market Study	**SERTA,** a marketing firm, completed a market study for PMM in early 2006.
ProMujer	Decentralization	Local consultant **Maria Olazabal** worked with experienced Peruvian microfinance consultant, Leopoldo de la Jara to develop the internal control system necessary for operational decentralization at PMM.

In early 2006, AFIRMA carried out an evaluation of the supply side of the market for microfinance support services with Ricardo Calvo of Acción International and independent consultant Katie Kohlstedt a junior American microfinance specialist who lives in Mexico City, as an input for the training described below. Also, AFIRMA will hire local microfinance research specialist Pilar Campos to support the Rural and Agricultural Finance Workshop to be held in June. AFIRMA will also hire local consultants to support FINCA with its analysis of options for becoming a regulated MFI.

3.2.2 Microfinance Training of Trainers Program

Mexico has substantial general human resources and consulting capacity, but limited specialized consulting capacity for microfinance, and significant differences in quality of services from one region to another. One of AFIRMA's key goals under Task 2 is to strengthening consulting and training firms, universities and research firms in areas outlined above as priorities for AFIRMA partner MFIs.

To the extent possible, efforts under this activity will be linked with Task 1, will be coordinated with ProDesarrollo wherever possible (taking into account their plans, workload and capacity to coordinate additional efforts) and will focus initially on designing and delivering a training-of-trainers program. To this end, during the following quarter AFIRMA, in coordination with Acción International, will:

- ***Evaluate consulting and training firms*** – This built upon the demand survey in August 2005, focusing primarily on the current supply of support services, to include an analysis of the supply of services. Acción senior consultant Ricardo Calvo, in coordination with Katie Kohlstedt a junior America microfinance consultant based in Mexico with knowledge of the local services providers in Mexico through experience with Planet Finance Mexico, interviewed various training firms, technical assistance providers, independent consultants and specialized microfinance consulting firms. Key results of this process included:
    - o The study segments providers into 3 areas according to service and market orientation: Traditional general technical assistance and training (TAT) firms, TAT firms focused on the microfinance sector, and highly specialized support services firms.

- The primary areas in need of capacity building based on analysis of the demand and for, and suppy of, TAT were: Credit methodologies and product development.
- The target audience for the pilot course should be: Traditional training and TAT firms interested in diversifying client portfolios. The strategy for highly specialized firms should be different, including meetings or workshops with peer-institutions from elsewhere in Latin America.
- As part of this program it will be necessary to establish a monitoring and evaluation strategy for local firms trained.

Based on this evaluation, AFIRMA Microfinance Training Specialist Claudette Martinez will work with Acción to design a training program (curriculum and training toolkit) in late 2006.

- ***Contract local firms*** – Additionally, Ms. Kohsltedt finished brief institutional profiles of each provider, and a local providers matrix, which will help with selecting potential providers (that could be trained in the program mentioned above) and contracting services in 2006. At least one local provider in the primary areas needed for MFIs under Task I was identified. However, with the exception of legal transformation under the LACP, there is clear need to strengthen specialized local firms.

Beginning next quarter and continuing throughout the rest of 2006, based on evaluations, AFIRMA will work with Task I partners to solicit proposals and contract with specialized firms, partnering them with international specialists where appropriate.

3.2.3 Mentoring Program

There is no shortage in Mexico of intelligent, educated, young professionals who, with the right training, could fill positions in AFIRMA partner institutions or work as microfinance consultants. However, part of the general training that is missing in Mexico is an intensive, practical course to offer young professionals the tools required to work effectively in microfinance. AFIRMA's approach to addressing this challenge will focus on strengthening independent consultants, trainers, and potential employees of MFIs in the theoretical foundations and practical application of microfinance in Mexico through a microfinance education program for junior consultant trainees. The program will include classroom work and practical application through paid field work (possibly pairing with the GoM required *Servicio Social* work) for qualifying students.

During this quarter AFIRMA defined main content for classroom work and has established contact with public and private universities in order to develop this program in coordination with other Mexican and international programs (e.g. TIES, INCAE CGAP, MFMI, GoM Programs). During the third quarter of FY 2006, AFIRMA will work to finalize the following activities under this component:

- Establish agreements with co-sponsors and finish the program design.
- Complete an operational manual and submit it to USAID for approval.

AFIRMA's approach focused on strengthening independent consultants will include the retention of well formed junior independent consultants who has worked under task I and show interest and commitment to work and gain knowledge in microfinance industry. One example is Juan Omar Flores, who works with AMUCSS. During the next quarter AFIRMA will contract Juan Omar Flores to work under supervision of Carlos Paredes in different information system projects.

3.3 TASK 3 – SUPPORT INNOVATIONS TO EXPAND ACCESS TO RURAL FINANCE & REMITTANCES

Implementation of Task 3 involves a grants-based approach to stimulating the introduction of new technologies, approaches, distribution channels, or other elements that facilitate rural clients' and small farmers' access to appropriate financial services, and to improve institutions' capacities to reach underserved populations, especially rural clients.

The USAID/Washington contracts office determined in project quarter 4 of year 1 that grants may be issued under an AMAP task order, clearing the way to launch Task 3. In early 2006 AFIRMA will focus on understanding the possibilities for spurring innovation in the design and delivery of financial services in Mexico, particularly in rural value chains. As discussed during the one-day AFIRMA planning retreat, an adjusted Rural and Agricultural Finance (RAF) workshop, based on those delivered through the USAID/Washington Office of Microenterprise Development (especially the workshop to be held in Peru in March to be delivered in part by DAI), will form the start-up activity for this task, followed by design and launch of the innovation fund, as described briefly below.[4]

3.3.1 Rural and Agricultural Finance Workshop

During the quarter AFIRMA began working with USAID Development Finance Advisor Geoffrey Chalmers in coordination with USAID/Washington to plan the initial RAF workshop, determine specific target audience, roles and responsibilities, and resources to be dedicated to the training. AFIRMA is now coordinating with USAID and QED to:

- Adjust RAF workshop material for Mexico and for an audience formed primarily of practitioners (the initial RAF was designed as an internal training for USAID staff)
- Deliver modified RAF workshop to 20-30 participants and generate a short-list of possible actors and initiatives to further develop this task

The workshop is scheduled for June 21-23, and will be facilitated by Robin Young, Rodolfo Quiros, both of whom have been trained as trainers of the original RAF course, and Pilar Campos, a Mexican microfinance research specialist, who will assist with "Mexicanization" of the materials. The course will also include participation of guest speakers Following the RAF workshop.

3.3.2 Design and Launch Innovation Fund

AFIRMA will build upon lessons from the RAF to:

- ***Design the AFIRMA Innovation Fund*** – AFIRMA proposes to request assistance from DAI consultant Steve Smith, currently Chief of Party of DAI's USAID-funded PREMIER project in Bolivia (if approved by both USAID/Mexico and USAID/Bolivia). Mr. Smith has designed an innovation grant fund in Bolivia and would provide strategic guidance to the AFIRMA fund. AFIRMA proposes that Brooke Jones, the home office associate for AFIRMA, who has an understanding of regulations related to grants under contracts, would support the initiative as well.

[4] A more complete description is provided in the AFIRMA Year 2 Work Plan.

- ***Launch the Innovation Fund*** – this will involve a presentation of the concepts behind the Innovation Fund, as well as the evaluation process and criteria, and will make available a simple format to follow for interested parties to present short descriptions of proposed innovations.
- ***Review technical proposals*** – a review committee (representatives from USAID, AFIRMA, and an external reviewer) will use established criteria to review proposals and select initiatives to support towards the end of Project Year 2.

3.3.3 Identify Areas for Intervention related to the Enabling Environment for RAF

Following the RAF workshop AFIRMA and USAID will assess whether any legal/policy issues related to RAF have emerged as high-priority obstacles worthy of consideration for USAID/AFIRMA intervention, most likely in close coordination with other donors and the GoM.

3.4 TASK 4 – STRENGTHEN THE REGULATORY ENVIRONMENT FOR MICRO- AND RURAL FINANCE

Although changes within the *Comisión Nacional de Bancos y Valores* (CNBV) have delayed start of this task, AFIRMA is now coordinating with the project's new counterpart to define how AFIRMA can support the CNBV and Federation Committees to improve microfinance supervision. AFIRMA COP Fernando Fernandez has kept in close touch with the CNBV, offering assistance with implementing supervision and regulation of microfinance and the CNBV has expressed strong interest to work with the project later in 2006.

In February AFIRMA staff and USAID Development Finance Advisor Geoff Chalmers met with the CNBV Vice-president for Supervision of Financial Institutions Alfonzo Orozco, who was in charge of implementation of the LACP, following the departure of Felipe Mariscal in December 2005. Although priorities may change following the meeting assistance is tentatively scheduled to begin in the second half of 2006, initially to involve:

- ***Work plan with the CNBV*** **–** Next quarter he Project will coordinate with the CNBV to develop technical assistance and training plans with the Federations.

- ***Training program for Federations*** **–** Based on initial diagnostics of the needs of federations, the project will mobilize Carlos Alba, ICC's Senior Regulatory Specialist, to work with the CNBV to design and deliver a training program for supervisors to whom the CNBV has delegated authority.

Based on planning with the CNBV next quarter, the project will define further activities.

3.5 TASK 5 – STRENGTHEN THE MICRO- AND RURAL FINANCE INDUSTRY

AFIRMA efforts for Task 5 include supporting initiatives with GoM agencies, private sector stakeholders in microfinance, and other industry initiatives such as improved access to various types of market information. Over the course of 2005 AFIRMA promoted microfinance sector initiatives along with stakeholders within the Mexican Government, such as Pronafim, Banco de Mexico (Central Bank), and Financiera Rural, as well as with the private sector member associations ProDesarrollo.

Initiatives over the last quarter are divided into three basic categories: initiatives with GoM agencies, Initiatives with private sector stakeholders in micro- and rural finance, and other industry initiatives. In 2006 activities under Task 5 will be along four main lines: market research, support of ProDesarrollo, support and work with GoM microfinance initiatives, and credit information services.

3.5.1 Initiatives with GoM Agencies

PRONAFIM

Following a highly successful partnership with PRONAFIM, the National Program for Microenterprise Finance (*Programa Nacional de Financiamiento al MIcroempresario*) within the Secretary of the Economy on AFIRMA's support of the design of the Fourth National Encounter for Microfinance, PRONAFIM invited AFIRMA to assist with planning the subsequent event, to be held May 29-31 in Guadalajara. AFIRMA has coordinated plenary presentations of USAID Mission Director Edward Kadunc and Development Finance Advisor Geoffrey Chalmers, and will also hold three breakout sessions highlighting the performance of 6 of the AFIRMA partner MFIs, to be facilitated separately by AFIRMA staff Fernando Fernandez, Nate Bourns, and Willy Escobedo.

Banco de Mexico

Beginning in late 2005, AFIRMA Credit Bureau Expert Miguel Llenas worked with COP Fernando Fernandez and DCOP Nathanael Bourns to coordinate with the Banco de Mexico in carrying out a diagnostic the credit information environment, a critical element for sound development and further deepening of the Mexican financial system. The diagnostic was very well received by the Banco de Mexico and during the quarter AFIRMA, held a high-level meeting with the *Banco de Mexico* to examine options to improve the regulation and supervision of credit information services, with the objective of increasing transparency of credit information in the Mexican market and reducing overall risks. The project will continue to coordinate efforts with representatives of the *Banco de Mexico*, in an effort to expand access to credit information, as one way to deepen the shallow Mexican financial market.

Mr. Llenas presented the diagnostic and AFIRMA distributed the written report at the project's bi-annual meeting January 27, 2006, attended by representatives from Banco de Mexico.

3.5.2 Initiatives with private sector stakeholders in micro- and rural finance

ProDesarrollo

In January, AFIRMA supported ProDesarrollo's strategic planning process, hiring Jack Burga and Jose Lombardi from COPEME (Peru), arguably the most successful association of microfinance institutions in Latin-America, to facilitate the planning process. AFIRMA has identified this TA is one of the most important contributions the project can make to ProDesarrollo's development, and has scheduled a follow-up meeting with ProDesarrollo in late May, once the new governance structure is set (the new President is Ivan Mancillas, one of the founders of Compartamos), to review plans and determine areas for support.

ProDesarrollo's members identified the need for a compensation study within popular finance in Mexico and base on this need and ProDesarrollo's plans, AFIRMA held a competitive bidding process for local firms to develop a compensation study for microfinance sector. Based on technical and price criteria and input from ProDesarrollo, next quarter, AFIRMA will contract Deloitte (Mexico City office) to carry out the study. This initiative is coordinated with ProDesarrollo, but will include other institutions to enrich the results of the study.

Credit Information Services – Circulo de Credito

AFIRMA offered assistance with designing products and processes to serve the popular finance sector in Mexico to both of the private credit bureaus. Circulo de Credito has responded enthusiastically, and Miguel Llenas has begun a customized technical assistance program based on Circulo's plans to serve the segment, and on the specific demand for services as expressed through meetings with AFIRMA partners and other microfinance institutions and credit unions.

3.5.3 Other Industry Initiatives

AFIRMA subcontractor The Ohio State University, led by Dr. Claudio Gonzalez-Vega continues to finalize the study on rural financial markets in Mexico. A team of researchers from the Rural Finance Program at OSU conducted the initial assessment between June and November of 2005. During the last quarter, the team conducted follow-up interviews in January 2006 in order to finalize the reports, following feedback from AFIRMA and USAID/Mexico on the drafts. Dr. Gonzalez-Vega and Marcelo Villafani presented the team's initial findings at the AFIRMA bi-annual meeting on January 27, 2006.

Following presentation of the reports, AFIRMA and USAID will work with OSU and other stakeholders to determine what if any other areas require investigation. Given the rapidly changing Mexican market, additional topics would require shorter-term, faster studies in order to ensure that they are useful to AFIRMA partners.

AFIRMA also continued to coordinate with the USAID-funded TIES program in coordination with OSU and the Mexican University CIDE (one of their tasks will be to develop a microfinance curriculum). On January 26, AFIRMA COP Fernando Fernandez presented the project's perspectives on the state of microfinance in Mexico at the TIES launch meeting for this topic.

4. PROJECT MANAGEMENT

Major developments in project management last quarter included:

- ***Presentation of AFIRMA at the "Coffee with the Mission Director" meeting*** – Upon the invitation of USAID/Mexico Mission Director Edward Kadunc, on February 3, Fernando Fernandez and Nate Bourns presented an overview of the project and results to date, upcoming challenges and opportunities for the project within a rapidly changing environment.

- ***Implementation of DAI's new Information System*** **–**DAI's Oracle ERP system went live January 1, 2006 and will, once fully implemented, provide greater tools for project management. In the meantime, however, it has created delays in some processes. As indicated in correspondence to the mission from DAI on this process, invoicing has been well behind schedule, but is being brought up to pace. By June, DAI should be back on a regular schedule of invoicing.

- ***Programmatic Adjustment to Funding Levels*** – Fernando Fernandez and Nate Bourns worked closely with CTO Geoff Chalmers over the quarter to adjust programming to the envisioned funding levels for 2006 and provided the mission with detailed projections of activities, based on various funding level scenarios. ***Every effort has been made to respond proactively to the need to lower the level of expenditure while remaining responsive to the needs and plans of AFIRMA partners.*** Priority has been given to activities to which AFIRMA had previously committed, while activities that have yet to begin, with the important exception of the RAF under Task 3, have been de-prioritized. In September 2006, partnership agreements signed at the beginning of the project with each partner will expire. Prior to that point it will be important to reexamine program priorities.

- ***Technical backstopping support from DAI Microfinance Specialist Robin Young*** –Hillary Miller-Wise announced her departure from DAI and Robin Young, who had previously filled in while Ms. Miller-Wise was on maternity leave, will take over technical backstopping support for AFIRMA, in close coordination with Home Office Associate Brooke Jones.

- ***Training of Local Administrative Staff*** – Project management worked with staff to conduct performance reviews, adjust responsibilities and set individual goals, and worked to ensure that they feed into the project's overall results framework.

4.1 AFIRMA BI-ANNUAL PARTNER MEETINGS AND TECHNICAL WORKSHOPS

As mentioned previously, January 27, 2006 AFIRMA held its second bi-annual meeting, with high-level participation. Following an introduction by USAID/Mexico Deputy Mission Director John Beed, Javier Gavito, Director of the state savings bank Bansefi presented on the role of his bank in implementing the LACP and Mari Carmen Diaz Amador, Director of the National Program for Financing Microenterprises (PRONAFIM) presented some of the program's accomplishments and plans. Claudio Gonzalez-Vega and Marcelo Villafani presented initial findings from the OSU market study, Miguel Llenas presented the credit information services activity, Nathanael Bourns presented performance monitoring information and Geoff Chalmers facilitated a session to gain feedback from participants on challenges in rural areas. Participants gave high marks to the meeting and its content in evaluations following the meeting.

5. ANNEX A – PROJECT INDICATORS

In January 2006, AFIRMA and USAID CTO Geoffrey Chalmers met to adjust the Performance Monitoring Plan (PMP) to the new Strategic Objective and Intermediate Results framework mentioned in the introduction to this report. AFIRMA has updated the PMP and the indicators below, divided by Task, reflecting the adjusted PMP.

5.1 TASK 1 INDICATORS

The indicators for Task 1 are shown in Table 3 in consolidated form, and most are included in the charts that follow. Activities for year one concentrated on Task 1, as outlined above and AFIRMA tracked the following categories of indicators for Task 1:[5]

- ***Outreach*** – Indicators measure MFIs' performance serving greater numbers of clients among underserved populations with loan, deposit, and other services.

- ***Sustainability*** – Indicators seek to gauge MFI ability to remain in the market in the long-term, thus providing clients with ongoing access to finance.

- ***Efficiency & Productivity*** – important to measure and improve since Mexican MFIs are inefficient by regional standards, and inefficiency is passed to clients in high interest rates.

- ***Portfolio quality*** – Portfolio quality indicators monitor the performance of the MFIs' principal asset, the loan portfolio.

- ***Compliance with standards for microfinance*** – The indicators in this category include partner MFI compliance with CNBV norms, including the LACP or other relevant frameworks, as well as compliance with accounting standards.

[5] See performance monitoring plan for indicators to be tracked under Tasks 2-5.

Table 3 – Task One Indicators

Indicator	Baseline Dec. 2004	Dec. 2005	Variance	LOP Target
1. Strengthen the institutional capacity of MFIs				
1.1. Number of active credit clients	455,639	669,581	+213,942	Increase of 500,000
1.2. Number of MFIs mobilizing savings deposits	3 (FC, AMUCSS, CL),	3 (+FIMEDER now licensed)	-	6
1.3. Rural clients	TBD	TBD	-	Increase – no specific targets set
1.4. Number of loans to female borrowers (annual) (9/05 includes CL, CAME not available)	600,391	662,995	+62,604	Increase – no specific targets set
1.5. Value (USD) of outstanding loans to women (annual) (9/05 includes CL, CAME not available)	$507,175,818	Annual in Sept.	-	Increase – no specific targets set
1.6. Number of loans under $400 (annual) (CAME, PMM estimated, see Yr. 1 Rept.)	316,775	349,845	+33,070	Increase – no specific targets set
1.7. Total Value (USD) of outstanding loans by AFIRMA MFIs (CL, AMUCSS not included)	$139,816,887	$242,838,942	+74%	Increase – no specific targets set
1.8. Increased Points of Service	299	398	+33%	Incr. POS 50%
1.9. Increased *Rural* Points of Service	TBD	TBD	-	Incr. *rural* POS 50%
1.10. Financial and Operational Self-Sufficiency	5 of 11 FSS.	8 of 11	+3	All MFIs FSS
1.11. Operating Expense Ratio	See Below			10 of 12 improve
1.12. Loan officer productivity	See Below			All MFIs improve
1.13. Portfolio-at-risk > 30 days	9 under 5%	8 under 5%	-1	< 5% for all MFIs
1.14. Portfolio write-off ratio	See Below			Minimize.
1.15. No. MFIs using accepted accounting practices due to AFIRMA support	0 (by definition)	1 (AMUCSS – partial)	+1	No specific targets set.
1.16. Compliance with regulatory standards due to AFIRMA support	0 (by definition)	1 (AMUCSS – partial)	+1	All partners meet requirements

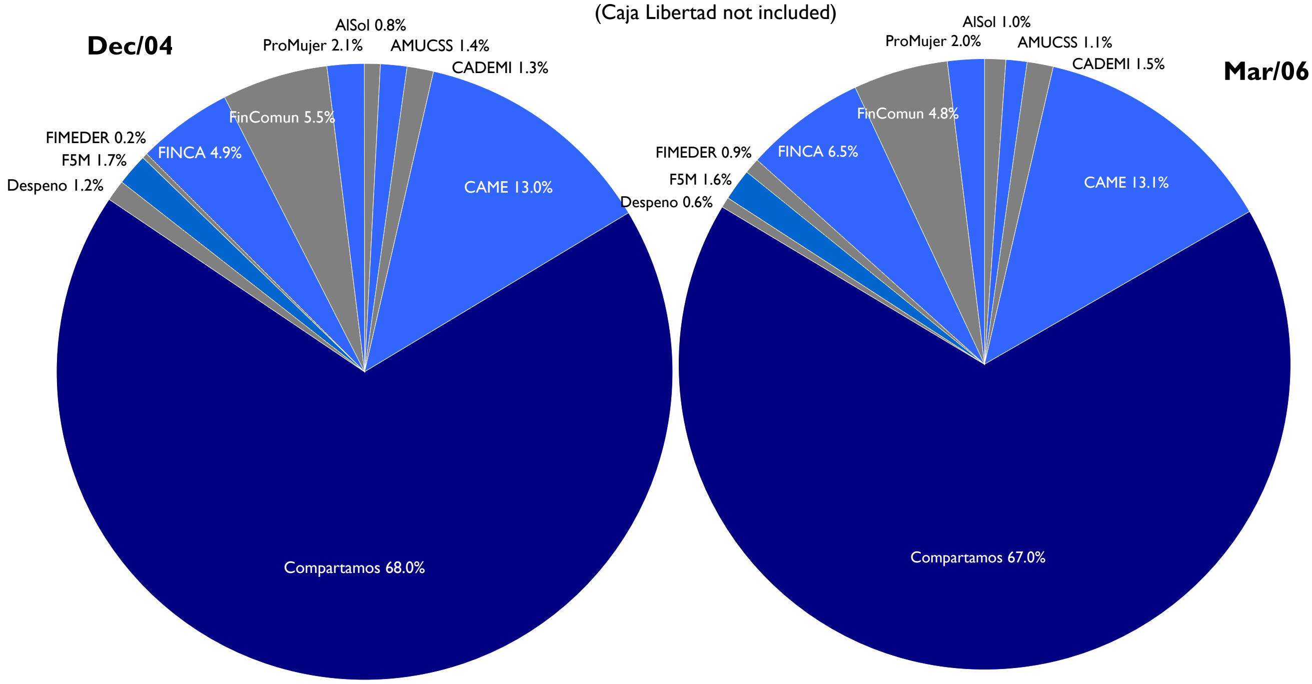
As shown in the "market share" charts below, Financiera Compartamos which declined by 1% in total active credit clients from the end of 2005 to March 2006, slightly lost market share among the 11, but maintains over two-thirds of all microcredit clients among the 11 MFIs for which data is included. [6] Overall, the 11 MFIs were serving 213,942 more clients in March 2006[7] as compared to the December 2004 baseline.

[6] Data for Caja Libertad is not included in the figures cited here for number of clients. AFIRMA is planning to assist Caja Libertad to segment their current portfolio. AFIRMA's preliminary estimates are that as of June 2004, Caja Libertad served around 15,000 micro and small enterprise clients with traditional cooperative credit products.

[7] CAME has not turned in data for March 2006, December 2005 data on total active clients used here.

"Market share" 11 AFIRMA Partner MFIs
Total Clients – Dec. 2004: 455,639 → March 2006: 669,581

(Caja Libertad not included)

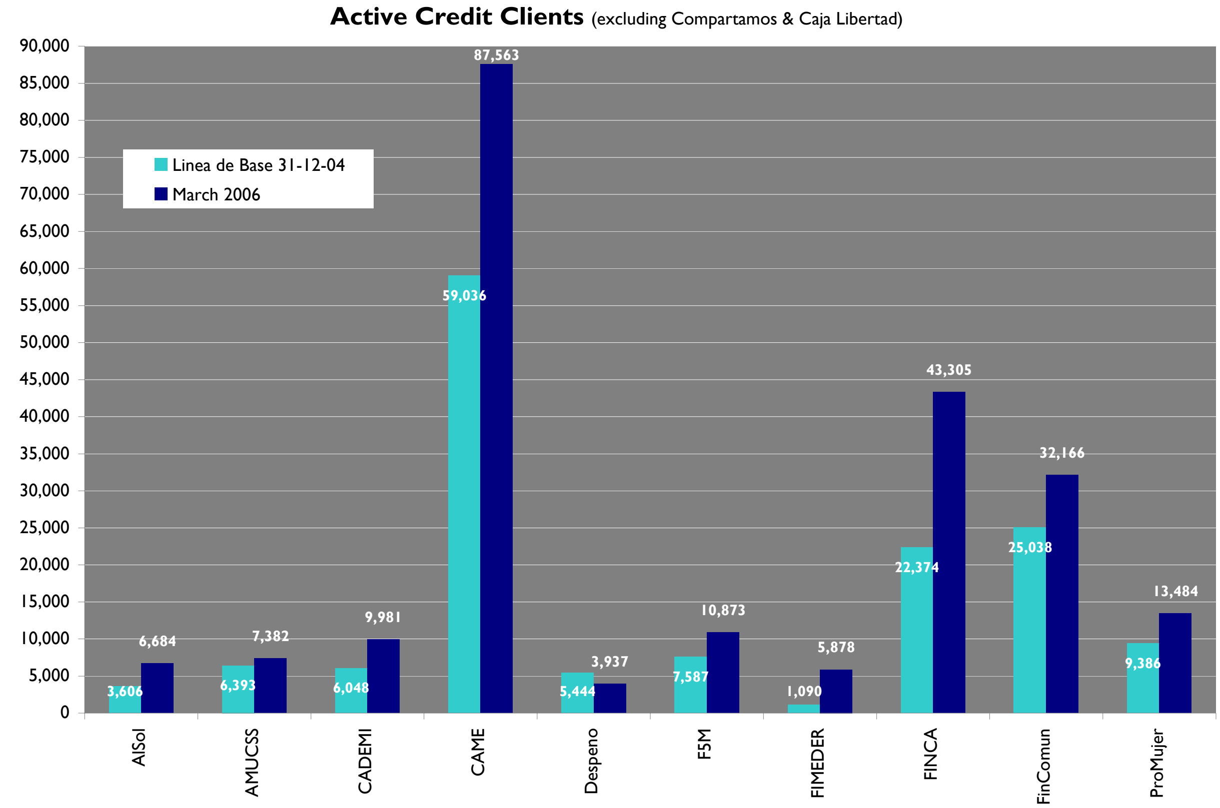


Over the December 2004 baseline, the total growth in credit clients was 47% as of March 2006, although there was almost no net growth in the first quarter of calendar year 2006. Not surprisingly, three of the four fastest growing institutions, FIMEDER, AlSol and CADEMI grew from relatively small bases of clients, while FINCA continues to grow from a larger base. Compartamos declined by 4,803 total clients (although that is only 1% of its total) last quarter, but it is worth noting that it did grow in the individual and solidarity group loan product segments that AFIRMA subcontractor Acción is supporting. Despeno continues to concentrate, with AFIRMA assistance, on building sound basis for growth in areas such as internal controls, methodological adjustments, or standardization of processes, prior to emphasizing growth.

Table 4 – Growth in credit clients

	Dec-04	Dec-05	Difference	% Growth
FIMEDER	1,090	5,878	4,788	439%
FINCA	22,374	43,305	20,931	94%
AlSol	3,606	6,684	3,078	85%
CADEMI	6,048	9,981	3,933	65%
CAME	59,036	87,563	28,527	48%
Compartamos	309,637	448,328	138,691	45%
ProMujer	9,386	13,484	4,098	44%
F5M	7,587	10,873	3,286	43%
FinComun	25,038	32,166	7,128	28%
AMUCSS	6,393	7,382	989	15%
Despeno	5,444	3,937	-1,507	-28%
TOTAL	**455,639**	**669,442**	**213,803**	**47%**

The graphic below excludes Compartamos in order to better show the growth in number of credit clients among the other AFIRMA partners.



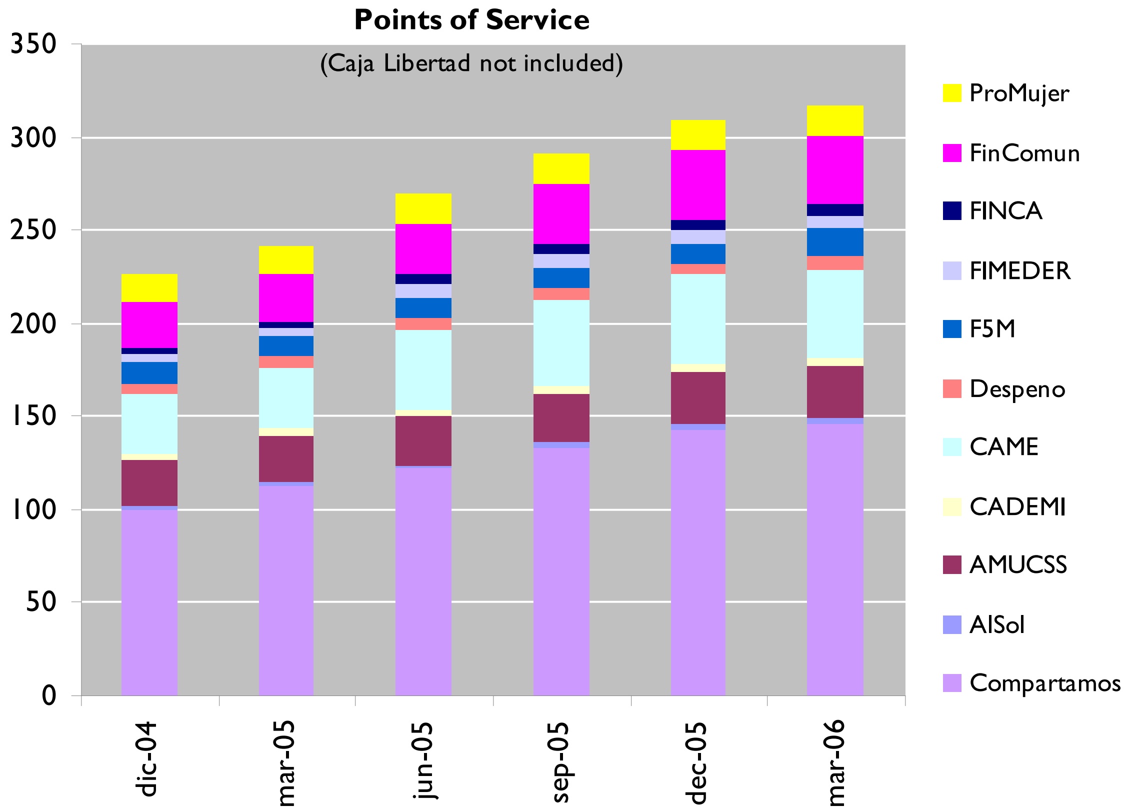
AFIRMA partners have expanded their points of service significantly since the beginning of the project. The total number of points of service of AFIRMA partners increased from a baseline of 299 in December 2004 to a total of 398 fifteen months later, a 33% increase.

Excluding Caja Libertad, the increase was from 227 to 317, a 39% increase (see chart below).

Most partners have added points of service and Compartamos has grown its structure very quickly from 100 to 146 during 2005.

Table 5 – AFIRMA Partners Points of Service

MFI	Dec-2004	March 2006
AlSol	2	3
AMUCSS	25	28
CADEMI	3	4
Caja Libertad	72	81
CAME	32	48
Compartamos	100	146
Despeno	6	7
F5M	11	15
FIMEDER	5	7
FINCA	3	6
FinComún	25	37
ProMujer	15	16
TOTAL	**299**	**398**



Eight of 12 partners have improved their **financial self-sufficiency**[8] ratios, while CADEMI, CAME, Despeno and FINCA decreased, each for very different reasons. FINCA continues to be profitable and the decline is based largely on investments in expansion that will most likely yield greater growth in future periods, although a higher non-performing portfolio erodes portfolio yield, and therefore profits somewhat. Despeno's financial results deteriorated significantly as it adjusted its operations and structure to a new market (microfinance vs. subsidized agricultural lending as described above) but have improved as compared to late 2005.

CAME has not delivered financial data for December 2005, nor March 2006 and AFIRMA will be meeting with management to address the issue. Data for Sept. 2005 is used here.

Table 6 – Financial Self-Sufficiency

MFI	Dec-2004	Mar-2006
AlSol	62.4%	114.0%
AMUCSS	N/A	N/A
CADEMI	119.9%	148.3%
Caja Libertad	78.3%	113.2%
CAME*	99.9%	93.3%
Compartamos	166.9%	174.9%
Despeno	106.2%	48.6%
F5M	67.1%	113.6%
FIMEDER	10.9%	88.4%
FINCA	142.7%	123.5%
FinComún	104.3%	110.2%
ProMujer	59.0%	115.6%
Average	**92.5%**	**113.1%**

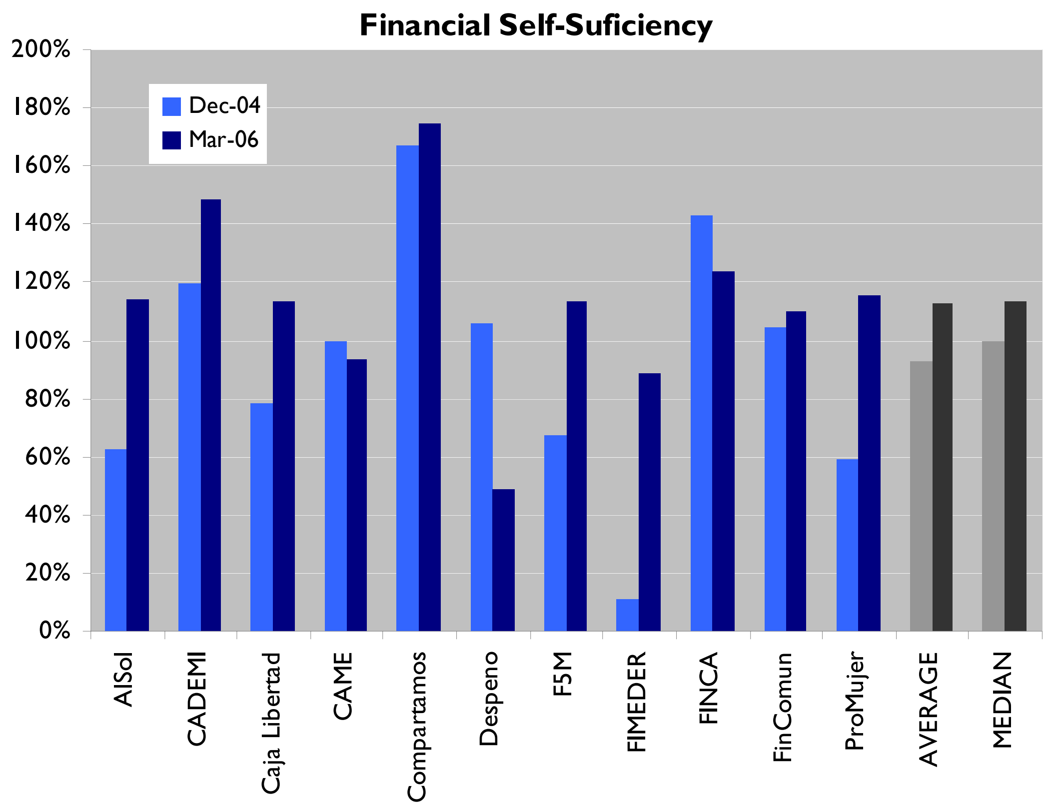
*CAME data unavailable – Sept.05 shown here

[8] The standard CGAP definition is applied: operating revenue (excluding donations) is divided by adjusted operating expenses, where adjustments are made for inflation, subsidized cost of funds, insufficient provisions, and in-kind donations.

The financial self-sufficiency of Compartamos increased slightly, maintaining its position as one of Latin America's most profitable financial institutions, of any type. AlSol improved steadily over the year, breaking even in early 2006.

It should be noted that since standard calculations are used for this indicator, in which a single "market" rate of funding is applied to funding liabilities,[9] the adjustment varies depending upon the structure of the balance sheet and the actual cost of funding of each institution. For instance, the adjustments affects Caja Libertad the most because they mobilize funds at a rate significantly below the "market" rate that AFIRMA uses, and this adjustment along with an adjustment for loan loss provisioning[10] results in a lower level of financial self-sufficiency.

Finally, pro-forma results are used for these indicators, and as AFIRMA partners complete their 2005 audits the numbers for 2005 will be updated accordingly.



As the financial self-sufficiency chart shows, there is significant variance among the partner institutions in terms of their ability to cover adjusted operating expenses with operating revenues.[11] Relatively high levels of financial self-sufficiency have been attainable in Mexico due in large part to the very **high levels of portfolio yield**, as shown in the portfolio yield ratio chart below.

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[9] AFIRMA uses the average asset price percentage rate TIEE 28 published by the Banco de Mexico, 9.48% annual as of September 2005

[10] CL provisions at rates lower than the CNBV standard and has a portfolio-at-risk over 30 days of 11%.

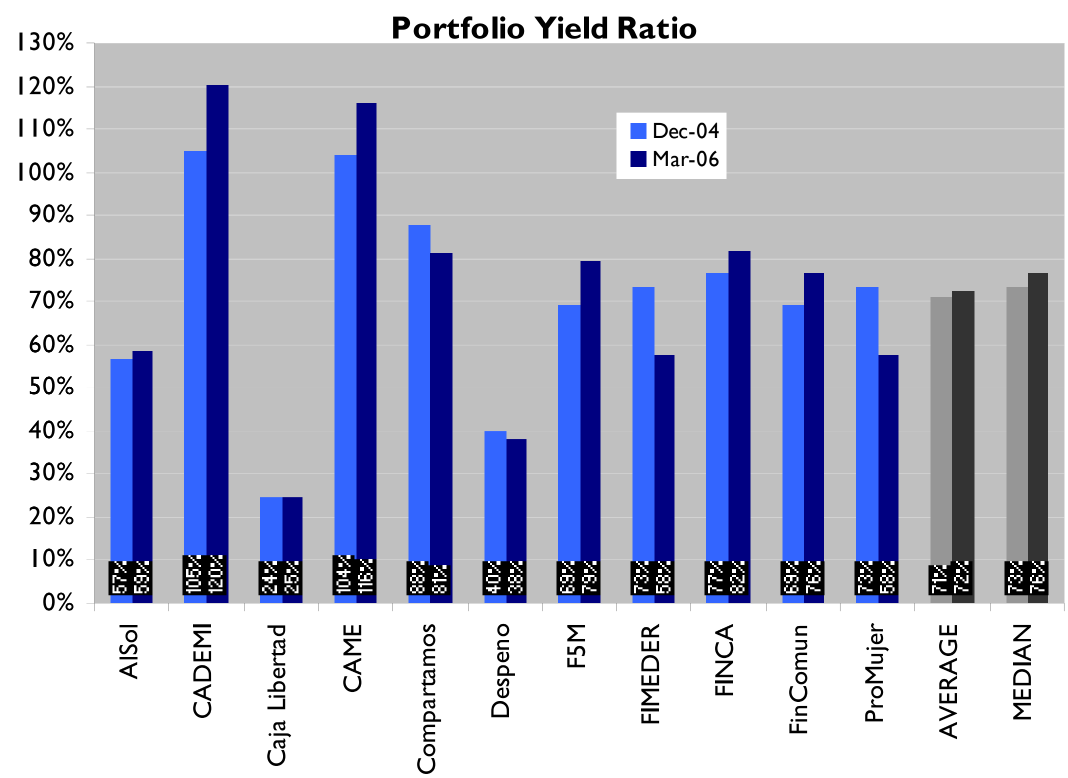
[11] AMUCSS has not yet implemented a standard accounting system among its microbanks and financial information was not available as of October 2005. Also, it is important to note that until September 2005, AlSol used cash-based accounting, as opposed to accrual accounting (used among the other 10) which makes its indicators un-comparable to the others for prior periods.

The high portfolio yields reflect high average interest rates charged to microfinance clients in Mexico as compared to other countries in the region, where competition has reduced rates dramatically in recent years. The 30 MFIs that MicroRate tracks in Latin America had, on average, a portfolio yield of 37.6% as of December 2004, well below the average of 72.2% among 11 AFIRMA MFIs in March 2006. This rate is pulled down by Caja Libertad, a credit union, and Despeno, which still carries on its books FIRA-backed agricultural loans that should be written off (which would reduce the size of the portfolio thus increasing the yield ratio). Also, it is worth mentioning that the MicroRate averages are boosted by Compartamos and FinComún, the only representatives of Mexico among the MicroRate 30, which have the two highest portfolio yield ratios of the MicroRate 30. Finally, it is important to note that the yield ratio for Compartamos has come down slightly as the institution lowers lending rates in some of the more competitive markets.

Table 7 – Portfolio Yield

MFI	Dec-2004	Mar-2006
AlSol	56.6%	61.7%
AMUCSS	N/A	N/A
CADEMI	104.8%	120.1%
Caja Libertad	24.4%	24.6%
CAME	103.8%	115.9%
Compartamos	87.7%	81.3%
Despeno	39.7%	37.8%
F5M	69.3%	79.4%
FIMEDER	71.1%	57.6%
FINCA	76.7%	81.9%
FinComún	69.3%	76.5%
ProMujer	73.4%	57.6%
Average	**70.6%**	72.2%

*CAME data unavailable – Sept.05 shown here



In general, the high portfolio yields continue to cover inefficient cost structures, as reflected in the operational efficiency chart below, although **efficiency improvements have led to the increased profitability** mentioned above. The average operational efficiency has improved dramatically among the 11, but is due largely to the extremely high initial figure of FIMEDER which has improved greatly.

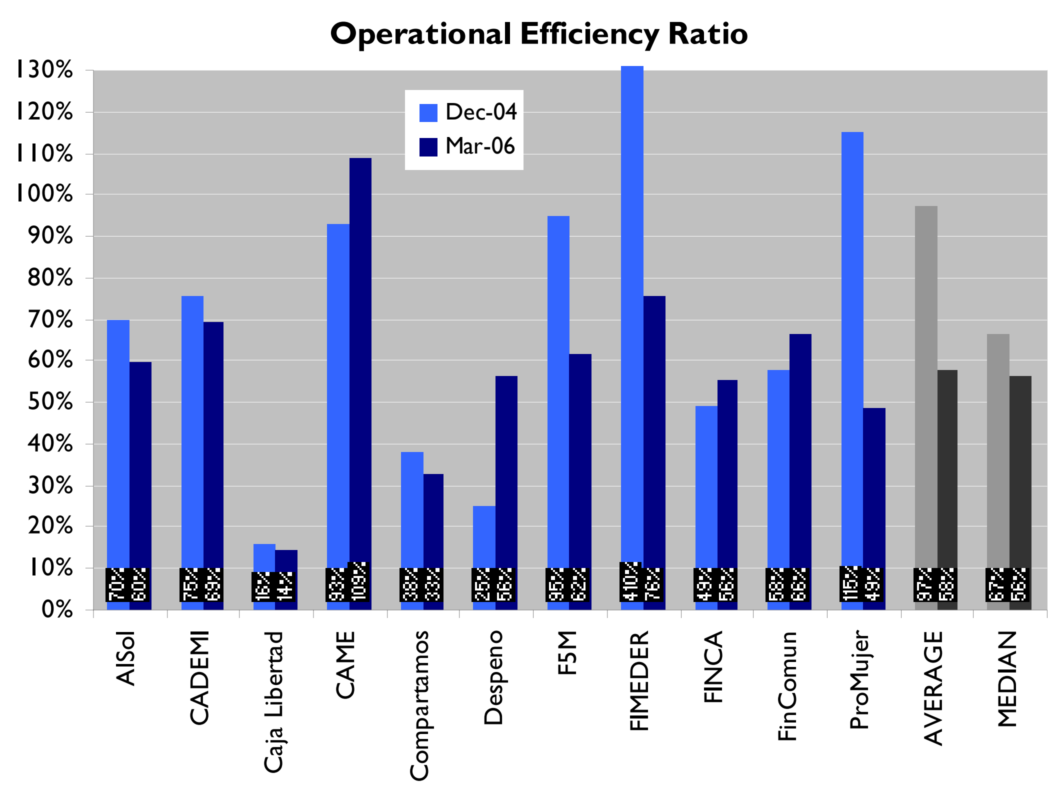
Seven of the 11 improved their efficiency as of March 2006, with AlSol, Fondo 5 de Mayo, and ProMujer (in addition to FIMEDER) making notable improvements. The average operational efficiency (personnel and administrative expenses divided by average gross portfolio) of 57.7% remains well above (i.e. partners are less less efficient than) the regional average reflected in the MicroRate 30 of 19.1% as of December 2004. As with the portfolio yield ratio, the average operational efficiency ratio is pulled down by Caja Libertad, with its large portfolio and lower cost structure consistent with credit unions. Many of the other partners use the village banking methodology, which carries higher operating costs relative to the loan size than individual lending now predominant in the rest of the region.

Table 8 – Operational Efficiency

MFI	Dec-2004	Mar-2006
AlSol	69.9%	45.6%
AMUCSS	N/A	N/A
CADEMI	75.4%	69.2%
Caja Libertad	16.0%	14.3%
CAME	93.0%	108.9%
Compartamos	38.2%	32.6%
Despeno	25.1%	56.4%
F5M	94.9%	61.7%
FIMEDER	409.6%	75.7%
FINCA	49.0%	55.5%
FinComún	57.8%	66.4%
ProMujer	114.9%	48.5%
Average	**97.4%**	**57.7%**

*CAME data unavailable – Sept.05 shown here

AFIRMA believes that this indicator will continue to improve over time as partners grow (since the denominator of this ratio is the average gross loan portfolio), as greater emphasis is given to being able to compete on service and cost, and, importantly, as staff productivity figures increase. Improved efficiency will likely become a key competitive factor in 2007 as increased competition puts pressure on lending interest rates.



As shown in the **loan officer productivity** chart, few of the AFIRMA partners reach levels of loan officer productivity approaching international standards, although some partners have improved significantly. The average for the MicroRate 30 was 309 clients per loan officer as of December 2004, while the AFIRMA average was 247 (not including Caja Libertad).

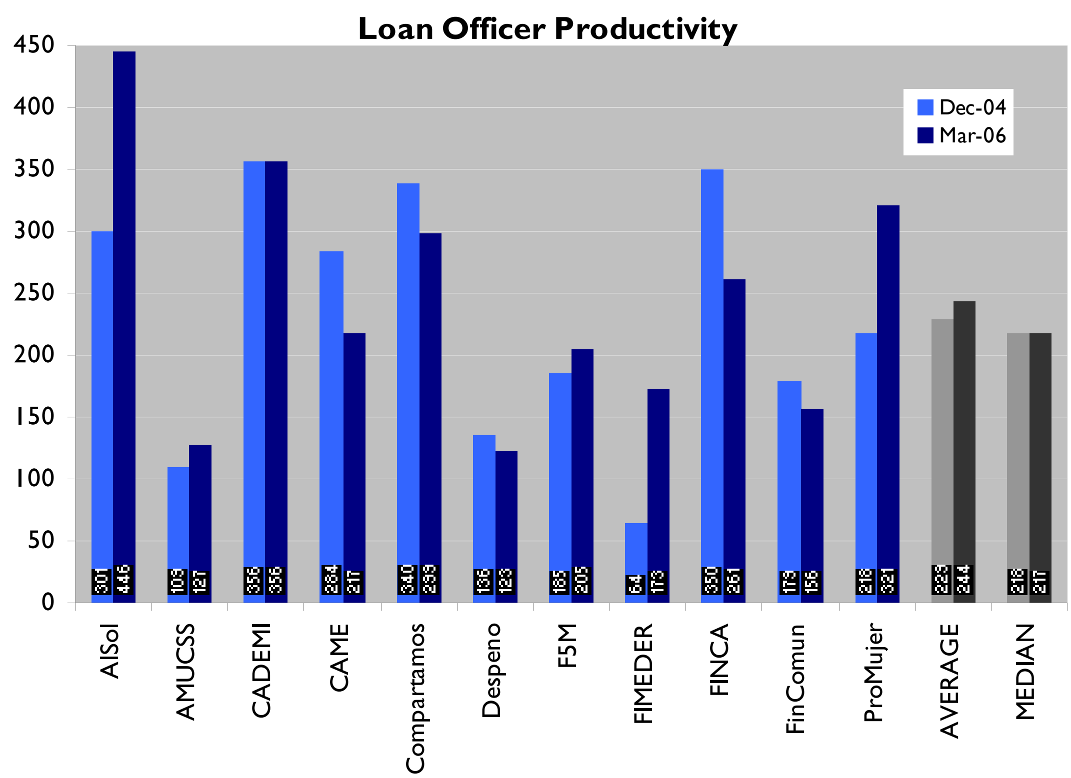
Major improvements at AlSol and ProMujer, both of which are now surpassing regional standards, and steady improvements at Fondo 5 de Mayo more than compensate for declines at CAME and FINCA, both of which are in the process of training new loan officers who will take time to attain desired levels of productivity.

Table 9 – Loan Officer Productivity

MFI	Dec-2004	Mar-2006
AlSol	301	446
AMUCSS	109	127
CADEMI	356	356
CAME*	284	217
Compartamos	340	299
Despeno	136	123
F5M	185	205
FIMEDER	64	173
FINCA	350	261
FinComún	179	156
ProMujer	218	321
Average	**229**	**244**

*CAME data unavailable – Sept.05 shown here

Caja Libertad, which had 1,326 credit clients per loan officer as of March 2006, is excluded from the average and from the table above since the traditional credit union lending methodology used there is not considered comparable with the other 11 partners.



On average, AFIRMA partners maintain high quality portfolios, as measured by the indicator of **portfolio-at-risk over 30 days** (balance of loans in arrears over 30 days divided by the gross loan portfolio). Risk in the portfolio as of March 2006 for most AFIRMA partners was well under control, although portfolios at Despeno and FinComún deteriorated markedly over 2005. AFIRMA continues to work with FinComún to develop a comprehensive approach to risk management and to adjust the lending methodology to improve repayment rates. Despeno has never written off bad loans, initially due to rules of FIRA, who financed the majority of the institution's agricultural lending portfolio. Although Despeno still carries non-performing FIRA-backed loans on its books, the total portfolio (the denominator of this ratio) has declined significantly, inflating this indicator substantially. Initial indications are that the recently-disbursed microfinance portfolio is performing well, although it remains to be seen what the effect is on the total portfolio over 2006.

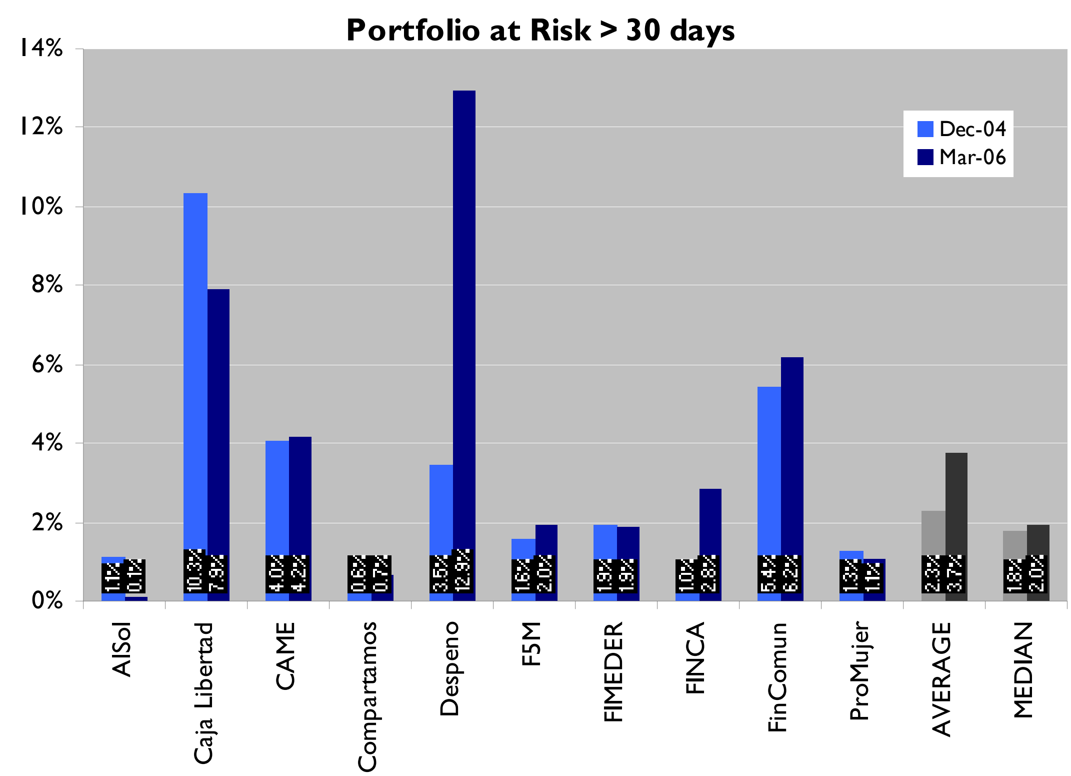
Table 10 – Portfolio-at-Risk > 30 days

MFI	Dec-2004	
AlSol	1.12%	0.26%
Caja Libertad	10.33%	7.89%
CAME	4.04%	4.17
Compartamos	0.56%	0.65%
Despeno	3.47%	12.92%
F5M	1.58%	1.95%
FIMEDER	1.92%	1.85%
FINCA	1.03%	2.83%
FinComún	5.44%	6.17%
ProMujer	1.28%	1.05%
Average	**2.3%**	**3.7%**

*CAME data unavailable – Sept.05 shown here

Caja Libertad maintains a high rate when compared to MFIs but has improved and the portfolio represents standard credit union lending to salaried workers which, as mentioned previously, carries much lower operational costs, but often higher loan losses than found in traditional microfinance.

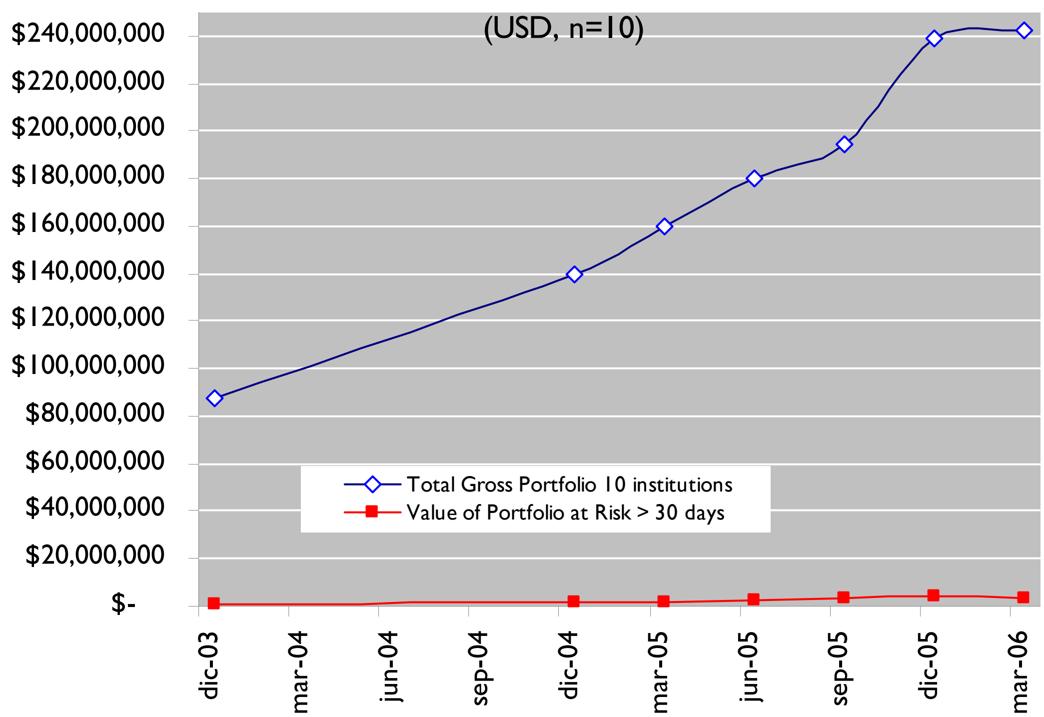
CADEMI is not shown in the chart below since the MFI's current management information system does not allow for calculation of portfolio-at-risk. CADEMI uses arrears rates and AFIRMA will assist the MFI to make the change with the implementation of the new MIS. Based on the very low level of arrears, AFIRMA estimates that CADEMI has a PAR>30 days below 5%.



AFIRMA partners also have, for the most part, avoided having to write-off significant portions of their portfolio, with the notable exception on FinComún, which wrote-off the equivalent of 5% of its gross portfolio in 2005. FIMEDER and AISol each wrote off 2%, while other partners had negligible write-offs.

The chart below also shows the entire portfolio of 10 AFIRMA partners (Caja Libertad is excluded and data for AMUCSS is unavailable) compared to the total value of the portfolios at risk over 30 days of those partners. The total value of the loan portfolios in March 2006 among these institutions was $242,838,892 (USD) a 74% increase in dollar terms as compared to December 2004. Although the figures continue to be driven by Compartamos, which represents 76% of the total portfolio, the chart reflects the high repayment rates consistent among clients of the project's partners.

Total Loan Port folio and Value of PAR > 30 days



The aggregate portfolio at risk of the 10 shown above was 1.5% in March 2006, as compared to 1.4% one year prior. If Caja Libertad is included, the figures rise significantly, to 7.5% as of the baseline in December 2004 and down to 5.5% in March 2006.[12]

[12] At $407 million USD in March, the CL portfolio is larger than the rest of the AFIRMA partners combined, and portfolio quality, as discussed above, is well below average of the MFIs.

5.2 TASKS 2-5 INDICATORS

Table 11 – Task One Indicators

Indicator	Baseline Dec. 2004	March 2006	Variance	LOP Target
2. Develop a local, commercially-based MFI support services industry				
2.1 Number of quality service providers	0 according to Partner MFIs in 2005 survey.	1 (SIN)	+1	> 1 quality service provider in each of the 5 most important service areas
2.2 Unsubsidized MFI purchase of local services	Very limited unsubsidized purchase of services	0 (although AFIRMA increasing cost-share)	-	> 6 MFIs procuring services at full cost by Year 5
2.3 Number of local firms used	0 (by definition)	8	+8	No specific targets set
2.4 Number of consultants trained in key areas	0 (by definition)	3*	+3	No specific targets set
3. Develop innovative products and technologies that expand access to rural financial services				
3.1 Number of effective innovations supported	0 (by definition)	0	-	5 effective innovations supported
3.2 Increased outreach due to supported innovation	Establish with each innovation as part of application	0	-	Increase – no specific targets set
3.3 Number of new or adjusted products	0 (by definition)	8**	+8	Increase – no specific targets set
4. Develop innovative products and technologies that expand access to rural financial services				
4.1 Work plans for key areas	0 (by definition)	0	-	Annual work plans established and implemented
4.2. TBD based on work plans with CNBV	TBD	-	-	TBD
5. Develop innovative products and technologies that expand access to rural financial services				
5.1 Increase provision of Useful market information	Sparse, disparate information available	Sparse, disparate information available	-	Useful Market information readily available
5.2 Benchmarking system	No effective system	No effective system	-	Global-standard Benchmarking system established

*The work of Local consultants Martin Yedra, Vayda Sosa and Rene Garcia work with international consultant for the dual purpose of providing TA under task 1 and increasing their capacity. Martin Yedra has also participated in AFIRMA-sponsored Audit and Internal Control training. This will expand significantly as the training programs under Task 2 are implemented.

**AFIRMA has assisted in the development of New/Adjusted products at FIMEDER, PMM, Despeno, Fondo 5 de Mayo (adjusted 1, implementing a second, not yet counted here), FinComún (adjusted 2 products – savings and loan), and Compartamos (re-designed 2: individual and solidarity loan products 2 more in process). Other products are in development at Caja Libertad.

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