

General Earthquake Assistance Provided by FOMIR/DAI Quarterly Report for October 1 – December 31, 2002

Introduction

The earthquakes of 2001 had significant impact on micro enterprise owners and microfinance institutions throughout the country. In earthquake affected regions, eight institutions determined that a significant portion of their clients were affected. Calpia was provided with direct assistance in the form of a guarantee. Of the remaining eight institutions, the credit union ACCOVI was the most severely affected. Accovi reported that nearly 40% of their clients were directly affected. In addition, ACCOVI main office was severely affected by the earthquake.

In response to the earthquake, USAID amended the DAI contract on July 23, 2001 with the following instruction:

DAI will respond to increasing technical assistance and financing needs faced by selected MFIs to better address micro-entrepreneurs' critical financial situation. This could include capital to increase lending for business activities, to cover loan losses and/or to create new credit lines and products for MFIs to provide an integrated response to their clients. Funds can be used to leverage USAID's guarantee mechanism to finance RFM grantees. This component will include technical assistance to develop new products and to assist MFI restructuring their loan portfolios.

Under expected results the amendment stated "the assistance to grantees will permit these institutions to resolve the financial problems they have been facing since the earthquakes".

Included in the amendment was USAID approval that DAI provide a combination of short term and long term technical assistance institutions affected by the earthquake. In respect to long term technical assistance, USAID approved the position of Senior Microfinance Advisors to plan and implement effective transformation plans and manage the final re-engineering of MFI systems, policies and procedures of assigned institutions.

Once receiving the contract amendment in July 2001, FOMIR reacted quickly and effectively to provide much needed technical assistance, training and increased access to finance to the microfinance institutions. These included Financiera Calpia, ASEI, ACCOVI, Banco Agricola, Banco Salvadoreño, CAM, FJND and FUSAI. As a result, the project helped local MFIs manage through the crisis and reverse what could have been a potentially devastating trend on credit portfolios.

Earthquake Technical Assistance to CALPIA

In respect to the USAID Development Credit Authority portfolio guarantee developed by FOMIR and USAID in response to the earthquake, as of December 31, 2002, Calpia has made no claims. Management intends to submit claims during the first quarter of 2003.

At the beginning of the USAID Loan Guarantee, June 30, 2001 Calpia submitted:

- 243 Small Enterprise Loans of an outstanding balance of US\$ 1,421,763.61
- 5,804 Micro Enterprise Loans of an outstanding balance of US\$ 3,076,518.66
- 6,047 Total Loans with an outstanding balance of US\$ 4,498,282.27

The status of the same loans per September 30, 2002 is the following:

- 73 Small Enterprise Loans with an outstanding balance of US\$ 494,281 are still under coverage
- 798 Micro Enterprise Loans with an outstanding balance of US\$ 419,353 are still under coverage
- 871 Loans with an outstanding balance of US\$ 913,635 are still under coverage.
- Calpia expect to make its first claim against the guarantee in March 2003 for a total of 90-100 loans that have defaulted for a value of approximately \$175,000. A claim rate of 4% against the original amount place under guarantee.

Earthquake Technical Assistance to ACCOVI

The credit union ACCOVI, located in San Vicente was especially hard hit. Headquarters is located in the middle of San Vicente and its branches are located in Ilobasco, Zacatecoluca and Cojutepeque. COEN reported that 63,500 homes were damaged and 69,000 homes destroyed in the departments served by ACCOVI. Ninety-seven percent of ACCOVI's clients are rural. After the earthquakes, arrears in the institution went to 26%. FOMIR/DAI intensified efforts to address the increased needs of the institution. Since the earthquake, FOMIR/DAI assistance to ACCOVI has addressed problems on a priority basis:

- First, FOMIR provided substantial assistance to address a serious problem with delinquency. By September 2001, ACCOVI's portfolio at risk more than 30 days had climbed to 21.6%. FOMIR responded with a combination of new portfolio management tools and assistance in redefining collection policies. As a result, portfolio at risk has declined to 15.84% at the end of September 2002.
- Second, FOMIR provided a combination of short and long term assistance to re-engineer the credit process and introduce new microfinance products targeted to the needs of the credit union clients. These changes have expanded ACCOVI's portfolio to include 691 new active loans for microfinance clients as of the end September

2002. These loans have provided clients with the resources they require to expand their income generating potential and rebuild homes and businesses.

- Third, FOMIR has provided ongoing assistance to improve their management information system. With FOMIR assistance ACCOVI, together with two other credit unions has procured and is customizing new financial service software.

In November 2002, USAID and FOMIR agreed that in order to complete the rebuilding effort, it is critical to assist ACCOVI in the process of regulation under the new Law for Non-Banking Financial Institutions. Implementation of required changes have delayed due to the need to address previously mentioned problems. By assuring ACCOVI's permanency, USAID and FOMIR will be supporting the creation of jobs and economic growth in one of the most severely-hit-by-the-earthquake departments.

USAID and FOMIR reasoned that if not assisted, ACCOVI would not be able to comply with all the SFS requirements. As a result, 4,750 of its total rural active loans and 11,592 depositors would be negatively affected since the institution would be forced to return deposits causing a liquidity crisis and putting the sustainability of the institution at risk.

Continued USAID assistance in helping ACCOVI become regulated will strengthen the institution and will expand access of financial services to current and future clients in search of resources required to re-build their livelihoods. Recent studies by FOMIR have demonstrated that microfinance loans increase income, create jobs and help poor families deal with economic shock caused by natural disasters. Technical assistance to ACCOVI will ensure that the institution provides sustainable financial support to earthquakes victims in San Vicente, La Paz and Cuscatlan. As a regulated institution, ACCOVI services will be monitored to ensure effective and efficient operation and client services. A recent evaluation of the projects recommended that FOMIR accelerate assistance to ACCOVI to achieve its approval by the SSF by June 2003.

Summary of Activities for the Quarter

Below is a summary of technical assistance provided by FOMIR. During the past quarter, FOMIR/DAI began an intensive technical assistance program to support ACCOVI in the implementation of its regularization plan with the Superintendency of the Financial System (SSF).

FOMIR/DAI began working with ACCOVI in mid-2000 to develop and implement a microfinance product in its rural branches. Due to the poor information system in ACCOVI and the other two credit unions supported by the project, the credit union's arrears crisis that was aggravated by the earthquakes of early-2001, and ACCOVI's decision to apply for a license from the SSF under the Non-bank Financial Intermediaries Law in mid-2001, FOMIR/DAI assistance has expanded to assist the credit union in these three critical areas.

Support for ACCOVI's regularization process began in late 2001 and initially was limited to developing some required policy manuals, identify accounting problems, and train staff in key elements of the SSF's norms. By mid-2002, ACCOVI's had repeatedly delayed finalization of the manuals and implementation of the accounting changes. In addition, the SSF expressed concern regarding ACCOVI's ability to comply with all requirements. Finally, ACCOVI elected a new President of the Board who requested FOMIR/DAI directly support the regularization process. The combination of these events led the project to dedicate additional resources and develop a comprehensive work plan for this initiative.

Justification

As stated USAID and FOMIR agreed that in order to complete the rebuilding effort, it is critical to assist ACCOVI in the process of regulation under the new Law for Non-Banking Financial Institutions. By assuring ACCOVI's permanency, USAID and FOMIR will be supporting the creation of jobs and economic growth in one of the most severely-hit-by-the-earthquake departments. Among FOMIR's 11 partner institutions, only ACCOVI has a branch in the department of San Vicente. By assisting ACCOVI, USAID is assisting 4,750 rural active loan clients and 11,592 depositors. Failure by ACCOVI to meet the requirements of the superintendent would force them to return deposits causing a liquidity crisis and putting the sustainability of the institution at risk.

Although the regularization of ACCOVI and all the work this implies is, in and of itself, enough reason to assist the credit union, FOMIR/DAI believes the real value is in the learning process that can be applied to other institutions planning to apply for a license from the SSF. As the first credit union to undertake the regularization process, ACCOVI is a pioneer and victim of the sometime unclear norms and procedures.

The Team

To assist ACCOVI, FOMIR/DAI has formed a highly qualified, multi-disciplinary team. FOMIR/DAI Technical Director Robin Young coordinates the technical assistance program. Luis Lievano, experienced and knowledgeable in credit union operations and the SSF, is the full-time, on-site consultant working with ACCOVI's management, and reporting directly to the President of the credit union, on implementation of the detailed work plan. John Hallen provides the management team guidance with organizational development. Enriqueta Claramunt is responsible for managing the software customization process. For ACCOVI, in addition to the standard customization process, this includes a process to define and check that requirements and programming comply with regulatory standards and norms as well as coordinating the SSF's testing and acceptance process. Claudia Ordoñez has worked to ensure the credit policy and procedures manuals and information system is in compliance with best practices in microcredit and the relevant laws and norms of the SSF. Luis Alfaro continues to advise and monitor ACCOVI's microcredit operations.

Work Plan

In October 2002, FOMIR/DAI in conjunction with ACCOVI's Management and Board developed and approved a comprehensive work plan to guide the institution and technical assistance team. This work plan drew from ACCOVI's regularization plan approved by the SSF, subsequent observations of the SSF, and input from FOMIR/DAI consultants' experience with the SSF and project management.

The key elements of the work plan are:

- creation of a regularization plan committee;
- completion of NIT data required for the SSF's credit registry;
- portfolio classification and reserve requirements;
- development, approval and dissemination of several policy and procedures manuals;
- verification of data, development and delivery of reports for the SSF's credit registry;
- clean-up of accounting practices and account reconciliation;
- hiring staff for key management positions;
- development and implementation of an internal auditing plan;
- revision of the legal contracts ACCOVI issues clients for loans and deposits for compliance and approval by the SSF;
- development of a policy manual and tracking procedures for extraordinary assets;
- development of a compliance and tracking system for related lending and financial indicators such as capital adequacy; and,
- coordination with the development and implementation of the new software system to ensure compliance and approval by the SSF.

Following is a brief description of the progress to date in each of these areas.

Creation of a regularization plan committee. In October, ACCOVI's Management and Board of directors approved the work plan and named the President and General Manager of ACCOVI as the parties responsible for supervising work plan progress. FOMIR/DAI named Luis Lievano as the day-to-day coordinator of the plan and Robin Young as the overall project manager. Mr. Lievano coordinates and supports a broad base of staff and managers from ACCOVI to complete the tasks on the work plan. He reports to the President of ACCOVI. Ms. Young monitors overall compliance, coordinates with the software customization project and other technical assistance for the credit union and conducts bi-weekly meetings with the President, General Manager and newly created Senior Management team.

Completion of NIT data required for the SSF's credit registry. As of October, approximately 20 percent of ACCOVI's outstanding credits lacked the NIT identification number required by the SSF for its credit registry. Through a process of follow-up with clients, cross checking various sources including the SSF's and Treasury Department's (Ministerio de Hacienda) lists, ACCOVI was able to identify all but about 190 of the NITs and requested the SSF assign an identification number to these clients per their

norms. ACCOVI also instituted a policy and process to ensure all future loans are registered with the corresponding NIT.

Portfolio classification and reserve requirements. With the SSF's announcement that it would conduct an on-site audit of ACCOVI's portfolio within a couple of weeks of initiating the comprehensive work plan, the initial focus turned to preparing loan files and other information for the SSF's visit scheduled for November 12. This included developing a method to prioritize loans (starting with all those over \$5,000) to locate, review, complete and properly file and track loan documentation, including contracts and guarantees. This method was eventually expanded to the entire portfolio and included staff at all levels from the credit department to branches, and the credit union's lawyer. In addition, FOMIR assisted ACCOVI to develop the reports necessary to present to the SSF for this process. The result of the SSF's field visit was an approximately \$480,000 increase in the reserve requirement to comply with the SSF's norms. ACCOVI reports it will fully account for this provisioning requirement in its final 2002 financial statements. Although ACCOVI reports that portfolio quality had improved by the close of 2002, with portfolio at risk over 90 days at about 15%, FOMIR/DAI has renewed its focus to work with ACCOVI's management to conduct a portfolio review with an eye to write-offs and arrears management in order to clean-up the portfolio during the first quarter of 2003.

Development, approval and dissemination of several policy and procedures manuals. FOMIR/DAI began assisting ACCOVI in late 2001 to develop the Functions, Administration, Credit and Deposits Policy and Procedures Manuals for submission to the SSF. During late 2002, FOMIR/DAI and ACCOVI placed a new focus on these manuals, completely revamping the credit and deposits manuals to ensure compliance with best practices and the SSF's and Banco Central de Reservas (BCR) norms. In addition, FOMIR/DAI consultants assisted ACCOVI to develop the Contingency Plan and Liquidity and Investment Policy Manual. All these manuals had been submitted to the SSF (and the deposits manual to the BCR) by the end of the quarter. ACCOVI is awaiting approval to finalize and disseminate the manuals to all staff. During coming months, ACCOVI and FOMIR/DAI consultants will finalize and submit the accounting and systems manuals to the SSF for approval. Currently, these are under development.

Verification of data, development and delivery of reports for the SSF's credit registry. The FOMIR/DAI Coordinator has worked with ACCOVI's technology staff to develop the reports required to send to the SSF for their credit registry. In addition, he has conducted reviews on samples of loans to ensure data consistency. Finally, with the hiring and initiation of the internal auditor in January and the first tests on data for migration to the new software system, additional efforts are being placed on data quality and reports.

Clean up of accounting practices and account reconciliation. The tasks under this activity primarily are in response to the observations of the Chicas Alfaro accountants hired jointly by FOMIR and ACCOVI in mid 2002 to review accounting procedures and information in ACCOVI's branches. ACCOVI reports significant progress in responding to the reports' observations and recommendations including establishing petty cash

accounts, locating and completing loan files (contracts, guarantees) and reconciling outstanding balances through 2001 and most of the 2002 accounts, and establishing a responsible accounting staff member and schedule for monthly reconciliations going forward. Work in this area is ongoing.

Hiring staff for key management positions. Both to comply with its regularization plan as approved by the SSF and to complete the basic management team required to manage the day-to-day operations of the organization, ACCOVI was required to hire several staff members. This included branch managers for the Cojutepeuque and San Vicente Branches, the Finance and Administration Manager, the Operations Manager, the Internal Auditor and the Legal Manager. FOMIR/DAI consultant John Hallen, assisted by Luis Alfaro, led ACCOVI in a process to define competency job descriptions and develop a recruitment plan. FOMIR/DAI consultants assisted ACCOVI in the recruitment and interview process, although all hiring decisions were solely ACCOVI's responsibility. As of the end of December, all but the Legal Manager had been hired and began working (Internal Auditor to begin officially Jan. 2, 2003). In addition to assisting in the hiring process, ACCOVI's President and General Manager requested FOMIR/DAI provide ongoing assistance from Mr. Hallen to build the management team. This includes bi-weekly coaching sessions for each senior manager, monthly team building and communications workshops for the entire management team, and periodic workshops and meeting with each manager and his/her staff. This work will kick off in early 2003 with a series of interviews and a workshop to define ACCOVI's new organizational chart and the key responsibilities and relationships of senior management. ACCOVI also requested FOMIR/DAI's support to train the new Operations Manager as he was promoted from within and lacks sufficient experience in many of his new areas of responsibilities. FOMIR/DAI will develop a training plan to help support this new manager in the newly created position.

Development and implementation of an internal auditing plan. ACCOVI hired a new internal auditor who will officially report to work in January 2003. In preparation of her arrival and in accordance with their regularization plan, the new Auditor prepared an annual audit plan that was reviewed by FOMIR/DAI consultants. This plan was submitted and approved by ACCOVI's Board and subsequently submitted to the SSF in December.

Revising the legal contracts ACCOVI issues clients for loans and deposits for compliance and approval by the SSF. In response to the SSF's observations regarding ACCOVI's loan contracts, the credit union revised its loan documents in conjunction with its lawyer. The new contracts were submitted and accepted by the SSF. The FOMIR/DAI consultant assisted in developing a tool to calculate the effective interest rate to be included in contracts.

Developing policy manual and tracking procedures for extraordinary assets. This activity is programmed to be developed during January 2003.

Compliance and tracking system for related lending and financial indicators such as capital adequacy. During the past quarter ACCOVI identified all related loans (employees, Board member and family members, etc.) and calculated and tracked the ratios to ensure compliance with the SSF's norms. In addition, these requirements have been incorporated into the new policy manual and software system to ensure ongoing tracking and compliance. Finally, all credit staff and credit committee members will be trained in these and other relevant norms.

Coordination with the development and implementation of the new software system to ensure compliance and approval by the SSF. FOMIR/DAI has established a complete and qualified team for the software customization project. To ensure the software meets the specific requirements of ACCOVI as a regulated institution, FOMIR/DAI has dedicated extra resources. These include the work of Claudia Ordoñez to review the credit module and provide additional requirements and testing, Luis Lievano to discuss and review the accounting and reporting requirements, and an additional programmer during January and February 2003, paid half by ACCOVI, to respond to the particular requirements of the SSF. In addition, FOMIR/DAI and ACCOVI have requested the SSF begin reviewing the system as the modules are completed in early 2003 rather than waiting to begin testing after the entire system is complete. The SSF has agreed to begin this process in February. However, with changes in the SSF's technology staff at the end of 2002, it is not clear who will be responsible for this process or if these changes will cause delays in the review and approval process. In addition, given the significant increase in new Managers in ACCOVI with valuable experience, additional efforts have been made to familiarize them with the new system and to try and incorporate their perspective and ideas into the system. Ms. Claramunt coordinates all these efforts.

In addition to this specific work plan, Mr. Lievano has provided general training to all of ACCOVI's staff, Board and Vigilance Committee on the Non-Bank Financial Intermediaries Law and has developed a training program for credit staff on norms for credit operations. He also has been instrumental in developing a participatory approach to building the management team and developing open channels of communication with the Board's President and Board. He has assisted the management team in the development and presentation of their annual work plan which was approved by the Board in early January, and has facilitated dialogue and helped build the relationship between ACCOVI and the SSF.

Key Activities for the Next Quarter

- ongoing meetings of the regularization plan committee;
- arrears management, including review of loans to be written off, and monthly review of portfolio classification and reserve requirements;
- approval, dissemination and training of policy and procedures manuals;
- monthly generation, review and certification of reports for the SSF's credit registry;
- ongoing clean-up of accounting practices and account reconciliation;

- hiring Legal Manager, initiating Internal Auditor, revising job descriptions, the organizational chart and functions manual, while building the management team through individual coaching and team-building workshops;
- implementation of the internal auditing plan;
- development, submission and approval of a policy manual and tracking procedures for extraordinary assets;
- development, submission and approval of the interest rate variation policy;
- development of reports and central processing calculations in compliance with non-bank financial intermediary norms as well as development and initiation of a work plan for the SSF to review and test the new software system for compliance and approval. The first visits are scheduled for February 3 and 18.

Overall Impact

The seven FOMIR related MFIs that provided credit in areas determined to be affected by the earthquakes in January and February 2001, reported 16,614 rural active clients as September 30, 2001. As of the December 2002, the number of rural active clients served by these seven MFI's has increased by 14.1% from 16,614 to 19,692 or an increase of 3,078 rural active clients.

Annex A provided of breakdown of clients by institution and municipality.

Budget and Expenditure for Earthquake Activity under the Project

The amendment to the DAI contract on July 23, 2001 allocated \$700,000 to provide earthquake TA and staff for management of the PAG grants. The table below provided a breakdown of the budget across various sub-projects.

Use of Earthquake Assistance Related Funds						
	Original Budget	Amount Utilized	Amount Remaining	Increase/Decrease Required	Revised Budget	
1	IMPACT ASSESSMENT/RESPONSE	\$ 27,500	\$ 53,312	\$ (29,000)	\$ 29,000	\$ 56,500
2	DEVELOPMENT CREDIT AUTHORITY F/CALPIA	\$ 12,500	\$ 8,202	\$ 4,298	\$ (4,298)	\$ 8,202
3	EARTHQ.STUDY HOUSING CONSTRUC.	\$ 22,000	\$ 7,139	\$ 14,861	\$ (14,861)	\$ 7,139
4	EARTHQ.STUDY DAMAGE TO PHYSICAL MKT	\$ 35,000	\$ 23,718	\$ 9,000	\$ (9,000)	\$ 26,000
5	EARTHQ.BMI NEW PRODUCT DEVEL. PROG.	\$ 95,000	\$ 84,801	\$ 10,199	\$ (14,779)	\$ 80,221
6	SENIOR MICROFINANCE SPECIALIST	\$ 323,000	\$ 223,685	\$ 99,315	\$ (80,000)	\$ 243,000
9	PRA Studies/Tools Kit	\$ 65,000	\$ 66,819	\$ (1,819)	\$ 24,000	\$ 89,000
7	TECHNICAL ASSISTANCE FOR ACCOVI	\$ -	\$ -	\$ -	\$ 81,338	\$ 81,338
8	Earthquake Related Technical Assistance	\$ 580,000	\$ 467,675	\$ 106,854	\$ 11,400	\$ 591,400
9	PAG Program Administration	\$ 120,000	105,987	14,013	(14,000)	106,000
10	Earthquake Vouchers	\$ 1,000,000	\$ 1,002,600	\$ (2,600)	\$ 2,600	\$ 1,002,600
	Total Budget	\$ 1,700,000				\$ 1,700,000

The remaining \$81,338 will be used to provide direct increased assistance to ACCOVI, not considered in the original Action Plan for the institution. Due to the effects of the earthquake, these additional funds will be used mainly to increase the technical assistance to ACCOVI to strengthen the financial management, finalize the application of new credit policies and procedures and project management support to ensure that the institution meet the requirements imposed by the SFS. This assistance will include:

1. \$25,000 to support to strengthen the financial management of the institution to ensure proper oversight of credit portfolio comprised of loans to clients living in the earthquake affected areas,
2. \$15,000 to finalize the application of new credit policies and procedures that should improve efficiency in delivering services to members and clients affected by the earthquake, and,
3. \$41,338 to provide project management support and training to ensure that the institution meet the requirements imposed by the Superintendent of the Financial System, thereby ensuring sustainability of services to the general population in areas hard hit by the earthquake.

As planned, FOMIR/DAI intends document experienced gained over the last 18 months in a set of guidelines and planning tools to be used by USAID and local Microfinance Institutions to respond to future disasters. The budget for this activity is estimated at

\$22,181. Based on the experience gained through the earthquakes, the Guidelines will be developed by local staff in collaboration with an expert with experience in rapid appraisal of microfinance institutions following disasters. The final documents will include basic information regarding benefits of restructuring loans, grace periods after disasters, timing of assistance and tools for use by credit officers in estimating potential impact on portfolios. The guidelines will be distributed to FOMIR/DAI 11 grantee MFIs and a minimum of 10 other sector stakeholders including CONAMYPE.

Annex A: List of Clients as of December 31, 2002 by Institution and
Municipality Affected by the Earthquake