

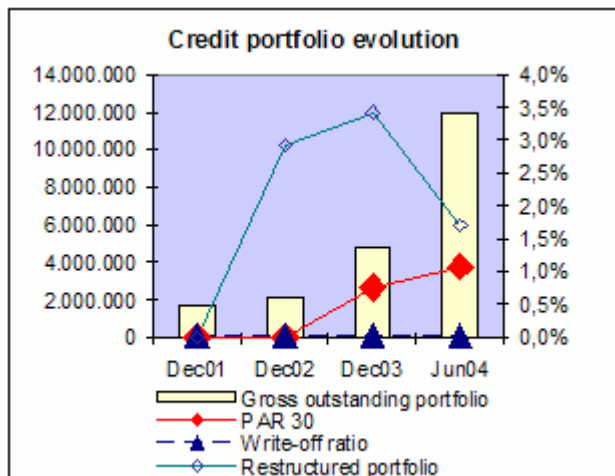
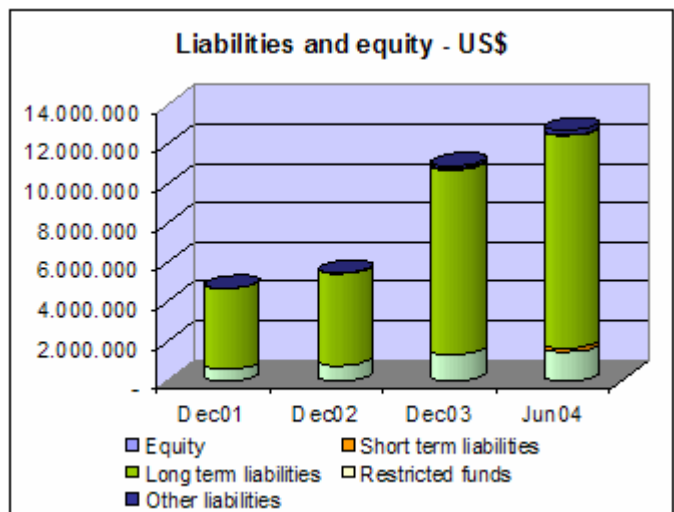
## RURAL FINANCE CORPORATION (RFC) – Moldova

<b>Final rating</b>	<i>Adequate capacity to meet its financial obligations. Good operations. Quite stable even if it could be affected by significant internal or external events.</i>
<b>BBB+</b>	
<b>Initial rating</b>	<i>Validity: 1 year if no relevant changes in operations or within the operation context will happen.</i>

Rural Finance Corporation (RFC) is a non-bank financial institution, legally incorporated as an open joint stock company. Created in 1997 under an agreement between the World Bank and the Government of Moldova, RFC joins today 298 SCAs as its shareholders (holding the 99,6% in RFC voting share). It provides rural financial services to farmers and rural entrepreneurs through SCAs, which on-lend to their members, and directly mainly to start-up businesses. RFC has very good relations with many actors in the microfinance sector in Moldova: the National Federation of SCAs (NFSCA), the Supervisory Body of SCAs (SSB), development agencies, etc.. The institution is mainly financing its portfolio with long term liabilities from international lenders and it is in the process of decentralization, foreseeing the transformation of the 8 regional offices into 8 branches.

Number	Dec02	Dec03	Jun04
Active borrowers	190	400	488
Active loans	274	566	1.011
Regional offices (marketing)	0	8	8
Total staff	27	30	29
Loan officers	14	14	13

<b>Legal Form</b>	Non-bank financial institution
<b>Year of inception</b>	1997
<b>Area of intervention</b>	Rural
<b>Credit methodology</b>	SCAs and direct lending

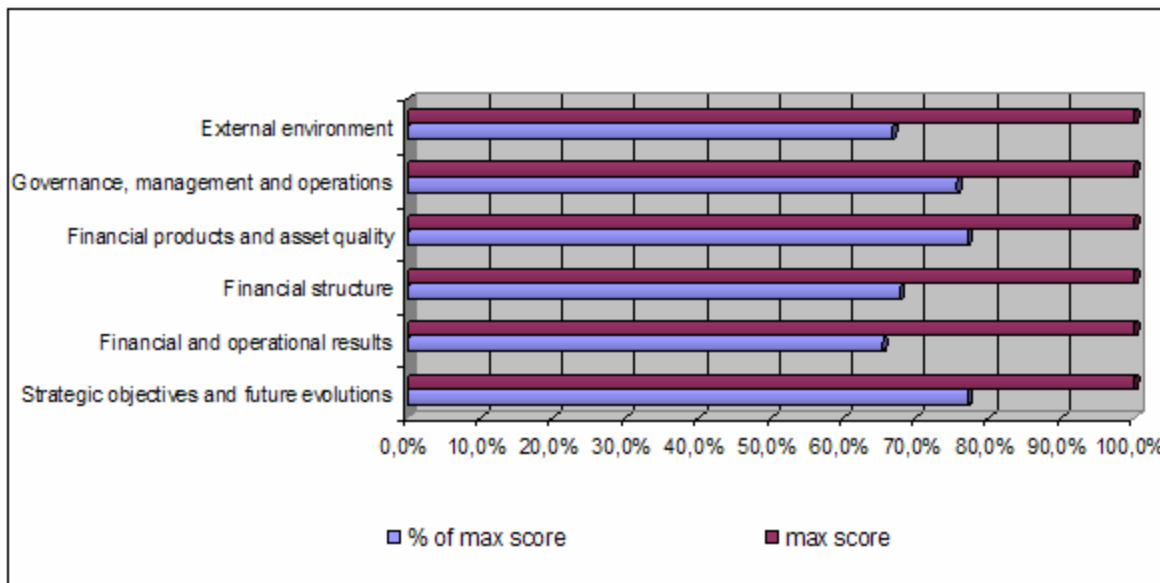


US\$	Jun04
Average disbursed loan size	14.711
Gross outstanding portfolio	11.999.236
Total assets	12.930.105

Financial Indicators	Dec02	Dec03	Jun04
PAR 30	0,0%	0,7%	1,1%
Restructured loans	2,9%	3,4%	1,7%
ROE	33,5%	37,5%	30,3%
AROE	-41,7%	-36,6%	-33,6%
Oper. Self-sufficiency (OSS)	149,2%	156,9%	133,6%
Fin. Self-sufficiency (FSS)	73,6%	78,9%	84,5%
Staff productivity (borrow.)	7	13	17
LO productivity (borrow.)	14	29	38
- SCAs	19	27	44
- Direct lending	16	54	74
Operating expense ratio	6,7%	5,4%	4,5%
Funding expense ratio	9,3%	8,5%	9,9%
Provision expense ratio	0,0%	-1,0%	0,2%
Portfolio yield - accrual	17,3%	16,4%	16,3%
Risk coverage ratio	na	130,6%	237,1%
Cost of funds ratio	6,6%	6,5%	8,9%
Debt/Equity ratio	5,9	7,3	7,9

### CONTACTS

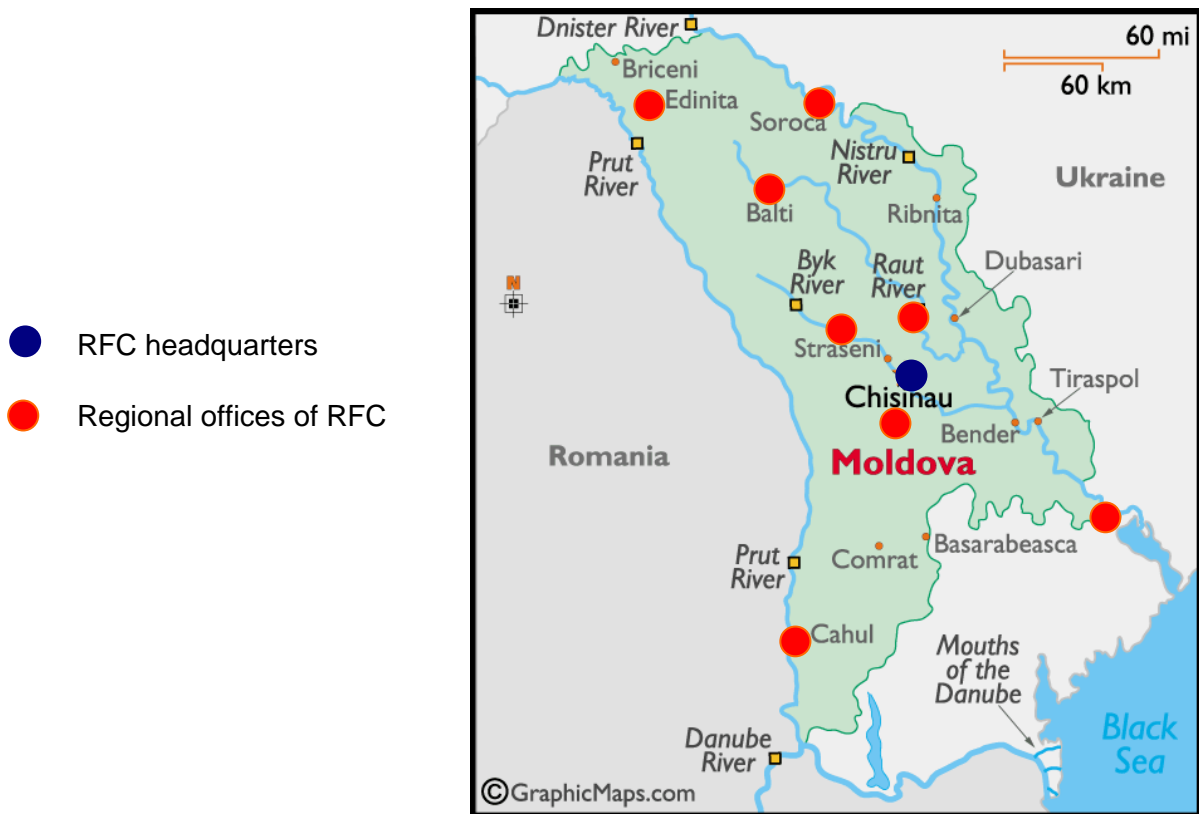
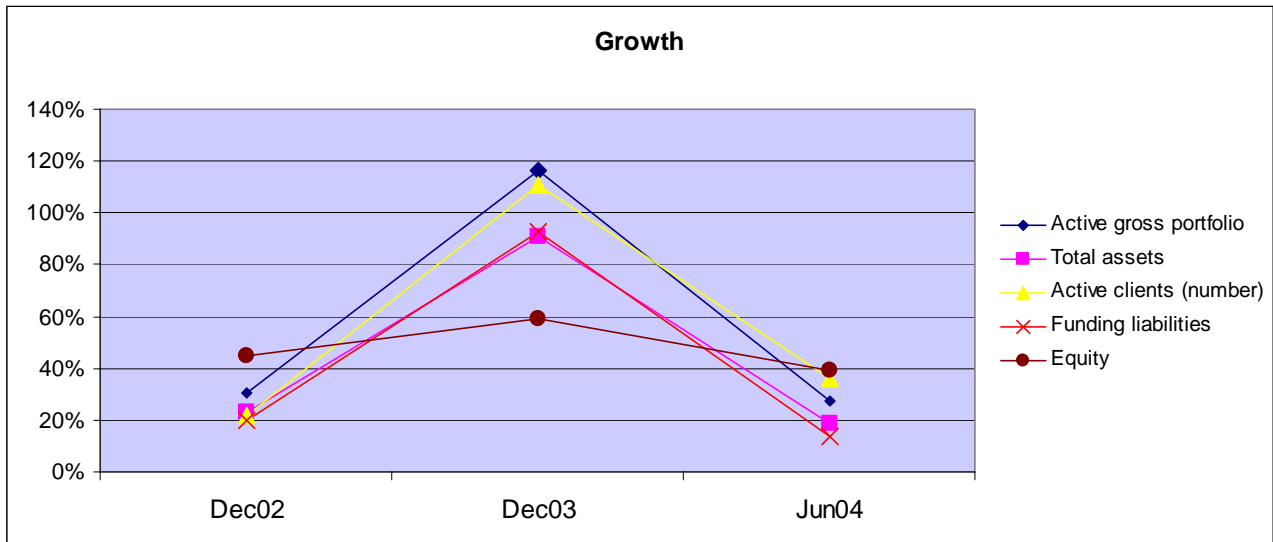
**RFC has obtained an aggregated rating score equal to **BBB+**.** This evaluation is the result of an in-depth analysis of different aspects of the institution, considering a differentiated weight for each area. The following table shows the score of each area<sup>1</sup> in absolute value obtained by RFC:



AREA	Risk factors	Relevance*
<i>External environment</i>	SSB weak supervision for SCAs	Medium
	Lack of a credit bureau for microfinance institutions and banking financial institutions	Medium-low
	National Bank is not considering the microfinance sector	Medium
<i>Governance, management and operations</i>	Decentralization in progress	Medium-low
	Integration between portfolio tracking system and accounting system in progress	Low
	Lack of personnel manuals and incentive schemes	Low
<i>Financial products and asset quality</i>	RFC's entire credit portfolio is rural	Medium
	Lack of further products according to the clients needs due to the shortage of financial resources	Medium-low
	30% of start-ups in direct lending	Medium
	Seasonality of portfolio	Low
	Still low SCAs management ability	Medium
<i>Financial structure and ALM</i>	Dependency on international financial investors	Medium-high
	Limited capacity of capitalization through the SCAs shareholders	Medium-low
<i>Financial and operational results</i>	Low adjusted results	Medium-low

\* Relevance refers to the damage/loss brought about by negative events (associated to each risk factor) and to the probability that damage/loss eventually occurs.

<sup>1</sup> The external environment refers to the banking and microfinance environment, regulation and supervision and the positioning of the institution. It does not include an evaluation of the political and economic context.



### Other highlights

- As for now, competition does not represent a threat for RFC**, but it should be noted that if microfinance portfolio profitability will increase and regulations change, Agroindbank together with other commercial banks, could be attracted by this potential market.

<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>➤ Excellent portfolio quality</li> <li>➤ Good governance</li> <li>➤ Qualified Management and Staff</li> <li>➤ Good results in sustainability and profitability</li> <li>➤ Speed of loan processing and disbursement</li> <li>➤ Loan assessment methodology for SCAs</li> <li>➤ Collaboration and support with international and national partners – WB, CGAP, IFAD, USAID, DFID, SIDA, Gov. of Moldova, SSB, National Federation of SCAs, development agencies (RDC, ACA, CCA)</li> <li>➤ Good regulation and supervision for SCAs (main clients of RFC)</li> </ul>	<p><b>Opportunities:</b></p> <ul style="list-style-type: none"> <li>➤ Potential market for existing and new products</li> <li>➤ Growth of the SCAs network</li> <li>➤ Expansion in new geographical zones</li> <li>➤ Transformation into a bank or deposit taking institution</li> <li>➤ Economic growth of Moldova (positive trends) and EU neighborhood</li> </ul>
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**External threats:** political elections in 2005

### Final opinion

RFC has set up strong operations with an effective management and governance structure. Portfolio quality is good and the institution benefits of important support from World Bank and other international external actors (donors/investors). At the moment RFC has some strong competitive advantages compared to other financial providers. Nevertheless RFC has still to consolidate its network of regional offices, it has to reduce the concentration of its outstanding portfolio into the rural sector and to improve the range of financial services. Furthermore it has to keep improving the level of financial self-sufficiency.

Absorption capacity for new funding, according to RFC's strategic plan, is there. There is good potential market both for existing and new loan products. The increase of alternative sources of funds (at national and international level) is a crucial issue for the growth of the institution in the medium-long term.

External environment is potentially instable and National Bank (NBM) is actually not considering RFC and the microfinance sector. These external factors could bring possible negative consequences on RFC's activities.

## Benchmarking

All figures are referred to the MicroBanking Bulletin (MBB) database<sup>2</sup> updated as of July 2003. RFC financial ratios indicated here do not fully correspond to the ratios presented in the report as they are calculated according to the *MicroBanking Bulletin* (MBB) methodology<sup>3</sup>.

Financial ratios	<i>Rural Finance Corporation</i>	ECA Large	Non Banks (FSS MFIs)	Individual (FSS MFIs)
<b>Gross Loan Portfolio</b> gross loan portfolio adj for standardised write-offs (US\$)	11.912.172	10.670.240	17.973.100	11.337.583
<b>Average Loan Balance per Borrower</b> gross loan portfolio / n. of active borrowers (US\$)	24.589	1.584	861	937
<b>Portfolio at Risk &gt; 30 Days</b> outstanding balance of loans overdue > 30 days / gross loan portfolio (%)	1,1%	0,6	4,0	3,9
<b>Adjusted Return on Equity AROE</b> adj net operating income after taxes / avg tot equity (%)	-7,48%	14,1	17,9	16,6
<b>Debt/ Equity Ratio</b> adj. tot. liabilities / adj. tot. equity	6,9	2,4	3,8	3,3
<b>Operating Expense/ Loan Portfolio</b> (operating expense + In-Kind donations) / avg gross loan portfolio (%)	4,9%	16,4	22,2	17,0

ECA Large, Eastern Europe and Central Asia, Gross Loan Portfolio (US\$) > 8 million

### Important matters of the *benchmarking*<sup>4</sup>

For benchmarking purposes RFC should be considered within the above peer groups (ECA large, non-bank financial intermediaries and individual lending)<sup>5</sup>. The main comments concerning the benchmark analysis are:

- **Average loan balance per borrower** is not directly comparable to other peer groups, being higher for RFC due to the SCAs lending. However, when comparing RFC to apex institutions, the benchmark seems adequate;
- **PAR30** shows a good portfolio quality, in line with the peer group of ECA large and even better than the other peer groups composed by financial self- sustainable (FSS) institutions;
- **AROE** is well behind the performances of other peer groups and presents a negative value. This is especially due to the fact that it has been calculated under the MIX standard adjustments, (for example adjustment related to the cost of funds). In order to better evaluate the financial sustainability of RFC, we have made an ad-hoc cost of funds adjustment for the ratios presented and analyzed in the rating report (see please Annex 2 and Chapter 6), considering the capital market in which RFC is involved and the opportunity to access further sources of funds;
- **Debt/equity ratio** is quite high compared to all other peer groups, but the long-term nature of borrowings received by RFC has to be taken into account;
- **Operating expense ratio** is not directly comparable to other peer groups, since RFC lends especially to SCAs and therefore it shows an higher average loan balance per borrower. In any case 4,9% is a very good result in efficiency, compared also to the Moldavian commercial banks.

<sup>2</sup> [www.mixmbb.org](http://www.mixmbb.org)

<sup>3</sup> The MBB adjusts the financial data to produce a common treatment for the effect of: a) inflation, b) subsidies, and c) loan loss provisioning and write-off (see *MBB*, Appendix I: Notes to Adjustments and Statistical Issues).

<sup>4</sup> As for the benchmarking about Charter Type and Credit Methodology, data are related to the financial self- sustainable (FSS) institutions.

<sup>5</sup> Further comparisons can be made looking at Microfinanza's rating reports of RFF (Albania) and KRK (Kosovo) available on the CGAP web site [www.mfirating.org](http://www.mfirating.org).

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# 1. External Environment and RFC positioning

## Institutional background

**Rural Finance Corporation (RFC)** was established in 1997 as a **non-bank financial intermediary**, under an agreement between the World Bank (WB) and the Government of the Republic of Moldova and legally incorporated as an open joint-stock company. RFC started its operations implementing the Rural Finance Project, designed by the WB, with the purpose to become an apex institution for on-lending to Savings and Credit Associations (SCAs) and to support rural development through the provision of credit and technical assistance. SCAs are now the main shareholders, holding the 99,6% in RFC voting share (from a 80% held by the 9 founders SCAs in 1997), while the remaining shares are held by the Government of Moldova and by the staff. During the first several years, RFC lent only through SCAs, providing more than US\$ 30 million reaching 35.000 SCA members and thus becoming the second largest lender to small-scale agricultural and rural sector after Agroindbank. Since late 2001 RFC has also been involved in direct lending activity, serving almost 200 clients. These are farmers and rural entrepreneurs, as well as registered businesses, corresponding to a portfolio of around US\$ 2,8 millions. So far resources for lending have been internationally borrowed funds. RFC partners include many well-known international organisations: the **World Bank** and **CGAP**, International Fund for Agricultural Development (**IFAD**) and US Agency for International Development (**USAID**) among others. Since starting its activity, RFC has been operating from a head office located in Chisinau, using intensively mobile credit officers. From 2003 a process of decentralization has started with donor support and assistance (Swedish International Development Agency **SIDA**, **USAID/CNFA**) leading to the creation of 8 regional offices. Decentralization represents now the main issue, in order for RFC to grow along with the market and keep its market position.

## Macroeconomic context

Since 1999, Moldova's economic performance has been commendable, in contrast to its deteriorating performance during the early years of the 1990s. After starting out at independence in 1991 as a middle-income country, **Moldova is still the poorest nation in Europe**. Its **GDP per capita** of US\$ 570 (December 2003) is significantly below the average for the Commonwealth of Independent States (CIS) and the Central European countries. In addition,

### Sovereign risk<sup>6</sup>

Moldova	Foreign currency		Domestic currency	Rating Outlook
	Short term	Long term	Long term	
<b>MOODY'S</b>	na	Caa1	Caa1	stable
<b>S&amp;P</b>	na	na	na	na
<b>Fitch</b>	B	B-	B	stable

Moldova is now one of the region's most heavily indebted countries with a debt per capita of US\$ 397.<sup>7</sup> Moldova's transition to a market economy has

### Moldova

Macroeconomic Indicators	Dec01	Dec02	Dec03	Jun04
Exchange rate in US\$ (end of period)	13,1	13,8	13,2	12,0
Inflation rate (end of period)	6,4%	4,4%	15,8%	12,2%
Deposit rate	20,9%	14,2%	12,6%	14,0%
Lending rate	28,7%	23,5%	19,3%	20,0%
Real GDP growth	na	12,3%	6,3%	6,1%*
GDP per head (US\$)	400	450	570	na

\* 6,1% growth in January-March 2004

Source: International Finance Statistics, EIU. na = not available

<sup>6</sup> Scales used: **MOODY'S**: Long term - AAA, AA1, AA2, AA3, A1, A2, A3, Baa1, Baa2, Baa3 (Investment grade), Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C (Speculative grade); Short term - Prime-1, Prime-2, Prime-3 (Investment grade); Not Prime (Speculative grade); **S&P**: Long term - AAA, AA, A, BBB (Investment Grade); BB, B, CCC, CC (Speculative grade); SD (Selective Default); D (Default) - Rating from AA to CCC may be modified by a + or -; Short term - A-1(+), A-2, A-3 (Investment Grade); B, C (Speculative Grade); SD (Selective Default); D (Default) **Fitch**: Long term - AAA, AA, A, BBB (Investment Grade); BB, B, CCC, CC, C (Speculative grade); DDD, DD, D (Default) - Rating from AA to CCC may be modified by a + or -; Short term: F1, F2, F3 (Investment grade); B, C (Speculative grade); D (Default).

<sup>7</sup> Source: "Country Brief – 2004" by the National Statistic Offices and World Bank staff estimates.

been difficult, experimenting a severe economic collapse following the break-up of the Soviet Union. After a decade of decline, GDP growth has averaged more than 6,7% a year. Although further strong real GDP growth of around 5% is expected in 2005, it will continue to be driven overwhelming by consumption, fuelled by large inflows of remittances from Moldavians working abroad, as well as by election-related wage increases. Important structural reforms (pension reform and privatization) are now giving their positive impacts on the economy, fostering recent improvements in Moldova's performance. **Inflation** is unstable. It was brought down from 18,5% in 2000 to 4,5% in 2002 but increased in 2003 up to 15,8% and fell to 12,2% in June 2004. Moreover, inflation is expected to trend further downwards, falling at the end of 2004 to 10%. The **exchange rate** has been depreciating for various years, and by March 2002 the Moldovan Leu (MDL) had depreciated by 12% in real term since end-2000. An opposite trend emerged in the last years: starting from 2003 the MDL strengthened in both nominal and real terms against the US dollar, reaching a 10% appreciation as of May 2004. Although further moderate nominal appreciation is expected in 2005, the MDL will still remain weaker in real terms than it was in 2000-02. The **currency's relative strength** in recent years is partly a reflection of improved macroeconomic stability in Moldova and the region as a whole, but is primarily a consequence of large-scale foreign currency remittances.

**Moldova's economy relies on agriculture and agro-processing** as most of the country's territory is represented by agricultural areas. Privatization of agricultural land was completed in 2000. As a result about 800.000 private farmers became landowners.

On the political side, the current administration will continue with efforts to integrate more closely into the European Union, following the recently finalized Action Plan which is the base of Moldova's participation in the **EUs European Neighbourhood Policy** (ENP). In the meanwhile, political elections are falling due in the first months of 2005, and this will probably create considerable political turmoil.

#### Financial and banking system

As of June 2004, the banking system includes 16 commercial banks and is highly concentrated, with the six largest banks accounting for over 75% of the total assets. Among the main commercial banks, **Agroindbank** represents the only actor which is involved in the microfinance rural market. In fact, the microfinance portfolio does not represent an attractive niche for commercial banks, due to tighter supervision by the National Bank (NBM) linked to the unsecured lending, the low margins and the riskier nature of start-up clients. **Overall, Moldavian banking system is quite developed and capitalized**, with a capital adequacy ratio in 2003 of 32% (well above the NBM's minimum of 12%). Boosted by rising deposits and improved macroeconomic conditions, the outstanding loan portfolio in 2003 increased by almost half in nominal terms to equal US\$ 134 millions even if it still represents a small share of the GDP. After a banking crisis in 1991, people tend not to trust banks and neither SCAs and **savings are still low**, even if on an upward trend. Deposit rate on savings averages around 16-17%, while commercial lending interest rate averages around 23-25%.

**National Bank is not considering the microfinance sector** and it is not currently willing to supervise microfinance institutions. Nevertheless **RFC is lobbying the NBM with WB support and it is also gaining a good image in the financial market thanks to their good operations**. Moreover an interesting collaboration between commercial banks and microfinance is foreseen thanks to the development of an USAID guarantee scheme designed to open credit lines in favour of MFIs.

#### Microfinance sector and the network of SCAs

Moldavian microfinance sector as of June 2004, comprises three microfinance institutions (**RFC, ProCredit and MicroInvest**) and a growing network of SCAs operating in rural areas (currently there are more than 500 operating SCAs, 475 in 2002 and 369 in 2001). RFC is lending mainly to SCAs and also directly to micro-entrepreneurs in rural areas, while the other 2 MFIs are serving mainly an urban target.

Although the sector is not much developed in terms of information exchange facilities (**there is not a Credit Bureau**), competition in the microfinance sector is not really there for the moment, also due to differences in targeting policy. Possible competition from commercial banks could increase,

as the banks become more advanced in microlending and this portfolio more profitable. Nevertheless, the market is expected to grow 20% on average per year, assuming the availability of financial resources in the international and national market. **The risk of over-indebtedness could appear in the medium-long run, if the information exchange facilities will not develop.**

In order to develop a SCAs network providing financial services in Moldavian rural areas, in 1997 the **World Bank Rural Finance Project** was launched. In the last 7 years, World Bank and other donors<sup>8</sup> provided assistance and support to the establishment of the SCAs system<sup>9</sup> and **a good network of actors has developed, including development agencies** (acting as incubators for new businesses and start-ups), the **National Federation of SCAs** (NFSCAs), which represents the SCAs at legislative level and offers training and consultancy and the **State Supervisory Body** (SSB) in charge of supervision.

In 1997, two local development NGOs were established with the support of international organizations in order to create local capacities for assistance to SCAs: the **Moldovan Microfinance Alliance** (MMA) and the **Rural Development Centre** (RDC). These 2 development institutions have training programs for SCAs, have regional offices, perform the monitoring of the SCAs' activity and offer services to SCAs' borrowers, to SSB and to NFSCAs.

SCAs are non for profit institutions that provide financial services exclusively to its members in strict conformity with the financial prudential rules set by the State Supervisory Body. All SCAs have a business oriented approach and a large number of them are sustainable (they ask for high interest rates that allow accumulation of sufficient income to cover operational costs and ensure capitalization). SCAs' sources of funds are: membership shares, savings from members and credits from financial institutions. Nevertheless, until now, **the main fund sources for SCAs are the loans provided by two commercial creditors (RFC and a local commercial bank, "Moldova-Agroindbank")**, which are on-lent to SCAs members.

#### Regulation and supervision

In June 2004 a **new law on microfinance** has been approved by the Ministry of Finance. Under this general regulation, **three MFIs have been recognized: RFC, ProCredit and MicroInvest**, which will probably have specialized by-laws in the future. At the same time, within the existing legal framework, **MFIs are not empowered to accept deposits**, mainly because of a lack of supervision. RFC is not even entitled to take deposit even from SCAs shareholders. Being a non-bank financial institution, in the form of a joint stock company (JSC), RFC is not under the incidence of the Law on Financial Institutions and it is not supervised and regulated by the National Bank. Instead, it reports to the Ministry of Finance and international lenders under the agreements signed with them. Due to its JSC connotation, RFC is regulated by the Law of Joint Stock Companies, Law on Entrepreneurship and Enterprises, and other general legislation and it is submitted to further supervision by the National Commission for Capital Markets.

The legislation on Savings and Credit Associations is based on a specific "**Law on SCAs**" introduced in 1998 and on the "**Financial prudential rules in the activity of SCAs**" developed pursuant to the Law on SCAs (a new updated version will be in force from January 2005).

The **State Supervisory Body** (SSB) is in charge of supervision and monitoring for both MFIs and SCAs. The SSB was founded in September 1998, in accordance with the Law on SCAs and it is financed according to the State Budget legislation. The SSB performs control of the associations' activity in cases of violation of the Law on SCAs and Financial Prudential Rules. All SCAs comply with legislation provisions, met accounting requirements and submitted quarterly financial statements to the SSB. However, it is worth to stress that **SSB supervision is currently weak due to its scarce resources**. As the SCAs network is increasing, the World Bank is going to support SSB by providing it with funds.

<sup>8</sup> USAID, DFID, WOCCU, Soros Foundation, GTZ

<sup>9</sup> WB support was provided mainly in the following activities: drafting of legislation, financial prudential rules, and accounting standards for SCAs; establishment of the SCAs apex financial institution (RFC); establishment of the licensing and supervision system for the SCAs network; set-up of local NGOs that focused on service and training to SCAs.

Market positioning

**RFC is positioned on the market as the leader provider of rural credits.** As of June 2004, SCAs loans represent almost 80% of the RFC total portfolio. Although its focus has been lending to SCAs, RFC is now pursuing a balance of 50-50 between SCAs lending and direct lending. In a market characterized by a huge unsatisfied demand and low competition, RFC is now facing the process of decentralization and growth, thanks to the opening of 8 regional offices. The main competitor is **Agroindbank**, a commercial bank, which is lending about US\$ 10 millions to SCAs through its own resources. However, at the moment, its involvement is mainly recognized as a “social project” for the low profitability of the microfinance portfolio and for tighter supervision requirements. The SCAs are not attractive clients for the other local commercial banks, because the credit requests are very small and are unsecured. **ProCredit and MicroInvest**, the other 2 MFIs in Moldova, serve mainly an urban target even if they are gradually increasing their share of agricultural portfolio<sup>10</sup>.

**As for now, competition does not represent a threat for RFC**, but it should be noted that if microfinance portfolio profitability will increase and regulations change, Agroindbank together with other commercial banks, could be attracted by this potential market.

**RFC cooperates closely with development agencies** (especially with RDC) focusing on services and training provision to SCAs. By using such a mechanism, SCAs benefit from lending services offered by financial institutions and training, consulting and assistance provided by development NGOs. This cooperation ensures a high level of loans repayment by SCAs members and by SCAs themselves. **RFC is also working closely with NFSCAs** and in part with SSB.

RFC presents other relevant **competitive advantages**:

- Rapid and flexible (non-bureaucratic), but strict and transparent in procedures;
- More flexible in collaterals and terms;
- Good quality of service according to the credit methodology for SCAs, which includes support (advices and informal assistance) to SCAs management in their activities.

Main **competitive disadvantages**, potentially affecting RFC while the market develops are:

- Lack of cross-selling services compared to the banking services offered by Agroindbank (term deposits, bank accounts, money transfers, credit cards etc.);
- Credit portfolio diversification.

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<sup>10</sup> For instance, ProCredit started in 2004 its agricultural lending activity and counts now on 400 loans disbursed to large rural entrepreneurs and registered businesses

## 2. Governance and operational structure

### Ownership and Governance

RFC is a joint stock company. Since the Statutes do not allow other persons, different from SCAs, staff and the State, to become shareholders<sup>11</sup>, RFC is also comparable to a “cooperative type institution”, where the clients are at the same time owners. As of June 2004, RFC’s majority shareholders are 298 Savings and Credit Associations (SCAs), that own 83% of the total amount of share capital with 99,6% of voting right. Other shareholders are RFC staff (16,6% in the share capital) without voting right (preferred shares) and the Government (0,3% in the share capital).

OWNERSHIP						
	Number of shareholders	Number of shares	Amount (US\$) <sup>*</sup>	% of total amount	% of voting	Type of shares
<b>SCAs</b>	298	25.342	105.652	82,2%	99,6%	voting
<i>of which</i>	5	254	1.063	0,8%	0%	non-voting
<b>RFC staff</b>	15	5.107	21.367	16,6%	0%	non-voting
<b>Government</b>	1	90	377	0,3%	0,4%	voting
	<b>319</b>	<b>30.793</b>	<b>128.459</b>	<b>100%</b>	<b>100%</b>	

\* Exchange rate in US\$ as of June 2004 (end of period)

Initially, RFC has been founded by 9 SCAs (80% share capital) and the Government of Moldova (20% share capital). At the moment the Government is keeping a small percentage of the share capital but it will probably sell it to SCAs shareholders in the next future.

So far, SCAs shareholders have contributed to rapid and sound growth of RFC buying the shares issued by the institution. The last issue of additional shares to existing SCAs shareholders in September/October 2004 has been successful and doubled the capital. Nevertheless **the capacity of capitalization through the SCAs shareholders is still limited**. On the other side there is an increasing SCAs sector (both in number and in size) which should absorb the additional shares issued by RFC in the next future allowing the institution in keeping a fair capital adequacy. As other alternatives to increase the level of capitalization, RFC is looking for capital donations. Another alternative could be accepting commercial clients other than SCAs to be shareholders of RFC, but this option will be considered only if the capacity of SCAs to capitalize RFC proves unsatisfactory in the long run. RFC is not considering this option now as a desirable one, because as a consequence SCAs would not keep the majority share and could be a risk for the governance in the future.

RFC is governed by a **Board of Directors** representing the interests of shareholders. The BoD includes 3 representatives of SCAs shareholders, a Government representative and the President/CEO of RFC. The CEO sits in the Board in order to explain and support the management’s point of view and he is a voting member except when a conflict of interest is envisaged. Besides the Statutes, in order to avoid conflict of interests, it does exist an internal regulation for the administration and the structure of the BoD. All the members are locals. The CEO and the other members of the BoD have different backgrounds and a satisfactory experience in microfinance. The representative of the Government has also an extensive experience in accounting and business management (the Government is interested in keeping a seat in the BoD). **The Board of Directors is responsible for strategic issues and ultimate decision-making**. The Board physically meets at least quarterly, and the members have a continuous internal communication with the President CEO (especially the Chairman). In particular cases, participation from other top managers (especially the financial director, who is also the Deputy of the President) may be required. Co-operation and exchanges between the Board and the management seem to be effective.

<sup>11</sup> The Statutes of RFC limit to 5% the maximum amount of voting shares which may be held by a single shareholder.

Board of Directors		
Members	Charge	Background and current profession
<b>MR. VASILE MIRZENCO</b>	<b>Chairman since 1997</b>	Tataresti Mayor/Head of local public administration. Private farmer and director of Tataresti village farmers association; Chairman of Moldovan Farmers Federation, since 1997 Chairman of the SCA in Tataresti.
<b>MRS. LUCRETIA CIUREA</b>	<b>Member since 2004</b>	Diploma in business management and accounting. Senior specialist in Foreign Debt Depart. of the Ministry of Finance (MoF), accountant for the WB Project Implementation Unit within the MoF, private sector development projects. Since 2001 Head of External Financing and Debt Department of the MoF.
<b>MR. ALEXANDRU BOSTAN</b>	<b>Member since 2004</b>	Senior advisor and economist in large agricultural farms and agribusiness companies in Colicauti, senior economist of Briceni region public administration, general manager of a local agribusiness company in Colicauti. Since 2004 Executive Director of Colicauti SCA. Private farmer.
<b>MR. GHEORGHE FILIP</b>	<b>Member since 2004</b>	Deputy director of Dusmani village collective farm, mayor/head of local public administration in Dusmani. Since 1999 Chairman of Dusmani SCA; since 2004 Mayor of Dusmani; since 2003 director of Dusmani farm service cooperative.
<b>MR. ION GANGURA</b>	<b>Member since 2000</b>	President of the Moldovan Stock Exchange, consultant to WB Rural Finance Project in Moldova, Director of RDC (1998-2000), Vice President of Rural Finance Corporation (1998-2000). <b>Since 2000 President/CEO of RFC.</b>

Moreover RFC presents in its organizational structure a **Censor Committee** (constituted by 3 members elected by the General Assembly of shareholders), which is the control body. It controls its financial and economic activities and the compliance with Statutes and the legislation in force. The main issues of its audit report are presented to the General Assembly.

#### Management and staff

As of June 2004, RFC works with **29 staff members**, out of them **13 are loan officers**. Three loan officers are specialized in direct lending, while starting from June 2004, the 10 loan officers previously dedicated only to SCAs lending have started also to manage direct lending portfolio.

Personnel	Dec01	Dec02	Dec03	Jun04
<b>Total</b>	<b>19</b>	<b>27</b>	<b>30</b>	<b>29</b>
<i>Loan officers</i>	9	14	14	13
<i>Other staff</i>	10	13	16	16

RFC's top management includes, apart from the President-CEO, the Financial Director (CFO), also deputy of the President, the Head of Analysis and Strategy Department and the Head of Credit Department. They meet weekly.

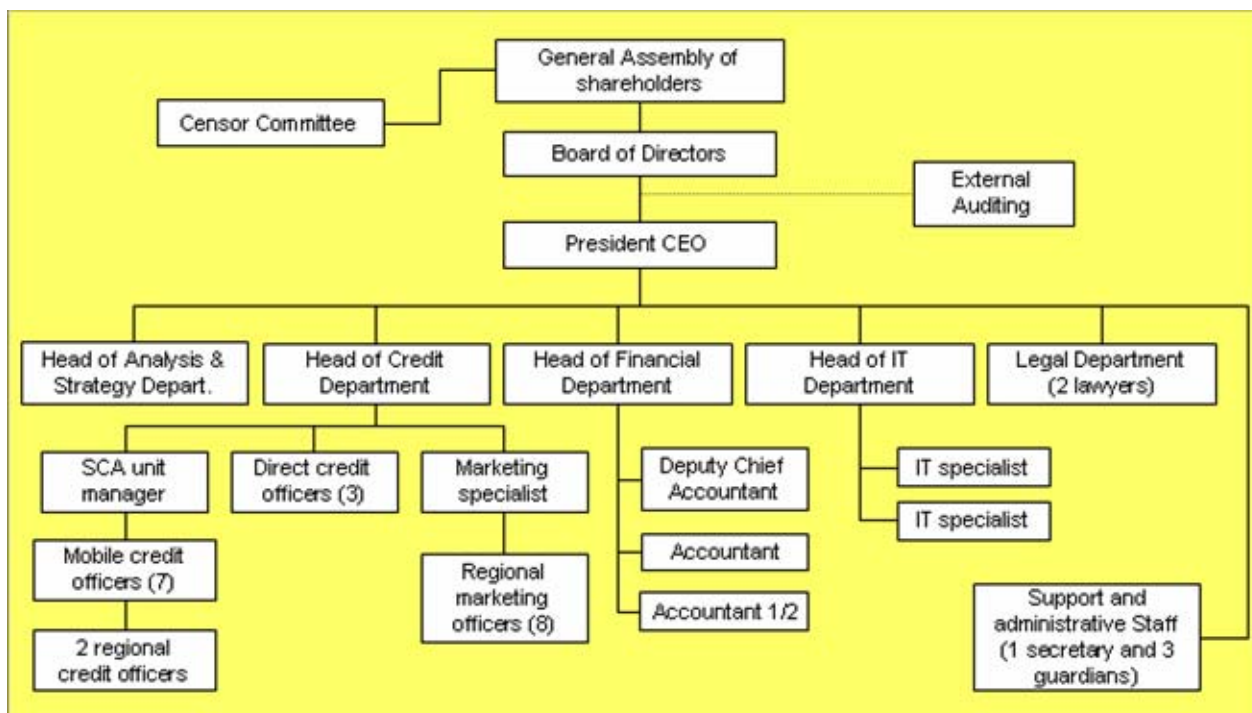
The CFO deals with current and strategic financial operations, while supporting CEO in fund raising and negotiations. This area is critical for RFC, given the shortage of funds at national level and the limits in taking deposits.

Since March 2003, 8 regional marketing officers (at the moment not productive) are not on the payroll of the Corporation, but are paid by SIDA<sup>12</sup>. The support of SIDA will last until February 2005.

**Internal control seems to be accurate, even if it does not exist an Internal Auditing function.** As the Corporation grows and decentralizes, the executive management is aware of the importance of a dedicated function and it has already planned to introduce it next year. The top management is also aware that other functions, as for example risk management, still have to develop along with the expansion of the institution.

<sup>12</sup> Sida, the Swedish International Development Cooperation Agency, is a government agency.

Organization Chart of Rural Finance Corporation, as of June 2004



Keeping quite a **lean and centralized structure**, the organization is functional and competences are well divided within the management with an effective internal control. In general, the institution can rely on a **strong management structure**, resulting also from an accurate recruitment.

#### Organization and structure

RFC is based in **Chisinau**, where it has its headquarters, that are also the only operational branch for the capital city and surrounding areas. At the moment RFC presents a **limited level of decentralization** and it uses mobile credit officers in order to reach its clients.

As a first step to decentralization<sup>13</sup> in March 2003 RFC has hired regional marketing specialists and trained them, while **regional centers** were opened and became operational during February-June 2004. The first objective of these offices is to promote RFC products, support and inform SCAs and direct clients and prepare them on how to get RFC's loans. Lately, along with the institutional development, these centers will be empowered to provide the full set of services available at the RFC head office now. In the future, as a result of the decentralization effort, regional offices will not only give a support close-by the SCAs but will also penetrate the market in search for direct clients. Within the project for the development of regional offices, 8 regional marketing officers were employed. From 2005 RFC strategy is planning to decentralize the lending activity at branch level, delegating the credit decision process within a local Credit Committee up to a maximum lending amount of US\$ 5.000.

All administrative and accounting issues are now centrally managed. The whole information flow is managed, processed and monitored at a central level. As we have already remarked, along with future institutional development, regional offices are supposed to gradually overtake some of the administrative functions as far as they will become **cost and profit centers**.

Concerning **manuals and procedures**, work has still to be done in terms of **personnel policies and procedures** as the institution grows and decentralizes. More formalization and standardization will be needed as for **internal control and risk management**.

<sup>13</sup> RFC has been assisted by SIDA and USAID/CNFA.

Accounting policies and procedures

Financial Statements as for the last 3 years were clean and no significant exceptions were noted according to the external auditors opinion. RFC have been audited by international recognized auditing company. Please see Annex 5 for more detailed information on RFC's accounting policies.

Information technology and MIS

Currently, 3 people are working within the IT department. They are responsible for the system, security and maintenance.

The **loan tracking system "EVIDA"** (version 3) has been designed and updated internally, tailored on RFC needs since 1998. It has been developed in Borland Delphi (database Firebird). The software is powerful and can process large volume of data by managing both SCAs and direct lending. A wide range of reports can be generated on request. There is a very good flexibility in the production of information. The IT department in collaboration with the executive management is in the process of creating new standard reports. Credit officers have direct access to the loan tracking system, which is user friendly.

The **accounting system, 1c enterprise**, is managed with another software. The integration of the two systems is at the last stage of implementation (testing phase) with positive results.

**Security system** seems to be quite **effective**, with frequent back-ups (in different places) and security access through passwords according to different levels. It does exist a user manual.

According to the RFC's medium-long term strategy, the MIS will be integrated (on-line) with the regional offices.

Personnel policy

RFC does not have a **Human Resources Department**, due to the lean and centralized structure of the institution. The CEO (supported by the Head of Analysis and Strategy Department) has been in charge of this function, including proposals of policies to put in place, recruitment and dismissals, evaluation of training needs and salary scale.

In general, the **quality of personnel of the institution is good** at all levels and a **very low turnover** is confirming that the staff itself is satisfied with the institution. RFC can choose its staff especially among the best RDC staff where people don't have a stable contract. As a consequence of that RFC can often recruit experienced persons who already know the SCAs market.

At the moment **it doesn't exist a personnel policies and procedures manual**. Management is aware of the importance to define a formal motivating human resource policy in order not to loose the positive atmosphere, also considering the fact that the institution has already started a process of decentralization with good growth expectations and that it will cope with high future workloads. **Work has still to be done** not only in terms of drafting the manuals but also in defining a succession plan, particularly relevant in the case of some key figures, and career paths.

Concerning **salary scale**, generally it is **in line** (or higher) with Moldavian microfinance and banking system, while **no incentive scheme are provided** to loan officers and for the management. The Strategy Department is currently in the process of preparing an incentive scheme policy for loan officers.

Staff is generally young and well prepared and **training has a relevant role** within the institution. RFC's **personnel have received extensive training**. In its strategy RFC foresees to provide minimum 5 days per year of training to the staff and it will be a combination of internal and external training.

### 3. Lending operations

#### Credit policy

RFC credit policy is focused on providing credit and related assistance to **rural areas**, being the leader and the only one which focuses its activity exclusively on rural area. The initial purpose was to create an **apex institution**, lending to **Savings and Credit Associations (SCAs)**, which on-lend to their member, however, since late 2001 RFC developed also products for **direct lending to registered businesses**. Over time, special focus has been maintained on start-ups and businesses formed by SCA graduates.

Since its inception, RFC has adopted clear and sound credit policies, intended both to fulfil international lenders' requirements, national legislative requirements and its own mission:

- Product diversification according to the nature of special purpose of funds received<sup>14</sup>;
- Strict respect of Financial Prudential Rules of RFC and Financial Prudential Norms of SCAs in terms of maximum loan amount, security and eligibility criteria for SCAs;
- Careful management of seasonality and efforts to reduce it.

Credit products definitions are reflecting the source of funds or the target attended (WB, IFAD etc.)

Credit products						
	RISP LG	RISP LS	FIDA	Own Funds	SCAs ST	SCAs LT
<i>Credit methodologies</i>	Individual	Individual	Individual	Individual	Group	Group
<i>Currency of the credit</i>	MDL	MDL	MDL	MDL	MDL	MDL
<i>Type of interest</i>	Declining balance	Declining balance	Declining balance	Declining balance	Declining balance	Declining balance
<i>Min. interest rate (%)</i>	18,2	18,2	18,2	18,2	18,5	18,5
<i>Max. interest rate (%)</i>	18,2	18,2	18,2	18,2	18,5	18,5
<i>Average interest rate (%)</i>	18,2	18,2	18,2	18,2	18,5	18,5
<i>Description of commissions</i>	1%	1%	1%	1%	0	0
<i>Min. credit amount (US\$)</i>	2.000	2.000	2.000	2.000	na	na
<i>Max. credit amount (US\$)</i>	55.000	30.000	15.000	55.000	250.000	250.000
<i>Max credit amount for the first loan (US\$)</i>	55.000	30.000	15.000	55.000	according to prudential norms	according to prudential norms
<i>Average credit amount (US\$)*</i>	22.102	8.886	4.798	7.611	17.236	7.145
<i>Min. loan maturity (months)</i>	na	24	na	na	na	na
<i>Max. loan maturity (months)</i>	180	180	180	24	12	36
<i>Average loan maturity (months)</i>	48	42	34,9	44,3**	11,0	28,2
<i>Periodicity of interests payments</i>	Quarterly, monthly	Quarterly, monthly	Quarterly, monthly	Quarterly, monthly	Yearly	Yearly
<i>Periodicity of principal payments</i>	Quarterly, monthly	Quarterly, monthly	Quarterly, monthly	Quarterly, monthly	Yearly	Yearly
<i>Grace period (months)</i>	36	36	60	na	na	na
<i>Collaterals (% loan covered)</i>	130%	100%-130%	130%	130%	No	No

\* Recomputed by Microfinanza Rating according to the figures received from RFC as of June 2004

\*\* This is due to loans which were submitted for examination to be refinanced by RISP credit lines, and which will move into other product categories

<sup>14</sup> Lending to rural areas has been supported by 2 international projects: **World Rural Investment and Service Project (RISP)** and **IFAD Rural Finance and Small Enterprise Development Project**, both providing credit lines and client

Credit products

The above table shows the features of the credit products currently provided by RFC.

RFC is lending to two main types of clients, offering them different products (short term, medium-long term etc.):

- **Savings and Credit Associations of citizens (SCAs)**
- **Direct borrowers.**

**SCAs lending** currently consists of two types of loans: short term working capital loans (up to 1 year), normally for purchasing farm inputs, and medium term loans (up to 3 years), for acquiring small-scale equipment, tools, animals breeding and small investment. The Financial Prudential Rules of RFC stipulates that the maximum loan to one SCA must not exceed US\$ 250.000.

Since late 2001 **direct lending** has been introduced, which includes registered private farmers or rural entrepreneurs, as well as registered businesses, LTDs, cooperatives. Out of the total number of direct lenders applications, 80% comes through development agencies channel.

Activities financed included investments in productive assets and permanent working capital, such as agricultural machinery, processing equipment, animal breeding, handicraft workshops, farm stores, perennial plantations and so on. Updated manuals exist for both lending methodologies: “Operations manual for lending to SCAs” and “Operations manual for direct lending”, containing detailed eligibility criteria to be subscribed. Further limits exist regarding the concentration of portfolio: the net outstanding loans to one person or to a group of persons acting together shall not exceed 25% of RFC equity and the 10 bigger loans can not be more than 50% of total portfolio.

Procedures for loans issuing

RFC has a **rapid process for loan disbursing**, which is on average 10 days for direct borrowers and between 3-5 days for SCAs. This represents a good and competitive performance of efficiency and quality of the service, compared to other microfinance institutions and banks.

The credit assessment procedure is correctly based on the careful **evaluation of the client’s repayment capacity** through a cash-flow analysis of the economic unit represented by the applicant and the study of the project business plan. SCAs also provide RFC with an asset/liabilities analysis and portfolio projections for the following year.

The **loan approval** is, as for the moment, made by the Credit Committee in Chisinau. Loans are disbursed by transfer of funds to the client’s bank account. Such a procedure avoids the direct handling of money by the loan officers improving their safety and reducing risk of fraud.

**Collaterals** are generally required only for direct borrowers. Nevertheless secured lending has been introduced as a new policy in SCAs for loans larger than US\$ 1.100, or in those SCAs where the economic potential of members has increased up to levels above current SCA loan ceilings. At the same time the risk of unsecured lending to SCAs is somehow limited by the risk fund created by each SCA (6% on short term loans and 8% on long term loans).

Overall, RFC is lending SCAs gaining a **5-7% margin on interest rates**. Interest rates paid to RFC by the SCA are about 18-18,5%, while interest rates to SCA members correspond to 23-25% and are pretty similar to commercial interest rates.

Other financial products

Two interesting innovative products have been tested in 2002: a “**plastic/smart card project**” and a “**mortgage loan for land purchase**”. Both the projects have been implemented thanks to donors support (CGAP and USAID), and have shown a good response in the market. However, due to a lack of funds, it has not been possible to continue and to develop such products.

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support. Both projects provided loan funds to a number of commercial banks in Moldova, while RISIP has been the main source of funding for RFC loan portfolio invested in rural businesses.

## 4. Assets structure and quality

### Assets structure

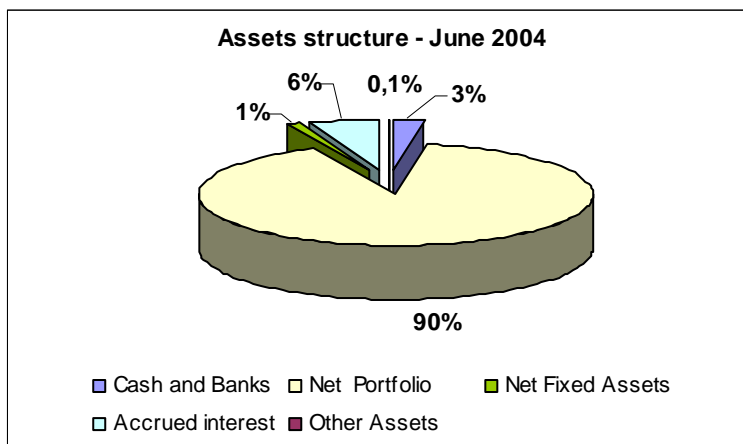
As of June 2004, RFC's **net portfolio represents 90% of total assets**, showing a very good concentration on lending activities. Nevertheless, **RFC assets structure is strongly influenced by the seasonality of its portfolio**: for example as of December 2003 the net portfolio was just 43% of total assets, while short term financial assets, represented by Government bonds, was 44%.

RFC is aware of this risk and that is why it is using government bonds as a liquidity management tool in order

to keep assets productive before re-investing them in loans<sup>15</sup>. RFC uses also an attentive cash-flow analysis and it is slowly reducing seasonality through direct lending and new long term loans to SCAs (in fact as of December 2002 the net portfolio was just 37% of total assets).

As of June 2004 **liquidity (cash and banks)** is 3%, which is a low level due to the fact that it is the period in which the institution is disbursing more. In general, the RFC policy is to keep liquidity and government bonds over total assets around 10%.

As of June 2004 **net fixed assets** represent 1% of total assets while **other assets** are less than 1%, showing a very low percentage of unproductive assets.



### Portfolio structure

As of June 2004 **the outstanding portfolio of RFC** is worth of US\$ 12,3 millions and it mostly comprises **SCAs loans** (short term and long term), representing almost 80% of the total portfolio. The share of **direct lending** has increased since its introduction in 2001, reaching 22% on average during 2003 and 20% for the first semester of 2004. According to the management, in a longer term perspective, RFC will reach 50:50 ratio between SCA portfolio and direct lending.

June 2004

Loan product	% of outst. portfolio	PAR >30 days	PAR > 30 weighted	number of loans	number of borrowers
RISP LG	8,1%	8,5%	0,7%	45	44
RISP LS	10,1%	0,1%	0,01%	140	140
FIDA	0,2%	0,0%	0,0%	6	6
Own Funds	2,0%	0,0%	0,0%	33	31
SCAs ST	57,5%	0,2%	0,1%	409	266
SCAs LT	22,0%	1,0%	0,2%	378	176
<b>TOTAL</b>	<b>100,0%</b>		<b>1,1%</b>	<b>1.011</b>	<b>488<sup>*</sup></b>

\* This is the total number of borrowers counting just once who has received more than one loan (that is why it is different from the sum of borrowers of all products).

**Growth of total active portfolio** has been very strong in 2003 (116,6% respect to December 2002). As for the current year, the growth rate has been lower (from July 2003 to June 2004 growth rate has been around 28%). In such an analysis it has also to be considered that the growth rhythm is also related to the seasonality of the portfolio and that RFC is in the process of reducing this seasonality.

<sup>15</sup> Government bonds are short with maturity ranging from 30 to 273 days. Yield on government bonds fluctuated from 10% to 21,42% during 2003. Government bonds are not taxable (while banking deposits are).

Both SCAs and direct lending present a **growing demand**. This is a good opportunity for RFC which has strong competitive advantages in the rural microfinance market, but a certain **lack of funds is limiting the institution**. In fact a “long term mortgage loan procedure” is ready to be delivered but financing sources are not available yet. Moreover, some of the potentially SCAs clients are actually served by Agroindbank. The shortage of financial resources joint to the dependency on international financial investors is also **limiting RFC in offering some products according to client needs**. In particular there are not resources for working capital loans to direct clients and the institution is currently seeking for alternative sources of funds (see chapter 7).

Portfolio features	Dec 01	Dec 02	Dic 03	Jul03-Jun04
<b>Gross outstanding portfolio (US\$)</b>	<b>1.712.102</b>	<b>2.196.092</b>	<b>5.001.283</b>	<b>12.269.030</b>
RISP LG	18.217	287.389	787.398	994.610
RISP LS	4.077	332.596	1.038.140	1.243.973
FIDA	0	0	0	28.785
Own Funds	0	176.655	190.578	251.159
SCAs ST	1.689.807	423.083	1.251.104	7.049.521
SCAs LT	0	976.369	1.734.063	2.700.982
<b>Gross outstanding portfolio (MDL)</b>	<b>22.412.950</b>	<b>29.208.048</b>	<b>63.275.928</b>	<b>143.396.874</b>
<b>Growth of active gross portfolio</b>	<b>64,1%</b>	<b>30,3%</b>	<b>116,6%</b>	<b>27,7%</b>
<b>Average disbursed loan amount (US\$)</b>	<b>12.055</b>	<b>16.434</b>	<b>11.652</b>	<b>14.711</b>
- SCAs	12.055	14.384	11.067	15.433
- Direct lending	na	13.027	16.740	11.176
- from SCAs to their own borrowers	174	183	232	248
<b>Av. disbursed loan size on per capita GDP</b>	<b>3011%</b>	<b>3654%</b>	<b>2043%</b>	<b>na</b>
<b>Number of active borrowers</b>	<b>156</b>	<b>190</b>	<b>400</b>	<b>488</b>
- Number of active SCA borrowers	22.000	27.000	32.000	33.914
<b>Number of active loans</b>	<b>231</b>	<b>274</b>	<b>566</b>	<b>1.011</b>

**RFC's entire loan portfolio is rural**, and consists in loans either to SCAs, which in turn on-lend to microentrepreneurs operating in rural and semi-rural areas, or to registered businesses. The pure focus on agriculture lending exposes the institution and its assets to potential risks since rural activities bear risks related mainly to weather and other external factors. Nevertheless RFC, aware of that, works on improving diversification of its direct loan portfolio as much as possible by lending not only to agriculture but also to other activities related to agriculture (as for example processing, construction, land improvement and transportation). For the same reason, also SCAs are diversifying their own portfolio by lending to different activities related to agriculture.

1st July 2004

By loan purpose	outstanding portfolio (US\$) <sup>a</sup>	% of outst. portfolio	PAR > 30 days	PAR > 30 weighted
<b>SCAs</b>	9.785.079	79,6%	0,5%	0,4%
<b>Agriculture &amp; food industry</b>	1.353.336	11,0%	3,1%	0,3%
<b>Transportation</b>	461.894	3,8%	9,7%	0,4%
<b>Construction &amp; land improvement</b>	4.184	0,0%	0,0%	0,0%
<b>Construction of real estate</b>	26.836	0,2%	0,0%	0,0%
<b>Industry and trade</b>	206.285	1,7%	0,0%	0,0%
<b>Purchase of real estate</b>	10.924	0,1%	0,0%	0,0%
<b>Processing of agricultural products</b>	302.323	2,5%	0,0%	0,0%
<b>Other</b>	148.628	1,2%	0,0%	0,0%
<b>TOTAL</b>	<b>12.299.488</b>	<b>100%</b>		<b>1,1%</b>

<sup>a</sup> The outstanding portfolio includes the portfolio under management

The number of total active borrowers is 488 as of June 2004 (400 in 2003 and 190 in 2002). As of June 2004, the average disbursed loan amount provided by RFC to SCAs is more than US\$

15.000, while to rural direct clients is more than US\$ 11.000. As far as outreach in depth is concerned, we have to take into consideration that SCAs, served by RFC, present an average micro loan of around US\$ 280 (which is about 50% of per capita GDP) showing good results.

**There is no client desertion** when we consider SCAs clients: during 2003 RFC didn't renovate the loan just to 2 SCAs, because they didn't observe the requirements (no similar cases in 2004). As for direct lending the drop-out ratio<sup>16</sup> is very low (2,47% as of the period Jan04-Jun04).

#### Loan portfolio quality

**Portfolio quality is quite good** with a consolidated **PAR30 of 1,1%** as of June 2004 (PAR30 has started in 2003 with 0,7% as of December 2003) and **write-offs** are non-existent. However, when we analyze RFC portfolio at risk, we have to take into consideration the lower than normal standards in microfinance frequency of repayments (yearly for SCAs and monthly/quarterly for direct loans).

Portfolio Quality Indicators	Dec 01	Dec 02	Dic 03	Jul03-Jun04
Consolidated PAR1	1,1%	3,0%	1,2%	2,0%
Consolidated PAR30	0,0%	0,0%	0,7%	1,1%
31-60	0,0%	0,0%	0,0%	0,0%
61-90	0,0%	0,0%	0,0%	0,0%
91-180	0,0%	0,0%	0,4%	0,4%
181-365	0,0%	0,0%	0,0%	0,6%
>365	0,0%	0,0%	0,4%	0,1%
Arrears rate (> 1 day)	0,0%	0,0%	0,9%	0,4%
Restructured portfolio	0,0%	2,9%	3,4%	1,7%
Provision expense ratio	3,0%	0,0%	-1,0%	0,2%
Loan loss reserve ratio	6,2%	4,9%	1,0%	2,6%
Risk coverage ratio (30 days)	na	na	130,6%	237,1%
Write off ratio	0,0%	0,0%	0,0%	0,0%

As of June 2004 there is a limited number of **rescheduled loans** (9 compared to 8 in December 2003), which represent 1,7% of total portfolio. Rescheduled portfolio presents a PAR30 of 20% as of June 2004. Even if rescheduling is made in exceptional cases and upon request, RFC has a special provisioning policy for these kind of loans (see Annex 5). This confirms soundness in the institution credit policies.

As of June 2004, the sum of the three categories of delinquency (bad debt, doubtful and overdue)<sup>17</sup> is around 0,4% on total portfolio that belongs to SCAs, showing **an healthy SCAs market**<sup>18</sup>, which represents 80% of the total loan portfolio of RFC. The regions<sup>19</sup> that experienced some problems were Orhei, Cahul, Hincesti and Soldanesti. In these rare cases the main cause of delinquency has been fraud within the management of the SCAs. However, RFC monitors carefully the risk of fraud of the management of SCAs. Moreover there also exists the control made by NFSCAs and by SSB.

**Overall portfolio quality seems to be very good** even if there are some potential risks:

- In the case of direct lending, the methodology is still new and **30% of the clients are real start-ups** (whereas other 50% is considered as extended start-up businesses being SCAs "graduates"). It has to be noted that start-ups are incubated by development agencies and RFC, aware of the risk of new businesses, carries out an attentive client evaluation.

<sup>16</sup> Measured as (number of active clients at the beginning of the period + number of new (first time) clients entering during the period – clients written-off during the period – number of active clients at the end of the period) / (number of active clients at the beginning of the period)

<sup>17</sup> In accordance with internal regulation the loan portfolio is classified as: standard, supervised, substandard, doubtful and bad debt.

<sup>18</sup> Also figures for late repayments from borrowers to SCAs is good, around 0,6%.

<sup>19</sup> RFC clients are located in more than 350 villages of Moldova which are in more than 30 regions.

Moreover, in the short term, a credit guarantee fund will be activated and it will cover 50% of the risk for the start-ups clients

- It seems that **SCAs management ability is still low**. Because of that, RFC constantly supports SCAs management in their activities as part of its credit methodology by giving them advices and informal assistance. Furthermore, NFSCA provides to SCAs formal training and the new Prudential Regulation for SCAs now obliges SCAs management to obtain a license to operate (provided by SSB).

**Risk coverage ratio** is high, 237% (on PAR30) as of June 2004. Nevertheless, **loan loss provisioning** seems to constitute an adequate protection.

Delinquency does not show any particular concentration by product and by loan purposes (see please tables in the previous paragraph).

As for **the portfolio by amount**, it has to be noted that delinquency in direct lending is mainly concentrated in the range of loans bigger than US\$ 33.470.

June 2004

By amount (US\$)	outstanding portfolio (US\$)	% of outst. portfolio	PAR > 30 days	PAR > 30 weighted
< 5.850	1.228.026	10,0%	0,5%	0,1%
5.850 - 33.470	6.968.599	56,8%	0,5%	0,3%
> 33.470	4.072.433	33,2%	2,3%	0,7%
<b>TOTAL</b>	<b>12.269.058</b>	<b>100%</b>		<b>1,1%</b>

**The direct lending portfolio of RFC is composed by medium and long term products** thanks to the existing external financial resources of RFC which have an adequate maturity and stability. Delinquency by term is concentrated on the medium term direct lending portfolio.

June 2004

By term	outstanding portfolio (US\$)	% of outst. portfolio	PAR > 30 days	PAR > 30 weighted
< 1 YEAR	7.038.580	57,4%	0,2%	0,1%
1 - 5 YEARS	4.550.161	37,1%	2,5%	0,9%
> 5 YEARS	680.317	5,5%	0,0%	0,0%
<b>TOTAL</b>	<b>12.269.058</b>	<b>100%</b>		<b>1,1%</b>

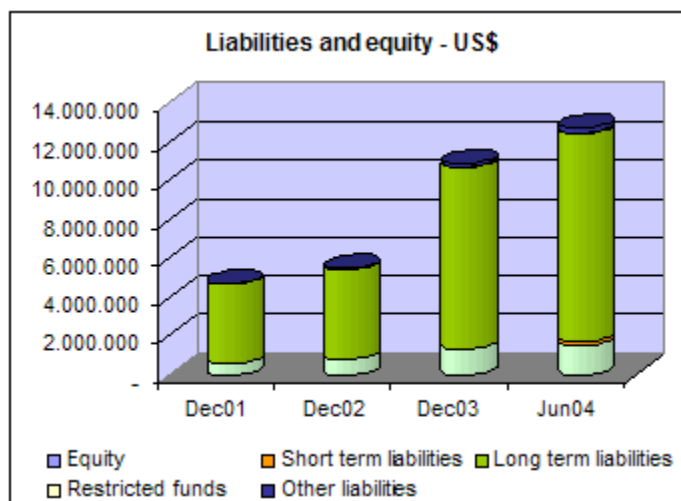
Finally, as for the direct lending portfolio (SCAs loans are unsecured) it can be noted that in June 2004 the delinquency is concentrated on loans secured by trucks as collateral.

Direct lending portfolio, June 2004

By collateral	outstanding portfolio (US\$)	% of outst. portfolio	PAR > 30 days	PAR > 30 weighted
TRUCKS	272.823	10,8%	16,4%	1,8%
REAL ESTATE	757.075	30,1%	0,0%	0,0%
UNSECURED	279.417	11,1%	0,0%	0,0%
ANIMALS & AGR. PRODUCTS	195.778	7,8%	0,9%	0,1%
EQUIPMENT	978.965	38,9%	4,1%	1,6%
OTHER	34.476	1,4%	0,0%	0,0%
<b>TOTAL</b>	<b>2.518.534</b>	<b>100%</b>		<b>3,4%</b>

## 5. Financial structure and ALM

To date RFC has based its growth almost completely on long-term borrowed funds received from international organizations directly to RFC or through Moldovan Ministry of Finance. In fact, shareholder's equity and retained earnings still have limited percentage in RFC financial structure (11,2% as of June 2004). This implies that the **debt/equity ratio** is high (7,3 in 2003 and 7,9 in June 2004) but it is mitigated by the long-term nature of the liabilities which have an average maturity more than of 18 years. Given the fact that the current liabilities are in national currency and are available on a long-term basis, RFC financial structure is not affected by **maturity gap and neither exchange rate risk**<sup>20</sup>.



To overcome the **dependency on international financial investors**, the backbone of RFC's strategy is access to additional and alternative financial resources at national and international level. Anyway it has to be noted that domestic banking sector it is still not trusting rural and unsecured microfinance market.

### Liabilities and ALM

Since its inception in 1997, RFC has always been dealing with **international financial sources of funds**. As of June 2004 RFC's total funding liabilities are equal to almost US\$ 12 millions, out of which 2% are short term loans and 85% are long term loans from international lenders. Although it is generally recognized by all stakeholders in the rural financial system that active savings mobilization and deposit taking are essential for long-term financial and institutional sustainability, the law on microfinance institutions in Moldova does not allow RFC to accept deposits. This limits possibilities for SCAs to contribute in a truly cooperative way to building RFC resources and additional functions and services that RFC could offer to its customers and shareholders.

So far the main lever to growth has been soft and long term **lending** from international operators, characterized for the long term nature of funds and for the interest rate they bear (linked to the average inflation rate plus a 1-2% spread)<sup>21</sup>. The **dependency on international financial investors** has limited RFC development not only in size, but also in quality and variety of products offered on the market. International lenders requirements have largely influenced RFC's loan products (in terms of target population to be served and range of products offered), while limited funds did not allow RFC to meet the borrowing needs of the clients.

**Cost of funds ratio** stands at 8,93% as of June 2004, which represents a sustainable level for RFC.

However the financial market in Moldova shows much higher interest rates than the international financial market in which RFC is presently borrowing its funds and so it doesn't represent a valid alternative for RFC in the short period. The national banking system is mainly characterized by low liquidity in national currency and unwillingness to provide loans to RFC. Despite this situation, future collaboration with the domestic banks is overseen thanks to the **guarantee scheme** developed by USAID for local commercial banks to open credit lines in favour of ProCredit and RFC.

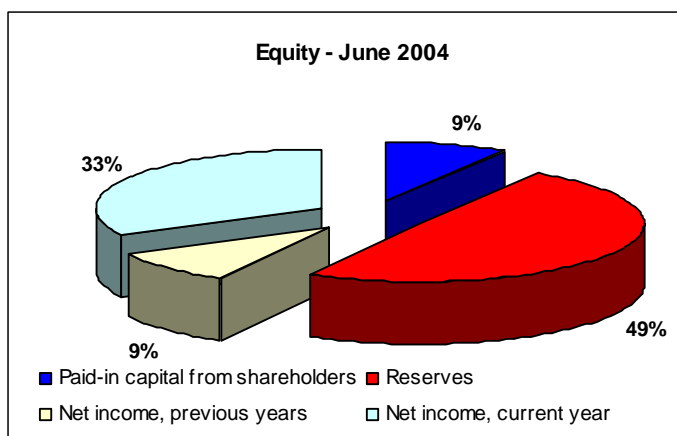
<sup>20</sup> As of June 2004 RFC holds a total assets denominated in US\$ (financial assets and cash and banks) worth of MDL 2.252.895 (US\$ 188.519).

<sup>21</sup> The average loan maturity is about 18 years and the interest rates are defined as a spread over the inflation rate. Only a loan is bearing a 0,75% interest rate, not linked in any way to the average inflation rate.

**Liquidity**<sup>22</sup> (cash and banks) over total assets stands at 10% as of December 2003 and at 3% as of June 2004. This difference is explained by the **seasonality of portfolio**, which implies that the bulk of reimbursements are falling due at the end of the year. Actually, the liquidity policy is strictly connected to the lenders agreement requirements and practically limited to use extra-liquidity to purchase government bonds and to keep bank deposits. **Liquidity management** at RFC does not require very sophisticated tools given the clear situation for funding sources and RFC not being deposit taking institution. For this reasons, RFC does not have a fully dedicated treasury department. **Interest rate risk** does not exist, as RFC is committed to maintain a 5-6% margin over the interest rate ceiling from international lenders and government. For this reason final borrowers pay variable interest rates depending on the interest rates RFC is paying to its lenders. It is also worth to note that RFC shows a good flexibility in adapting active interest rates to passive interest rates.

### Equity

**Total RFC equity is worth of about US\$ 1.454.300** as of June 2004 while it was US\$ 881.639 as of June 2003. In fact in 2003, RFC has accomplished a large issue of shares, increasing the share capital, as a result, more than three-fold during one year. Increasing its share capital is a part of the overall RFC strategy to capitalize and represents now an alternative source of financing other than domestic banking system or deposits.



The strategic plan of RFC describes a **good capitalization strategy** based on:

- Increasing profits thanks to sustainable interest margins, growth of loan portfolio, decentralization with future cost-profit centers;
- Increasing share capital through the issue of shares. Further issues of shares are foreseen for the year 2004, one of that has been just finalized in September 2004<sup>23</sup>, which brought total owners' equity up to US\$ 1.506.213
- Possible donors contribution.

Although RFC is not submitted to any specific requirements regarding capital adequacy standards, the CFO monitors and try to keep it at acceptable international recognized standards (capital adequacy ratio >12%). **Capital adequacy** ratio of RFC is 11,2% as of June 2004 (12,2% if it is calculated considering different weights for risk assets).

At the moment the Statutes of RFC do not allow other persons, different from SCAs, staff and the State, to become shareholders of RFC, and limit to 5% the maximum amount of voting shares which may be held by a single shareholder. The capacity of RFC equity **to support the growth** of the institution is strictly linked to significant efforts made by SCAs, which are themselves in the process of capitalization and this could eventually represents a limit for future developments. On the other side, the relatively high ROE makes investments for SCAs in RFC shares an attractive alternative and creates a waiting list for SCAs' application.

### Mobilization of savings

Within the present regulation, there is no room for development in mobilization of savings, meaning that a further burden on the National Bank supervision. Said that, it should not be forgotten that people in Moldova are not yet confident on the financial system and neither in SCAs and thus are reluctant to save. Furthermore, efficient and effective deposit management function requires specific experience, time and resources for developing the know-how and for setting a good management information system.

<sup>22</sup> It is worth to note that government bonds were 44% of total assets as of December 2003 and 0% as of June 2004.

<sup>23</sup> This is the largest issue of shares ever performed by RFC which doubled the share capital.

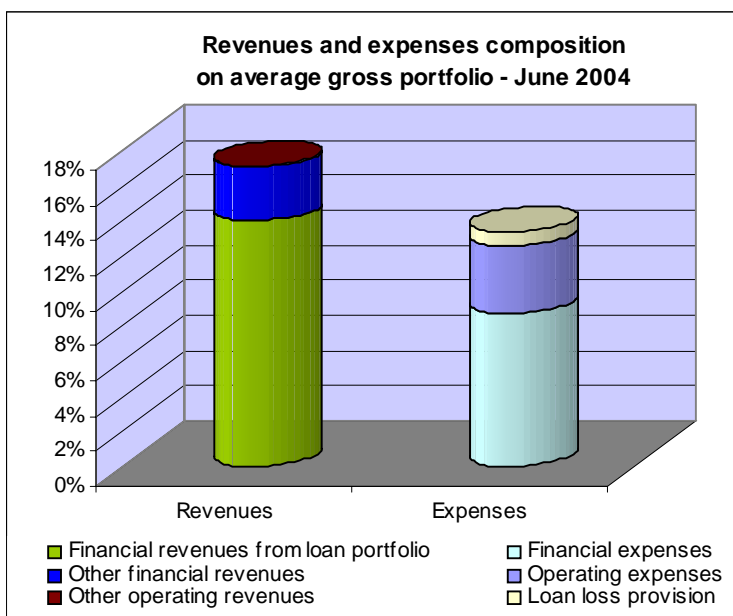
## 6. Financial and operational results

As of June 2004, RFC presents a high level of **ROE** which reaches 30,3% (37,5% as of December 2003, 33,5% as of December 2002) and a **ROA** of 3,2% (4,3% as of December 2003, 4,7% as of December 2002).

Concerning **sustainability**, it is worth to note that RFC has reached a good operational self-sufficiency with an **OSS** of 133,6% as of June 2004. **Financial self-sufficiency** ratio (FSS) is 84,5%<sup>24</sup>, showing a positive trend in the last years (from 73,6% in 2002 to 78,9% in 2003). The bulk of the financial adjustments, which are behind FSS, consists in the “subsidized cost of funds” adjustment<sup>25</sup>.

Nevertheless RFC has showed a clear business-oriented approach and a focus on maintaining an appropriate financial spread. Moreover, the risk related to low adjusted ratios is mitigated by the structure of the current liabilities of RFC (which represent the 89% of total assets -as of June 2004- the most of which with a long term maturity). This implies that as the institution accesses to commercial funds, financial costs, on average, will not increase that rapidly.

RFC presents an operating expense ratio of 4,5% as of June 2004, reduced from 5,4% in 2003 and 6,7% in 2002. Progressive improvements for the **operating expense ratio** underline efforts from RFC to maintain at a good level efficiency in both SCAs and direct lending. Such a good efficiency performance is mainly related to the average loan balance per borrower (about US\$ 10.000 as of June 2004) but it is also linked to the lean organizational structure of RFC (staff allocation ratio has always been around 50%).



Financial Indicators	Jan01-Dec01	Jan02-Dec02	Jan03-Dec03	Jul03-Jun04
Operating expense ratio (aver. gross portf.)	4,6%	6,7%	5,4%	4,5%
Staff allocation ratio	47,4%	51,9%	46,7%	44,8%
Loan officer productivity (borrowers)	17	14	29	38
- SCAs	17	19	27	44
- Direct lending	0	16	54	74
Loan officer productivity (amount)	190.234	150.940	341.884	923.018
- SCAs	424.799	449.841	675.093	876.613
- Direct lending	0	295.306	538.579	432.146
Cost per loan lent	418	578	410	613
Cost per borrower	765	952	957	1.010
Funding expense ratio*	14,1%	9,3%	8,5%	9,9%
Provision expense ratio	3,0%	0,0%	-1,0%	0,2%
<b>Portfolio yield (gross portfolio)</b>	<b>24,3%</b>	<b>17,3%</b>	<b>16,4%</b>	<b>16,3%</b>

\* exchange rate variations are not included in the calculation of the ratio

<sup>24</sup> Operational and financial self-sufficiency (OSS and FSS) do not include taxes unlike ROA and ROE. This is because we consider the first two ratios as a comparable measure of the sustainability of the MFI without taking into consideration external factors like taxes.

<sup>25</sup> For sake of comparison the performances of the institution have been recomputed in accordance with some standard adjustments. The most relevant one is the subsidized cost of funds adjustment which takes into consideration a 15%

However, the process of expansion and decentralization through regional offices, will require additional efforts in order to maintain and streamline efficiency. In particular key drivers to improve operational efficiency are related to the building of **cost-profit centers in regional offices** (diminishing transportation costs) and the reduction of administrative costs (monitoring and improving applications and procedures).

**Efficiency** seems very good when compared to similar institutions, but considerations have to be done due to the particular nature of RFC, working mostly as an apex institution for SCAs lending.

As for productivity, the analysis has been made considering **loan officer productivity** by number of active borrowers and amount for each lending methodology<sup>26</sup>. For this reason productivity analysis is based on two ratios (SCAs and direct lending) presented separately in the table above. The loan officer productivity in terms of average number of borrowers has been increasing, over years, both for SCAs lending (from 17 in 2001 to 44 in July 2003-June 2004) and for direct lending (from 16 in 2002 to 74 in July 2003-June 2004). Referring to productivity in direct lending, it is worth to note that, starting from a level of 74 borrowers per loan officers, there is room for improvements. RFC is well aware of potential improvements and is already taking actions to streamline loan officers activity. Nevertheless also **staff productivity** by number of borrowers and amount has been increasing over years (from 7 in 2002 to 17 in July 2003-June 2004 and from 78.625 in 2002 to 413.676 in July 2003-June 2004).

The particular structure of RFC portfolio, characterized by high seasonality and investment in government bonds, explains the 3,05% share of other financial revenue (not from loan portfolio). For this reason, along with portfolio growth, RFC is also putting particular effort in diversifying the loan portfolio and reducing seasonality.

**RFC portfolio yield is 16,3%** (as for the annual period July 2003-June 2004)<sup>27</sup>, almost stable compared to 2003 (16,4%) while decreasing with respect to its value in 2002 (17,3%). This does not permit RFC to build an high spread when comparing the portfolio yield to an **operating expense ratio of 4,5%, a funding expense ratio of 9,9% and a provision expense ratio of 0,2%**. However RFC is lending with a suggested spread of 5-7% on passive interest rates<sup>28</sup>. **Provision expense ratio** has maintained very low since 2002 thanks to the excellent portfolio quality.

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interest rate (representing the 75% of the average lending rate in the national market as of the annual period July2003-June2004). (see adjustments in annex 2).

<sup>26</sup> Starting from June 2004, loan officers previously dedicated only to SCAs lending have started also to manage direct lending portfolio.

<sup>27</sup> Portfolio yield as of the period January-June 2004 is 18,87%.

<sup>28</sup> This level of spread is recommended by the Ministry of Finance and international lenders.

## 7. Strategic objectives and financial needs

### General guidelines for future evolution

The main features of the projected institutional, operational, organizational and financial evolution of RFC are shown within the document “**RFC Strategic Plan for years 2004 - 2007**” dated March-May 2004. The methodology to develop the strategic plan is complete and well structured.

**RFC main objective is to grow along with the market and to keep its market position as leader in Moldova in providing rural credits to SCAs and SMEs.** To achieve this general objective, the main specific goals have been divided into: market goals, organizational goals, operational goals and financial goals.

Total assets of the institution will grow about 20% a year since 2004. At the end of the 4 coming years, total loan portfolio should increase by 85%. The number of new SCAs will increase 40% (60% in short term portfolio, 120% in long term portfolio), while the number of new direct borrowers, individuals and group businesses, will increase 45% (225% in short term portfolio and 50% in long term portfolio). In the long term, according to the executive management, RFC would like to look at a mix of 50% SCA loans, and 50% direct loans in the portfolio.

**Decentralization is the backbone of the RFC strategy.** It is “*the core to development the organization and the main structural support to reach the organizational goals*” and the planned growth of its business. Finally, the medium-long term aim of RFC is to empower regional offices, by gradually delegating authority and transforming them into cost and profit centers (branches). In order to support organizational goals management has planned to define a motivating human resource policy.

**MIS will be improved gradually and adapted to the new decentralized structure** which should also allow improvements of the operational efficiency. The institution will control operational costs and it will launch **a new internal audit function** in order to keep provisions for doubtful loans at low levels, and it will improve its risk management.

**RFC financial goals** (2000-2007) estimate: 400% increase in net profit tax (ROE above 30% and ROA above 5%), 200% increase in owner equity in relation to assets (especially through increasing profits and issue shares mainly to SCAs) and improvement of operational and financial sufficiency. To meet financial goals **the backbone for the entire RFC strategy is to attract additional funds** (see next paragraph for details) from local and foreign commercial and non commercial institutions.

**RFC’s financial projections**, delivered during the mission, are based only on one growth strategy based on the most likely assumptions discussed in the Strategic Plan. Nevertheless, the Financial Department produces different financial projections based on different growth strategies (sensitivity analysis according to different scenarios).

RFC’s strategy of growth, decentralization and introduction of new functions and departments seem to be well defined, realistic and very attentive.

### Financial needs

The last chapter in the “RFC Strategic Plan for years 2004 - 2007” is about **the potential source of funds that RFC is seeking for its business, which is the fundamental issue of the entire Strategic Plan.** To increase its outstanding loan portfolio at about US\$ 30 millions in 2007, additional financing up to about US\$ 17 millions is required.

RFC lending to rural area has been supported by 2 international projects WB RISP (rural and investment and service project) and IFAD project, both providing credit lines. In the strategic plan it is estimated that additional funding will come from WB and IFAD projects and that there is a funding deficit of US\$ 4 millions in 2004. This deficit will occur mostly in financing SCAs loans.

RFC is making strong efforts to seek other potential source of funds in order to realize the goals of the Strategic Plan. Another source of funds, not included in the strategy, will come from the Ministry of Finance through the reutilization of reflows of repaid loans related to the WB RISP project (US\$ 1 million in 2004 and US\$ 3 million a year since 2005).

Moreover RFC, supported by WB, is intensifying the dialogue with domestic possible commercial sources of financing. The collaboration with the World Bank plays a key role in the discussions with possible future lenders, and not included in the strategic plan, RFC will probably make use of a new **USAID guarantee scheme** to get additional loans from some local commercial banks.

Other potential source of funds could be international institutions, like **Blue Orchard Finance**, providing loans to MFIs also for direct lending or working capital loans.

Finally, in the long term RFC executive management is aware that being recognized as a deposit taking institution in order to mobilize savings (initially from SCAs shareholders) is a key factor for growth and sustainability.

## 8. Details of the risk factors

According to our analysis, the main **risk factors** of RFC are the followings:

AREA	Risk factors	Relevance <sup>29</sup>	Main measures implemented and/or to be implemented in the short term	Observations
External Environment	SSB weak supervision for SCAs	Medium	RFC strictly monitors and supervises the SCAs. Further supervision provided by NFSCA	SCAs is a growing sector and savings in the medium term are going to increase
	Lack of a credit bureau for microfinance institutions and banking financial institutions	Medium-low	Informal exchange of information with Agroindbank somehow exists as for SCAs. Most of the borrowers are start-ups incubated by development agencies or graduated clients from existing SCAs	Direct lending portfolio is increasing
	National Bank is not considering the microfinance sector	Medium	Lobbying the National Bank with WB support	Microfinance sector is increasing and RFC has already gained a good image
Governance, management and operations	Decentralization in progress	Medium-low	Good strategy of decentralization	Support of SIDA
	Integration between portfolio tracking system and accounting system in progress	Low	MIS testing phase at the last stage. Very good MIS, flexible and tailored on RFC needs	In the long term MIS will be integrated with the regional offices (branches)
	Lack of personnel manuals and incentive schemes	Low	Manuals and incentive schemes will be introduced in the short term. Very good personnel procedures	—
Financial products and asset quality	RFC's entire credit portfolio is rural	Medium	The management works on improving diversification direct lending portfolio by lending also to different activities related to agriculture	External financial resources with an adequate maturity and stability
	Lack of further products according to the clients needs due to the shortage of financial resources	Medium-low	RFC is looking for alternative sources of funds in the short term. Mortgage loan procedure ready to be delivered	—
	Seasonality of portfolio	Low	Careful cash-flow analysis and use of government bonds & bank deposits. RFC is reducing seasonality through direct lending and new long term loans to SCAs	—
	30% of start-ups in direct lending	Medium	Start-ups are incubated by development agencies. Attentive evaluation methodology	In the short term a credit guarantee fund will be activated and it will cover 50% of the risk for the start-ups
	Still low SCAs management ability	Medium	RFC supports SCAs management in their activities	NFSCA provides formal training. SCAs management must obtain a license by SSB to operate
Financial structure and ALM	Dependency on international financial investors	Medium-high	Seek of alternative source of funds at international and national level is a corner-stone of the strategy	Domestic banking sector still not trusting MFIs (high interest rates). No mobilization of savings in the medium term
	Limited capacity of capitalization through SCAs shareholders	Medium-low	Last issue of shares for existing SCAs shareholders doubled the capital. In the future RFC would accept other commercial clients as shareholders.	Increasing number and size of SCAs
Financial and operational results	Low adjusted results	Medium-low	In case of increasing funding expenses, RFC seems ready to increase effective interest rate in order to keep a positive spread	Inflation and subsidized cost of funds adjustments are the most relevant ones.

<sup>29</sup> Relevance refers to the damage/loss brought about by negative events (associated to each risk factor) and to the probability that damage/loss eventually occurs.

## Annex 1 - Financial statements

<b>Rural Finance Corporation</b>				
<b>Balance sheet (US\$)</b>	<b>Dec01</b>	<b>Dec02</b>	<b>Dec03</b>	<b>Jun04</b>
<b>ASSETS</b>				
<i>Cash and bank deposits</i>	209.001	386.655	1.117.963	336.158
<i>Short term financial assets</i>	2.831.895	2.984.918	4.818.322	-
<i>Net outstanding portfolio</i>	1.606.474	2.008.888	4.737.426	11.688.219
<i>Gross outstanding portfolio</i>	1.712.102	2.113.156	4.786.379	11.999.236
<i>Performing portfolio</i>	1.712.102	2.113.156	4.748.885	11.868.081
<i>Portfolio at risk &gt; 30 days</i>	-	-	37.494	131.156
<i>(Loan loss reserve)</i>	105.628	104.269	48.952	311.018
<i>Accrued interest</i>	26.015	33.369	80.281	735.055
<i>Other short term assets</i>	4.835	10.740	62.007	14.770
<i>Long term financial assets</i>	-	-	-	-
<i>Net fixed assets</i>	27.638	62.917	126.048	155.843
<i>Other long term assets</i>	575	143	60	60
<b>Total assets</b>	<b>4.706.432</b>	<b>5.487.630</b>	<b>10.942.108</b>	<b>12.930.105</b>
<b>LIABILITIES and EQUITY</b>				
<b>LIABILITIES</b>				
<i>Sight deposits</i>	-	-	-	-
<i>Short time deposits</i>	-	-	-	-
<i>Short term loans</i>	-	-	-	213.946
<i>Other short term liabilities</i>	17.338	20.578	156.252	235.054
<b>Total short term liabilities</b>	<b>17.338</b>	<b>20.578</b>	<b>156.252</b>	<b>449.000</b>
<i>Long term time deposits</i>	-	-	-	-
<i>Long term loans</i>	4.107.786	4.663.437	9.394.134	10.817.110
<i>Other long term liabilities</i>	241	1.919	2.633	153.503
<i>Restricted funds</i>	4.077	11.158	72.966	56.191
<b>Total Long term liabilities</b>	<b>4.112.104</b>	<b>4.676.514</b>	<b>9.469.733</b>	<b>11.026.805</b>
<b>Total liabilities</b>	<b>4.129.442</b>	<b>4.697.092</b>	<b>9.625.986</b>	<b>11.475.804</b>
<b>EQUITY</b>				
<i>Paid-in capital from shareholders</i>	17.936	33.975	116.123	128.459
<i>Donated equity</i>	-	-	-	-
<i>Quasi-capital</i>	-	-	-	-
<i>Reserves</i>	386.405	526.936	785.687	717.656
<i>Total retained earnings</i>	172.649	229.628	414.312	608.185
<i>Other equity accounts</i>	-	-	-	-
<b>Total equity</b>	<b>576.990</b>	<b>790.538</b>	<b>1.316.122</b>	<b>1.454.300</b>
<b>Total liabilities and equity</b>	<b>4.706.432</b>	<b>5.487.630</b>	<b>10.942.108</b>	<b>12.930.105</b>
<b>Off the balance</b>				
<i>Portfolio under management</i>	-	82.936	214.904	269.794
<i>Loan loss reserve (portf. under manag.)</i>	-	-	-	-
<b>Total off the balance</b>	<b>-</b>	<b>82.936</b>	<b>214.904</b>	<b>269.794</b>

<b>Rural Finance Corporation</b>				
<b>Income Statement (US\$)</b>	<b>Dec 01</b>	<b>Dec 02</b>	<b>Dic 03</b>	<b>Jan04-Jun04</b>
<i>Interest &amp; commissions received on loans</i>	710.607	525.958	965.053	909.825
<i>Financial revenue from investment</i>	167.973	199.416	181.985	149.129
<i>Other financial revenues</i>	1.430	1.434	57.840	20.745
<b>A) Financial revenue</b>	<b>880.011</b>	<b>726.808</b>	<b>1.204.877</b>	<b>1.079.699</b>
<i>Interest paid on borrowings</i>	411.711	281.573	499.238	569.765
<i>Interest paid on savings</i>	-	-	-	-
<i>Other financial expenses</i>	-	-	8.937	25.875
<i>Inflation adjustment</i>	-	-	-	-
<b>B) Financial expenses</b>	<b>411.711</b>	<b>281.573</b>	<b>508.175</b>	<b>595.640</b>
<b>Gross financial margin (A - B)</b>	<b>468.299</b>	<b>445.234</b>	<b>696.702</b>	<b>484.059</b>
<i>Loan loss provision</i>	87.925	461	56.520	124.571
<b>Net financial margin</b>	<b>380.375</b>	<b>444.773</b>	<b>753.222</b>	<b>359.488</b>
<i>Other operating revenue</i>	-	-	2.791	-
<i>Personnel expenses</i>	84.544	121.410	176.661	103.779
<i>Administrative expenses</i>	48.950	83.743	141.479	112.949
<b>C) Operating expenses</b>	<b>133.494</b>	<b>205.153</b>	<b>318.139</b>	<b>216.729</b>
<b>Net operating income</b>	<b>246.881</b>	<b>239.620</b>	<b>437.874</b>	<b>142.760</b>
<i>Extraordinary revenue</i>	-	-	2.572	-
<i>Extraordinary expense</i>	-	433	-	19.082
<b>Net income before donations, before tax</b>	<b>246.881</b>	<b>239.187</b>	<b>440.446</b>	<b>123.678</b>
<i>Taxes</i>	47.260	17.295	62.065	32.305
<b>Net income before donations</b>	<b>199.620</b>	<b>221.893</b>	<b>378.380</b>	<b>91.373</b>
<i>Donations in cash</i>	-	7.734	35.932	58.488
<i>Revenue not from the operations</i>	-	-	-	-
<i>Expenses not from the operations</i>	-	-	-	-
<b>Net income</b>	<b>199.620</b>	<b>229.627</b>	<b>414.312</b>	<b>149.861</b>

## Annex 2 - Financial statement adjustments

The financial statements in Annex 1 are the result of **standard reclassification**. They are expressed in US\$. The numbers are based on audited financial statements while the one of June 2004 is based on the financial statement prepared by RFC.

**Financial statements have been then adjusted** to allow a comparison with other institutions which use a different logic of presentation of the information and to evaluate the level of sustainability of the institution with market conditions. The main adjustments normally are:

- adjustment for the accrued interest on delinquent loans
- elimination of subsidies (donations in kind<sup>30</sup> and soft loans<sup>31</sup>)
- provisions are calculated with a standard formula<sup>32</sup>
- adjustments for inflation
- adjustments for write-off<sup>33</sup>

The most relevant adjustments for RFC are related to the **subsidized cost of funds** and to the **inflation adjustment**<sup>34</sup>. As for the former, the financial costs for RFC liabilities have been recalculated, to take into account the potential cost of local commercial financing.

**In-kind subsidy** adjustments refer to the salary of the marketing officers, paid directly by SIDA. **Loan loss provision adjustment** has been made only in December 2003 when the auditor has adjusted RFC financial statements by using a less strict provisioning formula respect to the other periods considered. The cumulative effect of these adjustments reduces the net income in all the periods.

Adjustments (US\$)	Jan01-Dec01	Jan02-Dec02	Jan03-Dec03	Jul03-Jun04
Reversal of accrued interest on non-perf loans	-	-	na *	2.037
Subsidized cost of funds adjustment	288.754	472.938	532.968	629.762
- Interest rate used (national currency)	21,5%	17,6%	14,5%	15,0%
Inflation adjustment	30.086	27.907	146.339	142.411
- Inflation rate used	6,4%	4,4%	15,8%	12,2%
Loan loss provision adjustment	-	-	53.574	-
In-kind subsidy adjustment	-	-	27.567	36.295
<b>Total variation of net income</b>	<b>318.839</b>	<b>500.845</b>	<b>760.448</b>	<b>810.506</b>

\* not available but not relevant

<sup>30</sup> Donations in kind are valorized and added to operational expenses.

<sup>31</sup> In the income statement it is registered the value of the difference between financial costs of the institutions and financial cost evaluated at the market rate. In particular, in the case of loans in local currency, it is considered 75% of the average lending rate in the national market (IFS Line 60P). In the case of loans denominated in foreign currencies (US\$ and Euro), it is considered the average value of LIBOR 1 year plus 3%.

<sup>32</sup> Provisions are calculated according to the following formula:

Portfolio:	1-30 days	10%	Restructured loans	1-30 days	50%
	31-60 days	30%		> 30 days	100%
	61-90 days	50%			
	>90 days	100%			

<sup>33</sup> Loans past due more than 180 days are written-off.

<sup>34</sup> RFC doesn't include a reserve for inflation in its financial statements

## Annex 3 - Financial ratios

## RFC (MLD)

Jan01-Dec01 Jan02-Dec02 Jan03-Dec03 Jul03-Jun04

**PROFITABILITY**

Return on Equity (ROE)	40,5%	33,5%	37,5%	30,3%
Adjusted Return on Equity (AROE)	na	-41,7%	-36,6%	-33,6%
Return on Assets (ROA)	4,7%	4,4%	4,3%	3,2%
Adjusted Return on Assets (AROA)	na	-5,6%	-4,6%	-3,5%
Operational self-sufficiency (OSS)	139,0%	149,2%	156,9%	133,6%
Financial self-sufficiency (FSS)	na	73,6%	78,9%	84,5%
Profit Margin	28,1%	33,0%	36,3%	25,1%

**LOAN PORTFOLIO QUALITY**

Portfolio at risk (PAR30)	0,0%	0,0%	0,7%	1,1%
Arrears rate (> 1 day)	0,0%	0,0%	0,9%	0,4%
Restructured loans	0,0%	2,9%	3,4%	1,7%
Provision expense ratio	3,0%	0,0%	-1,0%	0,2%
Loan loss reserve ratio	6,2%	4,9%	1,0%	2,6%
Risk coverage ratio (30 days)	na	na	130,6%	237,1%
Write-off ratio	0,0%	0,0%	0,0%	0,0%

**EFFICIENCY AND PRODUCTIVITY**

Staff allocation ratio	47,4%	51,9%	46,7%	44,8%
Loan officer productivity (borrowers)	17	14	29	38
Loan officer productivity (amount)	190.234	150.940	341.884	923.018
Staff productivity (borrowers)	8	7	13	17
Staff productivity (amount)	90.111	78.265	159.546	413.767
Operating expense ratio (average gross portf.)	4,6%	6,7%	5,4%	4,5%
Operating expense ratio (average assets)	3,1%	4,1%	3,6%	3,5%
Cost per loan lent	418	578	410	613
Cost per borrower	765	952	957	1.010
Personnel expense ratio (average gross portf.)	2,9%	4,0%	3,0%	2,3%
Admin. expense ratio (average gross portfolio)	1,7%	2,8%	2,4%	2,1%

**ASSETS/LIABILITIES MANAGEMENT**

Portfolio yield (gross portfolio) - accrued	24,3%	17,3%	16,4%	16,3%
Funding expense ratio*	14,1%	9,3%	8,5%	9,9%
Cost of funds ratio*	10,9%	6,6%	6,5%	8,9%
Current ratio	267,33	247,98	53,21	22,48
Liquidity over total assets	4,4%	7,0%	10,2%	2,6%
Debt/equity ratio	7,16	5,94	7,31	7,89
Capital adequacy ratio	12,3%	14,4%	12,0%	11,2%

\* exchange rate variations are not included in the calculation of the ratio

**OUTREACH**

Average disbursed loan size	12.055	16.434	11.652	14.711
- from SCAs to their own borrowers	174	183	232	248
Average outstanding balance	7.412	7.712	8.456	10.733

**GROWTH (amount in national currency)**

Growth of active gross portfolio	64,1%	30,3%	116,6%	27,7%
Growth of active borrowers	na	21,8%	110,5%	35,9%
Growth of active loans	na	18,6%	106,6%	51,3%
Growth of total assets	68,3%	23,1%	90,7%	18,4%
Growth of staff	na	42,1%	11,1%	-3,3%
Growth of funding liabilities	71,0%	19,9%	92,7%	13,9%
Growth of operating expenses*	na	62,3%	48,3%	19,2%
Growth of equity	52,3%	44,7%	59,2%	39,3%

\* As for June 2004 the growth is referred to December 2003

## Annex 4 - Definitions

	Description of the ratio	Formula
<b>Profitability</b>	<b>Return on equity (ROE)</b>	Net income before donations / Average equity
	<b>Adjusted return on equity (AROE)</b>	Adjusted net income before donations / Average equity
	<b>Return on assets (ROA)</b>	Net income before donations / Average assets
	<b>Adjusted return on assets (AROA)</b>	Adjusted net income before donations / Average assets
	<b>Operational self-sufficiency (OSS)</b>	(Financial revenue + Other operating revenue) / (Financial expenses + Loan loss provision expenses + Operating expenses).
	<b>Financial self-sufficiency (FSS)</b>	(Adjusted financial revenue + Other operating revenue) / (Adjusted financial expenses + Adjusted loan loss provision expenses + Adjusted operating expenses)
	<b>Profit margin</b>	Net operating income / operating revenue
<b>Portfolio quality</b>	<b>Portfolio at Risk (PAR30)</b>	Portfolio at Risk > 30/ Gross portfolio
	<b>Provision expense ratio</b>	Loan loss provision expenses / Average gross portfolio
	<b>Loan loss reserve ratio</b>	Accumulated reserve / Gross portfolio
	<b>Risk coverage ratio (&gt;30 days)</b>	Accumulated reserve / Portfolio at risk >30 days
	<b>Write-off ratio</b>	Write-off of loans / Average gross portfolio
<b>Efficiency and productivity</b>	<b>Staff allocation ratio</b>	Loan officers / Total staff
	<b>Loan officer productivity – Borrowers</b>	Number of active borrowers / Number of loan officer
	<b>Loan officer productivity – Amount</b>	Gross portfolio / Number of loan officer
	<b>Staff productivity – Borrowers</b>	Number of active borrowers/ Number of staff
	<b>Staff productivity – Amount</b>	Gross portfolio / Number of staff
	<b>Operating expenses ratio</b>	Operating expenses / Average gross portfolio (or Average assets)
	<b>Cost per borrower</b>	Operating expenses / Number of borrowers
	<b>Administrative expenses ratio</b>	Administrative expenses / Average gross portfolio
	<b>Personnel expenses ratio</b>	Personnel expenses / Average gross portfolio
<b>Financial management</b>	<b>Portfolio Yield (gross portfolio)</b>	Interest income from portfolio / Average gross or net portfolio
	<b>Cost of fund ratio</b>	Interest expenses on funding liabilities / Period average funding liabilities
	<b>Funding expense ratio</b>	Interests and fee expenses on funding liabilities / Average gross portfolio
	<b>Current ratio</b>	Short term assets / Short term liabilities
	<b>Debt/Equity ratio</b>	Liabilities / Equity
	<b>Capital adequacy ratio</b>	Total equity / Total assets
<b>Outreach</b>	<b>Average disbursed loan size</b>	Amount issued in the period / Number of issued loans
	<b>Average disbursed loan size on per-capita GDP</b>	Average disbursed loan size / Per-capita GDP

**Other definitions:**

Funding liabilities: Liabilities that finance the loan portfolio and the cash investments necessary to manage the loan portfolio

Operating expenses: Personnel expenses + Administrative expenses

Recovery from write-off ratio: Income from write-off (payments received from loan already written-off) / Average gross portfolio

Restructuring of delinquent loans: includes rescheduling loans (extending the term of the loan or relaxing the schedule of required payments) and refinancing loans (paying off a problem loan by issuing a new loan).

## Annex 5 - Guidelines of reporting and accounting

### Financial statements

Rural Finance Corporation, is a non-bank financial intermediary, legally incorporated as an open joint-stock company. RFC does not offer non-financial services as a separate product. In fact they provide with technical and consultative assistance for the creation and processing of the activity of savings and credit associations together with the lending activity. Its financial statements reflect only the results of financial activities and are prepared in accordance with International Financing Reporting Standard (IFRS). The Corporation maintains its accounting record in accordance with Regulations on Accounting and Reporting issued by Ministry of Finance. Financial statements are prepared on a going concern basis from those accounting records and are then adjusted to conform in all material respects with IFRS. Financial statements are presented in the national currency of the Republic of Moldova, the Moldovan Leu (MDL).

### Reporting

The Financial Department, assisted by the MIS department produce the following main reports on a regular basis:

- Quarterly financial reports (balance sheets, profits and losses, capital adequacy, efficiency and liquidity indicators)
- Quarterly and monthly fiscal reports
- Monthly and weekly management reports (lending portfolio qualification, liquidity report etc.)
- Quarterly and monthly financial analysis
- Monthly projection, budget and execution of the budget

### Loan loss provision and write-off

RFC sets and reviews the loan loss reserve on a quarterly basis. The Credit Committee is in charge of the verification of the conformity to maintain the minimum required level of provision foreseen under the provisioning policy. The following table shows the provisioning policy:

Aging portfolio in arrears	% provision
0 days	0%
1 - 30 days	2%
31 - 60 days	5%
61 - 90 days	30%
91 - 365 days	75%
> 360 days	100%

The cost of the provision, which is included in the income statement, is the difference between the loan loss reserve calculated at the beginning of the period and the loan loss reserve as it is at the end of the period deducting the write-off. The cost of the provision is recorded in the income statement and it is cumulated as a loan loss reserve in the balance sheet as a negative item of the assets. Particulars categories and percentages of provision are described for different types of loans (loans guaranteed by internal credit state guarantee, by local budgets and secured with state treasury bills).

Loans with an outstanding balance older than 365 days, which have been classified into this category for more than 3 years are written-off and recorded off-balance sheet. Since the beginning of his activity RFC has never registered write-off in loans. Penalties are charged at the rate of 0,2% daily of the overdue interest plus a 2% of the overdue instalment. The outstanding capital of a loan in arrear is classified as portfolio at risk according to the days of arrears.

### Accrued interest

RFC accrues interests on loans on a daily basis. As by now registration of accrued interest in the financial statements is made at the end of each month, however also accounting records will be done soon on a daily basis. The accrued interests are included in the income statement as an interest income and in the balance sheet as an "Other Assets". RFC keep on accruing unpaid

interest on late loans up to 6 months of arrears. As of June 2004, the amount of accrued interest for loans late more than 90 days is MDL 24.343.

#### Ratio of portfolio quality

RFC reports only data on portfolio at risk and on arrears rate. The standard portfolio quality ratio used in reporting is PAR 30. Portfolio at risk is calculated as the ratio of the outstanding balance of the loans past due out of the total outstanding portfolio.

#### Restructured loans

Restructuring is made in exceptional cases and upon request. However RFC does not refinance loans. Loans can be rescheduled (extending the term of the loan or relaxing the schedule of required payments) upon decision of the Credit Committee, based on the request of the borrower and recommendations of the credit officer. Prolongation of the loan can be made one single time for one single loan. Rescheduled loans are not tracked separately in the MIS however there is a special provisioning policy for such loans. Loans which have been rescheduled are subject to a 5% provision if the entire interest accrued by the date of prolongation has been fully paid, otherwise they are subject to 75% provision. The features of the rescheduled loan portfolio are presented in the following table:

Restructured loans	Dec01	Dec02	Dec03	Jun04
Rescheduled (number)	0	2	8	9
Rescheduled (amount)	0	851.416	2.170.119	2.429.886
Restructured portfolio	0,0%	2,9%	3,4%	1,7%
PAR > 1 day	0	851.416	0	1.230.657
PAR > 30 days	0	0	0	477.307

#### Insider loans

To date RFC has never provided insider loans. However it counts on a specific manual of internal procedures dedicated to this kind of loans.

#### Donations

RFC keeps good relations with different international donors (CGAP, CNFA, and SIDA/SCANAGRI). Accounting of donations (grant loan capital, grant for operating expenses, in-kind subsidies) is made according to IAS 20. Concerning in-kind subsidies, the only case which should be noted is the training assistance given by SIDA for the regional officers. As of today, a total amount of US\$ 45.480 has been paid in salaries and training, and was not registered in operating expenses, since it is directly paid from SIDA.

The details of the USAID donations are shown by the following table:

Donations received (US\$)			
Year	Amount	Destination	Source
2002	20.000	grant for an experimental project developing credit cards within SCAs	CGAP
<b>Sub-total</b>	<b>20.000</b>		
2003	20.000	grant for an experimental project developing credit cards within SCAs	CGAP
	14.820	furniture and equipment for regional offices	Scanagri Sweeden AB
	2.050	furniture and equipment for regional offices	CNFA
<b>Sub-total</b>	<b>36.870</b>		
2004	107.175	grant loan capital	CNFA
	65.148	furniture and equipment for regional offices	CNFA
<b>Sub-total</b>	<b>172.323</b>		
<b>TOTAL</b>	<b>229.193</b>		

Details of funding liabilities

As of 30 June 2004, RFC funding liabilities are as follows:

June 2004

Funding liabilities features						
Source	Loan amount (US\$)	Disbursement date	Maturity date	Principal repayments	Interest repayments	Interest rate
IFAD loan for SCAs	849.320	22-feb-02	15-nov-16	15 May/15 Nov, since year 2006	15 May/15 Nov	11,80%
IFAD loan for direct clients	33.806	22-jun-04	15-nov-11	15 May/15 Nov, since year 2006	15 May/15 Nov	11,80%
World Bank loan for SCAs (subordinate loan)	1.505.581	26-jan-00	15-dec-32	01 Apr/ 01 Oct	15 Jun/15 Dec	0,75%
World Bank loan for SCAs (subsidiary loan)	2.651.422	14-feb-00	15-dec-17	01 Apr/ 01 Oct	16 Jun/15 Dec	12,20%
World Bank loan for direct lending and SCAs (subsidiary loan)	5.990.927	19-mar-02	01-oct-18	01 Apr/ 01 Oct	17 Jun/15 Dec	12,20%
Ministry of Finance Credit Line Directorate (multidonor, under WB project)	283.173	04-apr-02	27-sep-25	-	-	-

June 2004

Loans borrowed					
Source	Currency (in which the loan is due)	Outstanding Balance (US\$)	Outstanding Balance Short term (US\$)	Outstanding Balance Long term (US\$)	Agreement, kind of product and collateral
IFAD loan for SCAs	MDL	849.320	0	849.320	loan agreement, government guarantee
IFAD loan for direct clients	MDL	33.806	11.872	21.934	loan agreement, government guarantee
World Bank loan for SCAs (subordinate loan)	MDL	1.505.581	0	1.505.581	loan agreement, government guarantee
World Bank loan for SCAs (subsidiary loan)	MDL	2.651.422	200.776	2.450.646	loan agreement, government guarantee
World Bank loan for direct lending and SCAs (subsidiary loan)	MDL	5.990.927	1.298	5.989.628	loan agreement, government guarantee
Ministry of Finance Credit Line Directorate (multidonor, under WB project)	MDL	283.173	0	0	Grant agreement (matching grant to RFC borrowers)
<b>TOTAL</b>		<b>11.314.229</b>	<b>213.946</b>	<b>10.817.110</b>	

Other accounting policy

The Finance Report is prepared on an accrual basis. Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis, using the effective yield method based on the actual purchase price. Fixed assets are depreciated using the straight-line system, with the estimated useful life of each class of asset. According to the IAS, adjustments for inflation are done only in case of hyperinflation. To date RFC has never considered the effect of the inflation in the financial statements.

Exchange rate variations and assets and liabilities denominated in foreign currency

Transactions denominated in foreign currency are recorded at the exchange rate ruling at the transaction date. Exchange differences are included in income and expenses at the time of settlement using the exchange rate ruling at that date. Monetary assets and liabilities denominated in foreign currency are expressed in MDL at the official rate of the National Bank at the balance sheet date. Foreign currency gains and losses arising from the translation of monetary assets and liabilities are reflected in the income statement for the year. According to IAS, all balances in foreign currency are adjusted monthly or at the date of transactions. The following table shows assets and liabilities in foreign currency as of June 2004:

**June 2004**

Moldovian Lei	US\$	Local currency	Total
<b>Assets</b>	<b>2.252.895</b>	<b>155.492.488</b>	<b>157.745.383</b>
Cash and banks	21.677	1.764.366	1.786.043
Financial assets	2.231.218	0	2.231.218
Portfolio	0	146.621.043	146.621.043
Fixed assets	0	1.863.119	1.863.119
Other assets	0	5.243.960	5.243.960
<b>Liabilities</b>	<b>0</b>	<b>157.745.383</b>	<b>157.745.383</b>
Loans	0	131.826.634	131.826.634
Other liabilities	0	2.809.009	2.809.009
Grants	0	5.730.123	5.730.123
Capital	0	17.379.617	17.379.617
<b>NET POSITION (in MDL)</b>	<b>2.252.895</b>	<b>-2.252.895</b>	<b>0</b>

## Annex 6 - Rating Scale

Rating grade	Definition
<b>AAA</b>	Extremely strong capacity to meet its financial obligations. Excellent operations. Very stable and highly unlikely to be adversely affected by foreseeable events.
<b>AA</b>	Very strong capacity to meet its financial obligations. Very good operations. Stable and unlikely to be adversely affected by foreseeable events.
<b>A</b>	Strong capacity to meet its financial obligations. Very good operations. Stable even if it could be affected by major internal or external events.
<b>BBB</b>	Adequate capacity to meet its financial obligations. Good operations. Quite stable even if it could be affected by significant internal or external events.
<b>BB</b>	Limited vulnerable capacity to meet its financial obligations. Adequate operations. Quite stable even if it could be affected by internal or external events.
<b>B</b>	Partially vulnerable capacity to meet its financial obligations. Sufficient operations. Not completely stable and vulnerable to internal or external events.
<b>CCC</b>	Vulnerable capacity to meet its financial obligations. Basic operations. Potentially unstable and vulnerable to external or internal events.
<b>CC</b>	Highly vulnerable capacity to meet its financial obligations. Poor operations. Potentially unstable and vulnerable to external or internal events.
<b>C</b>	Highly vulnerable capacity to meet its financial obligations. Poor operations. Potentially unstable and vulnerable to external or internal events.
<b>D</b>	Very high vulnerable capacity to meet its financial obligations. Very poor operations. Unstable and very vulnerable to external or internal events.

The rating grade can be corrected with a + or – sign, which implies a slight positive or negative variation respect to the main grade.