ACGF

CREDIT GUARANTEE FUND AFGHANISTAN

Short-term Technical Assistance

Terms of Reference / Scope of Work

Date: July 26, 2024

Project	**Due Diligence of Mutahid Development Finance Institution**	
Start Date	Expected start of the project September 1st, 2024	
End Date	November 15th , 2024, or the final acceptance of the final deliverable to be provided hereunder, whatever occurs later.	
Reports to	*Name - Title:*	Detulio Fumo
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Contract Type	Lump sum as per the acceptance of the achieved deliverables	
Review Committee to Monitor Consultants' Work	Detulio Fumo, Guarantee Business Sales Manager ACGF Board of Directors, ACGF Compliance Officer	

1. Background

1.1. Institutional Background

The ACGF - Afghan Credit Guarantee Foundation ("**ACGF**") was established in September 2014 by the German Federal Ministry for Economic Cooperation and Development ("**BMZ**") and DEG - Deutsche Investitions- und Entwicklungsgesellschaft mbH ("**DEG**") with approval and support from the Government of the Islamic Republic of Afghanistan and from the Central Bank of Afghanistan as well as from the Governments of both the United States of America and the Federal Republic of Germany.

ACGF provides partial guarantees to Afghan partner financial institutions ("**PIs**") which provide credit to local micro, small, and medium enterprises ("**MSMEs**"). It also provides technical assistance ("**TA**") to Afghan financial and other institutions. ACGF is supported by its 100 percent subsidiary SME Client Support Afghanistan LLC ("**SCSA**"), a Kabul-based financial consulting company focused on providing ancillary services to ACGF in the areas of credit guarantee business including TA for Afghan PIs on behalf of ACGF.

ACGF's mandate is to contribute to strengthening the emerging financial sector and to developing private-sector capacity in Afghanistan, thus, supporting the creation of employment and income. ACGF facilitates access to finance for Afghan MSMEs. ACGF's objectives are achieved mainly by sharing credit risk with the Afghan PIs by providing credit guarantees for MSMEs and by providing comprehensive TA (training, coaching, product development, risk management improvements, etc.).

1.2. Background to ProjectMutahid Development Finance Institution (Mutahid DFI) is one of the recipients of conditional Capital Support Grants and Technical Assistance under the Empowering Microfinance and Enterprises for Resilience and Growth (EMERGe) project (Component 1) implemented by ACGF. As core operations of Mutahid, working capital and investment financing is provided to Afghan MSMEs. To secure these operations, Mutahid is interested in becoming a PI of ACGF and thus in benefiting from ACGF's credit guarantees. Strong synergies between the EMERGe component of providing Capital Support Grants (CSG) and Technical Assistance to Mutahid and ACGF's guarantees have been identified. All components provide strengthening of Mutahid's implementation capacities with CSGs increasing Mutahid's financial position, targeted Technical Assistance for capacity building and risk mitigation with guarantees to build a sustainable and impactful business operation.

Both parties consider the preliminary discussions of potential cooperation encouraging and their results clearly justify further pursuit of potential cooperation. As of now, Mutahid DFI is 100% owned by MISFA. However, a non-governmental organization (NGO) has been registered with the Ministry of Economy in Afghanistan and the license has been issued. The NGO name is Community and Enterprise Development Organization (CAEDO). This NGO will be an independent entity governed by an independent Board of Directors. None of MISFA's current staff or Board are sitting on CAEDO's Board or management. It has been decided to transfer the ownership of Mutahid to CAEDO and the conclusion of the ownership transfer process of Mutahid DFI from MISFA to CAEDO is a precondition for the potential cooperation between ACGF and Mutahid DFI.

While ACGF has a longstanding business relationship with the other MFIs being part of the EMERGe project (OXUS and FMFB) and has a solid understanding of their financial and business status and TA needs, ACGF does not yet have a business relationship with Mutahid and seeks more insights into Mutahid's financial and lending capabilities, processes and procedures to identify capacity building needs.

In order to gain these insights , ACGF requires to conduct a due diligence of Mutahid DFI. The due diligence will focus on the general institutional strength, on an operational review of existing credit operations and scalability for SME lending as well as on identifying the main technical assistance needs in this context. The consultant is not expected to travel to Afghanistan. Any field or operational support on the ground will be provided by SCSA.

The assessment will focus on the financial institutional strengths and on operational reviews of the existing and future business models of PI.

2. The Assignment

2.1. Objectives

The objective is to conduct due diligence and assessment on Mutahid DFI which is essential for ACGF's stakeholders to understand the Mutahid's ability to sustain itself in the long term and to support the decision of ACGF's stakeholders to initiate cooperation between Mutahid DFI and ACGF.

Mutahid DFI has been one of the most relevant microfinance institutions in Afghanistan and became even more relevant after the government collapse with the integration of the portfolio of FINCA Afghanistan. Mutahid ended 2023 with 4,994 active clients and plans to reach 11,162 by the end of 2025. To achieve this significant growth in number of clients, Mutahid would need support to overcome some of the challenges that the institution is currently facing:

- in the recent past continuous losses and portfolio impairment have eroded Mutahid's equity which on June 30, 2023, is reflected at AFN 346.9 million. As a 'going concern,' this position has to be reversed with a combination of re-capitalization, (increased) profitability, and reversal of impairment (through collection of past due loans).
- Given Afghanistan's context and current economic and developmental fundamentals, Mutahid's sole option for funding is MISFA, which can be a constraint on expansion and growth in the long term. Mutahid will have to work on its corporate structure and equity position in order to be able to attract other investors/lenders.
- Mutahid's core methodology to lend against social collateral will change with an increase in average loan size and introduction of new products. It endeavors to work upon diversifying the collateral structure of the facilities, which includes credit guarantees.

The due diligence and assessment will identify potential risks that may impact Mutahid's solvency, liquidity, and capital adequacy. By identifying these risks early on, Mutahid can take proactive measures to mitigate them, and this will give the possibility for the institution to benefit from the Empowering Microfinance and Enterprises for Resilience and Growth (EMERGe) program which aims to build sustainable solutions for developing both the demand for and supply of finance for micro and small enterprises in Afghanistan, prioritizing women's financial inclusion. The provisioning of performance-based capital support grants (linked to sponsors' own capital injections) could contribute to solving the capital needs.

Additionally, the institution will be considered for TA support under the EMERGe program to support the transition to Islamic Finance through Shariah-compliant product development and operational capacity building. The due diligence will also encompass a TA needs assessment to inform the planning of the TA activities accordingly.

The due diligence is also needed to inform the decision to start or not the provisioning of ACGF guarantees for the MSMEs served by Mutahid DFI. Cooperation (for guarantees and beyond) between ACGF and Mutahid would certainly contribute to further business development and portfolio growth and thus to the institutional financial health of Mutahid. The due diligence – if having a positive outcome - will provide further strategic direction for the cooperation between ACGF and Mutahid.

2.2. Scope of Work

The consultant will conduct the due diligence of Mutahid DFI. The evaluation will specifically consist of the following activities:

Assessment methodology

Mutahid DFI shall be assessed based on a comprehensive framework, in coherence with common regulatory/best practice approaches for the assessment of financial institutions' viability. The framework shall assess the Mutahid DFI viability based on the assessment of three areas (at reporting date): 1) the country-level risk, 2) Institutional financials, and 3) Mutahid DFI operational capacities (including the review of its strategic plan, governance structures, etc).

The due diligence should inform ACGF if Mutahid DFI:

- Was able to maintain or regain its financial stability after the regime change in Afghanistan,
- Ensured continuity of its critical functions, all those that are necessary to permit smooth business continuity in response to its main target group needs and core activities
- Is aligned with current and future common regulatory/ best practice approaches,
- Is capable of implementing the respective institutional strategic plan.
- Have in place AML/CTF measures and mechanisms in place aligned with DAB, and all internationally accepted standards (e.g. FATF 40 Recommendations).
- The PI CDD/KYC and AML/CTF compliance capacity is thoroughly assessed, with special highlight on sanction screening practices
- Is capable of managing credit risk by assessing the credit and risk processes, procedures, staff skills and experience and appraisal methodology.
- Identify technical assistance needs to improve and strengthen the lending structures and capacities of the institution.
- E&S

2.3. Work Plan

No.	Phases, Activities, Deliverables	Suggested Time Frame
0	**Preparation**	**Week 1**
0.1	The Consultant conducts kick-off calls with ACGF and PI management, risk and operations units to discuss the assignment and align expectations.	Week 1
1	**Definition of the Assessment Framework**	**Week 1 - 2**
1.1	The Consultant reviews contractual agreements with PIs, ACGF reports, and other internal documentation related to the Due Diligence. The Consultant develops a preliminary list of all documents (FS, manuals, business plans and strategy, etc.) that shall be provided by Mutahid DFI and inform the assessment.	Week 1 - 2
	Deliverables: Draft assessment framework, including a comprehensive list of Mutahid DFI documents and a detailed implementation plan	
1.2	The Consultant discusses the draft assessment framework with ACGF staff to validate and further refine the results.	*Within 2 weeks of the assignment*
	<u>Deliverable 1:</u> Final assessment framework including a detailed implementation plan	
2	**Implementation of the Due Diligence**	**Week 3-8**
	Based on the final assessment framework, the Consultant undertakes the due diligence assessment. To this end, the Consultant reviews Mutahid DFI documentation and conducts interviews with its representatives. In particular, the assessment shall examine three main categories: 1) the country-level risk, 2) PI financials, and 3) PI's operational capacites (including the review of its strategic plan, governance structures, etc).	Week 3-8
2.1	**Country Risk Assessment**	Week 3
2.1.1	**Overall Country Risk Assessment** While it is known to both parties that Afghanistan has and will remain in a high-risk environment, the Consultant shall assess the overall country risk and its possible effects on Mutahid DFI operations. The Consultant should	Week 3

<table>
<tr><td></td><td>particularly reflect on the Institutional readiness in addressing the challenges imposed by the country risk levels of Afghanistan.

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<tr><td>2.2</td><td>Financial and Operational Assessment

<u>Financial Assessment</u>

Based on the final assessment framework and considering the results from the country level and regulatory risk assessment, the Consultant undertakes the financial assessment, considering: 1) Loan portfolio and ECL, 2) Financial position (Solvency and ALM), and 3) Financial performance.

To this end, the Consultant evaluates the last 3 years financial information provided and maintained by Mutahid DFI (Portfolio data, Balance Sheet, Income Statement, etc.) verifying the stated figures, their correctness and ensuring that a prudent approach is implemented related to estimates and the valuations used.

In line with international best practices and regular practices in Afghanistan, some adjustments to the existing standards shall be considered:
- Non-consideration of temporary time-bound relief measures (e.g. relief in credit classification/ provisioning policy).1
- Careful assessment of collateral valuation at current market condition (e.g. mortgage assisted by immovable property guarantee, loan assisted by central government guarantee).

The assessment shall include:

1. Loan portfolio quality management
- Loan Portfolio Concentration per product, sector and branch
- Portfolio quality per product, sector, and branch with an ECL estimation and projected ECL based on volume expectations.
- Credit operations and risk management
  - Capacities and the impact (if any) of staff turnover
  - Assess the adjustments made to the lending policies to properly address the challenges of managing the lending cycle (loan origination, assessment, decision, monitoring, delinquency management, collection) under the current market situation</td><td>Week 4-5</td></tr>
</table>

[1] The classification of the exposures should be assessed in line with ACPR, for instance, days past-due criteria on the correct PAR class without considering any relief for the loan portfolio; at the same time, provisioning level should be updated accordingly (so to account for potential losses on P&L) and capital determined consequently.

    - Ability to properly implement lending processes (post-disbursement loan monitoring, manage delinquencies, undertake recoveries, loan reporting)
    - Level of internal controls in place to detect frauds and details of historical frauds by branch in the past 3 years
    - Ability to structure (and availability of) appropriate lending products
    - Assessment of the risk management framework and capacity of the risk department to manage all risks

2. Solvency and AML
    - Capital adequacy and solvency
    - Liquidity management and risk
    - For both, particularly compliance with national regulations (Financial Capital amount, Total Capital ratio, Tier 1 ratio) and liquidity ratios (Broad liquidity ratio, Quick liquidity ratio)

      In line with international best practices and regular practices in Afghanistan, some adjustments to the existing standards shall be considered as per current and foreseen Afghan regulatory framework:
        - Additional buffers for thresholds to account for additional needs under stressed market conditions,
        - Adjustment of Asset Risk weights for various exposures (e.g. to central governments/ DAB, foreign and local banks to institutions)
        - Consideration of hard commitments (letter of comfort) by shareholders or other stakeholders (with positive effects on capital adequacy ratios) by means of capital increases or comparable measures
        - Revision of classifications of high-liquid assets and liquid assets to assess the real liquidity profile of financial instruments for each relevant currency, in line with Basel definitions for high-quality liquid assets.
    - Indebtedness, funding stability, and concentration risk, particularly considering future financial needs and plans (e.g. current negotiations with funders, expectations on the stability of deposits under consideration of eroding levels of trust among depositors, etc.).
    - Overall market risks exposure and management (interest rate risk, FX risk).

3. Financial Performance
    - Profitability and Sustainability: Historic and projected profits & losses, including the breakdown of income streams, the breakdown of costs,

	impairment provisions, and key ratios (e.g. net interest margin, cost/income, loan impairment); concentration to customer/ segment, with exception of one-off items, carefully considering the impacts of extraordinary revenues/costs of 2022-2023 and their future sustainability. - Efficiency and productivity The Consultant shall further develop a most likely scenario in terms of Mutahid DFI overall framework conditions and project the future evolution of selected variables as well as stress-testing selected indicators, to properly assess its potential future viability. Assessment of Governance and Operational Capacity Based on the final assessment framework and considering the results from the country level and regulatory risk, as well as the financial assessment, the Consultant undertakes the assessment of the Mutahid DFI governance and operational capacity and determines immediate and long-term TA needs. Based on an agreed prioritization[2] the following areas shall be considered: 1. Ownership and support by shareholders, in particular, their commitment to provide additional capital 2. Supervisory Board (composition, skills, supervisory and strategic functions) 3. Executive management and top-level management capacities (skills, experience, quality of decision making, risk appetite, market position, particularly considering current levels of staff turnover in management positions) 4. Overall HR and Staffing capacities, especially considering the increased turnover 5. Risk Management 6. Internal Control and Internal Audit functions 7. Compliance Management System (KYC), especially considering the elevated risks related to international sanctions: - Assessment of the general compliance framework and capacity to manage AML/CTF, sanctions risks. - Assessment of the CDD/KYC/UBO/AML/CTF policies and procedures to manage money-laundering risk	

[2] Under guidance of ACGF the Consultant shall define the extent of assessment for each of the mentioned areas. A special focus shall particularly be given to points 10) and 11).

	- Assessment of the controls they have to check whether procedures are complied with/followed. - Special attention to sanction screening and PEP procedures. 8. MIS, Reporting capacity and information quality 9. Access to (inter)national transfer system, with a special focus on its ability to send/ receive international and national payments and its impact on critical institutional functions 10. Assess IT department capacity and skills, data quality, and capacity to serve business and reporting needs 11. Appropriateness of Mutahid DFI business model and its strategic plan to function sustainably and remain viable, by assessing in how far the plan: - addresses the current situation and its market position; provides reliable estimates/ assumptions, particularly on delinquency, income generation, and disbursement volume - provides adequate and realistic expected return on equity/asset, funding availability, and diversification, risk level of the strategy (the complexity and ambition of the strategy compared to the current business model, etc.) assesses the main exogenous/ internal factors that influence the success of the business model (IT, resource & operational capacity, etc); - considers PI's ability to adjust and implement the strategic plan	
2.3	**Individual loan exposure review** The Consultant identifies a sample of MSMEs (at least 20 businesses from different branches) to be visited by SCSA. The consultant will guide the SCSA team members in the review of the application of credit procedures at branch level and acquire an opinion of the understanding of the credit procedures by Branch Management and the practical application thereof in the branch. At least 3 branches should be visited by SCSA. During the visit, all Branch Managers will be interviewed by the team, as well as other employees as decided by the Consultant, including but not limited to Financing Supervisors, Financing Officers, Risk Officers, and Back Office staff. To the extent possible, the interviews will take place over an agreed online platform to enable the Consultant to participate. Where this is not possible, the outcomes will be reported to the Consultant by SCSA in a format established by the Consultant in coordination with ACGF.	Week 4-5

	Deliverable 3: On-site visit reports for at least 20 MSMEs	*Within 6 weeks of the assignment*
2.4	**Consideration of on-site visits** The Consultant incorporates the findings of the on-site visits into the Mutahid DFI assessment. The Consultant finalizes the draft assessment report.	Week 6 and 7
	Deliverable 2: Draft assessment report.	*Within 8 weeks of the assignment*
3	**Discussion of Findings and Finalization of Report**	**Week9-10**
3.1	The Consultant discusses the draft deliverable with ACGF and based on the feedback given, undertakes additional evaluation measures to enhance preliminary findings.	Week 9
3.2	The Consultant shares the findings with Mutahid DFI to confirm the stated information and adjust (where necessary) based on feedback provided by the Institution.	Week 9
3.3	The Consultant prepares the final report, including business plan evaluation, country-level risk assessment, consolidated portfolio, financial and performance information, governance and operational capacity assessment, and AML/CTF compliance capacity as well as a final recommendation for ACGF stakeholders.	Week 10
	<u>**Final Deliverable:**</u> Final due diligence report, including business plan evaluation, country-level risk assessment, consolidated portfolio, financial and performance information, governance and operational capacity assessment, TA needs assessment as well as a final recommendation for ACGF stakeholders.	*Within 10 weeks of the assignment*
Total LoE		**10 weeks**

3. Procedure for deliverables review

The Consultant will give notice to ACGF in writing or via e-mail of the completion of deliverables and request acceptance. An approval and/or acceptance of deliverables by ACGF may require several feedback and revision rounds until deliverables are considered final. Review and acceptance of a deliverable must take place no later than 10 days after the Consultant has given notice in writing or via email of a deliverable being ready for acceptance. The Consultant should be available to hold discussions and present deliverables over conference calls with ACGF/SCSA and the project beneficiary, when necessary. The payment schedule will be linked to the outputs considering the following payment plan:

- 1st Invoice: Completion and acceptance of deliverable 1 as per the above work plan.
- 2nd Invoice: Completion and acceptance of the final deliverable and project closing as per the above work plan.

4. Application of Consultant

The Applicant must send confirmation of receipt of the REoI. The deadline for submission of the **Expression of Interest** is 9th of August 2024. Any **Expression of Interest** received beyond the mentioned deadline will be rejected and not included in the **Expression of Interest** evaluation process. ACGF reserves the right to decide to not implement the assignment or to terminate the procurement process if it is deemed appropriate.

Following the next stages of the procurement process, ACGF requests a minimum proposal validity period of 2 weeks after the date of deadline for submission of proposals (expected 30 August 2024).[3]

The Consultant may request a clarification of any part of the Terms of References ("ToR") timeline to do so will be shared with the Request for Proposal on the next stage of the procurement.

ACGF's evaluation process is aligned with WB Procurement Regulations, it is fair, transparent, free of discrimination, and adheres to the provisions in this document. ACGF exercises the authority to evaluate and select the best Expression of Interest. The Expression of Interest will be the basis for selecting the Consultant that will receive a Request for Proposal (RfP). The RfP will be the basis for negotiation and ultimately signing the contract with the Consultant.

5. Key Professional Experts

The following key experts are expected to be considered at minimum as part of the team composition:

- K-1 Team Leader: 15+ years of experience in MSME banking, including executive positions. Background in MSME lending, finance, and credit risk management. Familiar with the Afghan or similar market.

[3] The timeline is given to the Consultant for orientation as due to the formal procurement approval process through the STEP electronic platform, the exact deadline for submission of proposals cannot be specified at this stage of the procurement.

- K-2 Senior Finance Expert: 15+ years of experience in MSME banking. Background in finance and risk management. Experience in Executive (CFO) and Senior Management positions is an advantage.
- K-3 Senior Data Expert: Background in data management and credit risk modelling, financial risk management, asset, and liability management.
- K-4 Senior Credit Expert: 15+ years of experience in MSME banking. Experience in management positions at branch and head office level. Background in business development, lending, and credit risk.
- NK-1 Environmental and Social Expert: Minimum of five years of private sector work experience, including or associated with the assessment and management of environmental and/or social impacts. Knowledge of international good practice for private sector management of E&S risks

Logistics

The Consultant will be responsible for the timely delivery of activities and deliverables. The Consultant will report to Detulio Fumo. All communication, as well as written documentation/deliverables, will be in English.