



## **UNRWA Savings Study West Bank and Gaza**

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## List of Acronyms

ACAD	Arab Center for Agricultural Development
AE	Administration Expenses
APR	Annual Percentage Rate
ASALA	Palestinian Businesswomen’s Association
CEA	Credit Extension Assistants
CG	Commissioner General
CHF	Cooperative Housing Foundation
CLP	Consumer Lending Product
CMA	Capital Markets Authority
EIR	Effective Interest Rate
FATEN	Palestine for Credit and Development
FMMO	Field Microfinance and Microenterprise Officer
HL	Housing Loans
HRD	Human Resources Development
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
JD	Jordanian Dinars
MEC	Micro Enterprise Credit Loan Product
MFI	Microfinance Institution
MIS	Management Information Systems
MMD	Microfinance and Micro Enterprises Department
NGO	Non-governmental Organization

NBFI	Non-bank Financial Institution
NIS	New Israeli Shekels
oPt	Occupied Palestinian Territories
PA	Palestinian Authority
PARC	Palestinian Agriculture Relief Committee
P&I	Privileges and Immunities
PMA	Palestine Monetary Authority
R	Rate of Interest
RSS	Relief and Social Services
SGL	Solidarity Group Lending
SMART	Small and Microfinance Assistance for Recovery and Transition
SME	Small and Micro Enterprises
SSE	Small-Scale Enterprise loans
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNRWA	The United Nations Relief and Works Agency for Palestine Refugees
USAID	United States Agency for International Development

## **I. Introduction**

The United Nations Relief and Works Agency for Palestinian Refugees' (UNRWA) Microfinance and Microenterprise Department (MMD) is currently the largest MFI in the occupied Palestinian Territories (oPt) and has achieved considerable impact in expanding access to microfinance services for the poor in the West Bank and Gaza. Already offering a range of products and services for its clients, MMD is interested in developing voluntary and savings services for its existing clients as well as other low income populations in the Palestinian territories. UNRWA commissioned this Savings Study in order to explore the feasibility of introducing savings products.

According to the Terms of Reference (presented in Annex I), Banyan Global conducted a market and feasibility study to identify the scope for MMD to introduce savings services in the oPt. The study included market research, a review of the local regulatory and legal framework and an assessment of UNRWA MMD's existing operational procedures. Based on the market research, legal and regulatory review, and operational assessment, this study provides recommendations to UNRWA MMD on a range of deposit services, legal options for mobilizing savings, and institutional changes which would be needed for the expansion of services to include savings in the oPt.

This report includes an overview of the methodology of the market and feasibility study; a review of the political, economic and social environment; a discussion of financial services in Palestine; characteristics of the demand for savings; the legal framework for deposit-taking; and the institutional capacity issues for deposit mobilization. For the detailed results of the market research, please consult the Savings Study Market Research Report attached as Annex II.

## **II. Methodology**

The methodology used for the UNRWA Savings Study was based on the objectives outlined in the TOR. The Banyan Global team first conducted a desktop review of internal UNRWA documents and reports as well as external documents such as the Consultative Group to Assist the Poor (CGAP) study on the microfinance industry in the West Bank and Gaza, other World Bank reports, the PlanetFinance Impact and Market Research report, the PlanetRating report, and others.

The team also met with numerous groups and individuals, including UNRWA management, staff, and clients. In addition, the team conducted a review of the existing financial sector as well as the legal and regulatory environment. The team held stakeholder meetings with government oversight bodies such as the Palestinian Monetary Authority and the Capital Markets Authority, MFIs (Faten, Asala, PARC), Palestinian Microfinance Network, and numerous banks (Arab Bank, Bank of Palestine, Bank Al Rafah, Cairo-Amman Bank). A full list of the individuals interviewed for this study is provided in Annex III.

The Banyan Global team carried out a thorough assessment of UNRWA internal systems,

specifically focusing on: ownership and governance, management, leadership, organizational set-up, staffing, IT, accounting systems, internal controls, and general MIS. The internal review included meetings with individuals at the UNRWA head office, field offices and branches. The team also met with UNRWA's General Counsel, and the Banyan Global legal specialist, Kate Lauer, conducted a telephone interview with UNRWA's General Counsel and Chief, General Legal Division.

The Banyan Global team carried out the market research study utilizing both quantitative and qualitative tools to determine the nature and scope of demand for savings from the types of clients UNRWA serves within its operational areas. The market study focused on six Palestinian cities in the West Bank and Gaza where UNRWA is operational. Banyan Global conducted focus group discussions and surveys with both client groups and non-client groups from low-income market segments which UNRWA could potentially serve. The research investigated the magnitude of the demand and the type of savings products effectively required and covered issues such as proximity, affordability (including transaction costs), security, and liquidity.

The Banyan Global team worked closely with UNRWA management and staff throughout the entire research process, and several presentations and feedback sessions were held with UNRWA management.

### **III. Political, Economic and Social Environment**

UNRWA MMD operates in a very complex political, economic and social environment driven by a combination of forces from within Palestine and Israel, as well as regional and international actors. This environment has impacted UNRWA MMD and indeed all other players in the microfinance industry.

#### **A. Political**

While the crisis in the occupied Palestinian territories (oPt) has a long history, the current crisis can be traced to the second Intifada and the June 2006 elections in which Hamas won the majority of the legislative assembly seats. The current political crisis is characterized by a violent stand-off between Hamas and Fatah, which now control Gaza and the West Bank, respectively.

After the June 2006 elections, the Israeli Government and the international community reacted by refusing to recognize the government established by Hamas in the Gaza Strip. International aid was cut off and the government of Israel reacted with more closures and checkpoints. The suspension of international aid led to what is known as the "salary crisis" as the Palestinian Authority (PA) was forced to halt salary payments because it had no funds to pay them.

According to a World Bank report,<sup>1</sup> in the West Bank, closure is implemented through an agglomeration of policies, practices and physical impediments which have fragmented the

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<sup>1</sup>World Bank Technical Team of May 9, 2007: Movement and Access Restrictions in the West Bank.

territory into ever smaller and more disconnected cantons. While physical impediments are the visible manifestations of closure, the means of curtailing Palestinian movement and access are actually far more complex and are based on a set of administrative practices and permit policies which limit the freedom of Palestinians to move home, obtain work, invest in businesses or construction and move about outside of their municipal jurisdiction. These administrative restrictions, rooted in military orders associated with the occupation of the West Bank and Gaza, are used to restrict Palestinian access to large segments of the West Bank including all areas within the municipal boundaries of settlements, the ‘seam zone,’ the Jordan Valley, East Jerusalem, restricted roads and other ‘closed’ areas. Estimates of the total restricted area are difficult to come by, but it appears to be in excess of 50% of the land of the West Bank.

Currently there are peace talks sponsored by the ‘Quartet’ which includes Russia, the United States, the European Union and the UN to try to bring about a political settlement between the Israeli Government and the PA. However, with the Hamas party left out, many people believe that these talks may not result in a sustainable political settlement.

## **B. Economic**

The failure of the peace process and the recourse to political violence has undermined the capacity of the Palestinian Authority, frozen institution-building in the state system, alienated donors and driven the nascent Palestinian economy into a dire situation. The per capita GDP was \$1,129 in 2006, about a third less than in 1999.<sup>2</sup> Apart from the falling GDP, there is also the problem of the changing composition of the economy. Domestic income is dominated by government expenditure and remittances from Palestinians in the diaspora and donors, putting the sustainability of the Palestinian economy in question.

With the unemployment rate exceeding 30%, the West Bank and Gaza face an expanding labor force and a shrinking private sector; thus, the public sector has become the only alternative for jobs. Despite an unsustainable wage bill, the Palestinian Authority (PA) has resorted to absorbing workers as a way to alleviate poverty. At the same time, many workers have been hired as part of a trend to bolster political support. As a result, public sector employment has grown by 60% since 1999. While the public sector has expanded, the economy’s productive capacity has begun to hollow out making it increasingly donor dependent. Adding to this, the unpredictability of the border crossing and checkpoints has prevented Palestinian businesses from importing inputs and exporting products in a timely and planned manner. In response, enterprises have closed and large amounts of financial and human capital have fled. The pace of capital flight has reached an all-time high in the last two years with most local capital being kept abroad or invested in real estate or short term trading activities.<sup>3</sup>

From the outset, Gaza has been hit harder by closures and economic crises. 54% of employment in Gaza is private sector-driven (representing more than 100,000 jobs). It is estimated that the current restrictions have led to the suspension of 90% of Gaza’s industrial

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<sup>2</sup> The World Bank: Two Years after London: Restarting Palestinian Economic Recovery, September 24, 2007

<sup>3</sup> The World Bank: Two Years after London: Restarting Palestinian Economic Recovery, September 24, 2007

operations, which normally absorb more than a third of the private sector work force. Employment in construction and building has also been impacted by the suspension and cancellation of most construction projects due to lack of construction materials. Gaza's economic backbone and private sector vitality risk collapse if the current closure policy after Hamas' June 14<sup>th</sup> takeover of the Gaza Strip continues.<sup>4</sup>

### **C. Social**

The continuing conflict is perpetuating an internal cycle of violence, fragmenting social cohesion and affecting psycho-social well-being. Three quarters of Palestinians suffer from severe depression as a result of the current situation.<sup>5</sup>

Women, who historically play a key role as income providers, are increasingly relegated to the informal market as a result of movement and access restrictions. Their participation in the labor market, at 15.2%, is amongst the lowest in the world. Also, since September 2000, youth have been caught literally and figuratively in the crossfire of the conflict. Nearly 75% of the injured during the second Intifada were between 10 to 29 years old. Youth have also been active participants in the Intifada and have therefore suffered both violence and imprisonment with its consequent impact on mental health and physical disability. They also suffer from high rates of unemployment (60 percent) and are excluded from formal mechanisms of decision making.

Health indicators in the oPt have seen a steady drop over the last three years. Chronic diseases have surged 31% since 2005. Chronic malnutrition among children under five jumped 3% between 2004 and 2006. Ten out of every 100 children under five are stunted (13% in the Gaza strip and 8% in the West Bank). The number of households with safe drinking water has also dropped by more than 8% between 2000 and 2007. In the education sector, school enrollment is high but declining. The quality of education is also suffering because schools lack textbooks and other materials. The increasing insecurity, especially in the Gaza Strip, is having a devastating effect on the performance of students. In the West Bank, closures and restrictions on movement and access, especially due to the Separation Barrier, are preventing many students and teachers from reaching their schools.<sup>6</sup>

## **IV. Financial Services in Palestine**

### **A. Overview of the Regulation of Financial Service Providers**

The formal financial sector is made up of the financial services providers regulated by the Palestine Monetary Authority (PMA) and the Capital Markets Authority (CMA). The financial service providers include banks, mortgage finance companies, insurance companies, specialized lending institutions and other finance companies, money changers, and a privately operated stock exchange, and credit institutions.

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<sup>4</sup> World Bank Technical Team of May 9, 2007: Movement and Access Restrictions in the West Bank.

<sup>5</sup> World Bank 2007.

<sup>6</sup> The World Bank: Two Years after London: Restarting Palestinian Economic Recovery, September 24, 2007

The PMA licenses, regulates and supervises all banks in Palestine. Under the current law, only PMA-licensed deposit-taking institutions (i.e., banks) may take deposits from the public. The PMA is also responsible for regulating *any* finance company. However, the Capital Markets Authority Law (adopted in 2004) provides that the CMA will license, regulate and supervise insurance companies, financial leasing companies, mortgage finance companies and will monitor NBFIs. Although there is a lack of clarity regarding the roles of the PMA and the CMA vis-à-vis finance companies (including mortgage finance companies and NBFIs), the PMA reported that a recent cabinet ruling has clarified the situation. Specifically, the ruling reportedly indicates that the CMA will focus on those institutions referred to in the CMA law (presumably insurance companies, financial leasing companies, mortgage finance companies), leaving the PMA to regulate all other finance companies, including lending institutions.

The PMA has recently indicated that it plans to pursue a “self-regulation” model with credit-only MFIs. For these entities (which have very limited capacity to destabilize the monetary system), the PMA intends to rely on donors to supervise their partners’ activities and to intervene only if an MFI is considered in grave violation of its intended activities.

The PMA also indicated that there is room for negotiation and further discussion on the licensing and regulatory requirements for NBFIs that fall under its supervision. For example, the PMA suggested that it is open to the possibility of permitting an MFI to take savings provided that there is no intermediation (i.e., on-lending) of such funds. The PMA indicated that it might develop a modified set of regulations for such MFIs.

## **B. The Banking Sector**

The size of the banking sector has increased significantly since 1993, from only two banks, the Bank of Palestine and Cairo-Amman Bank, to the current 22 banks with over 138 branches. The banks consist of ten Palestinian banks and 12 foreign banks, including 11 Arab banks. Of these 22 banks, four are Islamic banks.

Deposits held at the formal financial institutions are estimated at over \$4 billion.<sup>7</sup> Banks are obligated by the PMA to maintain a 40% loan to deposit ratio, which many fail to do. While the amount of deposits are substantial and have not been impacted by the crisis, rising as opposed to falling in the past two years, the formal commercial banks are by and large focused primarily up-market. Although there is a high ratio of bank branches to population and the branches offer savings accounts, no bank does any substantial business in small-balance deposit accounts.

The largest and most widely used banks in Palestine today include the Bank of Palestine, the Cairo-Amman Bank and the Arab Bank. Their deposit products are presented here as a reference to existing services offered in the market.

### **1. Bank of Palestine**

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<sup>7</sup> Interview with PMA.

The Bank of Palestine, the largest and oldest indigenous bank, started operations in 1961 in Gaza. It has operations throughout the oPt, with 17 branches in West Bank and 13 in Gaza and over 60,000 clients<sup>8</sup>.

Regulated by the PMA, the Bank of Palestine provides a complete range of banking services targeting the upper side of the market, including institutions, importers and exporters and employees. It previously had a microfinance program serving around 2,000 clients, but due to the crisis, the program closed in 2003. Currently, the Bank of Palestine has no immediate plans to downscale to serve poorer clients, particularly those who seek credit. It is in compliance with the 40% of its loan to deposits regulation.

The Bank of Palestine has three savings products: Normal Deposit, Savings, and Education. The minimum amount for opening the Normal Deposit account is 200 USD. A client can make withdrawals and deposits on a daily basis and is eligible to earn an interest of 5% p.a. if the balance does not fall below 200 USD. The minimum deposit for the Savings account is 200 USD. The account holders qualify for lottery monthly prizes between 1,000 USD to 20,000 USD, but no interest is paid on this type of savings. The Education account is a long-term savings account for those who want to save for the education of their children. The terms are the same as the Normal Deposit, but there are no daily withdrawals.

## **2. Cairo-Amman Bank**

The Cairo-Amman Bank is one of the commercial banks in Palestine which intends to downscale its activities and serve the poorer clients of Palestine based on a resolution passed by its board to begin a micro-credit program. The bank is now developing a road-map and seeking partners to begin the program. It is likely that it will initiate the program soon as it is negotiating a guarantee agreement now with a potential partner. Management plans on having a microfinance unit within the head office and microfinance windows in 50% of the branches. With loans ranging from 500 USD to 10,000 USD, the approach will be cash flow-based lending and not collateralized, although they may also use one or two guarantors as peer pressure, as opposed to salaried employees.

Presently the Cairo-Amman Bank has 16 branches and 3 are under construction. The current savings products have no minimum balances. To qualify for lottery/prizes, there is a minimum of 200 JD required. Twice a year, it holds a drawing for 1,000,000 NIS. The bank also holds a monthly drawing for 50,000 NIS and a Volkswagon Gold. Quarterly, the bank does a draw for 250,000 NIS. The bank gives a 0.5% return on the daily balance (simple interest – not compounded). It does not charge fees on balances below 200 JD, and the average deposit is 1,500 USD.

## **3. Arab Bank**

The Arab Bank has 14 main branches but a total of 30 offices in both the West Bank and Gaza. The bank offers a whole range of services that includes ATMs, credit cards, visas,

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<sup>8</sup> Based on interview with Mr. Hani Nasr of the Bank of Palestine.

deposits and credit products. The offices provide nearly all the same retail services as branches except for commercial services like Letters of Credit.

The bank offers savings in three currencies – Israeli shekel (NIS), U.S. Dollars (USD) and Jordanian Dinar (JD). The current minimum balance for a basic current account is 500 USD in order to qualify for a return which accrues interest in months six and 12. The bank's minimum amount for opening an account is 200 USD. Below this, it is based on the judgment of each branch manager. Sometimes the bank makes exceptions for students or others. In addition to the basic current accounts, the bank also has deposit savings accounts with minimum balances of 5,000 USD. For these the bank offers higher interest rates. It also has one week, one month, three months, six months and one year term deposit accounts. Rates differ depending on terms.

The Arab Bank categorizes clients by deposit size – retail clients are those with balances of 500 USD to 100,000 USD. Corporate/private clients are those with balances above 100,000 USD. Interest is calculated at the end of the deposit term for deposit accounts. The Arab Bank used prizes to attract deposits in the past and has also given prizes for ATM usage and visa cards. In October, the bank will be launching a prize of 100,000 USD for balances with a minimum of 300 USD. This balance is intended to attract poorer people. The Arab Bank has done a lot of work with donors such as the U.S. Agency for International Development (USAID) and the International Finance Corporation (IFC). Under these programs, the bank has had more relaxed guarantees. According to bank staff, generally people perceive these as “grants” as word always spreads that these are donor programs.

#### **4. Bank Al Rafah**

Bank Al Rafah is the newest entrant in the commercial banking sector, as well as being the first and only commercial microfinance bank in Palestine and the broader Middle East. Bank Al Rafah has received support both from the IFC as well as the USAID-funded Small and Microfinance Assistance for Recovery and Transition (SMART) project. The bank was established in 2005 with equity capital of 30 million USD, 40% of which represented capital from the major corporations in Palestine including Paltel, Padico and the Trust Insurance Company. The bank is currently listed on the Palestinian stock exchange and has approximately 19,000 shareholders. Although labeled a microfinance bank, Bank Al Rafah also serves corporate clients as part of its business plan. It sees this as a prudent, risk diversification strategy, as well as a method to quickly achieve profitability for its shareholders.

Bank Al Rafah's average loan size is approximately 7,000 USD, but it intends to bring this further down to 3,000 USD. It has one full branch and will be opening branches in Gaza and Nablus shortly. It also operates from seven ‘windows,’ which it sets up within cooperatives and other corporate structures by grouping their employees. The bank offers the full services of other commercial banks, including financing, savings, insurance, investments, transfers, lines of credit and letters of guarantee.

With regard to savings, the bank requires ‘compulsory’ savings for its groups which currently average 5,000 USD for groups of between three to 12 people. Savings primarily serve the

function of collateral on loans as opposed to serving as voluntary accounts for clients. Loans can be up to ten times that of the savings balance of the group. There are also other forms of guarantees, such as gold and guarantors. The bank does maintain a standard voluntary savings accounts, but there does not seem to be an emphasis by the bank on mobilizing small accounts more generally.

### **C. The Microfinance Sector**

There are currently ten MFIs engaged in microfinance in the oPt. The MFIs have varying legal structures, which include non-governmental organizations (NGOs), for-profit companies, and cooperatives. Many of these institutions are credit-only and none are legally admitted to mobilize and intermediate savings. The leaders in the industry are: UNRWA MMD, FATEN, ASALA and CHF Palestine. Among them, they have 90% of the clients and 80% of the loan portfolio in the oPt. Two of the Palestinian MFIs, PARC and ACAD, help establish and organize credit cooperatives which mobilize deposits for their own membership.

As the larger of the two organizations supporting local cooperatives, this report provides a more detailed look at PARC. PARC was established in 1983 as a Non-Profit Organization, with a mission to work with rural women to help their families to become self-sufficient. It provided training to women in modern farming techniques as well as legal and human rights. PARC started its credit programs in 1994. With funding from the Spanish and Austrian donor agencies, PARC helped to organize women into groups which were then given loans to on-lend to their respective members. With further assistance from the International Fund for Agricultural Development (IFAD), PARC staff was trained to be able to provide technical assistance for the groups to manage themselves, keep basic books of account, open bank accounts and register with the Ministry of Labor.

Today, with more funding from IFAD, PARC supports 12 cooperative societies with technical assistance and grants for on-lending. The 12 PARC cooperatives cover all of the districts in the West Bank and Gaza with 132 locations. As of 30<sup>th</sup> June 2007 there were over 6,700 members. The PARC cooperatives have an outstanding loan portfolio of over 2.9 million USD (of which 25% is PARC/IFAD funding) with just over 2,000 active borrowers, and it holds almost 2 million USD in members' savings from 4,700 female savers.

However, in spite of PARC support the cooperatives are struggling and are not operating on a sustainable basis for a number of reasons: low repayments, low savings, not charging a cost covering interest rate on the loans to members and reduced technical assistance from PARC. This poses a risk to their future operations and severely limits the possibilities for expansion, both in terms of the number of members served and the variety of products offered. This also raises concerns for the long-term security of members' savings, particularly as donor subsidies become less abundant. In addition, there is no funded position within PARC to work specifically with and provide technical assistance to the cooperatives. Instead, the work is undertaken by PARC staff who are also working on other initiatives as well as by the cooperatives' member-elected committees. The lack of dedicated PARC staff translates into inadequate attention to the development of the individual cooperatives, the training of loan staff and the development of appropriate products (both loan and savings).

Two of the MFIs, FATEN and ASALA, take compulsory savings, but FATEN is phasing this out from its methodology. ASALA maintains approximately 40,000 USD in client deposits, which it maintains in an account on their behalf with its bank. Most of the other MFIs are very small with less than 3,000 active borrowers.

Many of the MFIs, as represented by the Palestinian Microfinance Network, have expressed an interest in intermediating savings. However, there is a complex process to obtain legal clearance to do so, and there are also issues pertaining to internal capacity. The Chairman of the network, Ms. Reem Abboushi, has indicated that it is in the interests of all MFIs to seek permission as a block or via the Network, as opposed to seeking permission individually as separate MFIs. Furthermore, the Network cautions against seeking legal reform requiring formal cabinet approval. With the current schisms in the political environment, the results of such an outcome are unpredictable and may lead to a negative outcome.

#### **D. The Informal Sector**

The informal sector is composed of savings and credit institutions which are not formal legal entities but which engage in the provision of financial services. The most notable of these types of structures in Palestine are rotating credit and savings associations (ROSCAs), which are quite prevalent in Gaza and the Northern West Bank. The CGAP report on the microfinance sector also highlights community-based organizations, informal insurance providers and money lenders as other institutions which serve the financial needs of poor households. The market research conducted by Banyan Global found that only ROSCAs stood out as highly visible informal providers, whereas none of the other institutions were mentioned by potential clients.

### **V. Characteristics of the Demand for Savings**

#### **A. Brief Overview**

A parallel report provides a detailed market assessment for savings services for UNRWA clients and other poor households in Palestine. The market research conducted included two complementary research methods: *focus group discussions* yielding qualitative results on people's savings and spending habits and their preferences for savings modalities; and a comprehensive *survey*, yielding statistically relevant quantitative findings on income levels, spending and saving patterns, and respondents' priorities in choosing savings products. The research was conducted in Gaza Rimal, Nusseirat, Nablus, Jenin, Bethlehem and Hebron, areas where UNRWA has branch offices.

Overall, the study finds that there is currently limited perceived *ability* to save, given the political and economic crisis and the ensuing pressure on livelihoods and business activities. However, the study also highlights that there is substantial *willingness* to save and that clients are already saving in various informal ways, despite their perception that they are not doing so. Respondents clearly perceive and understand the benefits of saving, mostly so for the education of their children and for unforeseen circumstances in the future.

It is therefore possible to conclude that when the economic situation will recover in the

medium and long term, the ability to save will match people's willingness to save, leading to significant demand for savings products in the future. Previous crisis events, such as the second Intifada, were instrumental in instigating many households to save, and it is expected that the current crisis will continue to build on that societal change. Thus, there is potentially a market opportunity in today's crisis environment.

As one of the strongest MFIs in the market and as a major UN agency with full confidence of the Palestinian people, UNRWA is in a unique position to support safe saving options for its clients and other poor households in Palestine.

## **B. Estimated Size of the Market for Savings**

The current level of deposits in Palestinian banks represents over \$4 billion. This number is significant considering the economic landscape and the repeated crisis in the oPt. While these deposits include both corporate as well as individual accounts, they are nonetheless significant as it is also known that many corporate and wealthy individuals have invested outside of the oPt given the political and economic situation. The PMA has indicated that deposits have actually increased in the last two years. This is partly explained by an expansion of the commercial banking sector into new regions and branches. It must also represent the capacity of the Palestinian diaspora and the remittances that flow into the economy. This, in particular, needs further study to understand the role of remittances in supporting domestic savings.

The fact that many of the commercial banks continue to expand their branch networks and to implement special deposit mobilization "programs" offering larger and larger prizes indicates that the formal banks see more growth in the savings business, which is yet untapped.

Estimating the potential market size for savings of *poor* households is complex and no standard tool exists. The findings of the market research showed that 45% of individuals surveyed do not have bank accounts. The focus groups revealed that many poor individuals do not use banks for savings at all, but rather, for receiving salary transfers. Thus the \$4 billion figure above excludes a significant number of individuals who are not currently saving in formal institutions.

The population of the Palestinian Territories is 3.7 million, of which 1.5 million are above 20 years old.<sup>9</sup> Assuming that 45% of these adults do not have bank accounts indicates that there are 675,000 adults who are currently unbanked in Palestine. The focus groups conducted for this study revealed that families aspire to open accounts for their children, when and if they can afford to, in order to save for their education and future. Thus the potential market for savings far exceeds that of the current adult unbanked population. Furthermore, many of those who are banked do not use the banks for savings, whether this is due to their inability to save at the present time or their unwillingness to save at banks. Hence, there is a large potential market segment of those who already maintain bank accounts with commercial institutions, but can and do save in other ways.

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<sup>9</sup> World Bank demographic data for 2005.

Using a slightly different metric, CGAP estimated that the demand by the poor for small-balance savings accounts and money transfer services to be 200,000 *households*.<sup>10</sup> Focus groups clearly indicated that numerous individuals within households can and do maintain separate accounts, often at different banks. As households in Palestine average between 6 and ten individuals, the actual number of accounts can potentially range from 1.2 to 2 million. Considering this represents half of the Palestinian population residing in the West Bank and Gaza, it is clearly a significant number of individuals.

Finally, it is important to keep in mind that UNRWA MMD is perceived as a non-bank and non-profit entity. People's willingness to open accounts with UNRWA MMD, which was over 90% of individuals surveyed for this research, shows that UNRWA MMD can potentially capture a significant number of the potential market of poor households in Palestine who are currently saving both in formal and informal ways.

### **C. Major Findings of the Market Research**

As mentioned above, the research included both focus groups and a survey, and it was completed in six of the major locations where UNRWA operates. For a more detailed description of the results, the reader is encouraged to review the full market research report. Only the major highlights are presented here as an introduction to the product recommendations.

#### Income Patterns

- Household income patterns confirm that a majority of respondents earn their income monthly, and most households' total income is below 5,000 NIS monthly.
- More than one third of respondents reported that they have an individual monthly income of less than 1,000 NIS.

#### Savings Habits

- Only a minority of respondents is currently able to save, which is a result of the economic crisis unleashed by the second Intifada and the current political stand-off, which have put pressure on people's income levels and inflated prices of many basic goods.
- There is no significant difference in respondents' ability to save across the different cities surveyed.
- Bank accounts are considered to be the most common method of saving, while non-cash savings such as buying land or building a house are also seen as a safe way of storing money.
- The reason for saving is most often to prepare for unforeseen circumstances in the future, while saving for education is less prevalent than the findings of focus group discussions suggest.
- There are some regional differences in the use of the various savings methods.

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<sup>10</sup> Khaled, Lauer and Reille. "Meeting the Demand for Microfinance in the West Bank and Gaza," January 2006,

- Savings does not appear to be linked to income levels.
- Contrary to the results of the focus groups, female respondents reported higher bank use and invest more often in livestock as a method to save than men.
- Saving by investing in land is more common among people with higher levels of education, while all other savings methods are equally used by people with different educational backgrounds.

#### Spending and Savings Patterns

- The amount of respondents' household spending is in line with their income patterns; almost 90% spend less than 3,000 NIS monthly.
- The largest chunk of spending goes to food, followed by transport and education.
- Spending in the West Bank is generally higher than in Gaza.

#### Product Features

- For many respondents security is the most important factor when choosing a place to save, while high returns and good customer service rank second and third, respectively. Freedom to withdraw at any time is also a much appreciated feature that people look for when choosing a savings instrument.
- While security stands out as the feature most looked for in a financial institution, there are regional differences. Respondents in Hebron, Jenin and Nablus favor high returns over security as their first priority. The second and third priorities also exhibit some slight regional differences, though overall, open withdrawal and good customer services are the leaders.
- There seems to be a clear preference for financial institutions versus ROSCAs, and over 90% expressed their interest in a savings product offered by UNRWA MMD.
- Most respondents look for opening balances of less than 300 NIS, while a third would like to be able to open an account with less than 100 NIS.
- For most respondents, the minimum balance required monthly should not be higher than 200 NIS, and they would be willing to make monthly deposits while being able to withdraw anytime.
- Males and females have largely similar preferences for product types and modalities. A slightly higher percentage of women are interested in ROSCAs, and female respondents have a preference for lower opening and minimum balances.
- To keep track of their savings balance, passbooks seem to be the preferred option.
- When choosing a savings instrument, respondents look for convenience. Almost two-thirds are not willing to travel more than 2 kilometers to reach a branch and are willing to spend no more than 10 NIS on the transaction. In addition, most would not want to spend more than half an hour of their time on a transaction.

- A savings account for education is the product type most appreciated by respondents, while many would also be interested in accounts for emergencies or housing.
- If UNRWA MMD were to offer a savings product, respondents would look primarily for open withdrawal and high interest rates; a lottery system as a savings incentive would also be appreciated by many.

#### **D. Product Recommendations**

Based on the market research results, it is clear that there is a strong willingness among poor households to save, particularly with UNRWA MMD. The current economic climate has clearly limited people's ability to save, although many continue to do so in informal ways, most notably through ROSCAs and through continued investments in housing, land and income-earning projects.

There are several key issues which stand-out from the data obtained during this research study which directed the product recommendations presented here. First and foremost is the fact that households in Palestine, in this current economic climate, can only afford to save very small amounts, many citing less than 300 NIS for opening balances and 200 NIS as the minimum monthly balance. During the focus groups, typical amounts contributed to ROSCAs were also in the 100 NIS range.

Secondly, the importance of savings for education was clear in both focus group and survey results and is a distinctive feature of the demand exhibited by the Palestinian market.

Thirdly, access to savings at any time stood out as one of the most important features demanded by the majority of those participating in the research, although among higher income groups, there is also an interest in term deposits.

Based on these three critical features, three loan products are proposed. For all three products, pricing is contingent on a more detailed costing study which would need to be conducted by UNRWA MMD. Recommendations here reflect market conditions and not necessarily what is feasible given the cost of introducing these products.

##### **1. Basic Savings – Current Account**

This product would serve as the backbone of UNRWA MMD's savings products. Clients opening other accounts would also likely maintain a basic current account. This type of product would effectively be competing with standard current accounts offered by banks. In order to compete effectively, while also taking into account individuals' preferences, the key features of this product should include:

- No minimum balance, or a minimum of 200 NIS
- Withdrawal at any time
- No fees for withdrawals

- An interest rate that is based on a costing exercise, but ideally higher than that offered by other banks

## **2. Savings – Term Deposit (3, 6, 9 and 12 months)**

Demand for this product was limited to individuals from higher income classes or those who require a disciplined approach. As such, demand for this type of product will be more limited. Nonetheless, the team believes that such a product would address the desire of individuals to maximize returns. Clearly, there will be a trade-off between returns and ability to withdraw at any time. The only viable way to address this is to follow standard banking approaches offering two different products to address these two opposing preferences.

As this product would be competing with standard bank products, which currently offer significant incentives in the form of lotteries and prizes, UNRWA would need to position itself in a way so as to attract the lower income individuals within this market segment, who may not have the 200 JD or higher required by other banks to qualify for a return and to enter a lottery for prizes. A suggested minimum balance is 50 USD. Terms can range from 3 to 12 months as per standard bank products. Ideally, UNRWA MMD would offer slightly higher returns than those offered by the commercial banks, but again, this would require completion of a costing exercise before determining the feasibility.

## **3. Education Savings**

Given that the majority of households can only save from 100 to 200 NIS and the fact that tuition and expenses for schooling and universities range from 700 NIS to 1,400 NIS each semester, it is difficult to fulfill the desire of clients given their capacity to save. UNRWA can address this by offering multiple options based on people's capacity to save. Recommendations on the education savings product assume a 4-year schooling period and all would need a lottery system to compete with those offered by banks. Ideally, UNRWA MMD should offer free tuition for a semester for one or more students, depending on the costing for this product. Two options are presented here, a 200 NIS product and a 300 NIS product.

### 200 NIS Monthly Contribution

- Clients save 200 NIS every month for 8 months before a student begins school (i.e., in January of the year the student is starting school)
- Clients withdraw 1,000 NIS in September and January each year of schooling
- Clients continue to save 200 NIS every month during the year except in September and January when there are withdrawals from the account
- Students get the accrued interest on the savings account upon completion of his/her education

### 300 NIS Monthly Contribution

- Clients begin saving 300 NIS each month at least 4 months prior to a student starting school (i.e. in May of the year the student is starting school)
- Clients withdraw 1,000 NIS in September and January each year of schooling

- Clients continue to save 300 NIS each month during the year except in September and January when there are withdrawals from the account
- No deposits are needed in the 4<sup>th</sup> year of schooling
- Students get the accrued interest on the savings account upon completion of his/her education.

#### **4. Other Products**

The results of the market research also showed that ROSCAs are a significant method for saving/borrowing in Palestine. During the focus groups, individuals indicated that ROSCAs are particularly popular because they have no associated fees, are easy to administer, and require a certain discipline which many need in order to save. In fact, many individuals viewed contributions to ROSCAs as expenses as opposed to savings. The survey showed that 85% of respondents are interested in UNRWA-organized ROSCAs.

There are many complexities associated with a ROSCA-type product, first and foremost the fact that there is no income-earning potential for UNRWA from this type of product. Many organizations, most notably Care in Niger and elsewhere, have promoted ROSCA-type savings groups as a precursor to credit products, which in due time provide an income earning stream for the MFI. Most of the largest MFIs in the world offer some form of savings at the group level, alongside their group lending activities.

As an MFI interested in promoting savings among its clients with no interest to intermediate these savings in the short to medium term, it would appear that a ROSCA-type product would be in line with UNRWA's stated mission and market positioning. While UNRWA's group loan products may not be performing as desired and as such UNRWA is not interested in building on this product, the failure of the group lending product is more a reflection of the methodology used by UNRWA as opposed to any prevailing market dynamics. For example, basic group lending principles demonstrate that self-selection of groups is the key to their success.

Given the prominence of this informal savings mechanism, it should not be ignored. This study recommends further analysis and research as to how such a product may be designed for the Palestinian market. Case studies of other MFIs adapting ROSCA structures should be sought and studied.

## **VI. Legal Framework for Deposit-Taking**

### **A. Internal Legal Considerations**

As a precursor to introducing savings products under the umbrella of the UN, it is necessary to verify that there are no internal prohibitions to take deposits. There have been various UN resolutions relating to UNRWA since its establishment in 1949, including (i) an annual (or near-annual) resolution renewing UNRWA's mandate and (ii) resolutions making slight adjustments to the mandate, commending the agency for having taken initiatives (including references to contributions by the MMD). In addition, UNRWA prepares a detailed

biennium program budget that is submitted to and approved by the General Assembly. (MMD's proposed savings component would be flagged in the 2008-2009 biennium budget.) General Assembly endorsement constitutes authorization. While this document has yet to be endorsed, there is strong belief internally that there will be no objections to this activity.

UNRWA also benefits from certain privileges and immunities accorded to the UN. These privileges and immunities do not put the agency or any staff outside the law; rather, they provide that the local courts do not have jurisdiction over the agency or its staff. There may be an agreement (or agreements) between the agency and the Palestinian Authority exempting certain UNRWA programs from application of local law. However, notwithstanding any such agreement, UNRWA has made clear that it would seek the permission of the Palestinian Authority prior to pursuing an activity that would contravene local law.

The only internal prohibition which impacts UNRWA's MMD program as a full financial service agency is the fact that the UN generally has a prohibition on borrowing commercially. The UN is only permitted to operate based on budgets approved by the General Assembly.

While this study does not focus on a spin-off or transformation, it is understood that UNRWA MMD is contemplating such a transaction. Of course, it will be important to examine carefully the internal legal and policy issues associated with such a transaction. (It appears that there is one precedent for a spin-off of an UNRWA project into a company. However, it took place in Jordan and dates back more than 40 years.) As the plans for transformation were not a part of Banyan Global's TOR, we did not research how such a transaction would be effected under UNRWA's internal policies and procedures or applicable local law nor did we research the Jordanian experience. However, in general, a transformation from a department of a non-profit or a UN agency to a separate legal entity (whether a newly established or previously existing entity) raises difficult and complex questions, especially if the separate entity is a for profit company.

Based on these findings, there do not appear to be any legal restrictions limiting UNRWA MMD's introduction of savings services, either within the UN system or eventually as a separate legal entity.

## **B. Possible Avenues for Taking Savings**

Today, MMD has three courses of action for taking savings. First, MMD could act as agent for one or more banks - either in MMD's current status as part of UNRWA or as a separate legal entity, post-transformation - collecting funds from clients and depositing them in one or more bank accounts. (As discussed below, the PMA is currently preparing bank outsourcing instructions that would permit such an agency arrangement.) Second, MMD could take savings directly if it were to transform into a bank. Third, as a last resort, UNRWA could approach the President's Office and request a special decree. There is also the possibility that, in the future, the PMA will permit MFIs to take savings provided that such funds could not be intermediated (i.e., on-lent). However, the PMA is only generally

discussing the possibility of pursuing this course and it is entirely possible that it will not happen.

## **1. Bank Agent**

The PMA is currently preparing instructions on bank outsourcing. According to the draft instructions, a bank is allowed, subject to the prior approval of the PMA, to outsource those activities it generally performs in the course of its daily activities. The PMA confirmed that daily activities include collecting savings on behalf of a bank. Based on discussions with the PMA, the instructions will require any bank wishing to outsource (i) to submit a feasibility study demonstrating the need for outsourcing as well as the anticipated benefits for the bank's operations and (ii) to state the financial returns of such operations and the cost involved. In addition, the bank must also have clear internal policies on outsourcing and the bank's board of directors must approve all feasibility studies and the justifications for outsourcing activities. However, given that the PMA has never reviewed a bank proposal for outsourcing the collection of savings, one cannot be absolutely certain that the PMA will approve such an arrangement.

In theory, MMD could act as bank agent either as part of UNRWA or as a transformed entity. In both cases, the arrangement would be subject to PMA approval.

If MMD were to pursue an agency arrangement (whether as part of UNRWA or post-transformation), MMD could open an account for each customer. However, given that the account balances might be below what some of the banks currently set as a minimum, banks may not be interested in such an arrangement (i.e., managing a large number of accounts with small balances). In such case, MMD could open accounts in which customers' funds are pooled. (Funds could be pooled based on geographic location of the clients.) This type of pooling arrangement would likely involve MMD acting as trust on behalf of the clients. However, any benefits to a bank of setting up pooled accounts might be counterbalanced by complications with determining how to comply with bank Know Your Customer (KYC) and anti-money laundering (AML) requirements. (See Annex IV for the AML guidelines applicable to banks.)

## **2. Transformation into a Bank**

Currently, only banks are permitted to take deposits from the public. (Savings and credit cooperatives may take savings from members but not from the general public.) Thus, under current law, if MMD wishes to transform into a separate legal entity and to take savings directly, then MMD will need to establish itself as a bank. Operating as a bank involves meeting the licensing requirements (see Annex IV) and complying with various prudential and other regulations, including "KYC" (know your customer) and (AML) anti-money laundering (see Annex IV). Complying with these requirements is a substantial undertaking. (Note however that the PMA recently submitted a draft AML law to the council of Ministers. According to the draft law, AML requirements would apply to all financial institutions as well as UNRWA/MMD.)

### **3. Presidential Decree in Favor of UNRWA**

UNRWA could approach the President's Office to request that a Presidential Decree be issued allowing UNRWA to engage in taking savings under Presidential sanction. Such a decree would authorize specific activities and their scope and would set forth reporting mechanisms. (Generally a Presidential decree allows an activity to operate independent of the legislative framework. Because the CMA and PMA laws both authorize the respective agencies to license financial institutions, UNRWA would seek clarity through such a decree and authorization to operate under the power of decree as opposed to the relevant laws.)

We understand that UNRWA/MMD is not interested in a route that would effectively bypass the existing laws. We would recommend this route only as a last resort for various reasons. First, the other two options described above are preferable from the perspective of predictability as well as MMD's relationship with regulators and other MFIs. Second, a Presidential Decree is highly political and tends to antagonize the relevant government agencies (e.g., the PMA and the CMA.)

### **4. Future Possibility for MFIs to Take Savings**

As stated above, the PMA has indicated that there is room for negotiation and further discussion on the licensing and regulatory requirements for NBFIs that fall under its supervision. Specifically, the PMA suggested that it is open to the possibility of permitting an MFI to take savings provided that there is no intermediation (i.e., on-lending) of such funds. The PMA would determine whether such MFIs are subject to a modified version of the regulations applicable to banks.

## **VII. Institutional Capacity Issues for Deposit-Mobilization**

### **A. History**

UNRWA was established by General Assembly resolution 302 (IV) of 8 December 1949 as a separate entity within the United Nations system. It began operations on 1 May 1950.

In 1991, UNRWA started the microfinance and microenterprise program through its Microfinance and Microenterprises Department (MMD) first in Gaza and later in the West Bank. The program began in response to the first Intifada and Gulf War and mainly targeted the most vulnerable Palestinian refugees. In 2003, the program extended its microfinance activities to Jordan and Syria.

The 16 years of existence as a serious microfinance practitioner has allowed MMD, as opposed to UNRWA, to acquire the necessary experience, reputation (not only in the minds of its clients but by the Palestine people in general) and the expertise to venture into new areas of providing inclusive financial services, including savings.

### **B. Governance and Legal Form**

MMD is one of 11 departments, of which five are service programs within UNRWA.<sup>11</sup> Headed by the Commissioner General (CG), UNRWA reports to the General Assembly through a ten-member Advisory commission which includes representatives of the Agency's donor and host authorities. The Advisory commission sits annually with a mandate to review and approve the annual report and workplan for the following year. The mandate of UNRWA has been renewed repeatedly, most recently by Assembly resolution 59/117 of 10 December 2004, when it was extended until 30 June 2008.

MMD is headed by a Director who reports directly to the CG operationally and administratively. There is an MMD Advisory Board which meets once a year and is made up of the Deputy Commissioner, Controller, five UNRWA directors (including the MMD director), and two outsiders. The two outsiders include an economist/Banker and International Microfinance Expert who formerly worked for United Nations Capital Development Fund (UNCDF). The two associate members consist of the Microfinance Operations Manager – West Bank and the Field Microfinance and Microenterprise Officer – Gaza. MMD Advisory board's mandate includes providing:

- Policy advice to both the Commissioner General and MMD;
- Appraisal of the adequacy of MMD's plans, scope and effectiveness of activities;
- Technical advice to ensure that MMD meets commonly accepted microfinance standards; and
- Financial management counsel and review the annual report of independent auditors.

As part of UNRWA, MMD enjoys certain benefits which come with the name and the image of UNRWA – a UN Agency. It is exempted from corporate and employee income taxation and has more funding resources than other MFIs, given its UN mandate. Although the Israeli authorities continue to restrict the freedom of movement of UNRWA personnel in the oPt, its UN mandate puts it at a competitive advantage compared to other MFIs. These factors, therefore, make it easier for MMD to operate and expand its activities in the West Bank and the Gaza Strip. In addition, MMD's Advisory Board adds significant value to MMD's operations, not least because of the skills and experience the board members possess.

However, being part of UNRWA has its own challenges. MMD is a program and as such it has no legal personality. It cannot sue or be sued and its continued legal existence depends on the existence of UNRWA. Hence, all of its transactions are carried out under the legal personality of UNRWA.

Related to the above is the fact that MMD has no owners. The absence of shareholders who have financial/social stakes has an impact on the organizational culture and drive to become a market leader. Good performance can thus only depend on quality management and dedication as presented by the current management, but not necessarily on the 'owners'.

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<sup>11</sup> The others are: Education (Amman), Health (Amman), Relief and Social Services (Amman), Legal Affairs (Jerusalem), Human Resources (Amman), External Relations (Jerusalem), Internal Oversight Services (Amman), Administrative Services (Amman), Finance (Amman), Executive Office (Gaza)

### C. Vision and Mission

MMD's first mission was to create employment through capital investment loans to existing and start-up enterprises. In 1994, the program changed its mission from SME development to microfinance intermediation where the program introduced several other lending programs in Gaza. MMD's mission endeavours to improve the quality of life of small business owners and micro-entrepreneurs, sustain jobs, decrease unemployment, reduce poverty, empower women and provide income-generating opportunities to Palestinian refugees and other poor and marginal groups through the provision of credit.

The mission seems to be well-known, appreciated and embraced by key personnel in MMD and with personnel in the branches visited. Program reports also indicate that during its years of existence, MMD has registered significant achievements in terms of its social agenda embedded in its mission. From the informal discussions with clients in the various branches (during the focus group discussions), many benefits were articulated by clients as a result of their participation in the program, including increased incomes, improved family welfare and standards of living, improved child welfare, enhanced self-esteem in the face of the occupation, and improved business skills. According to the 2006 Planet Finance Impact and Market Research report, MMD's clients lead a relatively better lifestyle than non-clients. 91% of MMD's clients use their profits for family life improvement and 54% use part of their profit for reinvestment.

MMD has, however, not stated its vision. The vision is inspirational and unique to an organization and should enable the organization to make the right decision on major and broad issues. It is recommended that as MMD plans to transform, expand and begin providing savings products, it should clearly state its vision. Furthermore, it is recommended that its mission should be revised to include the new services and not just 'Provision of Credit'. MMD should also state its *core values* - the beliefs and values that an organization holds dear and become a fundamental part of the way staff think and carry out their day-to-day activities.

If MMD wants to continue to be a key player in the microfinance industry, it must be set apart from other players. Therefore, it is the vision, mission and core values that will set the stage for all its interventions.

### D. Organizational Structure

The scope and scale of MMD's lending activities have expanded over the years. The department has been strategically repositioned within UNRWA from a programme to a full department. MMD's current profile is analogous in reporting and organizational relationship to UNRWA's three core programs (Education, Health and Relief and Social Services). The department now has a Central Office in the West Bank. In addition to these reform changes, the differing roles for credit in the MMD and UNRWA's Relief and Social Services (RSS) program have been clarified and harmonized. RSS' direct credit programs are being phased out and the provision of all credit, including providing the poorest segments of the refugee community with a social safety net, will be the responsibility of MMD. UNRWA serves a variety of market segments from larger enterprises in Gaza to women and poor households

throughout the oPt.

The highest level of MMD's structure is the Central Office which houses the Director (head of the department – operationally and administratively) and the Chief, Microfinance Operations (effectively the deputy –for operational matters). Also at the Central Office are the Head of Finance and Accounts who reports to the deputy and the Business Economist (Gaza) and the Microfinance Training Officer (Gaza).

The second level is the Field Offices, which is analogous to regional offices in a standard organizational structure. There are four field offices in Gaza, the West Bank, Syria and Jordan. Each field office is staffed with the Field Microfinance and Microenterprise Officer (FMMO), who is effectively the head of the field office and who reports directly to the Chief, Microfinance Operations, at the Central Office for operational matters. Reporting to the FMMO are the Accounts and Finance Officer, the Loan Management System Officer and the Credit Operations Manager.

The structure also includes MMD's branch network, which is considered the third level. This is made up of six branches in the West Bank, three branches in Gaza, three branches in Syria and three branches in Jordan. The Branch manager, reports to the Credit Operations Manager at the Field Office. Below him are the Area Loan Supervisors and the Credit Extension Assistants (CEA). Other positions at the branch level include the cashier and the clerk.

The strengths of the current structure include a clear representation of the chain of command/ lines of authority, accountability and reporting relationships within UNRWA core departments and within MMD – in the three respective levels, Central, Field and Branch. Strength is also found in the branch network, which is spread out in the operational areas of MMD. The closer the MFI gets to its customers, the larger the number of small clients with access to financial services. This is a clear indication of the intention of MMD's management to take the services as close to the clients as possible.

There are six layers of authority within the operations function. These include the following:

- Chief, Microfinance Operations (Central Office)
- Field Microfinance and Micro enterprise Officer (Field Office)
- Credit Operations Manager (Field Office)
- Branch Manager (Branch Office)
- Area Loan Supervisor (Branch Office)
- CEA (Branch Office)

These various levels may come with controls which are critical as the organization grows. This organizational structure earned MMD high marks in the recent rating exercise by Planet rating. However, there are some reservations with this number of layers within any organization. This analysis did not delve into detail to map the operations function and determine what the role of each level is in the 'value chain' of availing financial services to the clients. However, based on experiences in other MFIs, it is normally considered

inefficient to maintain such a long chain of command. It is highly recommended that MMD management maps (flowcharting and answering questions: what, who, when, where and how) all the processes within the operations function from the branch level to the Central office so as to determine which levels are critical. Those which are not necessary should be removed. In this way it will be able to create an appropriate and more effective atmosphere and structure for growth, including the introduction of savings.

Also of note is the fact that a key position, that of Human Resources Development (HRD), continues to be managed by UNRWA, which negatively affects some of the operations of MMD. A case in point is the fact that the recruitment and filling of the position of the internal audit function – officially known as Verification Officer – unnecessarily took quite some time to approve.

In addition, as noted above, MMD is part of UNRWA. This has its own administrative problems, which include:

- MMD's policies and regulations must be in line with UNRWA's regulations and therefore the introduction of business-oriented policies, such as staff incentives for MMD's staff for improved performance are not easy to approve.
- Slow response to client needs. For example, expansion, e.g. opening branches, is delayed due to the bureaucracy within UNRWA.
- The operating costs of MMD are high because most of the vendors charge exorbitantly for their services and goods since they know they are dealing with a UN agency which supposedly has 'unlimited funding sources'.
- Slow processing of procurements of services and products.

Clearly, the MMD needs to gradually break away from the UNRWA bureaucracy if it wants to remain a leader in the market, serving its clients based on business principles but at the same time with a social mission. Also, as the MMD continues to expand and broaden its product range to include savings products, it would be necessary to adjust the structure. A proposed organizational structure is presented as Annex V. Changes needed include the following:

#### Branch Level:

- Revise the job description of the CEA to include marketing of savings products. It would also be necessary to change the title from Credit Extension Assistant to an alternate title such as 'Field Assistant' to reflect the revised roles of promoting financial services beyond credit.
- Recruit additional cashiers – this will be driven by the number of clients anticipated per branch.
- Recruit a Customer Care Relations Officer, probably at the same level of Area Loan Supervisor. It should be noted that for credit products, MFIs choose their clients but

for savings products clients choose where to save and so the customer care function is critical in providing savings products. Customer care relations service is the ability of an institution to constantly and consistently satisfy clients' wants and needs.<sup>12</sup>

- Strengthening the security system in terms of hiring security personnel and also improving on safety of physical structures.
- Decision-making, e.g. loan approval is decentralized and completed at this level (with adequate oversight from the Field Office) to foster transparency and accountability.

#### Field Office Level:

- Revise the job title description of the Credit Operations Manager that will reflect the responsibilities of giving the required oversight to the provision of savings products.

#### Central Office Level:

MMD should advocate for having the Human Resources Development function for its staff managed at this level rather than have it within UNRWA as is the case now. Presently MMD's staff is close to 250 employees which therefore would make it a reasonable request. In any case, as mentioned above, MMD, because of its business orientation (in addition to its social agenda), has to make decisions regarding its staffing based on business principles, such as staff development and incentives. Staff development and appropriate incentives will go a long way in bringing on board dedicated staff, committed and inspired to serve the communities in which they work.

The timely recruitment of personnel particularly related to the introduction of the savings products at the three levels will depend on how fast this function can be brought within the scope of MMD control.

In the mid-term, MMD should also introduce a Research and Marketing function which can be incorporated within the job descriptions of existing personnel. This function will involve carrying out market intelligence (client and competitors analysis), identifying opportunities in terms of responding to client needs and coming up with a market strategy which will determine which markets to go into with what products. The right person will need to have commercial marketing skills but with a social agenda.

In the long run, depending on what type of license is granted to MMD, and therefore the risk the clients' savings would be exposed to, it may be necessary to have the Treasury function, essentially to manage such risks.

### **E. Management and Leadership**

Management and leadership within MMD are provided by the director, his deputy and the FMMO, Gaza. The three, amongst other things, are responsible for strategic oversight, operations and growth of the department, resource mobilization, motivation and supervision

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<sup>12</sup> Joana Ledgerwood and Victoria White: Transforming Microfinance Institutions.

of staff, and enforcement of policies and procedures. MMD's management culture is participatory, as opposed to 'autocratic' at one extreme and 'laissez-faire' at another. This participatory style accounts for most of the recorded achievements, and the director and his deputy are particularly credited for steering MMD's growth over the last 16 years. This participatory style is practiced throughout the organization and was evident in the Gaza field and branch offices, for example. MMD has emerged as the leading microfinance practitioner in the oPt. During this period, the team has been responsible for growing the loan portfolio to 7,183,000 USD (as of June 2007), building the organization's capacity to a team of 250 staff, and mobilizing resources to an asset base of 17,340,286 USD. The team has also put in place and implemented a number of policies and systems that have helped to streamline operations and protect the assets of the organization. When compared to other MFIs, MMD is the market leader.

MMD's success to date can be partly attributed to its highly participatory and interactive management style, whereby some key staff have risen through the ranks to high positions, and the management team's integrity, dedication and commitment to the organization's mission and objectives. Continuing this style of leadership is recommended to maintain buy-in at all staff levels for the introduction of savings services.

## **F. Organizational Culture**

MMD is part of UNRWA, which is hierarchical – a very formalized and structured place that is governed around procedures, formal rules and policies. While this approach lends order and stability, organizations of this nature tend to be inflexible and thus limit opportunities for growth.

However, perhaps because of the current leadership, MMD is adopting some of the elements in the *ad hoc* and *market* cultures which encourage being proactive, innovative and willing to take risks as evidenced by venturing into new areas like Syria and Jordan, and also planning to widen the product range to include savings. This is encouraged to continue as it will be an invaluable asset for an organization that wants to be a market leader.

## **G. UNRWA MMD's Proposed Transformation**

One of the most important findings of this study is the fact that there is tremendous public confidence in UNRWA, as a major UN agency and as the provider of a great deal of social services to the Palestinian people since its formation in 1949. This confidence was not exhibited for any other institution, whether commercial banks or other MFIs operating in the oPt. Thus, the responses to all questions pertaining to willingness to save with UNRWA must be interpreted within this narrow definition.

As UNRWA MMD plans to transform into a separate legal entity, yet to be determined, it must balance the benefits of the high confidence associated with the UNRWA brand as opposed to the flexibility associated with a structure that is legally capable of mobilizing savings.

It is the recommendation of this research team that UNRWA MMD should leverage its current position under the UN system to pilot test and launch its savings products. As clients gain confidence in the savings services, it will be easier for UNRWA MMD to transition into a new legal entity, thus transferring this market confidence along with it. It is understood that there will remain a legal question as to whether this is feasible and whether the PMA would approve and license this activity, without a separate legal registration.

Another recommendation which aims to build upon the ‘UNRWA brand’ is to maintain the clear linkage for the public through the marketing of the new legal entity. This is often done in the commercial world in several ways. One method is to continue to use the name and logo, along with the new name and logo, for a specified and agreed upon term. A second approach is for firms to use a sub-title format, such as ‘A Subsidiary of UNRWA’ next to the new name of the entity.

Given this critical and highly sensitive issue, UNRWA MMD should carefully assess and seek professional assistance on the branding and marketing of the new entity when it is formally registered.

In addition, UNRWA MMD is going to transform into a company with owners, it will be important to consider (i) whether to bring in outside owners and (ii) if so, how to identify and select appropriate investors. The selection of owners/investors will be crucial for purposes of determining the future growth and path of the transformed institution.

## **H. Products and Target Clientele**

MMD is currently a credit-only financial services provider offering five loan products. These include:

- Microenterprise Credit (MEC – short-term working capital loans to micro enterprises)
- Solidarity Group Lending (SGL – group guaranteed working capital loans for women )
- Small-Scale Enterprise Loans (SSE – long term investment capital loans to formal small-scale businesses)
- Consumer Lending (CLP – short-term loans to working class families for household assets, services and emergency needs)
- Housing Loans (HL – targeting refugees)

While all of these products are offered to clients in the Gaza strip, only CLP and MEC are presently offered in the West Bank, only MEC and SGL are offered in Syria and only MEC is offered in Jordan. The MEC product makes up the biggest part of the portfolio with a share of 72%.

The features of the products are the same and are standard across MMD’s branch network, apart from MEC, where the nominal interest rate is lower for Gaza and higher in Syria. The documentation reviewed and discussions with staff confirmed that the products are first

tested out to gauge demand and responsiveness to the targeted clientele before they are rolled out. According to the Planet Finance report referred to earlier, the clients are satisfied with MMD's products especially in terms of ease of its methodology. The clients like the fact that it is fast to get a loan and that the contract terms are easy and understandable; there is no required collateral and the repayment periods are responsive to the needs.

According to MMD management, product pricing takes into consideration the costs of operations.

In order to understand the effective financial cost (excluding opportunity cost and transaction costs) to MMD's clients and the theoretical portfolio yield for MMD, this analysis used the figures in the Table 1 below.

**Table 1: Effective Interest Rate Calculation**

	<b>CLP</b>	<b>MEC</b>	<b>SGL</b>	<b>HLP</b>	<b>SSE</b>
Average Loan size (USD)	942	1,040	652	6000	8,000
Effective Loan Term (months)	6	8	7	30	30
Repayment frequency	Monthly	Monthly	Monthly	Monthly	Monthly
Grace Period	0	0	0	0	0
Nominal Interest Rate (annual)	24%	24%	24%	9%	9%
Commission	0	0	0	1% upfront	0
Interest Rate Method	Flat	Flat	Flat	Flat	flat
Forced Savings	None	None	None	None	None
<b>Effective Interest Rate (EIR)</b>	<b>40.05%</b>	<b>41.06%</b>	<b>40.65%</b>	<b>16.35%</b>	<b>16.35%</b>

The EIR, in the last row, represents the actual financial cost to MMD's clients. Since there are no forced saving and the interest is not compounded, this EIR also represents MMD's theoretical Yield – the Annual Percentage Rate (APR). This EIR will help determine whether MMD is appropriately costing and adequately pricing its products. Using the MEC product for illustration, in 2006 it was the only product provided in the West Bank and so all the costs on the West Bank income statement were incurred for the provision of this product. Using the formula:  $R = (AE + LL + FC + K - II) / (1 - LL)$  and the information in Table 2 below, the interest rate that MMD should charge is 98% for the West Bank and 41% for Jordan. For Jordan the interest rate charged covers the cost but for the West Bank, MMD charges more than 50% less than what it should charge. Taking into consideration the volume of operations, the main difference between Jordan and the West Bank in the cost structure is loan loss (it is proportionately less) and this can be explained by the fact that Jordan is politically stable.

**Table 2: Pricing 2006 – MEC product**

	<b>West Bank Amount in USD</b>	<b>Jordan Amount in USD</b>
Operating expenses	1,239,916	361,218
Loan Loss	428,533	36,565
Financing costs – imputed cost of Inflation and subsidy	30,454	1,662

Actual Financing costs	0	0
Capitalization	108,765	55,402
Investment Income	82,661	11,080
Average Loan Portfolio	2,175,292	1,108,030
The Interest Rate that should be charged to cover the costs (R) –annual	<b>98%</b>	<b>41%</b>

From the above it is apparent that MMD’s pricing approach is intended to cover all the costs and growth. However, because of the current political crisis which has exacerbated the loan loss expense, it is losing money. Revising the interest rate may not be the solution. Coming up with strategies to mitigate the political crisis impact may be the answer. Such strategies may include: diversification of the loan portfolio either by way of products or by region. In this case, MMD may consider promoting products that are less exposed to risk such as housing loans. Another strategy would be to expand activity in Jordan and Syria.

Costing and pricing the savings products will be equally critical. If MMD puts these savings in risk free deposits in a commercial bank, as we would highly recommend, the investment income that MMD will earn on these deposits will have to cover the cost of collecting clients’ savings and also the interest cost it will have to pay to its clients.

Costing the MEC product above is relatively easy because all the costs were incurred for just this one product in the West Bank and Jordan in 2006. MMD now has 5 products and many more may be introduced including savings products. What this means is that MMD will have to put in place an efficient cost accounting system that will enable it to come up with accurate costs for each product – savings and credit alike – and price them appropriately so that it is sure to determine what to adjust. It is recommended that such a system will not only take into consideration the costs to MMD to provide such products but also the other costs to the client. These include transaction costs, such as transport to the branch and opportunity costs such as sales foregone for being away from the business to travel to MMD’s branch. With such cost to the client identified, MMD will have to come with appropriate technologies and methodologies to lower such costs because they benefit neither the client nor MMD.

## **I. Accounting and Financial Management**

The finance and accounting function is managed by a qualified accountant (MBA and CPA) with over 27 years of work experience in both the commercial and the NGO world. He has also attended short microfinance courses such as Business Planning with Microfin.

Accounting and financial data is processed at both the MMD’s four field offices and at the branches. Accounting data entry, however, is only made and processed into information by the Financial Management System accounting software at the field office. At the branch level, the cashier pays out small expenses from the imprest and only advises the field office about the utilization of the imprest whenever she needs replenishment. Regarding the loan repayments, the cashier advises the Field Office twice a week. She sends bank –pay-in slips and copies of the receipts. On the basis of this the accountant at the field office enters the data into the system. At the end of the month bank statements are sent to the Field Office

for bank reconciliations. Other MMD transactions, e.g. staff salaries, are paid by UNRWA through the field offices, and these are entered in the system at the Field Office level. Since the system is not activated for producing financial statements, the transactions are processed only as far as the trial balance- for individual Field Offices. Manually, in excel sheets, the Finance Officer at the Central Office prepares the consolidated trial balance and all the financial statements on a quarterly basis.

The main controls in the system are the restrictions of the access and taking particular actions in the system. The accountant at the Field Office can enter data but cannot post it until authorized by the Finance Officer in the Field Office. The Finance Officer – Field Office verifies and authorises the posting. The Finance Officer at the Central Office can only read but not enter any information. If there is a problem he can only advise the Field Finance Officers –MMD for adjustments.

The main strengths in the system are the chart of accounts, the in-built internal controls and the segregation of duties that seem to be robust enough to ensure timely and accurate financial reports.

The main challenges facing the system include the following:

- There is an emphasis on bookkeeping and production of financial reports.
- The system has no general ledger for MMD, only different ledgers for the various field offices.
- The system does not generate financial statements automatically. This is prone to error and may result in untimely reports.
- There is no connectivity between field and branch office, only in the field and in Central office.
- Since the accounting is not integrated with the loan tracking system, the accounting system only indicates the control account for the loan portfolio and therefore no breakdown for the individual clients.

Given the possibility of providing safe savings products, the accounting and financial management system needs to be strengthened in the following areas:

- Upgrade the accounting software and have the automatic generation of financial statements feature activated.
- Introduce an integrated MIS all the way from branch to central office.
- Introduce and strengthen the accounting function at branch level.
- Produce management reports that will include information and analysis on things like branch and product profitability.
- Strengthen the financial management function so as to look beyond just producing financial statements. Cost accounting (to accurately cost the products), compliance reporting and treasury to include financial risk management should be the new areas to consider. The financial management function should also play a key role in the business planning process to include capital budgeting, especially with the prospects of opening new branches. In addition, the finance function will need to inform

management when a new branch will break even with the advent of bringing on board new products such as savings.

## J. Funding and Utilization

MMD has three main sources of funding: grants (restricted and unrestricted), a concessional loan<sup>13</sup> and income from operations for its overhead and operational costs. MMD is not supported by UNRWA's regular budget. Given its current operational losses, MMD will continue to heavily depend on donor funding.

Seven of UNRWA's donors have provided significant funds of over USD 1 million to MMD over the past 16 years. The financing of MMD will require stronger marketing, diversification of funding sources and greater support from major donors. One of the steps MMD has taken is to invest some of the extra liquidity in short-term investments, and from this source it has been able to earn some income: USD44,529 in 2005, USD 271,542 in 2006, and USD199,918 as of June 2007. The table below indicates how the funds available to MMD have been used.

**Table 3: Fund Utilization**

	2005	2006	June 2007
Cash and Cash equivalents (including deposits)	44%	58%	48%
Loan Portfolio	47%	33%	41%
Other Assets	9%	12%	11%
Total Assets	100%	100%	100%

MMD is highly liquid and should be lending its excess funds. Since products like HLP are able to withstand current negative market conditions, MMD should be investing in these products. It should also be expanding quickly into regions not impacted by the economic crisis, like Syria and Jordan, which it has already been doing.

## K. Internal Control System

MMD benefits from the elaborate administrative controls of UNRWA and this, coupled with the integrity of the MMD's leadership and staff, are perhaps the major elements of its internal control system. Additionally, over the years, the management of MMD has produced operational and financial procedures manuals which guide staff in day-to-day operations and in the tracking of financial and operational data, and in processing it into usable information. It should also be noted that MMD's financial statements are subject to annual external audits. As a part of carrying out the usual statutory audit, the auditors also provide a management letter which points out areas of weakness which need to be addressed and provide advice to MMD in addressing these weaknesses. From the management letters reviewed, it is apparent that MMD responds and takes measures to follow up on the

<sup>13</sup> MMD indicated that this is not a loan, but a trust fund that they manage on behalf of OPIC Fund for International Development. It is, however, represented as a liability on the balance sheet,

recommendations by the auditors.

To reinforce this internal control system, a Verification Officer was recruited to manage the internal audit function. With a background in accounting and having attended short microfinance courses, the Verification Officer is quite well placed in carrying out this function satisfactorily. He makes regular branch visits and writes reports which management takes seriously.

However, it is important to note that the Verification Officer's focus is more on compliance, which makes his approach more reactive rather than proactive. As MMD expands its portfolio and plans to take on savings products, it is necessary to strengthen this function in several ways:

- Study and map each process – e.g. loan disbursement process, loan repayment process, petty cash payments, and cheque payment process. Each mapped process should indicate who does what, the documentation involved and their disposal (such as filing), the time taken at each stage, etc.
- Note weaknesses at each stage of a process, e.g. time lost looking for a signatory or loophole which may result in a financial loss to the organization.
- Come up with suggestions on how to speed up the process, how to close loopholes, etc.
- Come up with revised process and ensure implementation.
- Update procedures manual and ensure implementation.

#### **L. MIS Loan Tracking**

The loan tracking system is computerised, supported by an in-house, tailored Microsoft Access Data Base. The system operates in a very centralized manner which does not allow for online collaboration with people at the branch level. At the branch, repayment data is entered in the system and since there is no direct connectivity, the branch manager sends that information as an e-mail attachment to the central office. At the central office, data is extracted from the e-mail attachment by the MIS department, reviewed and then integrated into the main MIS system data base. Likewise, the MIS at the central office advises the individual loan disbursements by e-mail attachments to the respective branch offices. This information is extracted and used by the branch to update client records and balances.

According to the MMD IT Officer and the most recent external auditors' management letter, the system produces accurate and timely reports. However, according to the same sources the system has areas of weaknesses:

- The system in Gaza is different from that in the West Bank, such that consolidation cannot be done except externally to the MIS.
- In the absence of online connectivity with branches and with Gaza, timeliness of the reports is affected.

- The system does not allow for reporting in the dominant currency (USD). Each branch transaction record and report is based on its local currency.
- Microsoft Access is designed for small applications and is thus limited in capacity. With increased volume, the current software will not allow for speed in transaction processing and might be subject to crashes.
- The system can take on a maximum of 20,000 clients.

MMD management has researched and identified a new system and its purchase has been recommended by the MMD's Advisory Board and approved by UNRWA's HQ Contracts Committee. With the purchase of this new system, many of the weaknesses in the system will have been addressed. Given MMD's plans to introduce savings products, this is indeed a step in the right direction. MMD still has to purchase a savings module which does not come automatically with the new software. Additionally, as with any new software purchase, it will be important to maintain records in both systems while the new system is tested for accuracy.

#### **M. Performance Analysis: Outreach, Portfolio Quality, Profitability and Efficiency**

In its 16 years of operation, MMD has financed over 126,000 loans totalling \$131million. It is the leading microfinance provider in the Occupied Palestinian Territories and has also started operations in Syria and Jordan.

To be transparent and to follow 'Best Practices' disclosure requirements, MMD shares its performance indicators with Sanabel, the Microfinance network for Arab countries, and the Palestine Network of Microfinance Institutions. It benchmarks its activities with global, regional and local MFIs through its quarterly and annual participation in the MIX market, and by undertaking a biennial rating through a microfinance rating institution, the most recent being in 2005 by Planet Rating.

MMD has also introduced social performance management by training key staff in performance and impact assessment methodologies, and by building a framework for reporting, analysis, monitoring and evaluation of microfinance services and impact on clients. To ensure validation, an annual impact assessment is carried out by an external firm providing social performance management or impact assessment studies.

**Table 4: Key Indicators**

<b>Indicator</b>	<b>2005 USD</b>	<b>2006 USD</b>	<b>2007 – June USD</b>
<b>Outreach</b>			
Balance of Outstanding loans	7,859,641	6,014,089	7,183,938
Number of active loan clients	14,726	12,227	13,704
<b>Portfolio Quality</b>			
PAR ≥ 30 days	24.05%	32.59%	19%
<b>Profitability</b>			

ROA	-4%	-8%	-3%
Operational Sustainability	86%	68%	70%
Yield on Portfolio	45.7%	35%	34%-annualized
<b>Efficiency Ratio</b>			
Operating Expense Ratio	53.7%	51%	48% - annualized

From Table 4 above it is clear that 2006 was not a good year for MMD on all indicators, as a result of the economic crisis in the West Bank and Gaza. However, in 2007 there is a general improvement. Looking at the whole picture, however, if one relates the profitability indicators to the Portfolio Yield indicators (compared to the theoretical Yield for MEC<sup>14</sup> of 40.6%), the PAR ratios and the efficiency ratios, it is quite evident that in the MMD's sustainability equation the problem is on the expense side rather than on the income side. This means therefore that MMD should focus more on controlling and managing expenses.

MMD will have to create an atmosphere of efficiency as it plans to expand to introduce savings. This is mainly because savings mobilization will add to the costs of MMD without contributing to its income as it does not intend to intermediate.

A large percentage of MMD's costs are dependent on its being part of UNRWA. However, there are certain areas which are within its control such as the costs directly relate to service delivery. It is recommended that the following measures be taken to help reduce MMD's costs:

- Map the different processes – this will clearly indicate areas where there is inefficiencies
- Adopt a zero-based budgeting system – all members of staff need to be involved in this.
- Monitor actual costs against budget figures, analyze variances and take corrective actions
- Standardize operations as much as possible

## **N. Business Planning**

MMD developed a five year business plan in 2003 and later revised it in 2004 to cover the period up to 2009.<sup>15</sup> The business plan re-states MMD's mission, its objectives and contains an analysis of the socioeconomic and political environment highlighting the challenges and also makes financial projections. The business planning process involved some degree of consultations and involvement with various MMD staff. The current planning system follows standard UNRWA procedures and allows MMD to operate within the broader UN

<sup>14</sup> MEC makes up 72% of MMD's portfolio.

<sup>15</sup> The Medium-Term Plan for UNRWA's Microfinance and Micro enterprise Program: Contributing to Regional Growth, Rehabilitation and Recovery through Microfinance

system.

For short-term planning, MMD prepares budgets and twice a year carries out a variance analysis. However, with a large percentage of the costs controlled by UNRWA, the variance analysis does not lead to corrective action being taken.

While MMD is commended for the development of a business plan and having in place a budgeting and budgetary system, the current planning processes are not sufficient for a stand-alone financial institution, which is ultimately where MMD is heading. There are certain areas in the business planning process that require strengthening including:

- Articulate the vision and revise the mission appropriately to include savings.
- Carry out a more thorough SWOT analysis.
- Define and articulate a strategy.
- Define products including savings.
- Define financing strategy.
- Use of Microfin in the financial projections.
- Revise annually.
- Have input from the CEAs to the MMD's board members.

Such a comprehensive business planning process is a MUST for an organization like MMD that aspires to expand and collect savings. Although a business plan is not a crystal ball, the exercise of preparing one with participation by staff at all levels will help MMD in three ways:

- It raises key strategic and operational issues that MMD's staff and immediate stakeholders must address and, ultimately, resolve by consensus. These would include organizational restructuring, addition of new products including savings, entering into new markets, recruiting new staff, investment in new branches which would cater for savings, investment in training and upgrades in the MIS
- The financial and operational planning process, if carefully done, often reveals important, but not previously understood, dynamics of the business.
- The resulting plan serves as a roadmap for reaching the institution's goals. While there will always be deviations, a good and frequently updated plan would help MMD management to identify when it is deviating and the direction in which it needs to move in order to get back on track.

## **VIII. Conclusion**

As the largest MFI in the West Bank and Gaza, UNRWA is in a unique position to stretch the boundaries of microfinance as they have been practiced in the oPt. This study was part of UNRWA's overall strategy to expand its services to meet the needs of its clients, while

continuing to serve as the leader among the MFIs in the West Bank and Gaza.

The findings of this study clearly demonstrate the potential for expanding services to include savings. At the level of demand, while there is a limited capacity to save due to the economic crisis, there is a clear savings culture in the West Bank and Gaza with strong awareness among the Palestinian population that savings is a critical tool to help in future crisis. Individuals are currently saving using alternative channels such as ROSCAs and property. A large number of people also use the banking sector, although there are some complaints with the services. Through a series of focus groups and a survey conducted in the main regions where UNRWA currently operates, clients and potential clients demonstrated a strong interest in a tailored product for education as well as a current account which allows them to earn interest. With a long history serving the Palestinian people, UNRWA enjoys a level of credibility and trust that no other MFI can attain. UNRWA is well positioned to build on this trust with the introduction of savings products, even before it fully transforms into a bank.

As a UN agency, there does not appear to be any internal restrictions limiting UNRWA MMD's introduction of savings services, either within the UN system or eventually as a separate legal entity. With regard to legal restrictions, only licensed banks are allowed to mobilize savings in the oPT. As such there are several options open to UNRWA in order to introduce savings. These include serving as an agent for a bank, transforming into a bank or seeking a presidential decree allowing it to take deposits. There is also the potential that the PMA may authorize NBFIs to mobilize savings directly. In the immediate term, working as an agent may prove the easiest approach to launch savings products while using the goodwill generated under the "UNRWA brand". Eventually, as UNRWA pursues its longer-term goal to transform into a bank, mobilizing savings directly will be feasible.

Internally, UNRWA is a relatively healthy and strong MFI with sufficient capacity to introduce savings. Based on documents reviewed, staff and clients interviews, and observations, MMD is a key beneficiary of UNRWA's image in the eyes of the Palestinian people. MMD has been able to build a loyal client base over the years unrivalled by other MFIs in the region.

However, this same set up is also its major institutional impediment to sustainable and inclusive delivery of financial services, including savings (aside from the legal and regulatory issues raised by taking savings). MMD's expansion and the efficient provision of savings products calls for a more flexible organization, free from excessive bureaucracy, as this will be an important key for innovation.

Understandably, therefore, the first and main recommendation is the need for transformation of MMD into a separate legal entity, independent of UNRWA. Fortunately MMD has already started on this process by conducting a study which should set the stage for the transformation. Other recommendations as discussed in the different sections of this document will be more meaningful and have more positive impact if carried out in the framework of a transformed and independent MMD.

The summary of other recommendations for MMD include:

- The name of the new transformed MMD, as a separate legal entity should be linked to UNRWA so that MMD can continue to tap into UNRWA's image and reputation.
- State Vision and restate the mission statement to include savings services.
- Develop an organisational structure including a branch network set-up which will promote efficiency, easy access and customer loyalty.
- Put in place the internal HRD function and also have a Research and Marketing function that will ensure appropriate products and methodology which are responsive to client needs, affordable and easy to access.
- Put in place a cost accounting system to be able to cost and price products accurately.
- Upgrade the MIS.
- Strengthen the Accounting and financial management function to include the treasury function.
- Have in place a more proactive internal control system.
- Adopt a more comprehensive business planning process.

## ANNEX I Terms of Reference

While the Palestinian microfinance industry today provides tens of thousands of loans each year to microenterprises, low-paid consumers and householders, almost none of the current microfinance institutions provide savings or deposit services for the poor.

Over the past 15 years UNRWA has built up substantial client loyalty, staff capacity and professionalism in financing the credit needs of microenterprises, poorer consumers and households. As the largest microcredit provider in the oPt, UNRWA wishes to provide safe-savings services to the poorer and poorest Palestinians who have no access to banks because they cannot meet the minimum deposit requirement. The development of savings services will not compete with the private banking sector, but will market services among the poorest refugee and urban communities in the oPt.

UNRWA believes that as in other poor societies, safe-savings services can add to the coping strategies of the poor to help them survive in poverty and restore household assets and family security as they re-establish stable sources of family income.

There are no examples or models of voluntary savings and deposits services for the poor in the region. Therefore, UNRWA will contract technical assistance to review and assess the market for safe-savings in the oPt and propose a range of savings and deposit methods and deposit instruments that could be incorporated into UNRWA's microfinance operations.

This technical assistance and capacity building contract shall comprise of the following elements:

- Undertake a market and feasibility study identifying the scope for the introduction of savings services within UNRWA's microfinance operations.
- Consider how such services may be introduced under existing legal/regulatory conditions in oPt and/or what changes are required for UNRWA to provide such services (e.g. new regulations or MOU that could be negotiated and/or authorized by government legislation)
- Review UNRWA's existing operational procedures and determine what institutional, organizational, human resource, technical and IT conditions need to be developed to introduce safe-savings services.
- Propose/design a range of saving/deposit services and policies through which UNRWA could serve the needs of poor depositors and savers.

### **PROPOSED CANDIDATES (TO BE DETERMINED)**

The contracting partners should be an international consultancy firm or PVO with significant and diverse experience in the deposit taking and saving product development in the developing world, and familiar with the MicroSave Toolkits for market research and product design. While no direct experience of the Middle East will be required an institution/team with understanding of the microfinance sector in the MENA region would be better able to grasp and be more sensitive the political, economic and cultural issues involved in a transformation strategy.

A group of companies and/or PVOs with substantial experience in microsavings and the development of savings products will be pre-selected to participate in a bidding process through a

Request for Proposals. The selection of contractor will be undertaken jointly by UNRWA and AED in consultation with USAID.

### **REQUIRED DELIVERABLES UNDER THIS ACTIVITY**

By 30 June 2007:

1. Short list of pre- selected companies/PVOs for SMART review and comments.
2. Bidding documents (Request for Proposal) with time schedule, evaluation criteria and selection process description for SMART review and comments prior to publishing.
3. Documentation of the result of the selection process for SMART review prior to contracting.
4. Draft Contracting document including details of Company, final Scope of Work with time plan and deliverables, list of consultants assigned, task division and CVs for SMART review and comments prior to signing.

By 30 September 2007:

5. Draft Market Research and Feasibility Study report based on MicroSave Toolkits including findings related to legal and regulatory constraints in oPt; options and recommendations for savings/deposit services to be offered by MMD; assessment of MMD's current operational procedures and recommendations for institutional, organizational, human resource, technical and IT enhancements necessary to introduce the recommended savings/deposit services for SMART review and comments prior to finalization of report.
6. Concept Paper summarizing the findings and recommendations in the Market Research and Feasibility Study and proposing any changes required for UNRWA to provide savings services as recommended (e.g. new general regulations or specific license/permission (MOU) negotiated and/or authorized by government legislation).

**ANNEX II**  
**Market Research Report**

See attached PDF document.

## ANNEX III

### List of Persons Met

	Name	Position	Organization	Email contact
1	Ahamad R. Haj Hasan	Acting Division Chief	Palestine Monetary Authority	<a href="mailto:ahasan@pma.ps">ahasan@pma.ps</a>
2	Alex Pollock	Director of Microfinance and Micro enterprise Department	MMD, United Nations Relief and Works Agency	<a href="mailto:a.pollock@unrwa.org">a.pollock@unrwa.org</a>
3	Anwar Jayyusi	Managing Director	Palestine for Credit and Development(Faten)	<a href="mailto:ajoyyosi@faten.org">ajoyyosi@faten.org</a>
4	Ayed Al-Zeghari	Verification Officer	MMD, United Nations Relief and Works Agency	<a href="mailto:a.al-zeghari@unrwa.org">a.al-zeghari@unrwa.org</a>
5	Ayman Al-Seresy	MIS Consultant	MMD, United Nations Relief and Works Agency	<a href="mailto:a.alsaresy@unrwa.org">a.alsaresy@unrwa.org</a>
6	Gaamaa Hishigsuren	Manager, Rural Finance	MEDA	<a href="mailto:gaamaah@meda.org">gaamaah@meda.org</a>
7	Hani S. Naser	Regional Manager	Bank of Palestine	<a href="mailto:hnaser@bankofpalestine.com">hnaser@bankofpalestine.com</a>
8	Hiba Hussein	Lawyer	Hussein and Hussein	<a href="mailto:hh@hussein1.com">hh@hussein1.com</a>
9	Ibrahim Jabr	Senior Branch Manager	MMD, Nablus UNRWA	<a href="mailto:i.jabr2@unrwa.org">i.jabr2@unrwa.org</a>
10	Jane Giacaman	Chief, Microfinance Operations	MMD, UNRWA	<a href="mailto:j.giacaman@unrwa.org">j.giacaman@unrwa.org</a>
11	Khaled Walid Qutob	Program Officer	IFC	<a href="mailto:kqutob@ifc.org">kqutob@ifc.org</a>
12	Lex Takkenberg	General Counsel	UNRWA	<a href="mailto:l.takkenberg@unrwa.org">l.takkenberg@unrwa.org</a>
13	Loay S. Hawash	Credit &Collection Manager	ARAB Bank Ramallah	<a href="mailto:loayhawash@arabbank.ps">loayhawash@arabbank.ps</a>
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## ANNEX IV

### Licensing Requirements

The main bank licensing requirements are:

1. Obtain initial approval from the PMA to operate a bank prior to the registration of a company under the prevailing Companies Laws (the presumption is that only a corporate public shareholding entity can perform banking operations);
2. Provide the PMA with a completed application (PMA supplies the applicable forms);
3. Pay an application fee in the amount of \$105,000 (\$100,000 will be refunded in the event the application is denied);
4. Support the application with the following documents, among others:
  - a. the proposed articles of incorporation and by-laws of the company;
  - b. the organizational structure for the bank and business plan;
  - c. a feasibility study including the budget for the first three years of operations;
  - d. the names of founding shareholders; and
  - e. undertaking that the founding shareholders shall subscribe in 20%-50% while the rest shall be offered to the public for subscription.
5. Submit the application for PMA's review to obtain initial approval or denial;
6. Upon receipt of approval, proceed to registering the company (NB: share capital must not be less than \$30 million and must be issued, subscribed and paid for);
7. Once registration is complete, begin operations;

PMA's Banking Supervision Department will conduct an inspection of the bank set up operations to ensure satisfaction of the requirements. PMA has the discretion to revoke the initial approval if, during the inspection, the bank is found to have failed to satisfy these requirements. If the bank is deemed to have met all the requirements, the final approval will be granted. The bank has 30 days to commence operations from grant of final approval; otherwise, the PMA may revoke it. If such revocation occurs, it will be final and not subject to any appeal.

### KYC

In addition to existing circulars, the PMA is in the process of issuing detailed requirements for prudential regulations and knowing your client. According to the circulars, the bank is required to:

1. Obtain sufficient information and supporting documentation when opening a bank account for any customer.
2. Use the proper bank forms which must be completely filled out and signed by the customer.
3. Verify the accuracy of the information provided and ensure its veracity.
4. Supply the PMA with a copy of the account opening forms it uses.
5. Obtain a written undertaking from customers to provide the bank with all relevant changes to their addresses or personal information.
6. Ensure that the application includes the full name of the customer, citizenship, residential address, work address, postal address, current employment/work details of the customer and other information showing that the customer is opening the account for him/herself and not on behalf of another coupled with an undertaking that the customer is the only beneficiary of such an account.
7. Ensure that the customer undertakes to refrain from accepting deposits or taking any funds whose source is not known to the customer or whose source is suspect.

### Anti-money Laundering Guidelines

The PMA issued anti-money laundering guidelines for banks to follow. These guidelines aim to provide the banks with direction on how to guard against money laundering activities. The main aspects of these guidelines are:

1. Know Your Customer
2. Management of risk
3. Continuous supervision of banking operations and accounts
4. Watch for money laundering general indicators
5. Watch for funds coming from countries known to harbor money laundering activities
6. Watch for wire transfers that are large and tend to have repetitive partners
7. Watch for financing operations through third parties
8. Evaluate the obligations of third parties in relation to any existing account
9. Ensure proper internal supervision over credit cards and e-banking
10. Watch for unusual transaction at tellers
11. Watch for credit and investment indicators that involve settlement of unusually large amounts
12. Watch for indicators related to conduct of staff or customers

## ANNEX V

### Proposed Organizational Structure

