

5 March 2010

Dear Godwin,

We hope you are well. We are writing to you once again as a group of lenders to LAPO to voice our common concerns, this time in response to the rating by Planet Rating. We wish to emphasise that we are writing as your partners, and send this letter in a constructive state of mind. We are particularly pleased that you are going forward on the hiring of a professional CFO, and look forward for the conclusion of this process. We appreciated as well that you went through a rating exercise, as we recommended in our previous letter (dated 14 September 2009).

The present letter arises from a number of issues raised by the rating. While we are pleased with the content and thoroughness of the rating, we do believe that the "Uncertain" outlook may not be warranted. Nonetheless, given LAPO's importance in the Nigerian and African microfinance sector and its highly visible position internationally, we believe that it is essential to act as soon as possible on some of the valid recommendations made in the rating. We wish to share with you our most pressing concerns below, some of which have been discussed with you in the past:

1. Please do go forward with commissioning **an external audit by one of the big four auditing firms for the 2009 financial year**. This is perhaps the most urgent concern for all lenders. We kindly remind you that you mentioned a couple of months ago that you may go for a special audit as of June 2009 with a big four company. You didn't fulfil this expectation (see our previous letter dated 14 September 2009), to our disappointment. We feel strongly that an audit by a different and internationally recognised auditing firm will help LAPO in the process towards transformation, as well as facilitate the obtaining of new funding from national and international lenders.
2. We realise that LAPO charges one of the lowest interest rates in all of Nigeria for a similar loan size. We also appreciate your commitment to decreasing the interest rate on loans. Nonetheless, the **effective interest rate (EIR)** from the perspective of the end-client did increase in 2009. This is due to the increase in the minimum rate of compulsory savings from 10 to 20%. If you wish, we can share with you the calculation of effective interest rate to illustrate the effect of compulsory savings on the EIR. We understand that compulsory savings constitute an affordable way of funding your portfolio and limiting the fluctuation in savings, and that the decision to increase the minimum rate of compulsory savings was made separately from the decision to decrease the interest rate on loans. Nonetheless, the increase does lead to an increased *effective cost of borrowing* to your members. We urge you to **reverse this increase in the rate of compulsory savings as well as the decrease in the rate of interest paid to members on their savings**. Given the high rate of inflation in Nigeria, 4% is a very low interest rate to pay on savings.

3. We believe that LAPO should urgently push forward on transformation in order to avoid allegations of illegally collecting or on-lending savings. We kindly ask you to **please send a list of steps which have already been completed, and the steps which remain to be taken towards transformation, and to provide regular updates on the progress made** towards fulfilling these conditions.
4. We are concerned about the **high level of lending and investments to affiliated LAPO organizations**. This is a significant risk for a microfinance organisation, and not in line with the core business of LAPO. Please clarify if these loans and investments will remain with LAPO NGO or will be transferred to the MfB following transformation. Those investments represent today 23% of total equity. We'd like a commitment from your end on decreasing this exposure in the coming months. Please could you send us a chronogram for diminishing this exposure.
5. We are quite concerned about the fact that there is **no data available on the use of the risk premium** (page 12, footnote 32 in the rating) charged to clients at disbursement. This is an important part of your income and should absolutely be included in the external audit by the new auditing firm.

We hope that you understand our concerns as committed partners to LAPO, that you will take our common concerns to heart, and that you will act on them. We would appreciate to receive an answer before 19 March 2010.

We urge you to send regular updates on these issues as LAPO moves forward on these issues.

Kind regards,

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