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BANK GROUP FINANCIAL SECTOR STRATEGY AND ACTION PLAN

(for the five-year period 2011-2016)

Governance and Financial Reforms Department (OSGE)

October 2010

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ACRONYMS AND ABBREVIATIONS

AFMI	African Financial Markets Initiative
ADB	African Development Bank
ADF	African Development Fund
AMINA	African Development Fund Micro-finance Initiative for Africa
AML/CFT	Anti Money Laundering/Combating the Financing of Terrorism
APRM	African Peer Review Mechanism
AsDB	Asian Development Bank
AU	African Union
BIS	Bank for International Settlements
BSL	Budget Support Loan
BWIs	Bretton Woods Institutions (the IMF & the World Bank)
CFA	Communauté Francophone Africaine
CEMAC	Communauté économique et monétaire afrique centrale
COMESA	Common Market for Eastern and Southern Africa
DAC	Development Assistance Committee
DB	Doing Business
DBSL	Direct Budget Support Loan
DFIs	Development Finance Institutions
DP	Development Partner
EAC	East African Community
ECA	Economic Commission for Africa
ECCAS	Economic Community of Central African States
ECOWAS	Economic Community of West African States
EADI	African Development Institute
ECON	Office of the Chief Economist (of ADB)
EDRE	Research Department (of ADB)
ESTA	Statistics Department (of ADB)
ESW	Economic and Sector Work
EU	European Union
FATF	Financial Action Task Force (on Money Laundering and Terrorist Financing)
FSRB	FATF-Style Regional Body
FI	Financial Intermediary
FIRST	Financial Sector Reform and Strengthening Initiative
FS	Fragile States
FSAL	Financial Sector Adjustment Loan
FSAP	Financial Sector Assessment Program
FSS&AP	Financial Sector Strategy and Action Plan
FSTAP	Financial Sector Technical Assistance Programs
FTRY	Treasury Operations Department (of ADB)
FFMA	Risk Management Department (of ADB)
GDP	Gross Domestic Product
HIPC	Highly Indebted Poor Country
HLP	High Level Panel
IBRD	International Bank for Reconstruction and Development
IaDB	Inter-American Development Bank
ICF	Investment Climate Facility
IFC	International Finance Corporation
IFIs	International Financial Institutions
IMF	International Monetary Fund
ISP	Institution Support Project

KPI	Key Performance Indicator
LIC	Low Income Country
LOC	Line of Credit
M2	Currency in circulation + demand deposits + savings deposits
MDB	Multilateral Development Bank
MFI	Microfinance Institution
MFWFA	Making Finance Work for Africa Partnership
MIC	Middle Income Country
MLT	Medium and Long-Term
MSME	Micro, Small and Medium Enterprises
MTEF	Medium Term Expenditure Framework
NEPAD	New Partnership for Africa's Development
NBFI	Non-Bank Financial Institution
NGO	Non-Governmental Organization
NPA	Non Performing Asset
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OIVP	Vice Presidency Complex (of ADB) covering Infrastructure, Private Sector, NEPAD, Regional Integration and Trade
ONRI	NEPAD, Regional Integration and Trade Department (of ADB)
OPEV	Operations Evaluation Department (of ADB)
OPSM	Private Sector and Microfinance Department (of ADB)
ORVP	Vice Presidency Complex (of ADB) covering Country Operations
ORRU	Cooperation and Partnerships Unit (of ADB)
OSGE	Governance, Economic and Financial Reforms Department (of ADB)
OSVP	Vice Presidency Complex (of ADB) covering Governance, Social and Agriculture Sectors
PBL	Policy-Based Loan
PRSP	Poverty Reduction Strategy Paper
PSO	Private Sector Operation
RBCSP	Results Based Country Strategy Paper
REC	Regional Economic Community
RFI	Regional Financial Integration
RISP	Regional Integration Strategy paper
RMC	Regional Member Country
ROSC	Report on Observances on Standards and Codes
RTGS	Real Time Gross Settlement
SAL	Structural Adjustment Loan
SME	Small and Medium Enterprises
SWAP	Sector Wide Approach
TA	Technical Assistance
UA	Unit of Account (= SDR, Special Drawing Right)
UEMOA	Union économique et monétaire ouest-africaine
UNDP	United Nations Development Program
UNECA	United Nations Economic Commission for Africa
WAEMU	West African Economic and Monetary Union (UEMOA)
WAMZ	West African Monetary Zone
WAMI	West African Monetary Institute
WB	World Bank

BANK GROUP FINANCIAL SECTOR STRATEGY AND ACTION PLAN, 2011-2016

EXECUTIVE SUMMARY

1. This paper outlines the strategic directions of the African Development Bank Group in support of financial sector development in regional member countries (RMCs). The Financial Sector Strategy and Action Plan (FSS&AP) takes into account the experience of the Bank in the implementation of its Financial Sector Policy, adopted in 2003, emerging issues and lessons learned in financial sector development during the last decade and through the recent global economic crisis that originated in the financial sector. It also reflects guidance on the future directions of the Bank's financial sector work, notably by the ADF Deputies and through the Bank Group Medium Term Strategy as well as the recommendations of the independent High Level Panel (HLP) on 'Investing in Africa's Future: The ADB in the 21st Century' of January 2008.

2. While African countries have made progress in financial sector reforms, the achievements have been inadequate in deepening the financial systems and putting them on a sustainable path of development, in addressing emerging real sector concerns, or in fulfilling the sector's potential role in growth and poverty alleviation. The recent global financial crisis has also re-emphasized the need to still pay attention to financial sector issues. As the agenda for financial sector development and demand of RMCs for support have broadened, the operations of Development Partners (DP) in the sector have also increased.

3. The FSS&AP provides a rationale for focus in the Bank's financial sector activities. The strategic focus is guided by (i) the Bank's mandate, track record and internal capacity; (ii) the need to create synergy with the activities of other partners as well as coherence in Bank activities; and (iii) opportunities to contribute to addressing the financial sector challenges in RMCs. Based on these considerations and the agenda of financial sector development in RMCs, the FSS&AP focuses on activities that reflect the Bank's roles as knowledge builder, strategic partner and catalytic financier and its core mandates in regional integration, governance, and private sector development. Operationally, the activities will be undertaken at four levels, namely:

- Regional Level: to enhance regional collaboration and harmonization to strengthen financial integration;
- Country Level: to strengthen policy dialogue, analytical work and country systems towards integrated and coherent financial sector development;
- Sector Level: to improve financial governance by supporting the strengthening of financial regulation and supervision as well as of financial infrastructure; and
- Financial Institutional Level: to enhance the diversity and commercial viability of financial institutions to increase opportunities for the Bank's funding of MSMEs.

4. In addition, at Bank Group level, the FSS&AP will ensure coherence and synergy in Bank support to financial sector development by focusing on specific activities that support each other at the various levels and that fit into the Bank's Medium Term Strategy.

5. Even so, given the scale and complexity of the challenges of financial sector development and the limited internal resources and capacity, the Bank will prioritize and phase the implementation of the activities, while establishing the necessary internal expertise and staff strengths and mobilizing resources towards the strategy's effective implementation. A further critical success factor for implementation will be to ensure that the imperative of financial sector

development is properly reflected in the Bank's operations. This will require alignment of sector and spatial strategies and operational programs of relevant organizational units across the Bank, with the strategy. The Governance and Financial Reforms Department will ensure this alignment and will monitor the implementation of the strategy.

BANK GROUP FINANCIAL SECTOR STRATEGY AND ACTION PLAN, 2011-2016

I INTRODUCTION

1.1 This paper, that outlines the African Development Bank Group's Financial Sector Strategy and Action Plan (FSS&AP) for the period 2011 to 2016, consists of five sections. The first provides a brief background to the Bank Group's work in the financial sector, and the rationale for intensifying its interventions to enhance access to financial services by the poor as a means of alleviating poverty in Africa. The next section briefly outlines the main trends in, and challenges to, financial sector development in Africa, and the opportunities that the Bank seeks to seize as Africa's premier development financial institution. The third presents the Bank Group's past experience in the sector, and the lessons it has learned, as well as those learned by others, including, development partners. The strategy and its pillars are presented in the fourth section, which also outlines the key guiding principles for the Bank's engagement. The final section discusses the institutional, implementation, and monitoring and evaluation arrangements that are required to enhance delivery of the Bank Group's strategy.

II BACKGROUND AND RATIONALE

2.1 Since it issued its Financial Sector Policy in 2003, the Bank intensified efforts to foster financial sector development in Africa as a means of sustaining higher economic growth, and alleviating poverty. In this context, in 2006, the Bank Group reorganized its structure, including the establishment of a Governance and Financial Reforms Department (OSGE) to lead financial sector work as well as the broadening of the mandate of other departments to support the areas of microfinance and SME financing (OPSM) and financial integration (ONRI). Further, the Governance Strategic Directions and Action Plan for 2008-2012 that was approved by the Bank in 2008, re-focused the Bank's work on good economic governance, in several fronts, including financial sector soundness, at both country and regional levels. Finally, the "Making Finance Work for Africa"[1] partnership that was set up in 2008 by development partners, and whose Secretariat is hosted by the Bank, is creating synergies among donors and other stakeholders to leverage their financial sector development efforts in line with the principles of the Paris Declaration on Aid Effectiveness, and the Accra Agenda for Action.

2.2 As such, the Bank Group, and other development partners, have been in the forefront of providing advisory, technical and financial support to its Regional Member Countries (RMCs) in their endeavors to develop their financial sector. This is in recognition that a well-functioning financial sector is critical to Africa's development, and its poverty reduction efforts[2], and a prerequisite for enhanced mobilization of internal resources to reduce external aid dependency. Further, the Bank is aware that promoting the soundness and integrity of financial markets

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[1] Making Finance Work for Africa's contributors include African governments, the World Bank, the African Development Bank (AfDB), the German Development Corporation (GTZ), the Consultative Group to Assist the Poor (CGAP), the European Investment Bank (EIB), the Financial Sector Reform and Strengthening Initiative (FIRST), the French Development Agency (AFD), the UK Department for International Development (DFID) and the Swedish International Development Agency (SIDA).

[2] The financial system is defined in this Strategy to comprise three components: *financial policies* (monetary, financing of the public sector, external sector, and provision of financial services), *financial infrastructure* (legal and regulatory framework, audit systems, accounting and financial disclosures, collateral registries, credit bureaus, and payments systems), and *financial institutions* (banks, non-bank financial institutions, money and capital markets) and their products or *instruments*.

through improved regulation and supervision, will also be beneficial in the fight against corruption, cronyism, and corporate looting, that all impose unbearable burden on the poor[3].

2.3 Despite these efforts by the Bank and other partners, financial markets in several RMCs remain shallow and fragmented, and therefore, are not yet effective tools for advancing Africa's economic developmental prospects. Further, the slowly receding economic crisis that continue to pose major economic difficulties for African economies, and the launching of several new initiative for the continents development, all point to the need for the Bank to intensify its financing and advisory services in financial sector development (see Box 1).

Box I: Africa's Financial Development Priorities

- The impact of the global financial and economic crises on Africa has reinforced the need to strengthen the continent's financial sector, to both improve the efficiency of domestic resource mobilization, and prevent/mitigate future financial crises.
- Regional programs, such as the African Peer Review Mechanism (APRM), and regional economic communities (RECs), are intensifying efforts to enhance economic and financial governance, strengthen regional monetary and financial infrastructure, and to revitalize private sector development in Africa through increased access to finance.
- Despite the progress made by countries to reform their financial sectors, recent research highlight remaining challenges that constraint the role of the financial sector in Africa's economic development and poverty reduction efforts[4]. Thus Africa's governments are increasingly seeking resources to finance reforms and to strengthen the capacities of financial sector institutions.

2.4 The Financial Sector Strategy and Action Plan (FSS&AP), 2011-2016, therefore, aims refocus the Bank Group's work in the financial sector to remove potential constraints to future growth in the sector, and to seize emerging opportunities based on competitive advantages. It provides the rationale for greater strategic selectivity and focus in the Bank's financial sector development work. It defines guiding principles for delivering results and achieving impact. It is based on the shared vision that the Bank's credibility, especially as Africa's premier development finance institution, hinges on its capacity to deliver results and demonstrate impact. Achieving this, will require matching ambitions with resources by concentrating on those areas where the Bank has a distinctive contribution, a track record and comparative advantage. It will also requires re-aligning Bank resources−financial and human resources−on a selected range of strategic priorities, both in terms of its portfolio, and knowledge generation.

2.5 Underpinning this Strategy is several thorough analysis and recommendations by a broad range of stakeholders. It adheres to the recommendations in the report by an independent High Level Panel (HLP)[5], the Bank's Medium-Term Strategy 2008-2012, and Regional Financial Integration studies[6], as well as lessons by other development partners, including, the World Bank[7], the International Monetary Fund (IMF), and several bilateral agencies. In all these information sources, support for financial sector development in Africa is listed as a major

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[3] An efficient financial system also provides services of channeling funds to client countries that are essential for translating the benefits of the operations of the Bank and other development partners. Thus financial instability not only disrupts these developmental functions, but also, the huge, lingering costs of failure can set back development and poverty reduction efforts for years.
[4] See, for example, Honohan, Patrick and Beck, Thorsten '*Making Finance Work for Africa',* World Bank, 2007.
[5] See report, *"Investing in Africa's Future: The AfDB in the 21st Century"*: Report of the High Level Panel, 2007
[6] AfDB, 2009 (unpublished): 'Regional Financial Integration in Three Subregions', Tunis.
[7] See: (i) Honohan, Patrick and Thorsten Beck, 2007: *Making Finance Work for Africa*, The World Bank, Washington, DC.; and (ii) World Bank, 2008: *Regional Financial Integration in Two Subregions*, Washington.

priority if Africa was to accelerated sustainable economic growth and poverty reduction. The Strategy has been developed following an intensive consultative process[8].

III FINANCIAL SECTOR DEVELOPMENT IN AFRICA: THE AGENDA, OPPORTUNITIES AND CHALLENGES

3.1 Agenda for Financial Sector Development in Africa

3.1.1 The history of financial sector reforms in Africa dates back to the late 1980s with the liberalization of interest rates, lifting of barriers to entry and exits in the sector, and the privatization of state-owned financial intermediaries. Recognizing that such reforms failed to achieve meaningful structural and institutional reforms, governments in Africa embarked in the second phase of reforms that targeted strengthening regulatory frameworks and making central banks more independent. More recently reform efforts have targeted enhancing corporate governance with the aim of improving transparency and accountability of institutions, and putting further emphasis on improving the mobilization of term finance and supporting private sector development[9]. Further, the receding financial crisis has refocused efforts on need to maintain financial system stability and soundness.

3.1.2 Despite these major reform efforts and the progress that Africa has made in implementing financial sector reforms, various analyses including those by the governments, the Bank and other development partners, the results overall show that various weaknesses, namely, intermediation deficiencies, development deficiencies, and poverty reduction deficiencies, remain (see Box 2). Performance of most African financial sectors demonstrates some major constraints in serving the development and private sector needs of their respective economies and addressing emerging issues such as the growing need for trade finance in a globalized and competitive international trade environment[10]. The rising youth unemployment−reflecting increasing population −, the adverse impact of the global economic crisis, increased urbanization−with its implications for increased demand for housing−, all of point to the need for policy makers to pay greater attention to linkages between the financial system, and the real economy. Further, there is need to respond decisively to climate change through mitigation policies and mechanisms, and to develop safety nets−especially for farmers and small and medium enterprises (SMEs)−, both of which require an effective financial system.

3.1.3 To eliminate these deficiencies (see Box 2, Annex 2) require a focused agenda for financial sector reforms and development in Africa, at national, sector, regional, and institutional levels. The key priorities across countries, lay emphasis on establishing a healthy and sound financial system to eliminate the intermediation deficiency; diversifying and deepening the financial sector to address the developmental deficiency, and promoting financial inclusion to curtail the poverty reduction deficiency.

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8 After initial consultations with in Tunis during the 2010 African Economic Conference, October 27-29, 2010, further consultations were held with partners and stakeholders through several fora, including access through the Public Information Centre, field offices, and the Bank Group's website, in line with the Bank Group's Policy on Disclosure.

9 Governments have emphasised: strengthening corporate governance (including improving information disclosure requirements, investor education, and implementing internationally accepted accounting and auditing standards), and establishment of institutional frameworks of finance (commercial courts, collateral registries and credit reference bureaus).

10 The recent accentuation of this demand in the wake of the financial crisis led to the Bank's establishment of the Trade Finance Facility. However, early recognition of the importance of trade finance led to the Bank's support in the creation of the Afreximbank

Box 2: Deficiencies in the Africa's Financial Sector

- ***Intermediation Deficiency:*** The structure of many African financial systems remains small, fragile, inefficient and highly risky, impeding their intermediation function. Such markets are shallow, volatile and risky (from political and economic shocks11) and are beset by governance deficiencies (corruption and difficulties in enforcement of contracts and creditor rights) and information asymmetries. These constraints force SMEs to rely more on their own internal funds rather than bank loans.

- ***Development Deficiency:*** Overall, the financial sector, especially in low-income Africa, does not provide adequate services to support private sector growth and development, while the issue of high cost of capital, which had prompted the earlier interventionist approach by governments, remains. The financial systems are dominated by banks that are heavily geared towards the short end of the market. Sources of long-term finance are under-developed or poorly performing as only a few countries in Africa have capital markets; and where these exist, the majority, are small and illiquid. Further, government financing needs mostly crowd out private enterprises' access to finance.

- ***Poverty Reduction Deficiency:*** Generally, access to finance remains lower in Africa than in other developing regions, with the result that many of the poor resort to informal sources for financial services. While some countries such as Kenya have leveraged technology to enhance financial inclusion, many countries suffer structural weaknesses that hamper the development of products suitable for micro, small and medium enterprises (MSME) lending, preventing the financial system from addressing adequately the needs of the poor. Despite these constraints, microfinance is developing, with the growing interest from banks and private investors12, while support services and regulatory frameworks are also being put in place.

3.2 Opportunities for Financial Sector Reform and Development

3.2.1 Country, sector, regional, and international dimensions are important elements for further considerations when defining and prioritizing financial sector reforms that would eliminate intermediation, developmental, and poverty reduction deficiencies, and allow the realization of enhanced economic growth opportunities for Africa's economies.

3.2.2 *At the national level,* African countries, except for a few fragile ones, have made progress in financial sector reforms by enhancing financial system soundness, and modernizing and deploying new instruments and innovations. At the same time, the past and ongoing broader economic and political reforms, especially the political stability, good governance, and transparency and accountability of governments are laying a foundation for robust financial sector growth. Further, the growing importance of the private sector, the adoption of market-based system of economic management, the gradual reduction of barriers to trade and capital flows, and the improvements in national infrastructure, are all creating the opportunities for Africa's enhanced economic growth prospects. Continued success in these areas hinges on financial sector stability, and continuity and predictability of financial sector policies.

3.2.3 *At the sector level,* debt cancellation and other debt relief initiatives that benefited many African countries in addition to new aid mechanisms such as budget support and Sector Wide Approach (or SWAPs) and the introduction of Medium Term Expenditure Frameworks (MTEF), have all increased macroeconomic and financial management capacity in African countries. Further, African economies are benefiting from increased "policy tolerance", which has widened

[11] The economic shocks reflect high dependence on exports of primary products and susceptibility to both demand-side shocks (terms of trade volatility) and supply-side shocks caused by natural disasters such as floods and droughts as well as political disruptions and civil unrest. On average, an African country survives little more than a decade without major social, political or economic disturbance (See Martin Meredith, 2005: *The State of Africa: A History of Fifty Years of Independence*, Free Press London.

[12] The MFIs include banks, post office banks, DFIs, deposit taking and non-deposit taking MFIs, cooperatives, and some NGOs.

the degrees of freedom in policymaking. Thus African policymakers today are finding it easier to implement policy measures that were considered “unacceptable” a few years ago.

3.2.4 *At the regional level*, the New Partnership for Africa’s Development (NEPAD) puts the financial sector at center stage in African development, as it emphasizes the importance of improving conditions for international private capital flows, regional financial integration and domestic resource mobilization. It also embraces the importance of implementing good economic and corporate governance, including banking and financial standards, and has incorporated the assessment of progress in these areas within the African Peer Review Mechanism (APRM).

3.2.5 *On the international front*, barriers to trade and investment flows continue to be lowered or removed. In addition, significant advances have been made in the international financial system, both in terms of the range of institutional financial arrangements and the instruments available to savers and investors. Development partners have also stepped up support for financial sector development in line with the Paris Declaration on Aid Effectiveness by establishing the Making Finance Work for Africa framework that African countries are using to advance their financial sector development agendas.

3.3 Challenges of Financial Sector Reform and Development

3.3.1 Several challenges inherent in Africa’s financial sector undermine effectiveness in financial sector as an engine for growth in Africa (Box 3). There is, therefore, broad consensus that a holistic approach is required to address Africa’s financial sector developmental needs. Nevertheless, implementation of financial sector reforms needs to proceed in a gradual and sequential manner, taking into consideration the political, macroeconomic, and institutional contexts in across countries and sub-regions in Africa[13].

Box 3: Financial Sector: Key Challenges

- *Small size of the sector* (as measured by the absolute size of liquid liabilities and the ratio of liquid liabilities to GDP):
  - reduces scope for arm’s length relationships
  - lower productivity and skills shortages
  - prevents banks from exploiting scale economies, and financing large investments
- *High exposure to economic and socio-political shocks*, including crop failures, sharp changes in prices of traded commodities, civil unrest, and unexpected changes in government and government policies:
  - limits the time horizon of savers and investors
  - restricts governments’ as well as private sectors’ planning horizons
- *The high incidence of informality*, especially lack of documentation and formal contracts in personal, professional and business transactions:
  - restricts access to credit markets by poor and rural households, and micro-entrepreneurs
  - accentuate information asymmetries prevalent in the system
  - makes government interventions less effective as a large percentage of the population is excluded
- *Governance and regulatory deficiencies*, including weaknesses in the contractual framework, high degrees of corruption, risks of expropriation, lack of capacity of the regulatory institutions and inefficient bureaucracies:
  - limits to the effectiveness of government interventions
  - curtails the extent to which the benefits from financial sector reforms can reach the majority
  - entrenches self-interest that sometimes evolve into greed and selfishness and shifts focus from the long-term commitments to the short-term transactions

[13] The ‘Lessons of Experience’ in the Bank Group Financial Sector Policy (2003), remain valid today as in 2003.

IV EXPERIENCE OF BANK GROUP AND OTHER DEVELOPMENT PARTNERS

4.1 Support for Financial Sector in Africa

4.1.1 The African Development Bank, in partnership with other development partners, deploys several instruments and activities−lending and non-lending−to enhance the financial sectors of Africa's economies. Currently, the Bank's support to the financial sector is provided on the basis of the Bank Group's Financial Sector Policy (2003), the Private Sector Strategy (2008), the Governance Strategic Directions and Action Plan GAP 2008-2012, and the Regional Integration Strategy (2009-2012).

4.2 Lending Activities

4.2.1 The Bank provides loans and grants to promote financial sector development, through investment projects, lines of credit, and policy-based operations (including general and sector budget support). The Bank deploys investment projects to enhance the capacities of financial sector regulators, supervisors, and institutions, to better deliver on their mandates. The Bank also offers lines of credit (LOCs) to financial institutions for on-lending to small and medium sized enterprises. Finally, the Bank supports reforms and to help strengthen financial sectors through policy-based and budget support operations (grants and loans).

4.2.2 In the past, when financial sector reform was not on the top of policy makers' development agendas, the Bank's main approach was to support the real sector by channeling loans to financial intermediaries that on lent the funds long-term to agriculture, industry, and housing. However, during the 1980s, many of these intermediaries needed bailouts. More fundamentally, questions arose about the design of these loans, which limited their impact. At that time, Dirigist regimes in most of the member countries did not allow for a congenial policy environment that could ensure competitive and distortion-free economies. As such, lines of credit (LOCs) to financial intermediaries narrowly focused on the benefits to, and the viability of, the borrowing institutions14, rather than on the overall health and efficiency of financial institutions or the broader enabling conditions for an efficient financial sector. The recipient institutions, ended up failing to provide the necessary long-term finance required to support the development in the real sectors. Policy makers realized that there was need for more comprehensive reforms with greater emphasis on policies, institutions and reliance on market forces. This view was also reinforced by the awareness of the importance of the financial sector to economic performance in the real sectors.

4.2.3 By the mid-1990s, most RMCs had removed distortions, and the financial sector development agenda had evolved to improving financial governance, building financial infrastructure and strengthening institutions (including privatization and restructuring). The Bank, therefore, developed a broader perspective about its role in the financial sector development in 1996, when it articulated its policy in regard to private sector development, and introduced new and varied intervention instruments, such as guarantees, equity and quasi-equity investment, and agency lines, which have the capability of strengthening financial institutions, while also fostering the development of the financial sector. In 1998, the Bank further broadened its financial sector perspective when it created the AMINA Unit to support the development of microfinance in Africa. However, the Bank did not provide financing for microfinance activities

[14] These operations provided liquidity (access to foreign exchange resources and credit funds), while their long-term tenure also allowed the borrowing institutions to extend the maturity of their lending operations. They also enabled the Bank to indirectly and efficiently reach a larger number of enterprises than would otherwise be possible, particularly the SMEs.

until after 2006, when microfinance was introduced in private sector operations. Rather, financial sector issues were broadly addressed both in the context of the structural adjustment loans (SALs) and financial sector adjustment loans (FSALs). However, these operations in many ways overlapped with those of the World Bank and the IMF.

4.2.4 In the areas of regional integration, governance, and capacity building, where the Bank has a clear mandate or has built capability, the Bank has implemented some programs on its own. Recently, with improvements in governance in RMCs, the Bank has used budget support to support countries to address macroeconomic imbalances, and to help countries to mitigate the adverse effect of the global financial crisis. An analysis of the current focus of the Bank's lending activities indicate that the bulk of the lending operations were catalytic financing delivered at the institutional level, followed, to a much lesser extent, by sector and national level operations, and rarely at the regional level. Annexes 3 & 4 presents a sample of the Bank Group's lending operations in the financial sector from 2006 to 2009.

4.3 Non-Lending Activities

4.3.1 ***Policy Dialogue:*** The Bank, in collaboration with other development partners, conducts policy dialogue with client countries and regional institutions to enhance understanding of financial sector issues and their implications on development. For example, in response to the global economic crisis, the Bank intensely engaged regional organizations to organize high-level conferences to discuss specific challenges posed by crisis on Africa's economies, and the possible solutions. With the opening of field offices, the Bank has also stepped up its country-level dialogue, including in areas of financial sector developmental.

4.3.2 ***Technical Assistance:*** The Bank's advisory work has been largely centered on building institutions or knowledge in RMCs. These advisory services include special advisory services on project structuring and financial packaging; financial advisory services for privatization of projects or to private enterprises; and policy advice on microfinance and private sector development, foreign investment, capital market development and other related subjects. All technical assistance is in the form of grants, and the bulk is used to manage the project cycle.

4.3.3 ***Economic and sector work (ESW):*** The Bank, like other multilateral institutions, makes use of ESW to obtain analytically based information about the development conditions, constraints, and prospects in RMCs to facilitate the formulation of macroeconomic, structural, and financial sector, interventions in RMCs. For example, in 2009 the Bank undertook a study on regional financial integration in Africa, which provided an instrument for dialogue with the RECs and other donors and facilitated the formulation and prioritization of the Bank's work on regional financial integration[15]. Though limited in depth and breadth, the Bank has also undertaken assessment of the financial sector of countries including Ethiopia. However, so far, the Bank has not devoted sufficient staff time and resources nor strategically undertaken ESW to help develop important but missing tools relevant for supporting financial sector development.

4.3.4 ***The African Peer Review Mechanism (APRM):*** The Bank is a strategic partner to the African Peer Review Mechanism, in which it is designated to provide advice to the whole process and technical support in the assessments of corporate governance, including banking and finance standards. Given that the Bank does not participate in either the Report on the Observances of Standards and Codes (ROSCs) or the Financial Sector Assessment Programs (FSAPs) conducted by the Bretton Woods Institutions and whose coverage of African countries is far from complete (see Annex 5), the APRM provides the Bank with an alternative opportunity to assess the

[15] ADB, 2009 (unpublished): 'Regional Financial Integration in Three Subregions', Tunis

situation and progress in financial sector development in the participating countries and to assist in drawing action plans to guide implementation of future reforms. The breadth and depth of the APRM have helped to identify systemic challenges and good practices, including for financial governance, within the assessed countries. Membership in the APRM, however, is voluntary and not all RMCs have been, or even will get to be, assessed.

4.4 Assessment of Bank Group Experience

4.4.1 A thorough and comprehensive evaluation of the Bank's financial sector interventions is not available. Rather, the performance of individual projects and programs is assessed through supervision and project completion reports, and is certain cases through reviews of regional programs. Generally, while the Bank's Financial Sector Policy (2003) has identified relevant areas for the Bank's interventions in line with its comparative advantages, Bank activities have been largely undertaken in isolation, without taking into account their mutual and reinforcing relationships within the institution. Moreover, the interventions have not been guided by a strategy or benefited from comprehensive frameworks for financial sector development at the regional and country levels. Terms and conditions for individual operations tend to be decided on a case-by-case basis, as projects are selected on the basis of their individual viability, and their impact on the financial sector development is rarely directly factored into the preparation or monitoring of the project. Another challenge remains the need to be selective, and to focus on the relevant areas of the Bank's comparative advantage and phase the activities in accordance with the Bank's available resources. Otherwise, institutional reforms made at the Bank have established the key institutional structures recommended for the implementation of the Financial Sector Policy, including the establishment of a special structure to support financial sector work in OSGE and a NEPAD/regional integration unit (ONRI) as well as a platform for collaboration arrangements with donors and other stakeholders (Partnership for Making Finance Work for Africa)[16].

4.4.2 At the national level, performance to date of PBLs has been mixed partly because of design and implementation problems due to the human and institutional capacity limitations of the recipients[17], as well as at the Bank. Essential for PBLs is a continuous policy dialogue with the member countries, which is possible only when an in-depth analysis of the individual country situations is undertaken, and policy alternatives commensurate with the underlying economic conditions are explored. In this regard, while the field offices play an important role in the dialogue process, the Bank suffers a disadvantage of not being able to participate in the FSAPs, a joint IMF and World Bank program that aims to increase the effectiveness of efforts to promote the soundness of financial system. Moreover, even when programs are designed in line with FSAPs recommendations, country capacities for implementing the programs are weak. On the policy reforms front, progress in good governance (both political stability as well as financial governance) reforms and conducive macroeconomic environments, have paved the way for the Bank to increasingly undertake budget support operations in several countries.

4.4.3 A recent mid-term review of the Bank's private sector catalytic transactions show an improvement in their reach and impact at the institutional level, as most operations exceeded their targets. However, so far, LOCs and equity operations have yielded a limited pay-off in terms of the development of the financial sector at the policy level. Indeed, several post-1986 LOCs were found not to have included reforms of the financial intermediary involved, and if the reform measures were included they were narrowly defined and limited to the concern of the lending operation, with little direct or ripple effect on the rest of the financial system. The Bank has

[16] Although the Financial Sector Policy recommended the establishment of these structures, other considerations might also have led to the decisions to establish the structures as part of the institutional reforms.
[17] Bank Group Experience with Policy-Based Lending, OPEV 2007.

attempted to correct this deficiency by adopting, in 2007, a Private Sector Development Strategy that aims at adding diagnostic and strategy development and enabling environment programs to the traditional catalytic financing, but the implementation of this aspect of the strategy has been weak. However, at the institutional level, LOCs and equity investments have provided liquidity (access to foreign exchange resources and credit funds) and have contributed to institutional development and capacity building. Importantly, the long-term tenure of the LOCs allowed the borrowing institutions to extend the maturity of their lending operations. LOCs and equity investments also allowed the Bank to indirectly and efficiently reach a larger number of enterprises than would otherwise be possible, particularly the SMEs.

4.4.4 A review of the Bank's microfinance operations revealed that while the Bank has adopted a microfinance strategy, its operations and support lacked focus and, internally. Further, the Bank has not committed the necessary human and financial resources nor provided adequate guidance and skills training to enhance its work in the area. Moreover, despite the designation of OPSM as the technical lead for microfinance, operations in this area are disaggregated across several departments, and each one appears to have its own systems for staffing, assuring quality, monitoring performance, and managing learning. This weakness within its microfinance activities appears to reflect a general weakness of the Bank's internal arrangements for the implementation of its Financial Sector Policy and the operations, which are also currently scattered across various departments each with its systems for staffing, quality assurance and performance monitoring, and knowledge management.

4.4.7 Regional and sub-regional institutions face several constraints that undermine their effectiveness to design and implement regional financial integration programs. Of prominence is the proliferation of regional economic communities (RECs), with overlapping mandates, and weak capacities. Further, there is lack of harmonized legal and institutional frameworks across RECs. The Bank's regional financial integration study, thus recommends that to leap the benefits of financial integration, there is need to strengthen collaboration, and the harmonization frameworks across countries, and sub-regions.

4.5 Focus of other Development Partners

4.5.1 The role of the financial sector as a central condition for growth and development is well recognized among development partners, both multilateral institutions and bilateral donor agencies. As such all development partners have realized that developmental efforts often fail due to financial systems constraints. They therefore, support programs to enhance the development of financial sector in Africa. However, financial sector development is a broad area and, while many development partners are involved, each has its distinctive contribution, added value and comparative advantage (see Annex 7, 8 and 9). As such, no single development partner is able to cover the complete array of financial sector development activities. Broadly, interventions cover policy and regulatory reforms, financial governance and financial infrastructure, and support to financial institutions, including banks, and non-bank financial institutions (NBFIs), and MFIs.

4.5.2 Important changes have occurred in aid policies and financial sector strategies of key partners since the Bank adopted its own Financial Sector Policy in 2003. The World Bank, for example, has added support to housing finance in response to increasing urbanization as well as increased priority to the development of instruments to help the poor mitigate their vulnerabilities to adverse impact of climate change. The IMF has also increased attention to improving financial sector soundness, including support to strengthening financial governance. The Bank for International Settlements (BIS) has also stepped up its capacity building activities in banking regulation and supervision, especially in the wake of the recent global financial crisis.

4.5.3 Bank experience in implementing its Financial Sector Policy has indicated that, given the broad scope of activities and emerging changes, closer donor coordination and harmonization is an imperative. Going forward, therefore, the Bank will continue to align its activities working with others to complement approaches to financial sector development. The Bank will continue to coordinate and cooperate with other bilateral and multilateral institutions and partners supporting financial sector development in Africa to harmonize support and forge strong partnerships. In this context, the Partnership for Making Finance Work for Africa, whose Secretariat is hosted by the Bank, is coordinating and enhancing inter-institutional support, exchange of views and collaboration on financial sector development activities. This mechanism provides an excellent opportunity to leverage Bank Group's financial sector activities, and create synergies with the work of other partners to enhance the effectiveness of interventions.

4.5.4 While strengthening partnerships at donor level is important, it is equally important that country systems be strengthened. The Accra Agenda requires donors to work within country systems. However, several countries lack institutional capacity and skills to lead or manage the process required. Therefore, it is important that development partners build technical assistance and other capacity building programs into their support.

V BANK GROUP STRATEGY

5.1 Guiding Principles

5.1.1 The financial sector touches on all Bank operations and it is a core part of the development and poverty alleviation efforts in Regional Member Countries (RMCs). The Bank issued its Financial Sector Policy in 2003 and, since 2006, has embarked on a new phase of institutional reforms towards scaling up its interventions in RMCs. However, major issues have emerged that reveal weaknesses in the global and national financial systems. The unfolding global economic crisis has re-emphasized the importance of financial sector development, while also helping to clarify the roadmap for financial sector development. African countries are increasingly seeking financing from the Bank for financial sector reforms and capacity building. Given the growing demand, there is a need to adopt a strategy towards providing effective support to RMCs in financial sector development.

5.1.2 Therefore, the proposed Bank Group's Financial Sector Strategy and Action Plan (FSS&AP) will enable the Bank to rationalize its activities and sharpen the focus of its interventions, while strengthening partnerships to enhance the results of the Bank's financial sector activities. FSS&AP is underpinned by the following criteria:

- ***Ownership:*** Bank interventions will be conditioned upon commitment of the beneficiaries, and will also seek to empower them to participate in the design of the programs/projects and to take the lead in managing their implementation. At the regional level, the Bank will ensure not only ownership of developmental programs by the RECs, and their member countries;
- ***Comparative advantage and mandate:*** The Bank Group has limited resources in relation to the magnitude and complexity of financial sector challenges. The Bank will concentrate its efforts and resources in areas where it has clear mandate and comparative advantage, as reflected by its track record and internal capacity, and where it expects to make substantial contributions to development impact. In particular, the Bank will also be able to build on its advantage as a strategic partner of the APRM and an institution that enjoys special insights into the aspirations and concerns of African policymakers;
- ***Selectivity and value added:*** The Bank will evaluate the specific impact of its operations, as well as their long-term sustainability, and ensure 'best value for its money'.

Furthermore, as a multi-sector institution with its focus on governance, infrastructure development and regional integration, the Bank will take a broad view of development and help to apply financial sector policies within a broader context of sectoral, developmental and poverty reduction dimensions. It may, therefore, intervene in those areas which it considers necessary in the context of its own core strategy and where other institutions may not be involved or involved insufficiently. For example, the Bank has accumulated some experience and is building expertise in areas such as regional financial integration, human resource development, capacity building and knowledge management, private sector development, governance and transparency (including financial standards and judicial reforms), gender-awareness, and micro finance, where its involvement could have added value;

- ***Complementarily and partnership:*** The Bank is one of many institutions and donor organizations that are actively pursuing strategies to support financial sector development and impact in African countries. Moreover, given its limited resources, the Bank cannot play a sole leadership role in this area and must foster strategic partnership with others, especially the IMF and the World Bank who have the mandate, the resources, and technical capacities to assume that role. Partnerships are key to effecting co-ordination, efficient use of scarce resources, as well as mutual learning and knowledge exchange. Bank support will, therefore, be based on its ability to complement programs of other development partners that include, besides the Bretton Woods Institutions, the Bank for International Settlements, Financial Stability Forum and key bilateral agencies at the international level and the UNECA, AU, RECs and REC institutions, including the UEMOA and CEMAC institutions at the regional level;
- ***Relevance and synergy:*** The Bank's interventions will be tailored to regional and countries' financial sector challenges, reform priorities and potential for progress. It will also be based on the need to create positive interactions with the rest of the Bank's portfolio, especially involving areas of the Bank's core mandate such as of governance, infrastructure development, regional financial integration and the provision of technical assistance in which it has a clear mandate and comparative advantage. Within the financial sector also, interventions at regional, country, sector and institutional levels will be made coherent and supportive of each other; and
- ***Focus on development effectiveness and results:*** The Bank Group will strive to achieve tangible results in the financial sector operations that it supports. Greater attention, therefore, will be paid to monitoring the implementation process closely; and providing necessary and timely technical support to ensure successful outcomes.

5.3 Overall Goals and Core Objectives

5.3.1 The core and operations objectives of the strategy, which reflects identified deficiencies in the development of the Africa's financial sector, are summarized in Box 4, below.

Box 4: Objectives of the Bank Group's FSS&AP

Core Objectives	Operational Objectives
▪ Establish financial sector soundness and stability to create an enabling environment for investment ▪ Deepen and diversify the financial system ▪ Promote inclusive finance, so that all levels of the society have access financial institutions and instruments that protects their savings, offer credit, and help in risk management	▪ Ensure coherence and synergy in Bank support for financial sector development ▪ Enhance regional collaboration and harmonization to strengthen financial integration ▪ Strengthen policy dialogue, analytical work and country systems to foster integrated and coherent financial sector developmental efforts ▪ Improve financial governance and support the strengthening of financial infrastructure to deepen financial sector

	▪ Enhance the diversity and commercial viability of financial institutions to increase opportunities for funding MSMEs

5.3.2 The Bank will strive to reflect these core and operational objectives in all its financial sector interventions. To prioritize and sequence interventions, the Bank will however need to make choices based on the following considerations:

- Value addition, as determined by the potential development impact of the intervention, ability to deliver on the task, and additionality of the Bank's intervention if other development partners are already engaged in activity (see Table 1, Annex 10); and
  - Comparative advantages based on resource availability, the Bank's mandate, or other considerations (see Table 1, and Annex 9).

Table 1: Strategic Priorities Based on Development Needs and Bank's Comparative Advantage

	A. Low Opportunities (Prerequisites mostly not in place)	**B. Medium Opportunities (Reasonable support by other donors)**	**C. Highest Opportunities (Demand for support by RMCs not adequately met by donors)**
I. Highly Developed And Recognized Capability			
II. Developed Capability Or Mandate	• Promoting longer-term financing by banking system • Introducing instruments and interventions that may encourage gender-awareness approach to the provision of financial services	• Promoting special instruments (e.g. infrastructure bonds) to mobilize term finance • Enhancing capacity of regulatory agencies	• Strengthening regional financial markets through harmonization and collaboration, including building regional platforms for deepening capital markets, and improving regional payments systems and regional macroeconomic convergence • Building capacity of MFIs and DFIs based on market principles • Consolidating and expanding MF by concentrating on a few successful ones • Assessing financial sector to identify its strengths and weaknesses • Improving access and efficiency of domestic and regional payments system • Strengthening legal systems and property rights
III. Presently Limited Capability	• Extending the reach of formal financial institutions in rural areas. • Establishing mechanisms for the harmonization of cross-border regulation and practices of microfinance	• Financial support towards macro-economic (and financial) stability • Promoting competition by allowing entry of new banks • Reducing state-ownership and control of FIs • Reforming and strengthening contractual savings/pensions institutions • Supporting housing finance • Supporting diversification of microfinance(including introduction of microinsurance) • Direct Financing of MFIs • Building capacity for cross-border banking regulations and supervision	• Building institutional capacity for macroeconomic and domestic debt management • Ensuring consistency between reform in financial and real sectors (Developing financial sector plans and prioritizing TA) • Developing national and regional monitoring and early warning systems • Restructuring weak banks and FIs • Promoting (or building capacity in) money and capital markets • Building infrastructure for mobile banking and credit bureaus

5.3.3 As outlined in Table 1, below the Bank's interventions will be in the areas in which it has developed capability or mandate and where there are medium to high opportunities (Rows II, Columns B and C). At the same time, the Bank will initiate steps to enhance its internal capabilities to support areas where it has a mandate, but its capacity to deliver results is weak (Row II, Column A). Over time, while collaborating with, and yielding lead role to, other development partners, the Bank will scale up its interventions to cover areas where there are high opportunities, but where its capacity or mandate is limited (Row III, Column C). The Bank will not support areas of low-medium opportunities in which it has no capacity or recognized mandate (Row III, Column A; and Row III, Column B). Generally, the Bank's support to financial sector development will seek to leverage the Bank's ongoing activities, especially in infrastructure development−for example, regional payments and settlement systems−, promotion of regional financial integration and financial governance, business climate improvement, and private sector development.

5.3.4 This approach which is aligned with the guiding principles is informed by the Bank's triple role of catalytic (or strategic) financier, knowledge broker, and strategic partner. As such, the key activities that the Bank will undertake at regional, country, sector, and financial institutional levels, involve *knowledge building; capacity development in client countries; strengthening partnerships; and financing strategic investments.*

5.4 Levels of Intervention

Level I - Regional Level

5.4.1 **At the regional level, Bank will leverage its ongoing work on regional integration, and will build partnerships and enhance collaboration and harmonization across RECs.** The Bank's support at this level, currently very limited, should become more important given the new impetus to macroeconomic convergence, regional monetary and financial integration and cooperation in the wake of the recent global financial and economic crisis that underscored the vulnerability of African economies and the need to strengthen regional systems and cooperation. The Bank's support will put emphasis on knowledge products, including commissioning strategic analysis that will underpin policy dialogue, strengthening capacities of regional institutions, and information dissemination, while working in partnership with other development partners. A study that the Bank has already undertaken and that defines the roadmap for enhancing regional financial integration in three African subregions[18], and which has facilitated dialogue on emerging issues with regional institutions and donors, is a good example.

5.4.2 **The Bank's support at the regional level will focus on improving macroeconomic convergence[19], and harmonizing financial governance and standards** (financial and banking standards, legal and regulatory frameworks, audit systems, accounting and financial disclosures). **Further, will support strengthening of regional financial infrastructure** (payments systems and credit rating mechanisms), **and removal of regulatory obstacles that hamper the development of efficient financial systems.** Key regional initiatives are shown in Box 5. To pursue its mandate by the New Partnership for Africa's Development (NEPAD), the Bank will encourage the adoption and implementation of international standards and codes that contribute to financial sector soundness. In this regard, the Bank will develop the capacities of regional networks and institutions to anchor regional standards and codes of good economic and financial governance. Through the African Domestic Bond Fund (ADBF), the African Financial Markets

[18] ADB, 2009 (unpublished): 'Regional Financial Integration in Three Subregions', Tunis and Workshop on Regional Financial Integration in Africa, Tunis, December 3-4, 2009.
[19] The Bank has drafted the Bank Approach Paper for supporting Macroeconomic Convergence in African RECs and is developing a short and medium-term Work Plan to move this agenda forward.

Initiative (AFMI)[20] will spearhead a cooperative approach to African bond market development, working together with governments including central banks, African regional associations, development partners, public and private sector market participants. The Bank will also support programs to enhance intra-regional and domestic capital flows by strengthening payment and settlement systems through the provision of financial support to acquire the necessary infrastructure, and by helping to harmonize retail payments systems, and developing the regulatory frameworks to enable innovations and the application of modern technology).

Box 5: Key Regional Initiatives

- Assessment of Regional Integration in Africa (with UNECA, AU)
- Macroeconomic convergence (COMESA, ECOWAS, WAMZ, ECCAS, and EAC)
- Enhancing banking and financial standards, focusing on the APRM
- Building capacities for regional payment systems (ECOWAS, COMESA, ECCAS, and EAC)
- Implementing the African Financial Markets Initiative (with MFWFA and AACB)
- Building capacity for cross-border and regional regulation of financial institutions (with other development partners)

5.4.3 The Bank will build partnerships with other donors such as the IMF, World Bank, and the Financial Sector Reform and Strengthening (FIRST) Initiative as well as bilateral agencies, regional and national stakeholders in support of the regional financial integration programs. Such partnerships will be built both through the Bank's ongoing collaboration with these institutions and in the context of the Partnership for Making Finance Work for Africa.

Level II: Country Level

5.4.4 **At the country level, the Bank will focus on helping RMCs to strengthen country systems and institutions** (in particular, the central banks, non-bank financial sector regulators, and ministries of finance) **for managing financial sector soundness** (that is, improving financial stability and reducing risks). The Bretton Woods Institutions (BWIs) have traditionally taken the lead in advising countries and helping to design financial sector programs. This strategy proposes that, in most cases, at the national level, **the Bank will focus on capacity building and strategy development to complement the programs led by the BWIs and, in this regard, will leverage its governance and institutional capacity building expertise.**

5.4.5 **The Bank will enhance policy dialogue and capacity building to improve diagnostics and strategy development and ensure the financial sector's alignment with real sector development.** The Bank is already collaborating with the BWIs through its support to the African Technical Assistance Centers Initiative (AFRITACs) and will leverage this partnership to support systems and institutions towards improving financial stability and its surveillance in African countries. Specific areas of enhanced engagement will center on the central banks, regulators of non-bank financial institutions, and ministries of finance and planning, and include macroeconomic management and financial information systems.

Macroeconomic Management

5.4.6 The Bank will support stronger macroeconomic management and greater alignment between the financial sector policy (at the central banks) and budget management (at the ministries of finance) to ensure consistency among monetary and fiscal policies and real sector priorities, including poverty reduction strategies. Therefore, in collaboration with the BWIs, ***the***

[20] The African Financial Markets Initiative (AFMI) that the Bank launched in 2008 to contribute to the development and deepening of domestic financial markets in Africa has two separate but complementary pillars: (i) African Financial Markets Database (AFMD); and (ii) African Domestic Bond Fund (ADBF) (see Annex 10).

Bank will also provide technical assistance to build capacity of institutions (central banks, non-bank financial institutions regulators, and ministries of finance and planning) tasked with managing the macroeconomy.

5.4.7 However, an essential first step to establishing good macroeconomic management is an assessment of the economic and financial situation. While the FSAPs and aspects of the APRM provide such assessments, the coverage of these programs in terms of countries is not complete (see Annex 5)***. The Bank will, therefore, enhance its support to the APRM to speed up assessments and, where necessary, will undertake interim (targeted) country or sector assessments to complement the FSAPs and the APRM.*** Such interim assessments, as in the case of Ethiopia which was conducted in 2009, have enabled the Bank to launch meaningful dialogues with client countries. Moreover, there is no consistent follow up on the FSAP and APRM assessments to inform macroeconomic management, enrich the PRSPs, or even more significantly, formulate comprehensive financial sector development plans. Some donors, especially the FIRST Initiative, have shown interest in financing the formulation of these development plans. ***The Bank will use its convening power to bring together development partners to support countries to draw from the FSAPs, the APRM assessments or its own country assessments to formulate financial sector development plans.***

Financial Information Systems to Enhance Financial Soundness

5.4.8 The Bank will step up its support to strengthening countries' capacities for monitoring (surveillance of) macroeconomic developments and identifying emerging challenges and stresses, which will contribute to mechanisms for early warning in the RMCs and management of vulnerabilities.

5.4.9 Many African countries lack capacity for the necessary statistical analysis because of a lack of up-to-date data, equipment or skills. The Bank will: provide technical assistance to build institutional capacity to gather and analyze data strategically; and support training programs to upgrade skills of staff of central banks, regulators of non-bank financial institutions, and ministries of finance, especially in identifying and addressing issues related to financial system soundness.

5.4.10 **The Bank will support implementation of appropriate frameworks to improve financial regulation and supervision**. In this regard, the Bank Group will use its role in NEPAD as the lead institution on banking and financial standards, and will leverage its ongoing work on corporate governance to foster the improvement in financial regulation and supervision. The competitive advantage of the Bank is that it can engage in closer policy dialogue with governments and play this role with continuity and commitment. Further the Bank, as a regional institution, can assure an informed vision and perspective on appropriateness of such standards. To this end, collaboration with the BWIs and other standard-setting bodies would ensure that standards and codes are properly adapted to the situation of African countries.

Support to Improving Financial Regulation and Supervision

5.4.11 The Bank will ensure that the implementation of its corporate governance strategy, which is still relevant, pays attention to improving corporate governance[21] in the financial sector. In

[21] The operational objectives of the Corporate Governance Strategy include encouraging the establishment of an integrated and coherent legislative policy framework for corporations, including banks; promoting corporate governance standards within SOEs, including the process of privatization; and assistance in broadening understanding within the financial and banking sectors about the importance of good corporate standards, including for their target clients, in order to minimize investment risks and maximize the benefits.

particular, the components of the corporate governance strategy include standards and norms development and institutional and human capacity building for law enforcement. In this regard, the Bank Group will support initiatives shown in Box 6:

Box 6: Key Initiatives to Improve Financial Regulations and Supervision

- strengthening analysis in country strategies to include financial sector development aspects
- assisting governments to formulate action plans to address weaknesses in the implementation of financial regulations
- supporting central banks, regulators for non-bank financial institutions, and ministries of finance, to improve their regulatory and supervisory frameworks over banks and non-bank financial institutions

Support in Combating Money Laundering

5.4.12 In the context of its NEPAD mandate, the Bank committed to supporting RMCs to develop mechanisms to address money laundering, and has formulated a strategy to guide its activities in this area. The strategy, which is relevant to enhancing financial sector soundness[22], emphasizes collaboration with other international and development agencies. Specific initiatives are shown in Box 7:

Box 7: Key Initiatives to Combat Money Laundering

- mainstreaming concerns on money laundering in the formulation of country strategies and the design of financial sector programs in RMCs[23]
- providing advice and necessary information to facilitate implementation of international AFL/CML (anti-money laundering - combating the financing of terrorism) standards
- providing assistance to RMCs, directly, and through FSRBs (Financial Action Task Force-Style Regional Bodies), in support of their efforts to develop AML/CFT laws and strategies
- supporting the establishment of effective sub-regional FSRBs

Addressing Special Country Needs

5.4.13 While the strategy outlined above is relevant for all RMCs, its implementation has to be targeted to fit regional and country specificities. Generally, this will be done through the Bank's programming instruments, the Results-based Country Strategy Papers and the Regional Integration Strategy Papers. While the general presentation reflects the situation especially in the Low-income (ADF countries), a few differences on the requirements in Fragile Countries and Middle Income Countries may be highlighted as indicted in Annex 11.

Level III - Sector Level

5.4.14 **As part of it's strategy to improve the business environment, the Bank will provide appropriate support to strengthen financial governance and financial infrastructure, while encouraging greater reliance on the markets and the private sector to enhance the deepening and diversification of the financial system** (see Annex 12). Deepening and diversifying the financial system will help develop sources of financing complementary to the banks, which are dominant in African financial systems, and to promote service to a diversity of clients, including SMEs and the poor as well as for a variety of purposes such as savings

[22] Money laundering and terrorist financing affect the soundness of the financial system in a number of ways. In particular, they divert financial resources from development activities and may involve sharp changes in financial flows that can also affect the stability of the financial system.

[23] The Bank is also committed to adopting measures to tighten its fiduciary safeguards, internal procedures and policies, and audit function to ensure that its own lending is used for its intended purposes and is not subjected to financial abuse, corruption or money laundering.

mobilization, credit, insurance and remittances. It is also important for reducing systemic vulnerability by providing safety nets and access to finance outside the traditional group of bank clients. The Bank will provide support for a number of facilities for capital market development, for the mobilization of medium and long-term (MLT) funds by financial intermediaries (FIs), and for policies and regulations towards microfinance finance institutions (MFIs), and development finance institutions (DFIs).

Capital Market Development

5.4.15 The Bank will draw on different dimensions of its financial sector development activities to support capital market development, especially in the middle income countries (MICs). The Bank's support in this area is reflected in Box 8:

Box 8: Key Initiatives to Develop Capital Markets

- sensitizing potential investors (investor education) through conferences and workshops
- providing training to strengthen financial sector regulatory and supervisory expertise as well as capacity to design effective regulatory environments for long-term capital mobilization
- supporting potential issuers and intermediaries to bring transactions to the securities markets (through AFMI)
- improving transparency in information and developing regional solutions to financial market development (through AFMI)

Mobilization of Medium and Long-Term (MLT) Funds by FIs

5.4.16 Improving the capacity of FIs to intermediate in MLT involves the strengthening of financial infrastructures to mitigate the risks in MLT finance, including refinancing mechanisms to help the refinancing of MLT, guarantee mechanisms and political risk insurance to cover aspects of the risks, rating systems to facilitate screening of borrowing firms, and deposit insurance to encourage MLT savings. The introduction of these facilities would involve the collective effort of governments, the FIs themselves and donors (including multilateral development banks). In this regard, the Bank will undertake initiatives shown in see Box 9:

Box 9: Key Initiatives Support FIs to Mobilize Medium and Long-Term (MLT) Funds

- Undertake studies on 'facilitating the mobilization of MLT finance
- Dialogue with governments and private sector (say through collaborative efforts among FIs) to set up refinance and other mechanisms to mitigate risks and to enhance intermediation in MLT funds
- Disseminate best practices and innovations in mobilizing and allocating MLT resources through workshops and conferences
- Collaborate with other donors to provide appropriate funding and build capacity for relevant institutions that mitigate financial sector risks
- Provide guarantees to viable institutions to help them mobilize MLT funds in international capital markets

Policies and Regulations towards MFIs and DFIs

5.4.17 The Bank will also leverage its capacity building experience across the institution and scale up support to policymakers and regulatory authorities to formulate appropriate policies and regulations for the DFIs and MFIs based on internationally accepted standards. The DFIs and MFIs are at the heart of the financial systems and poverty reduction efforts in Africa, while weaknesses in their regulation and supervision pose great risks to the stability of the financial systems. The Bank understands that greater reliance on markets and commercial principles can improve sustainability of these institutions, but also that the regulation and supervision of these institutions must be handled in an innovative way so that they can protect the public without constraining the capacity of the institutions to take appropriate risks[24].

5.4.18 However, the implementation of the new regulatory frameworks bring with it capacity challenges at the various (micro, meso, and macro) levels of the sector. Technical assistance would be required in several countries to implement the needed changes in processes to facilitate the shift to the new paradigms (see Annex 13 & 14). The Bank will, therefore, support activities and training related to policy and regulatory reforms, as depicted in see Box 10:

Box 10: Key Initiatives Supporting Policies and Regulations over MFIs and DFIs

- collaborate with other international organizations in their efforts to formulate policy and regulatory frameworks
- Through policy dialogue encourage policy makers and regulators to adopt best practices including best cases from other developing countries
- collaborate with other international organizations (e.g., CGAP and the UNCDF[25]), to build regulatory and supervisory capacity for DFIs and MFIs including capacity building of trainers
- leverage support to AFROSAI[26] to enhance capacity of audit firms to audit MFIs and DFIs
- collaborate with other development partners to strengthen financial infrastructure for microfinance and DFIs, including support to the setting up of or strengthening the capacity of guarantee funds, rating agencies, and mobile payments systems.

Level IV: Financial Institutional Level

5.4.19 **At the financial institutional level, the Bank, through its private sector operations, will provide funding support and capacity building as appropriate to develop institutions that are sustainable and can borrow commercially**. The Bank will leverage its private sector operations to reinforce its activities at the sector level aimed at diversifying and deepening the financial sector.

Development Finance Institutions (DFIs)

5.4.20 The Bank, through its LOC operations and technical assistance, will continue to seek revitalization of DFIs as shown in see Box 11:

Box 11: Key Initiatives Supporting Development of Finance Institutions

- ***encourage governments through policy dialogue to rationalize their interventions in DFIs,*** and to address issues of transparency and problems of conflicts of interest, moral hazard, and adverse selection that have constrained the performance of these institutions. In this regard, the Bank will encourage governments to implement the prudential guidelines and rating system for DFIs that it developed in collaboration with FIRST and AADFI[27]. In this regard, ***the Bank will support the training to DFIs to apply these guidelines to improve their corporate governance frameworks.***
- ***build the capacity of the DFIs in corporate management, project design and operations, financial management, and resource mobilization*** by mobilizing resources through the Fund for African Private Sector Assistance.
- ***provide catalytic financial support (through LOCs) to the well-performing DFIs to enhance their role in***

24 Under this approach, restrictions hindering the development of non-bank financial intermediaries that serve small depositors and borrowers (for example, microfinance institutions, credit unions, leasing companies, and private equity funds) need to be dismantled, particularly the unrealistic ceilings on the fees such institutions may charge.
25 CGAP and UNCDF stands for the Consultative Group to Assist the Poor, and the United Nations Capital Development Fund, respectively
26 AFROSAI stands for the African Organization of Supreme Audit Institutions
27 AADFI stands for the Association of African Development Finance Institutions

- ***financing development.***
- encourage governments through policy dialogue to address problems of insolvency in DFIs (e.g. through restructuring) within the broader context of financial sector reforms[28]. ***Where DFIs are being privatized, the Bank will provide technical assistance and advisory services and, where necessary, backed by financial support to ensure success of the operation.***

Microfinance Institutions (MFIs)

5.4.21 Microfinance is a strategic priority for the Bank because of its potential to expand opportunities for the poor and reduce their vulnerability. Moreover, apart from being a profitable investment opportunity, the Bank is building experience and comparative advantage in the field. **The Bank will refine its support to microfinance institutions by enhancing complementarity with other donors.** The Bank's strategy, in line with the new paradigm of microfinance (see Annex 14), proposes a shift from a supply driven approach, where credit is targeted to specific categories of the population, to a market-oriented, demand- driven approach, where a permanent access to financial services will sustain entrepreneurship and improve assets management of the low income population. To streamline its activities to reflect the strategic shift and enhance the value-added of its interventions, the Bank will leverage its private sector development expertise as well as relations with governments and provide funding to MFIs that are supported by the type of policy and regulatory reforms that the Bank will be facilitating at the sector level. The major elements of Banks support in this area covers technical assistance and financing (e.g. through LOCs) as see Box 12 shows.

Box 12: Key Initiatives Supporting Development of Microfinance

- through dialogue and technical assistance, encourage the creation of strong wholesale institutions and MFI networks and the transformation of NGOs to viable MFIs
- leverage expertise and comparative advantage to finance financial intermediaries
- working with meso level institutions such as regional funds, microfinance networks, apexes or DFIs provide wholesale finance and support to potentially large micro level deals (retail banks starting microfinance operations; large MFIs developing an upscale range of products for graduating clients)

Other Non-Bank Financial Institutions (NBFIs)

4.4.22 The Bank will promote other non-bank financial institutions, including leasing and insurance companies, and seek opportunities to strengthen the local capital markets through pension system development and reforms, strengthening and regulation of insurance institutions as well as instruments such as private equity funds, local currency financing and the introduction of innovative instruments to facilitate infrastructure financing.

VI OPERATIONAL MODALITIES

6.1 Sequencing

6.1.1 While the strategy seeks to achieve enhanced focus, the scale and complexity of challenges of financial sector development are significant. Deeper engagement in support of strengthening macroeconomic management and financial governance in RMCs will require careful sequencing, calibrated to the Bank's institutional capacities and organizational reforms, including its decentralization. An incremental approach is also essential in view of limited internal resources and capacity, and allows ramping up over time in line with increased resources

[28] Dealing with insolvent banks may involve either liquidation or recapitalization and restructuring. The second option would entail provision of additional capital, financial restructuring, and isolation and treatment of bad assets, in addition to institutional strengthening and capacity building in risk management.

earmarked towards priority focus areas as shown in the Results Matrix (Annex 1). After initial preparations at the Bank Group level, that includes launching institutional arrangements to implement the Strategy (see Section 5.3 below), the Bank will continue with the activities in which it has developed capability or mandate in the short-term (2011-2013). However, in the medium-term (2014-2016), the Bank will need to build its own internal capacity, while scaling up its support through partnerships with other organizations to address other high priority areas in which, currently, it has limited capability. The sequencing of these operational modalities is reflected in Box 13.

Box 13: Key Operational Modalities - Sequencing

Activities	Short-Term (2011-2013)	Medium-Term (2014-2016),
Regional Level	▪ support assessments of regional integration ▪ support revision of macroeconomic convergence criteria ▪ build capacity for regional payments systems ▪ support to AFMI	▪ support building capacity for cross-border and regional regulation of financial institutions
Country Level	▪ support the APRM assessments and other targeted assessments ▪ design and launch training on financial system soundness ▪ launch formulation of financial sector development plans and action plans ▪ support mainstreaming of banking and financial standards in its own CSPs and in country development plans, including PRSPs[29]	▪ build statistical capacity for macroeconomic management ▪ build capacity at country level for capital market development (AFMI programs)
Sector Level	▪ launch programs to sensitize potential investors in capital markets ▪ launch study on facilitating intermediation in MLT finance ▪ support for enhanced microfinance policies and regulatory reforms ▪ sensitize governments to implement prudential guidelines for DFIs ▪ dialogue with AFROSAI to build capacity for auditing MFIs and DFIs ▪ support payment system reforms	▪ build or strengthen financial infrastructure for MLT finance and microfinance ▪ launch training programs to improve financial regulations and supervision of banks, capital markets, MFIs and DFIs
Institutional Level	▪ support training of DFIs in prudential guidelines and project and financial management ▪ create MF networks, and launch wholesale financing of microfinance and financing for performing DFIs ▪ launch design of instruments to support mobilization of private finance for infrastructure financing	▪ implement financial instruments to support mobilization of private finance for infrastructure financing

6.2 Bank Instruments

6.2.1 The Bank will deploy an array of instruments to support financial sector development in RMCs, aligning its operational portfolio to the financial sector strategy; enhancing the synergies between Bank instruments (policy-based lending, institutional strengthening loans, grants, guarantees, and equity participation; non-lending activities, including dialogue, analytical and advisory work) and working with others to ensure synergies and complementarities (see Annex 15 for the menu of Bank instruments).

[29] PRSPs stand for Poverty Reduction Strategy Papers

Financing Instruments

6.2.2 The Bank will continue to use policy-based lending (PBL), investment projects, and private sector financing to provide long-term support to financial sector development, but will improve strategic alignment and synergy between aid instruments. Improving the synergies and complementarities between aid instruments is critical to enhance the impact of the Bank's interventions in any given country.

- PBL support will be based on a thorough understanding of the financial sector's operations and its development needs. There will be continuous close collaboration with the member countries and the BWIs in determining the specific policy reform needs of respective countries. The strengthening of financial infrastructure and institutional reform could be a lengthy process. The formulation of PBLs by the Bank on its own could, therefore, make heavy demand on staff time. Consequently, even though the Bank has at its disposal the basic staff experienced in PBL operations concerning the financial sector, it will continue to take a pragmatic approach by working closely with the BWIs in the design of adjustment policies and collaborating with them to prepare the necessary background studies and policy framework papers. However, in the area of financial governance, where the Bank will also benefit from assessments under the APRM and its governance profiles, the Bank will prepare itself to design PBLs on its own.
- Private sector operations (PSOs) (including LOCs, equity participation, guarantees and agency lines of credit) will be narrowly focused on specific elements of reform, and serve specified objectives in the development of a specified sector. The Bank will seek to direct PSOs to two inter-related objectives, i.e. to address market failures (such as limited longer maturity lending and limited SME's access to credit), and to strengthen the capacity of the participating financial institutions to lend more to SMEs. Thus, in the financial sector, the Bank will seek to make PSOs directly instrumental in improving competition, promoting internal governance of financial institutions, promoting trade, and helping the integration of the developed financial system countries with the global markets[30].
- The Bank will also establish special facilities and utilize instruments in response to special country circumstances (Fragile States Facility) or events (such as the Emergency Liquidity Facility (ELF) and the Trade Finance Initiative introduced to help RMCs mitigate the impact of the global economic crisis).
- The implementation of the strategy will require substantially new resources than can possibly be provided through ADF replenishments and the ADB window. Therefore, the Bank will step up co-financing and seek to explore various avenues, including utilization of trust funds and mobilization of financing from the Gulf States and emerging donors such as India, China and Russia as well as from foundations and the not-for-profit NGOs, which could support the financing of knowledge generation and capacity building as well as the special or dedicated facilities. In this regard, the Bank will also look at the modalities of establishing a dedicated Financial Sector Trust Fund Facility to cover its interventions in the financial sector that cannot be financed by existing Bank facilities. By doing so, the Bank would send a clear signal that Africa's financial sector is of great importance to economic development of the continent.

[30] For example, the Bank may provide complementary loans to financial institutions in Category C countries in conjunction with their efforts to borrow in the international markets when they have acquired a satisfactory rating from international rating agencies. The Bank will direct PSOs to institutions which have in place good and transparent management, suitably designed operating standards, especially for accounting and provisioning for risks, good negotiation with clients and proper supervision. However, the Bank will also regularly review and refine its use of PSOs, including issues of design, conditionalities, subsidies, and internal controls.

Other Instruments

6.2.3 ***Policy dialogue:*** The Bank will actively engage in policy dialogue with key stakeholders to address policy and regulatory constraints, and facilitate and enable financial sector development in RMCs. **The Bank's activities in financial sector development will be guided by a careful assessment of country needs and potential for success.** RBCSP[31] will guide the approach to strengthening macroeconomic management and regulatory reforms at country levels, while the Bank's Regional Integration Strategy Papers (RISPs) will guide intervention at the regional level. These will be complemented by targeted studies and Economic and Sector Work (ESW). Support to financial intermediaries will be programmed within the planning of private sector operations. Regional Departments will ensure that country and regional strategies are based on a thorough assessment of and dialogue on weaknesses, challenges and opportunities for financial sector development, generated through ESW or informed by other Bank instruments such as the country governance profiles, the assessment of business climates, Africa Economic Surveys (carried out with the OECD), Assessment of Regional Integration in Africa (with the UNECA and the AU). The Bank's participation in the APRM provides an additional entry point to strengthen financial sector in RMCs, while the FSAPs, which will now be systematically published, will also provide very useful insights. The role of Field Offices will be pivotal to lead the Bank's dialogue on governance at the country level and collaboration with the BWIs will be useful.

6.2.4 ***Knowledge development:*** **The Bank's analytical** (including applied research, statistics and data analysis) **and advisory work on financial sector development will be enhanced to provide quality advisory and analytical services to RMCs.** Knowledge-sharing will be facilitated through partnerships and convening conferences and seminars on pertinent topics related to improving financial sector soundness and enhancing financial access in Africa. The Bank together with other development partners will support African policy think tanks and research institutes focused on the Bank's financial sector priority areas, as provided for in the Bank strategy for supporting research in Africa[32].

6.2.5 ***Enhanced partnerships:*** **The Bank's focus on financial sector development will add value to the work of other development partners through enhanced partnerships, including the Partnership for Making Finance Work for Africa.**

- *At the global level:* the Bank will seek to strengthen its collaboration with the Bretton Woods Institutions through coordination of work and missions in the field, exchange of information, co-financing of operations, training, institutional building and the preparation of the PRSPs. In the area of microfinance, the Bank has been an active member of the CGAP, where donor collaboration has been very useful in the development of best practices, the undertaking of diagnostic studies and the organization of training[33]. Collaboration in the area of ESW, a necessary activity in financial sector reforms, can also provide economies in the utilization of staff time and other resources. The Bank will also collaborate with special financing and capacity building/advisory facilities (AFRITACs, FIRST, ICF, ACBF)[34] to leverage resources for financial sector development. Other key

[31] ADB, *Annotated Format for Bank Group Results-Based Country Strategy Paper* (RBCSP), October 2006.
[32] ADB, *Bank Group Strategy and Framework for Support to Research and Capacity Building Institutions in Africa*, ADB ORPC, 17 October 2006, ADB/BD/WP/2006/110 and ADF/BD/WP/2006/128.
[33] See CGAP SmartAid for Microfinance Index Indicators (Annex 6) and Review of Gaps and Priorities in Development Partners' Support to Financial Sector Development (Annex 8)
[34] ICF and ACBF stands for Investment Climate Facility for Africa, and the African Capacity Building Foundation, respectively. [deleted ICAS – what did it stand for?]

partner institutions include the BIS/FSF, regional development banks, the United Nations system, the OECD, and bilateral partners.

- *At regional and sub-regional levels:* The key institutions and mechanisms that the Bank will work with include AU, NEPAD-APRM, UNECA and various regional associations of financial sector institutions[35].

6.3 Internal Institutional Arrangements

6.3.1 In view of the increased emphasis on financial sector development, the Bank established OSGE to champion the Bank's financial sector development (and Governance) activities, in collaboration with other departments. This Strategy proposes OSGE to focus on actions at the national and sector level and regional investment operations; ONRI on knowledge generation and management and capacity building (including activities involving policy harmonization) towards strengthening regional financial integration; and OPSM on support at the financial institutional level[36]. However, the activities of these three lead departments will reinforce each other, and their collaboration is imperative. The financial sector activities at the country and sector levels, including support to the development of legal and institutional framework and secure transactions and development of capital markets and refinance mechanisms (led mainly by OSGE) will improve financial system soundness and stability, which would enhance the environment for private sector development and so enable OPSM to find viable FIs and SMEs as its clients.

6.3.2 Similarly, OSGE activities at the country and sector levels (say of enhancing macroeconomic stability) and the regional activities (macroeconomic convergence and the AFMI) will be mutually beneficial. Moreover, in the economic and monetary unions, suppot to individual countries may have regional dimensions and implications that might need to be addressed. The activities of other complexes, departments and units (ORVP, OSVP, ECON, GECL, FTRY, COMMU and ORRU) will be leveraged, as appropriate. Therefore, the implementation and monitoring of the Strategy, which have both internally and externally-focused dimensions, will be carried out as a collaborative effort by a number of departments, but will also involve clarification of responsibilities as well as sharpening, realignment, and mainstreaming of activities as outlined in Annex 16.

6.3.5 The implementation arrangements indicate several areas of overlap of responsibilities of OSGE with those of other departments. The Results Matrix (Annex 1) highlights the responsibilities of the individual organizational units in respect of specific elements of the strategy. There is also a further overlap of the responsibilities of the Governance and Financial Reforms Divisions with respect to support to economic and financial governance. Annex 17 proposes a delineation of the responsibilities to facilitate work.

6.4 Resource Implications

6.4.1 Over time, the Bank will establish credible internal expertise and capacity in a number of mission-critical areas, such as macroeconomic management, regulatory reforms, payments systems, regional financial integration, microfinance and institutional restructuring.

[35] Other partners include: the Association of African Central Banks, the African Capacity Building Foundation (ACBF), the Association of African Development Finance Institutions (AADFI), the African Economic Research Consortium (AERC), and African civil society organizations and policy think tanks.

[36] It is important to make a distinction at the regional level between support to **regional integration** efforts, which seek to unify or integrate the geographical space, where it is proposed for ONRI to lead, and **regional cooperation** efforts, in which common goals are pursued and actions build synergy at the national, sector or institutional level to provide economies of scale (but not necessarily for the purpose of unifying the geographical space), where the most relevant department (ONRI, OSGE, or OPSM) may lead.

6.4.2 As indicated above, the implementation of the Bank Group FSS&AP will be mainstreamed in various departments across the Bank. Therefore, each Department will need to assess specific staffing and other resource gaps and ensure that these are addressed through recruitment, the budgetary process and targeted training.

6.4.3 The implementation of the Strategy will require an incremental scaling-up of the staff strength and administrative budget resources to provide the Bank with the means and capacity to deliver in terms of professional competencies, skills mix, knowledge base, and staff numbers. In the case of OSGE, the mobilization of these resources, which will be carried out through annual administrative budgets, the ADF, and special trust funds, will include:

- Resources for recruitment of staff with the required new skills such as, for the short term, statistics and management information systems, capacity building, and payments systems specialists and, for the medium term, additional skills in financial regulation and supervision, microfinance, and capital markets[37]. The Bank will also seek to leverage specialized expertise through technical assistance and secondments, and short-term staff exchanges with BWIs, aligned with the priorities of the strategy;
- Additional resource will need to be allocated for staff training, special studies, dialogue with countries, and sensitization workshops at Bank, country and REC levels;
- Other resources will be required for operations (project identification, preparation, supervision, and mid-term reviews and as well as project completion reports, in addition to the allocation for country and regional operations;
- Consideration should be given to seeking ways to improve collaboration between the Bank and the BWIs in financial sector interventions, particularly those related to the FSAP and ROSC diagnostics.

6.5 Risks and Mitigation

6.5.1 The implementation of a bolder strategy to scale up Bank support to financial sector development and provide impetus to 'making finance work for Africa' is accompanied by a number of risks. The key risks, as well as mitigation measures, are summarized in the Results Matrix in Annex 1.

6.6 Results Framework

6.6.1 The objectives, high-level actions, results and indicators associated with each strategic pillar are outlined in the Results Matrix in Annex 1.

6.6.2 **Monitoring and Evaluation.** At the level of individual initiatives and financing operations, the responsible departments will assume responsibility for monitoring progress with preparation and implementation. At the program level – regional, national, sector and institutional – the prescribed monitoring frameworks will be applicable. The strategy will be monitored annually to gauge its effectiveness and adjusted accordingly. OPEV will undertake periodic evaluations of selected initiatives, programs and projects supported by the Bank in the sphere of financial sector development, with a view to measuring the development effectiveness of Bank interventions and extracting lessons of experience to enhance future efforts by the Bank and other stakeholders. There will be a mid-term evaluation of the implementation of the strategy towards the end of 2013.

[37] The actual number of new staff will be bench-marked with those in comparable regional banks (such as AsDB and IaDB).

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BANK GROUP FINANCIAL SECTOR STRATEGY AND ACTION PLAN

(for the five-year period 2011-2016)

ANNEXES

Governance and Financial Reforms Department (OSGE)

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Annex 1: Action Plan and Results Matrix for Financial Sector Development

Purpose	Action	Start date	Responsible (Lead* and Support)	Expected Results	Indicators	Assumptions, Risks (R) & Bank Mitigation Measures (M)
Level I: Promoting Regional Financial Integration and Harmonization through strategic partnerships						
Improve strategic alignment and coherence of Bank support at regional levels	Strengthen financial sector development components in RISPs	Ongoing	ONRI	Alignment of Bank operations to promote regional financial integration or harmonization	Number of RISPs with improved analysis on regional financial integration issues	R= absence of shared regional financial integration vision in the Bank M= ensure strong drive to promote regional financial integration in the Bank
Enhance policy dialogue on financial integration through advisory and analytical work	Enhance assessment and monitoring of regional financial integration	Ongoing	ONRI	Improved understanding of key challenges in regional financial integration	Number of thematic ESW focusing on financial integration issues Publication of ARIA series annually (in collaboration with UNECA and AU)	R= Lack of AU/UNECA/ADB collaboration; lack of resources for ADB to conduct assessment of RFI for ARIA M= enhanced dialogue with AU and UNECA; mobilize resources to participate in ARIA
Strengthen regional financial integration	Support establishment of regional macroeconomic mechanisms	Ongoing	OSGE and ONRI	Improved macroeconomic convergence and management	Number of RECs supported to redesign convergence criteria or assess and monitor progress on macroeconomic convergence	R= Lack of progress on agreement on macroeconomic convergence M= Improve dialogue with RECs; enhance support for economic reforms
	Assist in strengthening regional payments systems	2011	ONRI, OSGE and OPSM	Increased and more efficient financial flows	Number of payments systems infrastructure built or strengthened	R= weak links in national payments systems; lack of agreement on how to link national payments systems M= strengthen national payments systems; enhance intra-REC dialogue on linking payments systems regionally

Purpose	Action	Start date	Responsible (Lead* and Support)	Expected Results	Indicators	Assumptions, Risks (R) & Bank Mitigation Measures (M)
	Support regional harmonization of financial regulatory and supervisory frameworks	2012	ONRI with OSGE	Improved cross-border supervision and regulation of financial institutions	Number of capacity building programs for RECs and REC institutions on financial regulations Number of REC-level agreements on collaboration on cross-border financial regulation	R= weak links in national regulatory and supervisory systems; lack of collaboration at REC levels M= strengthen national systems; enhance intra-REC dialogue on cross-border financial regulation and supervision
Strengthen regional financial harmonization and collaboration to improve the enabling environment for private sector development	Leverage partnerships to implement the African Bonds Market Initiative (AFMI)	Ongoing	OSGE, FTRY and OPSM	Increased leveraging of resources to support implementation of the AFMI	Number of countries/central banks implementing the AFMI	R= lack of commitment of national central banks; lack of support from Development partners (DPs) M= enhance dialogue with central banks and DPs
	Support to implementation of financial standards and best practices in financial regulation through the APRM	Ongoing	OSGE, ONRI	Improved implementation of financial standards and best practices in RMCs	Number of APRM country reviews undertaken with Bank support	R= lack of commitment of RMCs M= increase dialogue with RMCs
	Stimulate regional partnerships to support financial and banking sector reforms	Ongoing	OSGE, ONRI with OPSM	Increased leveraging of resources to support financial sector reform	Performance indicators agreed by MFW4A Secretariat	R=Lack of interest of partners in MFWFA; lack of commitment by RMCs M= enhance dialogue within MFWFA and with RMCs

Purpose	Action	Start date	Responsible (Lead* and Support)	Expected Results	Indicators	Assumptions, Risks (R) & Bank Mitigation Measures (M)
Level II: Supporting country systems and institutions to create an enabling environment for financial sector development						
Improve strategic alignment and coherence of Bank support at country levels	Strengthen financial sector development components in RBCSP	2010	OSGE with ORVP	Improved Bank's understanding of financial sector challenges and mitigation of risks	% of RBCSP including financial sector analysis and risk assessments	R= absence of shared financial sector development vision in the Bank M= Ensure strong drive to promote financial sector development in the Bank
	Enhance strategic alignment of Bank financial sector development portfolio	2010	OSGE with ORVP	Bank support to financial sector development focused on macroeconomic, economic and financial governance strengthening (strategic alignment); Enhanced use of macroeconomic as well as economic and financial governance PBLs and DBSLs	Number of new macroeconomic and financial governance-focused PBLs • % of new OSGE operations focused on macroeconomic, economic and financial governance (including components of ISPs and PBLs) • % of new OSGE operations in fragile states focused on macroeconomic and financial sector development, including economic and financial governance (including components of ISPs and PBLs)	R= absence of shared financial sector development vision in the Bank M= Ensure strong drive to promote financial sector development in the Bank
Enhance policy dialogue and analytical work on financial sector assessments and development planning	Strengthen financial reforms and financial governance through peer pressure, review and learning	Ongoing	OSGE with ONRI and EDRE	Improved assessment of progress and impact of financial reforms and financial governance and support to national plans of actions (NPoAs)	Number of country APRM reviews with Bank support Improved APRM framework and review process with Bank support	R= lack of cooperation from RMCs; Bank has limited resources available to support process M= enhance dialogue with RMCs; ensure Bank has adequate resources

Purpose	Action	Start date	Responsible (Lead* and Support)	Expected Results	Indicators	Assumptions, Risks (R) & Bank Mitigation Measures (M)
	Enhance assessment and monitoring of financial sector stability	Ongoing	OPSM with EDRE, OSGE, and Field Offices	Enhanced enabling environment for private sector development	Number of Africa Economic Outlooks and Africa Competitiveness Reports published by the Bank	R= lack of cooperation from RMCs; Bank has limited resources available to support process M= enhance dialogue with RMCs; ensure Bank has adequate resources
	Stimulate partnerships to support formulation of national financial sector development plans and programs	2011	OSGE with ORVP	Increased support to the formulation and implementation of national plans of actions (NPoAs)	Number of RMCs with Bank support to the formulation and implementation of the NPoA or financial sector development plans	R= lack of cooperation from RMCs; parallel initiatives by Development Partners; Bank has limited resources available to support process M= enhance dialogue with RMCs and DPs; ensure Bank has adequate resources
	Enhance knowledge and evidence (data, statistical analysis and other analytical work) of linkage between financial sector development and the real economy	2013	ECON (ESTA & EDRE) with OSGE, ORVP, OPSM and other Sector Departments	Improved understanding of key challenges in the financial sector and linkage between financial sector trends and the real economy, including through generation of analytical data	Number of thematic ESW focusing on financial sector issues (including economic and financial governance) Publication of the 2010 African Development Report	R= lack of cooperation from RMCs; Bank has limited resources available to support process M= enhance dialogue with RMCs; ensure Bank has adequate resources
Strengthen country systems in RMCs to enhance financial sector management	Increase Bank support in building capacity for macroeconomic management	2011	OSGE, ORVP	Strengthened capacity of central banks and ministries of finance for macroeconomic management	Number of new operations with macroeconomic management capacity building components (ISPs and DBSLs) Number of countries with improved capacity for macroeconomic management	R= Bank has limited resources available to support process M= ensure Bank has adequate resources
	Increase Bank support to country systems in implementing regulatory reforms	2014	OSGE with ORVP, OPSM and GECL	Improved regulation of financial institutions	Number of new operations with capacity building components for financial regulations (ISPs)	R= Bank has limited resources available to support process M= ensure Bank has adequate resources

Purpose	Action	Start date	Responsible (Lead* and Support)	Expected Results	Indicators	Assumptions, Risks (R) & Bank Mitigation Measures (M)
Level III: Supporting the strengthening of financial infrastructure						
Enhance the diversification of financial systems	Support building of payments system infrastructure	2011	OSGE with ONRI, OPSM and ORVP	Payments system infrastructure built in RMCs	Number of payments system infrastructure built	R= Bank has limited resources available to support process M= Ensure Bank has adequate resources
	Sensitize regulatory & supervisory authorities on the adoption of best practices in the regulation of DFIs and MFIs	2011	OSGE with OPSM and ONRI	Regulatory and supervisory authorities sensitized on best practices in regulation and supervisory of DFIs and MFIs	Number of countries adopting good practices in the regulation and supervision of DFIs and MFIs	R= lack of buy-in from RMCs; Bank has limited resources available to support process M= enhance dialogue with RMCs; ensure Bank has adequate resources
Enhance Bank ability to improve the capacity of financial institutions to intermediate in medium and long-term financing	Sensitize national authorities and financial institutions on the establishment of refinance and guarantee mechanisms	2012	OSGE with OPSM	National authorities and financial institutions sensitized on the establishment of refinance and guarantee mechanisms	Number of countries in which refinance and guarantee mechanisms established	R= lack of buy-in from RMCs; lack of cooperation of FIs M= enhance dialogue with RMCs and FIs; ensure Bank has adequate resources
	Building capacity for the development of capital markets	2014	OSGE, OPSM, ADI	Potential investors sensitized; Capacity of regulatory institutions of capital markets strengthened; skills of financial brokers improved	Number of sensitization workshops for potential investors; Number of courses organized for capital markets regulators; Number of workshops organized for brokers	R= lack of capacity of RMCs; Bank has limited resources available to support process M= enhance capacity of and dialogue with RMCs; ensure Bank has adequate resources
	Mobilize resources to strengthen national payments systems	2012	OSGE	Payments systems strengthened in RMCs	Number of countries in payments systems are strengthened	R= Bank has limited resources available to support process M= ensure Bank has adequate resources

Purpose	Action	Start date	Responsible (Lead* and Support)	Expected Results	Indicators	Assumptions, Risks (R) & Bank Mitigation Measures (M)
Level IV: Enhancing diversity and commercial viability of financial institutions						
Enhance opportunities for Bank to provide catalytic funding to MSMEs	Mobilize resources and build capacity of DFIs in good corporate governance, financial management and project operations	2011	OPSM with OSGE	Capacity of DFIs to mobilize and on-lend resources enhanced	Number of DFIs adopting good prudential guidelines Number of DFI staff trained in project operations and good financial management	R= lack of interest of DPs to provide resources; lack of capacity in the Bank and of collaborating institutions to manage program M= sensitize DPs to the importance of building capacity of DFIs; ensure availability of staff in the Bank; provide adequate support to collaborating institutions to manage program
	Restructure funding to MFIs	2012	OPSM with FTRY and FFMA	Increased financing of the poor and MSMEs via wholesale FIs	Number of MSMEs benefiting from Bank financing	R= absence of skills and shared vision in the Bank M= Ensure strong drive and availability of skills in the Bank
	Promote special investment instruments for mobilizing term finance	2013	OPSM with FTRY	New Bank financial products introduced	Number of operations using new financial products Amount of financing provided to banks and other FIs Number of FIs benefiting from Bank financing Types of FIs benefiting from Bank financing	R= absence of skills and shared vision in the Bank M= Ensure strong drive and availability of skills to promote development of new products in the Bank

Purpose	Action	Start date	Responsible (Lead* and Support)	Expected Results	Indicators	Assumptions, Risks (R) & Bank Mitigation Measures (M)
Managing Implementation of the Financial Sector Strategy and Acton Plan						
Mainstreaming Financial sector development in Bank operations	Disseminate Financial Sector Strategy and Action Plan (FSSAP) inside and outside the Bank	2011	ERCU, with OSGE, ONRI, OPSM & EDRE	Increased awareness and visibility of the Bank's financial sector work	Number of dissemination and awareness raising activities	R= absence of shared financial sector development vision in the Bank and among DPs M= Ensure strong drive to promote financial sector development in the Bank and among DPs
	Align sector strategies/business plans to FSSAP	2011	OSGE with ONRI, OPSM, and relevant divisions and departments in ORVP, OSVP	Financial sector strategic objectives achieved	Individual business plans reflect financial sector objectives and action plan	R= lack of buy-in from relevant Bank Sector Departments; Sector Departments may lack skills to ensure proper alignment M= enhance in-Bank collaboration to ensure buy-in and support to realign sector strategies
	Establish a Bank-wide Financial Sector Working Group	2011	OSGE, ONRI, OPSM with relevant divisions and departments in ECON, FNVP, OSVP, ORVP,ORRU, CHRM	Bank financial sector work coordinated and consolidated and financial sector concerns mainstreamed in Bank operations	Establishment and frequencyof meetings to monitor implementation of FSSAP 2011-2015	R= lack of buy-in from relevant Bank Departments; M= stimulate interest within Bank
Invest in African partnerships and donor harmonization in financial sector development	Influence international debates on financial sector development by bringing African perspective	2011	PRST, with ECON, OSVP (OSGE), ORVP, OIVP (ONRI, OPSM)	Global financial sector development agenda informed and improved by African perspective	Number of key international and regional events on financial sector development with senior Bank participation	R= limited Bank participation in international for a M= ensure Bank participation in international for a at appropriate levels

Purpose	Action	Start date	Responsible (Lead* and Support)	Expected Results	Indicators	Assumptions, Risks (R) & Bank Mitigation Measures (M)
	Develop African partnerships for financial sector development	2011	OSGE	Better coordinated financial sector interventions at regional level	Number of strategic partnerships with key African institutions (AU, UNECA, ACBF)	R=lack of shared vision and collaboration of African regional organizations M= enhance dialogue with African regional organizations
	Influence donor harmonization on financial sector development by bringing African perspective	2011	ORPC with OSGE	African voice in donor harmonization efforts strengthened	Number of donor coordination and harmonization fora on financial sector development with Bank participation (number of meetings attended) Number of MFWFA & MDB WG joint position and policy papers with Bank contribution	R=lack of shared vision and collaboration of Development Partners; limited Bank participation in international fora M= enhance dialogue with DPs; ensure Bank participation in meetings of MFWFA
	Improve coordination and complementarity of the Bank's financial sector operations in RMCs with Development Partners	2011	ORVP with OSGE	Improved effectiveness of financial sector development support to RMCs	Number of financial sector development activities undertake jointly/co-financed with other development partners increased	R= lack of cooperation from Development Partners; lack of capacity of RMCs to lead process M= enhance dialogue with DPs; ensure RMCs have adequate capacity
Equip the Bank to implement the FSSAP 2010-2015	Undertake a skills gap analysis and prepare a HR plan for financial sector development (as part of HR plan under the mid-term review of the MTS 2008-2012)	2011	CHRM with OSGE	Financial sector expertise scoped and gaps identified	Capacity, needs and gaps assessed Financial sector development HR action plan drafted and approved	R= Delay process of conducting skills gap analysis M= ensure skills gap analysis undertaken early enough to feed into MTR of MTS
	Implement financial sector HR action plan	2011	CHRM with OSGE, OIVP, ORVP	Financial sector development work adequately resourced	Financial sector HR action plan implemented	R=Delay process of implementing financial sector HR plan M= expedite implementation of financial sector HR plan and utilize consultants in the interim

Purpose	Action	Start date	Responsible (Lead* and Support)	Expected Results	Indicators	Assumptions, Risks (R) & Bank Mitigation Measures (M)
	Realign OSGE	2011	OSGE	Adjusted organization of OSGE to balance country/regional focus, sector/technical focus and delineation of activities between Governance Division and Financial Reforms Division	Realignment and reallocation plan drafted, approved and implemented	R= lack of in-house agreement on how to realign OSGE activities M= enhance in-house discussion
	Explore the establishment of a professional cadre of financial sector specialists	2011	CHRM with OSGE, ORPU, OAGL	Strengthen Bank financial sector competencies and technical skills	Feasibility study completed Competency framework developed and accreditation system adopted Number of accredited staff in central, regional and country units	R= lack of buy-in from relevant Bank Departments; lack of CHRM capacity to expedite recruitments M= stimulate interest within Bank; ensure CHRM has adequate capacity to expedite recruitments
	Develop arrangements to mobilize specialized expertise, as required	2012	OSGE, ONRI, OPSM with ORPU, ORRU	Bank can leverage "just in time" specialized expertise	Number of networks and arrangements established (e.g. panels of accredited consultants, resource centres)	R= lack of flexibility in Bank consultant procurement rules; lack of resources to recruit consultants M= ensure adequate flexibility in Bank process of consultant recruitment; allocate adequate resources to recruit consultants; leverage external partnerships to obtain resources
	Leverage dedicated resources to support the implementation of the Bank FSSAP 2010-2015	2011	ORRU, with OSGE	Bank can mobilize resources and skills through TF-TA to implement the FSSAP 2010-2015 and support catalytic financial sector initiatives in RMCs	Establishment of a multidonor trust fund (FSSAP MDTF) with significant commitment capacity to support the implementation of the FSSAP, in particular for non lending work, and to develop Bank capacity	R= lack of in-house buy-in and shared vision/collaboration of donors M= ensure adequate sensitization within Bank and among donors

Annex 2: Deficiencies in the African Financial Sector

Intermediation Deficiency

The structure of many African financial systems remains small, fragile, inefficient and highly risky, impeding their intermediation function.

- Basic policy frameworks and institutional structures exist, but in comparison to other developing countries, financial depth and efficiency, as measured by deposit resources mobilized by banks and near-bank intermediaries relative to economic activity (ratio of liquid liabilities to GDP) and credit extended (private credit to GDP) is low[1.] The low monetary depth is also reflected in tendency of wealth holders to hold their liquid assets outside Africa (indication of capital flight)[2,] while the low credit compels SMEs to rely less on bank financing than on internal funds.
- African financial systems are not only shallow; they also remain volatile and risky (from political and economic shocks[3)] and are beset by governance deficiencies (corruption and difficulties in enforcement of contracts and creditor rights) and information asymmetries.
- The inefficiencies, high risks and lack of effective competition result in expensive banking services, reflected by high interest rate spreads and margins, high minimum deposit requirements, and high lending interest rates. Meanwhile, the financial system is dominated by a few banks, especially foreign banks. The banks remain highly profitable and liquid, although there are continuing doubts about the solvency and efficiency of the former state-owned DFIs that have not successfully reformed their operations[4].
- The high cost of credit, which reflect the high demand for funds by government, enterprises and households as well as risks and limited competition in the financial systems
- Formal regulatory frameworks are in place in many countries but they have not been effective in anticipating threats to the system, partly because of shortcomings in the reporting systems and lack of analytical data, but also because of weak capacity of the regulatory and supervisory institutions.
- Limited intermediation and focus on short-term transactions rather than long-term commitments also reflect the deficient governance structure in many countries (weaknesses in the contractual framework, high degrees of corruption, the risk of expropriation and inefficient bureaucracies)[5].

Development Deficiency

Overall, the financial sector, especially in low-income Africa, does not provide adequate services to support private sector growth and development, while the issue of high cost of capital, which had prompted the earlier interventionist approach by governments, remains.

- The financial systems are dominated, and will be for the foreseeable future, by banks. However, bank lending is still heavily geared towards the short end of the market for various reasons:

[1] Ratio of liquid liabilities to GDP average 32% in Africa compared to 49% in East Asia and Pacific and 100% in high-income countries, while the ratio of private credit to GDP average 18% in Africa compared to 30% in South Asia and 107% (See Honohan and Beck, ibid.

[2] Ratio of off-shore deposits in Africa to domestic bank deposits is significantly higher in Africa than in other regions of the world.

[3] The economic shocks reflect high dependence on exports of primary products and susceptibility to both demand-side shocks (terms of trade volatility) and supply-side shocks caused by natural disasters such as floods and droughts as well as political disruptions and civil unrest. On average, an African country survives little more than a decade without major social, political or economic disturbance (See Martin Meredith, 2005: *The State of Africa: A History of Fifty Years of Independence,* Free Press London.

[4] Honohan Patrick and Beck ibid; and Beck, Thorsten and Demirguc-Kunt, 2009:'Financial Institutions and Market Across Countries and Over Time – Data and Analysis' World Bank (unpublished).

[5] Honohan Patrick and Beck ibid.

bank balance sheets are dominated by short-term deposits; banks face acute problems of lack of information about creditworthiness of potential clients and difficulty of enforcing contracts and creditor rights that increase the risk of loan default; and weaknesses of the legal system (laws, registry, operation of courts), especially regarding property rights, limit the number of creditworthy borrowers and the capacity of financial institutions.

- Other sources of long-term financial resources are mainly under-developed or poorly performing: only a few countries in Africa have capital markets, which are mostly small and illiquid; corporate bond markets are almost non-existing in most countries, and with most countries having very shallow government bond markets, if at all; the insurance sector is small with shallow market penetration, and characterized by low loss ratios and high expense ratios)[6]. The state-owned development finance institutions (DFIs) are often poorly performing: many non-reformed DFIs are ridden with non-performing assets and access to their lending is limited to the few and connected.
- Government financing through the market has been crowding out private sector borrowers from access to bank credit.
- Many countries have been slow in implementing the corporate governance reforms and establishing the institutional frameworks for finance.

Poverty Reduction Deficiency

Microfinance is developing, with the growing interest from banks and private investors[7], while support services and regulatory frameworks are also being put in place. In many countries, with financial sector reforms, the policy and regulatory frameworks being implemented put emphasis on the sustainability of the MFIs by encouraging their operation on market-based principles. However, the shift to the new paradigm of market-based principles (see Box 11 on the new paradigm for inclusive finance) has its own challenges, processes and risks, and requires policy and regulatory reforms at the macro (policy and regulatory) level, as well as provision of new services (such as audits, accounting and refinancing) at the meso (sector) level, and organizational changes to conform to the new principles at the micro (or institutional) level. Meanwhile, generally, access to finance remains lower in Africa than in other developing regions, with the result that many of the poor resort to informal sources for financial services. While some countries such as Kenya have leveraged technology to enhance financial inclusion, many countries suffer structural weaknesses that hamper the development of products suitable for MSME lending, preventing the financial system from addressing adequately the needs of the poor. While the innovations in a few countries are encouraging, in many other African countries:

- Banks are not inclined to service low-income business or households (exacerbated by geographic dispersion of population outside of major urban centers and poor communication and transport deficiencies), and there are issues of affordability (high fees and minimum balances), eligibility (documentation requirements, including for collaterals) and product appropriateness with banking services for SMEs and the poor.
- Numerous financial products available in advanced economies and suitable for SME financing such as leasing, factoring are limited or even absent.
- The few informal microfinance institutions (MFIs) have limited outreach and many are poorly resourced and not sustainable in the medium term, while the lack of information on their financial performance exposes the poor dealing with them to high risks.
- Microfinance support services (such as training and auditing) are rare and of unequal quality.
- Supervisory and coordinating bodies have limited resources, while the legal frameworks are in a state of flux.
- The policy and regulatory frameworks as well as the activities of some non-governmental organizations (NGOs) that provide grants or concessional loans to targeted groups (e.g. women)

[6]See International Monetary Fund. 2008. *Regional Economic Outlook: Sub-Saharan Africa*. Washington, D.C.
[7] The MFIs include banks, post office banks, DFIs, deposit taking and non-deposit taking MFIs, cooperatives, and some NGOs.

still distort the market (such as through interest rate subsidies) with little regard to sustainability of the MFIs.

- The lack of safety nets (especially micro-insurance) to deal with climate-related hazards and the reduced provision of social services (free or subsidized health care and education) by governments introduce the risks that microloans may be used to respond to unforeseen misfortunes rather than in productive activities, increasing the possibility of non-repayment of the loans.

These deficiencies and nuances define the overall agenda for financial sector reform and development, which must be pursued at the regional, national, sector and institutional levels. In many countries, the key elements of the agenda going forward (summarized in Annex 3) should include establishing healthy and sound financial systems (in response to the intermediation deficiency), diversifying and deepening the financial sector (to address the development deficiency) and promoting financial inclusion (to mitigate the poverty reduction deficiency)[8]. Country differences and regional dimensions are important further considerations when defining and prioritizing reform measures to address these deficiencies.

Country Differences

Financial sector development differs across African countries, and as such the priorities of reform measures would also differ across countries from the broad picture painted above. In this regard, African financial systems may be divided into three groups, namely:

- *Least developed* – poorly functioning financial systems that are dominated by commercial banks and a narrow range of financial instruments (mostly cash, bank deposits and short-term loans);
- *Moderately developed* – system dominated by commercial banks but also having a limited number of specialized institutions that provide insurance, housing finance, and short-term finance facilities; and
- *Highly developed* – with fairly diverse range of financial intermediaries and functioning, but not very liquid, capital markets[9].

However, in judging the strength and potential for the development of a financial system or the appropriate strategies, it is also important to consider the 'initial or macro conditions' in which the financial systems operate[10]. Thus, in addition to financial sector depth, the financial development strategy should be further tailored to the macroeconomic situation in each country. In countries characterized by unstable macroeconomic imbalances[11], the policy stance would involve repairing the macroeconomic situation, while also taking steps to enhance financial intermediation along sequential stages. Particular attention may also need to be paid to strengthening the legal, supervisory and regulatory framework, as well as the monitoring systems, to ensure that the weak macroeconomic conditions do not lead to a weakening of the financial system.

[8] See the Bank Group Financial Sector Policy (2003) for further details.

[9] South Africa, which would be included in this group, is in a class of its own having a financial system comparable to that in industrialized countries.

[10] A financial system may be 'developed' in terms of the financial instruments, but if the system is not sound, or if it operates in an unsustainable macro-environment, it is highly unlikely to develop, and may in fact retrogress. One useful suggestion from the IMF for assessing the financial system soundness is to look at the macroeconomic and microprudential indicators (see Owen Evans, et. al.: *Macroprudential Indicators of Financial System Soundness* Occasional Paper 192, IMF, Washington D.C. 2000). The microprudential indicators are summarized as **C**apital adequacy, **A**sset quality, **M**anagement soundness, **E**arnings, **L**iquidity, and **S**ensitivity to market risks (**CAMELS** for short). Macroeconomic indicators on the other hand include *inter-alia*, economic growth, balance of payments, inflation, and interest and exchange rates.

[11] Such as Zimbabwe, DRC and many low-income African countries with high inflation rates.

On the other hand, countries having a stable macroeconomic environment but a relatively less developed financial system[12], would appropriately put priority on establishing suitable infrastructure and institutions to enhance the poverty reduction and development potential of their financial systems.

For countries with relatively developed and relatively stable financial systems[13], bond markets in domestic currencies could provide efficient ways of mobilizing long-term finance by tapping new sources of finance and diversifying the financial sector away from traditional reliance on bank lending and donor flows[14]. Privatization and the establishment of a variety of institutions such as finance companies, leasing companies, venture capital companies, and unit investment trusts, are also potential means of developing emerging capital markets. These countries should also aim at a greater integration of their financial systems with the global markets and should further refine their prudential provisions to conform to the internationally agreed standards.

There are other countries in special situations, including:

- *Post-conflict and Fragile countries*[15], which are characterized not only by an unstable macroeconomic situation but also a lack of credibility of the currency and high risks in the payments systems, which must be addressed;
- *Resource-rich countries* with less developed financial systems and weak institutions, which have to address financial governance and other issues of transparency to avoid the resource curse, with its social conflicts and civil unrest, while also paying attention to ensuring macroeconomic stability and avoiding the Dutch disease with its limiting effects of overvaluation; and
- *Countries in common-currency arrangements,* which not only have to consider the situation of the individual member countries but also the regional dimensions of the financial sector development programs.

Regional Dimensions

Despite progress in domestic financial reforms, financial market growth and efficiency in Africa have been constrained by the smallness and fragmented nature of the financial systems as well as vulnerability to external shocks (see section below on challenges on FS reform). African countries have, therefore, persistently considered regional monetary and financial integration as an important complement to domestic financial reforms. The benefits from regional financial integration result from the combination of policy, institutional, and regulatory actions, as well as market-driven extension and deepening of the financial system that can help overcome the financial market constraints[16]. The regional dimensions and integration agenda may, however, also introduce further nuances in the financial sector development agenda. In particular, the stage of regional integration, which increases from cooperation through harmonization and formal integration and adoption of common systems, may require certain emphasis in the financial sector development to enhance synergy with the domestic agenda[17].

[12] Many low-income African countries, especially in Sub-Saharan Africa would fall in this category.

[13] South Africa, for example, and many MIC countries (before the financial crisis), would fall in this category.

[14] The conditions for developing capital markets include maintenance of stable macroeconomic environment, supportive regulatory environment, a clearly articulated government debt management strategy, liquid and stable money markets, presence of large institutional investors (helped by the reform of the contractual savings and pension systems), appropriate investment and analytical tools, establishment of credit agencies and rigorous credit analysis, and adequate market infrastructure, transparency and efficient information flows.

[15] Such as Sierra Leone and Zimbabwe.

[16] Regional financial integration's contribution to growth comes through various channels: it provides further powerful stimulus for domestic financial reforms; it increases the scale of operations and competition, thereby increasing the system's efficiency and productivity; it induces foreign direct investment (FDI) inflows, and it enables the African systems to grow into being regional and ultimately global players in financial markets (see ADB; *Regional Financial Integration in three subregions*, Tunis, July, 2009).

[17] Most RECs are at the stage of collaboration and harmonization. See ADB, ibid on a proposed regional financial integration roadmap.

Annex 3: Bank Group operations in the financial sector, approved by the Board between 2006 and 2009

Regional Level: Mainly one operation in support of strengthening a regional payments system and facilitating payments transfers. This builds on the Bank's earlier experience in supporting the Project to Reform Systems and Means of Payment in the UEMOA, ongoing since 2002, which aims to upgrade the UEMOA payments system to comply with the Core Principles for Systemically Important Payments and strengthen risk management practices for large value transactions[18]. Other multinational operations were mainly directed at providing support to regional level institutions (AFRITAC and FI support to some regional development banks) and are analyzed at the institutional level.

National Level: There were mainly four operations whose objectives included supporting implementation of strategies to diversify the economy, improving the macroeconomy and business climate, and strengthening financial governance (regulation). One of the operations was specifically directed at building capacity of institutions managing the macroeconomy. These projects also build on the Bank's experience and ongoing projects in building capacity for regulatory reforms[19].

Sector Level: There were five operations specifically targeted at improvements at the sector level, although mostly designed and implemented at the national level. They aimed at developing efficient, competitive and market-based financial systems through (i) enhancing the efficiency in financial intermediation and risk management, (ii) strengthening supervision and control of the financial markets, and (iii) improving the national guarantee system to enhance access of microenterprises and SMEs to financial services.

Institutional Level: Forty-three operations were delivered at the institutional level mainly through lines of credit (LOCs) and equity with few through quasi equity and guarantees.

- ***Line of Credit (LOC) operations:*** LOCs mostly aimed at improving the supply of medium and long term resources, including foreign exchange, to the corporate, micro, small and medium enterprise (MSMEs) clients, primarily in the infrastructure and production sectors but also in leasing and housing. In some cases also, the LOCs aimed at developing the domestic financial sector and capital markets or regional infrastructure development by supporting medium and long-term financing by the financial institutions. In 2009, the Bank further enhanced the LOC by broadening it to cover trade (using its Trade Finance Facility (TFF)) to help financial intermediaries mitigate the impact of the global economic crisis, which affected most African countries through the trade channels. The design of LOCs ensured the competitiveness and operational efficiency of the beneficiary FI.

[18] Requests for support at the regional level have, however, picked up in 2009, with five projects being conceptualized: two projects for CEMAC (capacity building for regulatory reforms and payments systems); one to extend the WAMZ project to Liberia that has just joined the Zone; a macroeconomic convergence project for ECOWAS and a fiscal harmonization project for COMESA.

[19] The ongoing projects at the national level include the Mozambique Financial Sector Technical Assistance Project aimed at building capacity of financial sector regulators, improving the legal and judicial environment for financial transactions, and supporting the establishment of anti-money laundering regimes, and the Rwanda Competitiveness and Enterprise Development Project, which includes support to enhance the capital adequacy framework.

- ***Equity participation:*** The Bank participated in equity investments in a number of national and multinational institutions to help improve the supply of medium and long-term funds to specific sectors/areas (including infrastructure or intra-regional trade development) and to support orientation towards MSMEs. These interventions take a variety of forms: ordinary shares or preferred stock with or without participating features. In most instances, equity instruments are denominated in local currency and consequently entail foreign exchange risks for the Bank. In African countries, business firms are often small partnerships, relying on the funds of the owners. Through equity participation, the Bank is able to undertake an important function of bringing in other investors with capital, managerial skills and technical know-how, thereby contributing to the emergence of capital market in the member countries.

- ***Quasi-equity:*** The Bank is also empowered to make quasi-equity investment in various forms, ranging from subordinated loans, with or without conversion rights, and income notes to redeemable preference shares. Such quasi-equity holding normally ranks junior to loans in the event of liquidation. Their main characteristic is that they combine some features of loans with those of equity. They do not generally involve an exchange risk for the Bank and are retired under agreed schedules, making them more suitable instruments in countries without a well-developed capital market in which a ready sale of equity is difficult.

- ***Guarantees:*** The significance of this instrument is that it facilitates the access of the enterprise to local or foreign currency funding on attractive terms and maturities not otherwise available. However, to the Bank, guarantees carry risks similar to those for the loans to the enterprise. As such, the projects for which guarantees are issued by the Bank, are appraised, processed and supervised in the same fashion as project loans, and are subject to exposure limits[20]. Since the primary objective of the instrument is private sector development, the main beneficiaries are private enterprises, local or foreign, including financial institutions. Government-owned financial institutions may, however, also benefit from the facility if the operation could be of considerable advantage to private enterprises. Nevertheless, from the point of view of the financial sector development, guarantee operations of the Bank can have catalytic impact as commercial paper of short and medium term, guaranteed by the Bank, could contribute indirectly to the development of money and capital markets.

[20] African Development Bank: Policies for Lines of Credit, Agency Lines and Guarantees to Private Sector Financial Institutions, Board document, August, 1998.

Annex 4: Sample of Bank Group operations in the financial sector, approved by the Board between 2006 and 2009

	Project	Country	Method of delivery	Amount UA million	Major Cofinanciers	Main objectives
2006						
1	Financial Sector Reform Program	Egypt		337.98	USAID, World Bank	Develop an efficient, competitive, and market-based financial system to better serve Egypt's development and growth
2	Line of Credit to Access Bank PLC*	Nigeria	LOC	23.21		Improve supply of long term foreign exchange currency lending to Nigerian corporate and SMEs clients, primarily in the infrastructure sector
3	Second Line of Credit to Zenith Bank PLC*	Nigeria	LOC	66.32		Improve the availability of medium and long term funding in foreign currency to finance SME development, strengthen the local capital markets
4	SADC-Regional Infrastructure Development Facility to the Development Bank of Southern Africa Limited (DBSA)	Multinational		67.60		Increase support for the development and expansion of infrastructure and related development projects.
5	Social Fund for Development of Micro & Small Enterprises Support	Egypt		59.03 and 0.6 (grant)		The project includes a line of credit to provide loans to commercially viable micro- and small enterprises (MSEs)
6	Phase II of Regional Technical Assistance Centers Program (AFRITAC)	Multinational		ADF Grant 2.98		Consolidate financial systems including microfinance sector.
7	Entrepreneurship Promotion and Micro-Finance Development	Gambia		ADF		Increase access to financial services in rural areas through a microfinance scheme
2007						
8	Equity Participation in the United Bank for Africa Plc (UBA)	Nigeria		32.81		Increase support for private sector development and expansion and contribute to economic growth.
9	NEDBANK Group	South Africa		92.05	IFC	Provide resources for financing affordable housing and other forms of infrastructure in favor of low-income households
10	Equity Investment in the Access Bank of Tanzania	Tanzania		0.49		Provide a broad range of financial services to small and medium-sized enterprises (SMEs).
11	Line of Credit to Société Tunisienne de Banque (STB)	Tunisia		87.80		Finance SMEs and contribute to economic growth. The major components consist of a line of credit to finance projects generated by SME promoters
12	Equity Participation in TCX Investment Company Mauritius Limited	Multinational		16.31	DBSA, Netherlands, FMO	Eenhance capacity for financing projects and programs in local currencies in RMCs.
13	Equity Participation in Atlantic Coast Regional Fund Limited (ACRF)	Multinational		9.93	CDC, EIB, IFC	Assist in fostering capital market development with the ultimate objective of poverty reduction.
14	Pan African Infrastructure Development Fund	Multinational		33.77	PIC, DBSA, SANLAM, EPPF,	Provide equity and quasi-equity capital resources to infrastructure projects legally constituted and operating in Africa.
15	Microfinance Operators' Capacity-Building	Multinational		5.98 (ADF)		Increase funds to provide financial services in response to

	Project	Country	Method of delivery	Amount UA million	Major Cofinanciers	Main objectives
	Project (PRECAMF)					increased demand for microfinance support
	2008					
16	Advans Bank Congo (ABC) – Equity Investment	DRC		0.7	Luxembourg, Kfw, IFC, EIB	To deepen the financial sector in this fragile state by providing equity participation to establish this greenfield microfinance bank.
17	CAL Bank Ltd. – Line of Credit	Ghana		9.18		To enable CAL to extend long-term financing to meet increasing demand from viable SMEs in Ghana
18	Ghana Export-Oriented SME Guarantee Program	Ghana		14.90	FAPA	To extend a 50 percent partial credit guarantee facility to 2 partner banks in Ghana to expand access to credit for 210 export-oriented SMEs and SME organizations.
19	Banque pour Le Commerce et L'Industrie (BCI)– Line of Credit	Mauritania		4.90		To enable BCI to expand its commitment capacity for onlending to SMEs
20	Mauritania Leasing (ML) – Line of Credit	Mauritania		3.06		To increase the capacity of Mauritania Leasing (ML) to finance the procurement of equipment, machinery, and other movable and immovable assets for leasing to SMEs
21	Access Bank Nigeria (ABN)– Equity Investment	Nigeria		0.72		Facilitate access to credit to low-income individuals and micro enterprises
22	Nedbank – Line of Credit	South Africa		63.70	IFC, FAPA	To provide long-term foreign currency to Nedbank for onlending to infrastructure and industrial projects
23	Standard Bank of South Africa (SBSA) – Line of Credit	South Africa		11.47		The LOC will be used exclusively for US$ denominated projects in Africa but outside South Africa. SBSA would be contributing to African regional integration.
24	Zanaco Bank Ltd.– Line of Credit	Zambia		2.23	PCGF, USAID, IFC, FAPA	To enhance Zambian SMEs' access to longterm, low-collateral finance by providing long-term lines of credit (LOC)
25	Investrust Bank plc – Line of Credit	Zambia		140.14	IFC, FAPA	To enhance SMEs' access to medium-term, low-collateral finance and non-financial services
26	Eastern and Southern Africa Trade and Development Bank (PTA Bank) – Line of Credit & General Capital Increase	Multinational		32.11	FAPA	Providing foreign exchange resources to enable subprojects to procure imports of equipment
27	Emerging Capital Partners Africa Fund III (EAF3) – Equity Participation	Multinational	Equity Participation	60.61	HBD, CDC, Al Rashed Group, and ADIA.	To mobilize risk capital to unlock the potential of strategic and high-growth companies
28	GroFin Africa Fund – Equity Participation	Multinational	Equity Participation	15.30	FMO,CDC, GroFin Capital, IFC , EIB	To increase private entrepreneurship, contribute to economic development and poverty reduction, by targeting growth-oriented SMEs through small, selfliquidating loans
29	Rising Africa Infrastructure Fund (RAIF) – Equity Participation	Multinational	Equity Participation	92.42	FIDEPPP,Kuwait FH, DFIs	The Fund will provide finance for individual infrastructure projects
30	Second Maghreb Private Equity Fund 2 (MPEF2) – Equity Participation	Multinational	Equity Participation	18.63	EIB, IFC, CDC, FMO, SIFEM,	To support a private equity fund primarily targeting SMEs in Northern African countries of Tunisia, Morocco, Algeria, and

	Project	Country	Method of delivery	Amount UA million	Major Cofinanciers	Main objectives
					BIO, FPMEI	Libya
31	Fourth Program of Poverty Reduction Strategy (PRSSP-IV)	Burkina-Faso		20 (ADF Loan) and 25 (ADF Grant)	IDA , EU, Denmark , France, Netherlands, Switzerland, Sweden	To support Government's efforts in promoting strong and sustainable growth
32	Urban Poverty Reduction Strategy Support Program	Djibouti		17.94 (ADF Loan)	World Bank , IDB , AFD	To support socioeconomic growth and poverty reduction, particularly among the urban population.
33	West African Monetary Zone (WAMZ)Payment System Development Project (The Gambia, Guinea and Sierra Leone)	Multinational		14 (ADF Loan)		To promote economic integration, develop a single currency, and assist in the harmonization of payments systems among its members
2009						
34	Financial Sector Development Support Programme	Morocco	PBL	150	World Bank	To strengthen the governance of the financial sector and deepen it by improving access of the population and enterprises to financial services
35	Economic Diversification Support Programme	Botswana	PBL	3.23		To create competitive conditions for accelerated private sector growth, economic diversification and poverty reduction. Thus by, notably the improvement of financial sector governance and strengthening of the regulation of nonbank financial institutions
36	Liberia Bank for Development &Investments (LBDI)	Liberia		968.96		To increase available credit to the SME
37	Line of Credit to Intercontinental Bank PLC	Nigeria	LOC	67.03		To develop the SME sector
38	Line of Credit Zenith Bank PLC under Emergency Liquidity Facility	Nigeria	LOC	32.21		To increase available liquidity to underpin the financing of ongoing projects
39	Line of Credit to United Bank for Africa (UBA) PLC under Trade Finance Initiative (TFI)* and under Emergency Liquidity Facility (ELF)**	Nigeria		96.63		To Increase provision of funds for trade finance
40	Line of Credit to Company for Habit & Housing (Shelter-Afrique)	Multinational	LOC	20.11		Provide convenient and affordable housing
41	Line of Credit to African Banking Corporation Holdings Ltd(ABCH) Under Emergency Liquidity Facility	Multinational		18.87		To ensure bank liquidity for continued and adequate on lending to SMEs
42	Equity Participation in “Banque Congolaise de l'Habitat”	Congo	Equity Participation	1.04		To strengthen the expansion of the housing industry
43	Increase in the Bank's Equity Participation in	Kenya	Equity Participation	1.49		To enable K-Rep Bank to sustain its microfinance activities

	Project	Country	Method of delivery	Amount UA million	Major Cofinanciers	Main objectives
	Capital of K-Rep Bank Limited					and expand its outreach and coverage in order to stimulate entrepreneurship and economic growth.
44	Equity Investment in Pan African Investment Partners-II Limited (PAIP II)	Multinational		32.46		To boost the rate of investment and support RMC's economic growth
45	Equity Investment in Agri-Vie Fund	Multinational		9.47		To expand SMEs operating in the agribusiness sector
46	Increase in the Bank's Equity Participation in Company for Habitat and Housing in Africa (Shelter-Afrique)	Multinational		5.03		To maintain strong capital ratios in the face of increased future borrowing to finance growth in operations
47	Equity Investment in Africinvest Fund	Multinational		17.80		To provide investment capital for local companies with growth potential that are aiming for regional expansion
48	Equity Investment in Aureos Africa Fund, LLC	Multinational		19.38		To provide long term investment capital and capacity building for local companies
49	Equity Investment in West Africa Emerging Market Fund (WAEMF)	Multinational		12.62		To boost investment and support RMCs' growth by the provision of long-term risk capital
50	Guarantee Loan in Favor of "Maghreb Leasing Algeria"	Algeria		5.34		To increase credit supply for Algerian SMEs
51	Rural Income And Employment Enhancement Project (RIEEP)	Uganda		10.21 (ADF Loan)		To facilitate access to and utilization of affordable financial and business development services

Annex 5: APRM, FSAP and ROSC Country Assessments Completed

Country	APRM[21]	FSAP	ROSC Areas[22]							
			Transparency in Monetary & Financial Policies	*Banking Supervision*	*Securities Regulation*	*Insurance Supervision*	*Payments and Settlements*	*Accounting and Auditing*	*Insolvency and Creditors Rights*	*Anti-Money Laundering*
Algeria	*	*		*						
Angola										
Benin	*							*		
Botswana		*						*		
Burkina Faso	*									
Burundi								*		
Cameroon		*	*	*		*	*			
Cape Verde										
Central African Republic										
Chad										
Comoros										
Congo										
Democratic Republic of Congo										
Cote d'Ivoire								*		
Djibouti										
Egypt								*		
Eritrea										
Equatorial Guinea										
Ethiopia										
Gabon		*	*	*		*				
Gambia										
Ghana	*	*						*		
Guinea										

[21] APRM assessments cover (i) political governance and democracy, (ii) economic governance and management, (iii) corporate governance, and (iv) socio-economic development.

[22] ROSCs are a by-product of the FSAPs. ROSCs summarize the extent to which countries observe certain internationally recognized standards and codes. The IMF has recognized 12 areas and associated standards as useful for the operational work of the Fund and the World Bank. These comprise accounting; auditing; anti-money laundering and countering the financing of terrorism (AML/CFT); banking supervision; corporate governance; data dissemination; fiscal transparency; insolvency and creditor rights; insurance supervision; monetary and financial policy transparency; payments systems; and securities regulation; AML/CFT was added in November 2002

Country	APRM[21]	FSAP	ROSC Areas[22]							
			Transparency in Monetary & Financial Policies	*Banking Supervision*	*Securities Regulation*	*Insurance Supervision*	*Payments and Settlements*	*Accounting and Auditing*	*Insolvency and Creditors Rights*	*Anti-Money Laundering*
Guinea-Bissau										
Kenya	*	*						*		
Lesotho	*									
Liberia										
Libya										
Madagascar		*						*		*
Malawi		*						*		
Mali	*	*								
Mauritania		*								
Mauritius		*	*	*			*	*	*	*
Morocco		*	*	*	*	*		*	*	
Mozambique	*	*						*		*
Namibia		*								
Niger										
Nigeria	*							*		
Rwanda	*	*						*		*
Sao Tome & Principe										
Senegal		*	*	*				*		
Seychelles										
Sierra Leone										*
Somalia										
South Africa	*	*		*				*		
Sudan		*								*
Swaziland										
Tanzania		*						*		
Togo										
Tunisia		*	*	*	*			*		
Uganda	*	*	*	*	*	*		*		
Zambia		*						*		
Zimbabwe										
Central African Economic and Monetary Community		*								*

Annex 6: CGAP SmartAid for Microfinance Index Indicators

Strategic Clarity	**1**	Funder has a policy and strategy that addresses microfinance, is in line with good practice, and is based on its capabilities and constraints
Staff Capacity	**2**	Funder has designated microfinance specialist(s) who are responsible for technical quality assurance throughout the project/investment cycle
	3	Funder invests in microfinance/access to finance human resources
Accountability for Results	**4**	Funder has a system in place that flags all microfinance programs and components
	5	Funder tracks and reports on performance indicators for microfinance programs and components
	6	Funder uses performance-based contracts in its microfinance programs and components
	7	Funder regularly conducts portfolio reviews
Knowledge Management	**8**	Funder has systems and resources for active knowledge management for microfinance
Appropriate Instruments	**9**	Funder has appropriate instrument(s) to support the development of local financial markets

Source: CGAP (2009), *SmartAid for Microfinance Index 2009: Submission Guide*, World Bank, Washington, DC

Annex 7: Summary of Strategies of Development Partners

African Union and other African Regional Organizations
• **Several African institutions** have a mandate over different dimensions of financial sector development. The **African Union** has a political mandate to promote regional unity and integration, and has been spearheading efforts to strengthen financial integration and to set up continental financial institutions and an African common currency. The APRM, an AU program, also assess implementation of good governance practices, including financial governance, and helps countries to draw up action programs to correct deficiencies. However, incorporating these action plans in national strategies remains a challenge.   • The **RECs**, as the building blocks of regional integration in the continent also promote financial integration, and several of them have programs to establish common currencies or regional financial institutions.   • **UNECA's** support to financial sector development focuses on rationalizing the role of government and support to regional financial integration and private sector development through policy analysis, research and technical assistance in support to the APRM.
The International Monetary Fund
• **International Monetary Fund** oversees the international monetary system and monitors the financial and economic policies of its members. Its regular monitoring of economies and associated provision of policy advice is intended to identify weaknesses that are causing or could lead to financial or economic instability. **This process is known as surveillance** and is done at the national (Article 4 consultation), regional and global levels. The IMF is also committed with the World Bank in the realization of the **Financial Sector Assessment Program (FSAP)** aiming to increase the effectiveness of efforts to promote the soundness of financial systems in member countries. These assessments aim to identify the strengths and vulnerabilities of a country's financial system; to ascertain the sector's developmental and technical assistance needs; and to help prioritize policy responses. Detailed assessments of observance of relevant financial sector standards and codes, which give rise to **Reports on Observances of Standards and Codes** (ROSCs) as a by-product, are a key component of the FSAP. The IMF shares its expertise with member countries **by providing technical assistance and training** in a wide range of areas aiming to help improve the design and implementation of members' economic policies, including by strengthening skills in institutions.   • **The African Regional Technical Assistance Centers (AFRITACs)** are part of the IMF's Africa Capacity-Building Initiative. The Initiative promotes strengthening the capacity of African countries to design and implement their poverty-reducing strategies, as well as to improve the coordination of capacity-building technical assistance in the PRSP process. As part of the Initiative, three African Regional Technical Assistance Centers (AFRITACs) have been established: East AFRITAC (Dar es Salaam, Tanzania), West AFRITAC (Bamako, Mali) and Central AFRITAC (Libreville, Gabon). The centers' activities take place in close cooperation with the African Development Bank and donor partners. This facilitates a coordinated design, implementation, and monitoring of ongoing technical assistance programs in member countries. Some training activities are carried out jointly with the Africa Capacity Building Foundation, of which the IMF is a member.   • In Africa IMF intervenes in the financial sector through leading the FSAP and providing punctual technical assistances.

The World Bank Group
• The World Bank Group's areas of intervention in African financial sector are the following: Accountability assessment; Accounting and Auditing; Banking; SME finance; Legal and regulatory financial framework; Payment systems; Microcredit; Financial capability; Housing finance, Capital markets; Pensions, Insurance; FSAP follow-up; M-Banking; NBFIs and remittances • **The World Bank** has **a financial sector strategy paper** approved by the board in April 2007 which guides the Bank's intervention on that area. The central goals of the new strategy are to build financial systems permitting the optimal allocation of funds and risks by improving investment opportunities, accessibility, transparency and risk management. The Bank implemented the strategy **by building and strengthening financial market and institutional infrastructure** - the enabling environment for financial market transactions - and actively facilitating the development of well-regulated, diversified financial institutions and markets. The World Bank strategy of 2007 proposed a shift in emphasis from banking markets to more systemic issues like capital markets, regulation and oversight. • The **International Finance Corporation** (IFC): At the IFC, the Global Financial Markets Department builds local financial institutions, develops local equity and debt markets, and introduces new financing instruments. The goal is to develop efficient financial systems that will fuel economic growth in developing countries. As the I**FC's mandate is to invest in and lend to the private sector**, it is not generally involved in the regulatory or supervisory aspects of financial sector reform. Most of its activity is investment in both privately and publicly owned banks or other non-bank financial institutions. That involvement can come through loans, equity investments or purchase of bonds. • The **Consultative Group to Assist the Poor** (CGAP): CGAP's mission is to improve poor people's access to convenient and affordable financial services so that they can improve their living conditions and build a better future. CGAP works with donors and investors to improve the effectiveness of funding for microfinance. Its focus is on increasing transparency within the funding landscape and help funders to improve how they work in microfinance. CGAP has five core areas of work : Developing and strengthening a wide range of institutions and means, both financial and non-financial, that deliver financial services to the poor; Improving the quality and availability of information about institutional financial performance; Establishing supportive legal and regulatory frameworks; Improving aid effectiveness and Reaching poor and unserved clients and ensuring impact on their lives. • The Financial Sector Reform and Strengthening (FIRST) Initiative is a multi-donor grant facility providing technical assistance (TA) to promote financial sector strengthening. FIRST's specific objectives are notably to: (i) Fund technical assistance in the areas of financial sector regulation, supervision and development in response to country demands, provide support to countries to strengthen their financial systems or implement standards and codes in advance of Financial Sector Assessment Programs (FSAPs) or Reports on Observances of Standards and Codes (ROSCs), and facilitate systematic follow-up of related recommendations; (ii) Assist recipients in preparing prioritized action plans addressing financial sector development and the sequencing of reforms; (iii) Promote coordination in the delivery of financial sector technical assistance and capacity building. FIRST intervenes in the African financial sector through technical assistances in the following areas: Accounting and auditing; Banking; Legal and regulatory financial framework; Payment systems, Microcredit; Housing finance; Capital markets; Insurance; Credit bureaus; Credit rating agencies and NBFIs.
The Bank for International Settlements and the Financial Stability Forum
Coordinates regulations in the fields of financial services to promote *international* financial stability. In this regard, among other activities, it promotes discussion and policy analysis among central banks and within the international financial community, and can provide resource persons at workshops to make presentations on the banking standards.

Regional Development Banks
• **Regional Development Banks** have also developed a strong focus on financial sector development. Financial sector development is a key pillar in the Asian Development Bank's Strategy 2020, and is providing support to the financial sector at the regional and national levels by helping to develop financial infrastructure, institutions, and products and services. The Bank also promotes inclusive finance through the creation of an enabling environment for MFIs and SMEs and the use of technologies to expand the reach of the formal financial system to rural areas. At the regional level, AsDB supports cross-border bond transactions. AsDB also helps to build the capacity of financial institutions—and of their regulators—as well as supports the establishment of anti-money laundering regimes in partnership with the BWIs and other aid agencies. • The **Inter-American Development Bank's** Financial Market Strategy (FMS) is aimed at helping client countries to achieve complete, harmonized and integrate financial markets and identifies two specific objectives: building upon existing reforms (and consolidating these as necessary); and developing the new instruments, institutions and markets needed to meet the savings, investments and risks management/risk transfer requirements of individuals and firms in the region. Primary emphasis is placed on the banking system as it remains the backbone of finance in client countries, but attention is also placed on the development of capital markets and risk management system as well as supporting the expansion of financial services to meet the needs of the poor and the rationalization of the role of the state in financial markets.
Bilateral Partners
The interventions of the bilateral agencies in the financial sector cover a range of areas that reflect those of the MDBs, with varying emphasis and focus as in the sample below: • **USAID** works to identify and address constraints to the emergence of sound financial systems in developing and transitional economies worldwide. USAID supports host country efforts to develop and strengthen their country's financial and business environment, often in collaboration with the other development partners. The USAID's initiatives in this sector include: development of collateral registries and credit bureaus that expand access to finance by reducing lending risks; strengthening of capital markets and use of term lending for housing, plant and equipment; development of accounting standards that better enable borrowers to document their debt service capacity to access finance; improvements to financial market regulation and supervision; and development and strengthening of payment systems that facilitate trade. **USAID**'s areas of intervention in the financial sector of Africa are: Agricultural and rural finance; Banking; SME finance; Legal and regulatory framework; Microcredit; Housing finance; Leasing; Collateral registries; Credit bureaus and M-Banking. • **DfID** reported in a published briefing note of 2004 "Financial Sector Development: a Prerequisite for Growth and Poverty Reduction" the ways policy makers and donors can promote pro-poor financial sector development. DfID's interventions in the financial sector rely on Agricultural and rural finance; Banking; SME finance; Payment systems; Microcredit; Financial capability; Housing finance; Capital markets; Pensions, Insurance and Remittances. • **GTZ** supports directly or indirectly projects and initiatives aiming to enable the vulnerable population in developing and transition countries to access financial services. Mainly GTZ is active in the micro insurance sector and is involved as a partner of the MFW4A initiative. **GTZ**'s areas of intervention for the financial sector in Africa are: Agricultural and rural finance; Banking; SME finance; Microcredit; Capital markets; Project finance and Informal finance.

Annex 8: Review of Gaps and Priorities in Development Partners' Support to Financial Sector Development

Priorities for Financial Sector Development and Reform

Based on an analysis of the current context in most African countries, a preliminary ranking of the objectives for reform (and development assistance) is shown below. While progress in all areas would be desirable, some are more critical than others as conditions for the financial sector to support broader-based growth of the real sector in the near term.

HIGHEST OPPORTUNITIES[23]	
1. Drawing Financial Sector Development Plans and ensuring consistency between reform in financial and real sectors	• The financial sector is not delivering the benefits of efficient financial intermediation to the economy. High lending rates constitute an important constraint on productive investment. Commercial banks serve a limited clientele of large enterprises • The high level of interest rates (during a period of generally weakening inflation) is in large part due to the high lending risks and continued fragility of banks that need to maintain excessively high spreads to offset the impact of NPLs. Delay in addressing this issue has a major negative impact on the real economy. • The low level of savings in African countries (4-6% of GDP) also acts as a brake on the development of the economy (and a source of continued dependency on external development assistance). This is in part due to the limited outreach of the banking system and lack of active contractual savings institutions. **Raising the rate of domestic resource mobilization is a one of the major economic challenges facing African countries.** • Government financing through sales of treasury bills on the local financial market provide commercial banks with a remunerative and risk-free use of funds that tends to "crowd out" private sector borrowers from bank credit. • The Bretton Woods Institutions have traditionally taken the lead on assessing the financial sector (through the FSAPs) and advising countries and helping to design financial sector programs in this area. • However, there is no consistent follow up on the FSAPs to draw strategic plans to address weaknesses identified. Even when plans are drawn up, many programs face implementation challenges, not because of defects in design, but because some countries do not have the institutional capacity and skills to manage implementation of the programs successfully, and the BWIs do not have the mandate or financing facilities for the necessary longer term TAs to support the program implementation.

[23] Based on the mapping of donor support activities in the financial sector submitted to the Secretariat of the Partnership for Making Finance Work for Africa.

2. Strengthening the legal system, including enforcement of creditor and property rights	• The conservative lending policies of the banks reflect inadequacies of the legal framework for creating and enforcing contracts, perfecting collateral, etc. • Strengthening the legal system (laws, infrastructure and institutions) is an essential condition for the further development of banking and financial services. • Emergence of new ways of banking including mobile banking and microfinance that may not be underpinned by strong regulations and supervision. Since these are becoming an important means of reaching the unbanked it would appear that regulators will need to look at ways of strengthening regulations and supervision of these new ways of banking without slowing growth potentials in these financial sector subsectors. • Despite extensive donor support for legal reform, progress has been slow. The weakness of a functioning legal system results in a dearth of creditworthy clients for the banks and contributes to the under-capitalization and financial fragility of many businesses. • There is an urgent need for donors to support countries to make progress in addressing these issues. • The Bank has a mandate to foster implementation of financial standards, which include creditor rights. Significantly also, the Bank has built capacity to support such financial sector reforms, which overlap with the agenda for broader governance reforms.
3. Developing monitoring and early warning systems	• Since liberalization of the financial systems in the late 1980s, the banking sector of many African countries has been beset by crises, indicating weaknesses in banking regulation and supervision. As the financial sector becomes more competitive and regionalized, there is an urgency to develop (and apply) effective early warning systems of banking supervision. • However, developing capacity for banking regulation and supervision takes time. While the Bretton Woods Institutions and the BIS can provide short-term training, they do not have the facilities to support long-term technical assistance and training on a sustainable basis.
4. Restructuring weak banks and FIs	• Many African countries have taken steps to address the immediate threats that the distressed former state-owned banks posed for the financial system (including privatization. • However, some financial intermediaries remain severely under-capitalized. The negative impact of fragile institutions on the efficiency and dynamism of the banking and financial sectors require the Government to take a more proactive (but market-related) approach to the restructuring of weak FIs. • The restructured banks would require support in the form of resources to extend credit. • In the wake of the financial crisis and widespread bank distress in donor countries, resources may be scarce

5. (a) Establish/strengthen MFIs and DFIs based on market principles; and (b) Support successful MFIs to consolidate and expand their operations	• Beyond restructuring, the problem of many African DFIs remains the need to improve corporate governance and build capacity to ensure that resources mobilized are allocated to profitable activities so that eventually the problem of non-performance assets will not re-emerge. • Given the propensity of the formal banking system to concentrate their efforts on a limited (mainly urban and corporate) clientele, and the continuing competitive pressures for rationalization, SME/MF institutions have a potentially important role in providing a majority of the population, particularly in rural areas, with financial services and hence on poverty reduction. • Many donor programs focus on providing lending resources through MFIs. • While a number of initiatives have been launched to extend access to credit, they have not been developed within a comprehensive planning and policy framework, and most MFIs are small and under-capitalized. • There are opportunities to concentrate on a few successful MFIs and support them to expand their operations
6. Developing money and capital markets	• The money and capital markets in many African countries are young and not yet in a position to support private sector development. Actions should be taken to increase the supply of securities, through privatization, and generate demand for securities through the development of contractual savings institutions and pension reform. • However, the development of capital markets should give priority to addressing the weaknesses of the legal infrastructure and of the market size through strengthening cross-border linkages or other regional initiatives rather than focusing on national institutions. • Support to national institutions should be selective and limited to more developed financial markets during the period of this strategy.
7. Improving access and efficiency of domestic and regional payments services.	• While many African countries have made good progress in reforming their payments systems and in a position to implement a wholesale payments system infrastructure (i.e. RTGS), many central banks do not have a clear legal mandate for payments system oversight, nor the skills to carry out the oversight function. Effective implementation therefore calls for legal reforms, staff development and investment in IT. • Meanwhile, there is need to harmonize retail payments infrastructure (ATMs, card systems etc) in response to the growing number of banks but also to support regionalization and globalization of the provision of banking services. • New technology has also given rise to innovations in the payments systems (such as mobile banking) that hold much promise for improving provision of financial services. • Efforts are also being made by regional groupings to establish or strengthen regional payments systems.

8. Building infrastructure for mobile banking and credit bureaus	There is need and room to help the expansion of financial services through mobile banking and the establishment of credit bureaus.
9. Promoting regional harmonization and integration of financial markets; and improving regional macroeconomic convergence and surveillance	• Increasing regional harmonization and integration of financial markets could yield benefits in allowing resources to flow to their more efficient uses, to economize on scarce professional and administrative capacity and to attract greater interest from foreign investors. • Many regional groupings have embarked on programs to establish common currencies, but these are not achievable during the period of this strategy. • The regional financial integration programs have also brought to the fore the need to improve macroeconomic convergence among countries with programs to establish a common currency. The achievement of convergence is likely to be long term, and there may be some benefits in the establishment of surveillance mechanisms to facilitate progress towards convergence • Also developing regional institutional structures (such as regional payments systems and regional cross-border capital market networks) in the interim could be beneficial. • Meanwhile, there has been a rise of regional banks (especially those that have spread out from Nigeria, South Africa and some North African countries) with significant cross-border activities that need to be monitored and regulated. The coordination of regulatory and supervisory mechanisms within the region would also be essential. • The Bank has a mandate to support regional integration and has built capacity and experience to provide technical assistance in this area.
MEDIUM OPPORTUNITIES (REASONABLE SUPPORT BY OTHER DONORS)	
10. Maintaining macro-economic stability and improving domestic debt management	• Many African countries have already achieved the first stages of financial sector reform, involving improvement of the macroeconomic situation: moderating inflation and changes in interest rates and exchange rates. However, given exposure to exogenous shocks, the need to regularly fine-tune the macroeconomy remains important. • The Bretton Woods Institutions have traditionally taken the lead on advising countries and helping to design programs to improve the macroeconomy and domestic debt management. • However, many programs face implementation challenges because of lack of adequate capacity to manage the programs successfully.

11. Promoting special investment instruments to mobilize term finance	• Many African countries have undertaken financial sector reforms. However, there is still a dearth of term finance, partly because of the risks in the system but also because of lack of appropriate instruments for mobilizing tern resources.
	• As countries implement supply-side programs, there is a realization of the need to promote investment instruments to encourage private participation in certain investments.
12. Enhancing the capacity of regulatory agencies	• Although adequate supervisory frameworks exist in many African countries, there remain many areas of weaknesses in application, and the development of a more effective banking supervision capability, especially for regional banks, remains an issue. • The insurance sector in several African countries suffers from a lack of a sound legislative framework and effective regulation and supervision support is needed for legislative reforms and building supervisory capacity.
13.Reforming and strengthening contractual savings/pensions institutions	• The financial sector does not provide adequate mechanisms for risk protection, and contribution to the social safety net is negligible, which should be important poverty reduction objectives. • The insurance sector is underdeveloped and, in many countries, dominated by state-owned insurers, which lowers the industry standard. • In many countries, the pension system has limited coverage for private sector workers and is characterized by unfunded schemes for state employees. • There is a need to support restructuring and capacity building in the contractual savings/pensions industries.
14. Reducing state ownership and control of FIs or improving their corporate governance	• Continued state shareholding in major financial institutions could represent a source of moral hazard for effective regulation and an important obstacle to increasing efficiency and competition in the financial sector. Given the increasing presence of competent private sector operators in many African countries, governments should pursue a more proactive strategy of disengagement or improve corporate governance of these state-owned institutions for them to be competitive and profitable.
15. Promoting competition among banks	• Although the number of banks is growing in many African countries, the banks are, in most cases, all targeting a limited number of high quality clients, while the cost of banking services – both lending rates and fees for services – remains high. The lack of competitive pricing penalizes the real sector and limits the use of financial services. Action is needed to promote more competitive behavior among FIs.

16. Supporting housing finance and the introduction of micro-insurance	• Global developments and climate change and their hazards (health and agriculture) as well as impact on rural-urban migration have created new demands on the financial sector to support the expansion of housing and the provision of insurance, especially for the poor, farmers and MSMEs. • Some institutions such as the World Bank and Shelter Afrique are providing support, but there is still opportunity for additional support by other Development Partners. •
LOW OPPORTUNITIES (PREREQUISITES MOSTLY NOT IN PLACE) IN THE SHORT TO MEDIUM TERM	
17. Promote longer-term financing by banking system	• There is a general lack of term finance for the local private sector, although this partly mitigated by the substantial inflows of donor assistance and FDI. Although the banking system is liquid, several key pre-conditions for developing sound term finance – monetary stability, the efficiency of contract enforcement and realization of collateral – are not in place. Without these pre-conditions, the prospects for promoting term finance initiatives are poor. • Therefore, during the period of this strategy, efforts should be put in realizing these preconditions.
18.Extending the reach of the formal financial system in rural areas	• Most rural areas do not have formal banking facilities. Following privatization of the banking sector, the number of rural bank outlets is being further reduced. The prospects for reversing this trend are not good. The private banks do not have strong connections with the informal and rural sectors, and do not regard them as sufficiently profitable to warrant attention. While efforts to encourage banks to extend their reach in rural areas are desirable, these are not likely to have a major impact in broadening access to financial services in the near term. • In the near term, efforts should rather focus on encouraging linkages between the banks and the MFIs.
19. Harmonizing cross-border MFI regulatory and supervisory systems	In many countries the regulatory and supervisory framework for microfinance is still evolving, and there is need for countries to adopt best practices before the frameworks can be harmonized regionally.
20. Introducing instruments and interventions that may encourage gender-awareness approach to the provision of financial services	Many countries are still in the process of reforming their financial sector and introducing new instruments. However, the high level of financial illiteracy in most of these countries does not permit the introduction of gender-based financial services. It must be noted, however, that, in microfinance, there is already a high involvement of women in many countries.

Annex 9: Bank Group Comparative Advantage in Priority Areas for Financial Sector Reform

The Bank's human and financial resources are limited. Hence the Bank must choose its priority areas for intervention in the financial sector, taking into account its capabilities and track record relative to other development agencies.

In seeking to define the Bank's comparative advantage, several factors should be borne in mind.

- Since the 2000's the development of the financial sector has been a strategic priority of the Bank. Actions that the Bank has taken include the development of its financial sector strategy in 2003, and increased interventions at country and regional levels to deepen financial sectors and develop regional payments systems. Specific examples include development and reform of systems and means of payment in the UEMOA and West African Monetary Zone (WAMZ) countries. Other initiatives include funding technical assistance programs in countries such as Mozambique and broader reform programs such as the one for Egypt, and in microfinance (AMINA). However, compared to the Bretton Woods Institutions, the Bank is clearly a new entrant to financial sector assistance. While a substantial volume of ADB operations involve channelling financing through local financial intermediaries, most of these were intended to support the development of the real sector. **Building on areas that the Bank has developed internal capacity, the Bank has to be increasingly involved in supporting other financial sector development areas; and the strategy proposed in this report represents a first step to articulate a targeted contribution to financial sector development.** As such, it is intended as a modest but credible initiative on which to build in the light of the results achieved and the experience gained.
- **The purpose of this analysis is not to rank the Bank's capabilities relative to other development partners but to determine where its limited resources should best be used.** This will mean that the Bank's strategy does not duplicate that of others. It may intend concentrate on areas where others are not active, or seek to co-operate with other donors in collaborative programs.
- **The Strategic Plan reaffirms the Bank's commitment to enhancing is its human and knowledge management resources.** The definition of Financial Sector Development Plans for individual countries will provide a basis for identifying areas where the Bank should make a particular effort to acquire or enhance its capabilities for the future.

Against this background, the table below assesses the Bank's comparative advantage for addressing priority needs for Financial Sector reform. It classifies these areas between those where the Bank has:

- Highly Developed and Recognized Capability or clear mandate: In view of the Bank's past limited role in financial sector operations, it does not have a highly developed and recognized capability in any of the areas identified.
- Developed Capability or Mandate: The Bank has acquired a specific capacity and/or mandate to contribute to development in these areas.
- Presently Limited Capability or no recognized mandate: The Bank presently has relatively limited experience or capability in these identified areas or other development partners have established experience and/or ongoing programmes.

HIGHLY DEVELOPED AND RECOGNIZED CAPABILITY	
Not applicable	Not applicable
DEVELOPED CAPABILITY OR MANDATE	
Assessing the financial sector to identify weaknesses	• The Bank has is a strategic partner of the APRM, and assists countries to assess their financial sector situation, and undertake corrective measures • As a predominantly African-owned institution it is uniquely placed to engage in dialogue with regional governments on defining socio-economic policy objectives, focusing on poverty reduction.
Enhancing capacity of the regulatory agencies.	• The Bank has mandate from NEPAD to promote financial governance. • The Bank has in the past supported programmes in this area including an ongoing Financial Sector Technical Assistance Program (FSTAP) in Mozambique and a past budget support operation for Egypt. • The Bank has established a Governance Division with a focal point to spearhead its support in this area.
Promoting regional harmonization and integration (including standardizing payment systems and macroeconomic convergence) and support to creation of Regional Public Goods (RPGs).	• The Bank has a specific mandate to promote regional economic integration and has substantial experience in supporting regional co-operation through its training and capacity building activities. • The Bank has established a Regional Integration and Trade Division to spearhead its support in this area. • With the implementation of the development of payment systems for the UEMOA and WAMZ regions the Bank has established a clear comparative advantage of creation of RPGs in this area. • RMCs are increasingly looking forward to the Bank to support them in this area.
Promote longer-term financing by banking system.	• As a leading regional development finance institution, the Bank has an established role and experience as a source of long-term funds for productive and social investment. • However, the Bank's potential to meet demand is constrained by limited development of local currency lending instruments.
Promote special investment instrument s such as Infrastructure bonds to mobilize term resources	See row above. The promotion of special instruments would help countries overcome the constraint of limited local currency investment instruments.

Strengthening Legal System, including Property Rights.	• A large number of donors have been active in this field but progress has been slow. There is strong link with the Bank's governance work in this area.
Ensuring consistency between reform in financial and real sectors.	• The World Bank has devoted significant staff and consulting resources to the preparation of a FSAL operation, which is currently under active consideration, to address this issue. However, the World Bank and the IMF do not have the mandate to provide extended TA to implement programs. The Bank does not have up-to-date information available to the BWIs through the conduct of the FSAPs, but participates in the APRM, which undertakes limited assessment of economic and financial governance and the drawing of national programs of action. • The Bank also does not have any explicit mandate constraints for supporting RMCs to improve their capacity in the financial sector, including providing longer term TAs. Indeed, it is working with the IMF through the AFRITAC to help countries strengthen their human and institutional capacity in several fronts including the financial sector.
	• The bank can exercise its convening power to bring development partners together to design financial sector development plans. • Other development agencies are increasingly looking forward to the Bank to be the lead agency for building the capacity of itself and RMCs to develop data and information to support better knowledge on the interdependence between the real economy and the financial sector.
Introducing instruments of intervention that may encourage gender awareness approach to provision of financial services	• The Bank has built the capacity and experience of mainstreaming gender dimensions in its operations
Establish/ strengthen MF/SME institutions based on market principles.	• The Bank has accumulated experience in the area of micro-finance, through the AMINA program, on which to build. The mid-term review of AMINA recommended that the Bank should focus on promoting institution building in this sector. • Microfinance, serves primarily lower-income groups, and is directly related to the Bank's poverty reduction objectives. • The Bank has specific experience in supporting rural development in a number of African countries. • However, an independent assessment of the Bank's internal arrangements found them to be weak and need of improvements. In particular, the assessment suggested that the Bank could leverage its experience to concentrate on few successful MFIs and help them to grow.

PRESENTLY LIMITED CAPABILITY OR MANDATE	
Maintaining macroeconomic stability.	• The BWIs have historically had the leading role in devising and supervising market-based reforms under structural adjustment and, more recently, poverty reduction and growth programs. • A major drawback of the programs, and where the Bank can help, relates to inadequacy of attention paid to human capacity in different institutions (e.g. the Ministry of Finance and the central bank) and weak institutional arrangements (the lack of proper coordination in the actions of different parties). • The Bank's involvement in these issues in the near term is expected to continue through co-operative participation in the preparation of PBL. • The Bank would need to upgrade its in-house capacity for macroeconomic diagnosis and policy analysis in order to justify a more proactive role in this area and to meet increasing requests from regional bodies for support in regional programs towards macroeconomic convergence.
Reducing state ownership and control of FIs.	• These areas have proven highly problematic and are closely linked with overall financial sector reform, and the BWIs have been heavily involved in addressing these issues.
Restructuring weak banks and FIs.	• The Bank has only recently redefined the PSD mandate to cover involvement in privatization operations.
Promoting competition among banks.	• This area has proven highly problematic and is closely linked with overall financial sector reform. • The BWIs are heavily involved and have established capability in addressing these issues.
Extending the reach of formal financial institutions in rural areas.	• This area has proven highly problematic and is closely linked with overall financial sector reform, and the BWIs are heavily involved in addressing these issues. • While LOC could be designed to support bank lending in rural areas, the effectiveness of narrowly targeted programs is doubtful.
Direct financing of MFIs	While some donors have provided financing directly to MFIs, the Bank has focused on supporting lending to MSMEs by going through other DFIs and banks (through the use of LOCs)
Supporting diversification of MF, including introduction of micro-insurance	The Bank has yet to build experience in supporting insurance industry, including micro-insurance.
Establishing mechanisms for harmonization of cross-border regulation and practices of microfinance	While the Bank assists in fostering best practice regulation of MFIs, it has not yet built the experience in supporting regional programs in harmonizing microfinance practices

Developing monitoring and early warning systems.	• The BWI have been actively involved in developing central bank policies and short-term institutional capacity building programs in this area. However, the BWIs do not have the mandate or resources to support longer-term capacity building programs. These institutions have the mandate to oversee the stability of the financial systems through the FSTAP's.
Reforming and strengthening contractual savings/ pensions institutions.	• Reforming and developing contractual savings institutions would contribute to extending the maturity profile of financial assets in the system without engendering unwanted foreign currency risk and also contribute to improving social protection for lower income groups. • Although the Bank has limited direct experience in financing or reforming contractual savings institutions, no other development agency has developed a leading position in this area.
Supporting housing finance	
Developing money and capital markets.	• Other development agencies have track records in this area. However, the Bank has tested limited involvement in this area (compilation and publication of directory of stock exchanges and the ongoing work on the African Financial Market Initiative) and plays a supportive role to the BWIs in this area. • The Bank is well placed through AFMI to play a more important role in debt market development that is a key component of capital market development. However, there is a need to build staff strength and capacity if the Bank should play an active role in this area.

Annex 10: The African Financial Markets Imitative (AFMI)[24]

1. **The need for an African Financial Market Initiative:** The African Development Bank has launched an initiative to foster the development of the domestic bond market and associated infrastructure. The objective of developing bond markets in Africa is to (i) allow governments to improve the terms on which they borrow (ii) reduce the dependency on foreign denominated debt (iii) increase financing options available to the corporate sector (iv) create a permanent forum for discussion and provision of technical assistance on domestic bond market issues (v) act as a catalyst for the development and stability of financial markets and (vi) foster regional integration. Through these channels, the AFMI will contribute to the overall development of the *real* and financial sectors.

2. **Project Implementation:** The Bank will work with the Bank for International Settlements (BIS) and the South African Reserve Bank (SARB) to develop and co-ordinate an African Bond Market Initiative: the BIS participated in the Asian Bonds Market Initiative led by the AsDB and the SARB would contribute expert advice on capital market development and reforms. Initially, the initiative would be opened to countries with the most suitable financial markets but would be extended to other participants in the future. The Bank will mobilize the central banks of participating countries to define and drive the Initiative in order to ensure their commitment to undertake reforms. The steps in the realization of the project comprise:

> ***Phase 1: Creation of a forum to allow central banks to define an African Initiative (including country selection),*** *with the assistance of the* ADB, BIS and SARB
>
> ***Phase 2: Creation of dedicated Working Groups to*** discuss market reform and harmonisation – important for the creation of a "co-operative product" (Phase 3)
>
> ***Phase 3: Creation of a "co-operative product" (yet to be defined), but could include***
> *(i) Creation of a portal for African Fixed Income Markets (such as* a website to centralize information on African bond markets
> *(ii) Creation of one or several indices that cover certain bond markets in Africa—this is expected to* help mobilise funds from a broader investor base and foster the development of capital markets
> *(iii) Creation of associated index-tracker fund(s)*

3. **Institutional implications: T**he Bank must commit to developing the necessary intellectual resources and research capacity in the field of African fixed income market products and infrastructure, and set up the necessary institutional team (multidisciplinary), headed by an expert in capital market development, to manage the process.

[24] Source : ADB Concept note on the AFMI

Annex 11: Consideration for Special Country Situations

Fragile States

1. In **fragile and post-conflict states, there are special challenges in development management.** At the same time, post-conflict contexts and "turnaround" countries provide the greatest potential for progress. Restoring basic systems for mobilization of financial resources and their open and sound management is essential for rebuilding government capacities, delivering essential services and restoring public confidence in the state, while healthy financial systems are also essential in rebuilding the confidence of private sector operators in the currency and payments systems. **The Bank's strategy on building institutions and strengthening capacity on macroeconomic management, budgetary management and financial governance, therefore, becomes even more significant in such states.**

2. Creating stable macroeconomic conditions and good financial governance are important objectives in the Bank's enhanced engagement in fragile states. Enhanced support to fragile states will be an integral part of the refocused strategic approach to 'making finance work in RMCs' and supporting financial sector development. Financial sector development will buttress broader economic and governance reforms towards improving conditions in fragile states. Microfinance, which is critical in enhancing access to finance for the poor and supporting rehabilitation of economic activities, will also be given special attention. Effective engagement in fragile states and the institutional capacity building activities, nevertheless, requires continuous policy dialogue in the field, which will be driven by the Bank's field offices.

3. The Bank, through its private sector support operations, will scale up resource mobilization for development programs through innovative approaches (such as use of partial risk guarantees to mitigate country risk). Special focus will be given to the promotion of public private partnerships, especially in the infrastructure sector.

4. In resource-rich fragile states, special attention will be paid to the good management of revenues from natural resources so as to avoid creating conditions for the Dutch disease, where appreciation of real exchange rates can crowd out private investments and stifle efforts at economic diversification. Again, this will reinforce the Bank's Governance strategy that is aimed also at improving the management of public resources to tackle poverty and also help to avoid the phenomenon of "resource curse" and relapse into resource-driven conflicts.

Middle-income Countries (MICs)

5. **In middle-income countries, the Bank's approach to financial sector development will focus on building synergy with its broader governance promotion and private sector development activities to improve financial governance and create enabling environment for private sector development.** Therefore, in line with the Governance Strategic Directions and Action Plan and Private Sector Development Strategy, the strategy proposes that the Bank progressively scales up its support to improving the business environment and the investment climate in the Middle-Income Countries. It will do so through support to macroeconomic, regulatory and financial governance reforms; economic competitiveness and the investment climate; financial infrastructure, as well as SMEs and women entrepreneurship. The Bank will also support the development of capital markets in the MICs, including with the AFMI, and encourage their regionalization to foster regional financial integration.

6. The Bank will scale up its role in these countries sequentially, building on ongoing governance, business environment improvement and private sector development initiatives, as the Bank's own internal capacity and expertise are built up. Generally, the MICs have capable institutions that can implement and monitor programs. However, they require financing with more flexible terms that they can access in the capital markets and they can also be

demanding in terms of policy advice. In this regard, the Bank's knowledge building and technical assistance as well as budget support and catalytic transactions (FI lending) activities will be useful in delivering support.

Annex 12: Bank Group Planned Activities towards Improving the Business Environment and Economic Governance

OSGE has recently developed a paper, identifying possible future Bank Group strategic orientations in business environment development as a complement to the Bank Group Governance Strategic Directions and Action Plan (GAP). The areas identified were based on increased selectivity and focus on themes where the bank can develop a comparative advantage. The paper, therefore, initially examined 10 business environment themes (including registering a business; registering property/land titling; business licensing reform; business law reform; strengthening institutions to enforce business laws; tax reform; trade facilitation; labor registration; financial sector reform; and legal and regulatory frameworks for PPPs) and filtered them through an analysis of the Bank's ***strengths*** (areas linked to governance or requiring regional approaches, sustained country dialogue, or credibility and sensitivity to African-specific circumstances) and ***weaknesses*** (process-related reforms and those requiring prior commitment to technical assistance) as well as areas where other partners have a strong comparative advantage and are already involved. On this basis, four themes were retained: business ***law reform*** (including corporate governance); ***strengthening institutions to enforce business laws*** (commercial courts, land and collateral registries); ***basic regulatory framework for PPPs*** (including extractive industries, large-scale land deals, infrastructure and public enterprise governance); and ***financial sector reform***. The paper also made proposals regarding ***internal arrangements*** and collaboration among departments (OSGE, OPSM, ONRI, OINF, GECL and ECON) and ***financing instruments*** that could be used to deliver the activities.

Annex 13: Promotion of Inclusive Finance in the UEMOA: Microfinance Support Program

Overall Objective	**Consolidate the sector and enhance risk management towards promotion of microfinance activities in the UEMOA Zone**	
Components	**Pillar 1** **Adapt and strengthen microfinance supervision in the WAEMU zone to comply with the new regulatory framework**	**Pillar 2** **Build capacity of MFIs in the generation and management of financial information**
Expected Outputs	✓ The new legal framework is disseminated and its implications made clear to Ministry supervisory units and professional associations ✓ The law is put into effect and improves the health of the microfinance sector through effective supervision and oversight ✓ Improved quality and standardization of financial reporting (new accounting framework and credit bureau) ✓ Statistics on the microfinance sector is available and made public	✓ Identification and testing of Management Information Systems that comply with the new accounting framework and BCEAO rules ✓ Improved MFI internal controls through dissemination of appropriate methodologies ✓ Appropriate external controls that follow supervisory unit standards ✓ Microfinance is formalized and self regulated within the networks

Source: BCEAO and the Luxembourg Cooperation Agency, Dakar, Senegal

Annex 14: Characteristics of Old and New Approaches to Microfinance

Old Paradigm	New Paradigm
Primary Goals	
• Growth and income expansion (pursued by introducing modern technologies with concessionary credit). • Poverty reduction.	• Growth and income expansion (pursued by introducing modern technologies with concessionary credit). • Poverty reduction.
Working assumptions	
• Accelerated economic development requires controlled commodity and financial markets (such as control of food prices and interest rates). • Small farmers and rural entrepreneurs cannot pay commercial interest rates. • Small farmers and rural entrepreneurs cannot save. • Access to concessionary credit is essential to growth and poverty reduction.	• Accelerated economic development requires enhanced competition in goods and financial markets (through applying flexible prices). • Small farmers and rural entrepreneurs can pay commercial, market rates of interest. • Small farmers and rural entrepreneurs can and want to save. • Access to non-subsidized financial services is essential to growth and poverty reduction.
Role of Government	
• To directly intervene in and control the production sector and credit.	• To create a favorable policy environment, while minimizing direct intervention in and control of the production sector and credit.
Mechanisms of Government Intervention	
• Government interventions in product markets that favor cities and heavy industry. • Government control of interest rates, credit allocations, and institutions to provide low cost credit to particular groups that "cannot afford" market rates. • Emphasis on meeting lending targets, rather than sustainability of programs. • Provide special benefits and concessionary funds to state- owned Fls; subsidize on-lending interest rates to FI clientele to compensate for policy biases and distortions in the production sector. • Cover loan losses of FIs and frequently bailout loss-making institutions. • Support poorly administered production insurance and credit guarantee schemes. • Underdeveloped legal framework and accountability.	• Reduce government intervention in markets (for example, agricultural prices and supplies), switch to direct income support for the poor, and reduce inflation, which is a heavy tax on the poor. • Maintain a level playing field among economic sub-sectors and enhance competition. • Raise or remove ceilings on on-lending interest rates (to cover costs) and small scale deposits (which provide income for depositors and increases stability of funding. • Utilize a wide range of financial intermediaries (commercial banks, specialized financial institutions, microfinance NGOs, cooperatives, credit unions and grass roots saving groups), supported by second tier institutions that fund only well-performing intermediaries; Allow financial services to cover their costs, which will encourage new products. • Privatize FIs (or segments thereof) where appropriate and shut down inefficient and unsalvageable FIs. • Introduce insurance-type instruments to help households manage risk and review effectiveness of credit-guarantee schemes. • Improve the legal framework.

Old Paradigm	New Paradigm
Policy variables and outcomes	
• Subsidized interest rates are used primarily as compensatory mechanisms and not for resource allocation. • Subsidies mostly benefit mainly well-to-do, influential entrepreneurs. • Insufficient provision of savings facilities and artificially low deposit interest rates result in limited savings mobilization; RFIs depend on rediscounting facilities and donor and budget funds to back their (subsidized) loan portfolios. • MFIs do not enjoy autonomy; most operational decisions (such as on-lending interest rates, cost of borrowed funds and staff policies) are dictated. • Special privileges are often extended to MFIs, resulting in dependence on concessionary funds, lack of competition, and no incentives to improve performance. • No commercial imperatives exist for (state-owned) Fls; management is not accountable for FI performance; financial indiscipline and poor loan collection prevail.	• Positive real interest rates serve as a resource allocation mechanism. • All entrepreneurs have access to financial services. • RFIs' dependence on borrowed funds from donors and governments is reduced as domestic savings mobilization becomes the main source of finance, improving financial self-sustainability. • MFIs enjoy autonomy in introducing efficient operating methods. • No special privileges are extended to state-owned MFIs; a level playing field is maintained and competition among MFIs is encouraged; access to subsidies (when warranted) is not contingent on an MFI's ownership. • Institution building and financial discipline is encouraged through management's accountability for RFI performance; poor loan collection is not tolerated.

Source: Adapted from J.Yaron, M. Benjamin and G. Piprek, *Rural Finance: Issues, Designs, and Best Practice*. Washington, DC: World Bank. 1997

Annex 15: The menu of Bank group instruments in the financial sector

			Non lending			**Lending**			**Knowledge generation & dissemination**		
			Policy dialogue & Advisory services	***Assessment and ESW***	***TA***	***PBL & FSAL***	***LOC***	***Other (equity guarantees & Agency LOC)***	***Training***	***Seminar& conf.***	***Research***
Improving financial stability and reducing risks	In collaboration with BWIs	Macro-economic/ public debt management	√	√	√	√			√	√	√
	In collaboration with BWIs, African regional organizations, and/or other donors	Financial Governance (including anti-money laundering)	√	√	√	√			√	√	√
		Supporting establishment of early warning mechanisms	√	√	√				√	√	√
Enhancing depth and diversity of the Financial Sector and Strengthening Financial Governance and Financial Infrastructure	Possible collaboration with other donors	Building capital markets	√		√		√	√	√	√	√
		Revitalizing/ Strengthening DFIs	√		√		√(1)	√(1)	√	√	√
		Strengthening financial infrastructure	√	√	√	√			√	√	√
Supporting sustainable FIs and enhancing access to financial services for all		Corporate and SME access to formal finance	√	√	√			√	√	√	√
		Promoting sustainable MFIs	√	√	√		√	√	√	√	√
Financial integration			√	√	√	√			√	√	√

(1): Financial instruments available only to financially sustainable DFIs

Annex 16: Institutional arrangements

Internal dimensions include:

- Aligning the Bank's financial sector operations in order to strengthen country systems (OSGE, ORVP), establish stable macroeconomy and strengthen financial regulatory frameworks (OSGE), strengthen regional financial integration (ONRI) and promote private sector development (OPSM);
- Sharpening Bank support to institutional development and capacity building in financial regulatory frameworks (OSGE), regional financial integration (ONRI), development financing (OPSM, FTRY) and microfinance (OPSM, OSGE and OSHD);
- Mainstreaming financial sector concerns in country and regional strategies (ORVP with support of OSGE, ONRI), peer-learning (OSGE, ONRI) and lessons learning from independent evaluations (OPEV);
- Mobilizing Bank resources to support financial sector reforms and financial governance (OSGE), regional financial integration (ONRI), and strengthening of financial institutions (OPSM);
- Building technical expertise relating to financial sector reforms and financial governance (OSGE), regional financial integration (ONRI) and financial institution strengthening (OPSM); and
- Increasing internal capacities in financial sector development, through the establishment of a cross-departmental network of financial sector experts for technical support and consistency (CHRM, OSGE, ONRI, OPSM, ECON, OPEV); through a re-alignment of staff skill-mix; and consolidating the Bank's knowledge of financial sector development (ECON, OSGE, ONRI, OPSM, ESTA).

External dimensions include:

- Serving as the primary interface between the Bank and national, regional and continental institutions mandated with financial reforms and financial governance, regional financial integration (with ONRI);
- Managing the Bank's advocacy and policy dialogue agenda with external stakeholders (OSGE, ONRI, and ORVP);
- Leveraging the activities of the Partnership for Making Finance Work for Africa (OSGE) and engaging multilateral and bilateral DFIs and other members of the donor community on matters of co-ordination (OSGE, ONRI), knowledge exchange (ECON) and resource mobilization (ORRU, OPSM with OSGE, ONRI);
- Discharging the mandate provided by the AU in respect of APRM (OSGE);
- Managing trust funds and special purpose initiatives related to financial governance (OSGE, ORRU) and financial sector dimensions of private sector development (OPSM);
- Helping to program, coordinate and monitor implementation of financial sector operations in RMCs (Field Offices, OSGE, ONRI and OPSM); and
- Improving the visibility of the Bank's financial sector work through effective communication (COMU, OSGE, ONRI, OPSM).

Annex 17: Proposed Delineation of Responsibilities in the area of Financial Governance in OSGE

In delineating responsibilities across the Bank for economic (public) and financial governance, it must be noted that the two areas cannot really be addressed in isolation without considering the institutional setting. Differences across countries in the degree of rule of law, competition, and in the effectiveness of the takeover market shape the effectiveness of governance measures. With respect to governance in the financial sector in particular, it is important for policymakers and interventions to recognize and take account of the country's unique institutional and legal climate. For example, it is useless to apply threat of litigation as an instrument for enforcing governance in a country that lacks the legal institutions or cultural tradition for lawsuits. Likewise, policymakers cannot expect that market discipline or "reputation risk" will rein in financial managers when the necessary mechanisms to ensure markets work well—transparency, ability to exit and enter markets, and competition—are lacking. Therefore, there is no single, universally applicable remedy to governance challenges in the financial sector. Instead, in most cases, a two-pronged effort, with each element reinforcing the other would be desirable: one that works to strengthen macroeconomic policy transparency and regulatory oversight on the one hand, while enhancing informational transparency, corporate governance and market integrity—in effect, greasing the wheels of the market—on the other (see ADB: *Framework for Implementing Banking and Financial standards under NEPAD*, Abidjan, 2002). In most cases, therefore, despite the proposal in the table below, there should be coordination of the responsibilities assigned to the Governance Division and the Financial Reforms Division within OSGE.

Table of Proposed Delineation of Bank Responsibilities for Strengthening Economic and Financial Governance

Area to be strengthened	Key Standard*	Lead Bank Structure
Macroeconomic Policy Transparency		
Monetary and Financial Policy Transparency	Code of Good Practices on Transparency in Monetary and Financial Policies	Financial Reforms Division
Fiscal Policy Transparency	Code of Good Practices on Fiscal Transparency	Financial Reforms Division
Budget Transparency	Best Practices for Budget Transparency	Financial Reforms Division
Public Debt Management	Guidelines for Public Debt Management	Financial Reforms Division
Data Dissemination	General Data Dissemination System (GDDS)/Special Data Dissemination Standard (SDDS)	Financial Reforms Division (with ESTA)
Market Integrity and Corporate Governance		
Corporate Governance	Principles of Corporate Governance	Governance Division and OPSM
Accounting	International Accounting Standards (IAS)	Governance Division
Auditing	International Standards on Auditing (ISA)	Governance Division
Market Integrity	The Forty Recommendations of the Financial Action Task Force on Money Laundering	Governance Division

Area to be strengthened	Key Standard*	Lead Bank Structure
Insolvency and Creditor Rights	Principles and Guidelines on Effective Insolvency and Creditor Rights Systems	Governance , Financial Reforms , and OPSM
Payment and Settlement	Core Principles for Systemically Important Payment Systems	Financial Reforms Division
Financial Regulation and Supervision		
Banking Supervision	Core Principles for Effective Banking Supervision	Financial Reforms Division
Securities Regulation	Objectives and Principles of Securities Regulation	Financial Reforms Division
Insurance Supervision	Insurance Core Principles	Financial Reforms Division