



Strengthening Financial Sectors

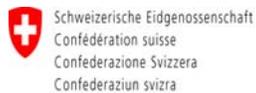
FINANCIAL SECTOR REFORM AND STRENGTHENING INITIATIVE

Consultative Group Meeting Report

Nairobi, Kenya
November 24, 2008



Of Canada



Swiss Confederation

Federal Department of Economic Affairs FDEA
State Secretariat for Economic Affairs SECO



Swedish International
Development
Cooperation Agency



Ministry of Foreign Affairs
Of The Netherlands



of the
United Kingdom

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I. Executive Summary

FIRST convened a Consultative Group meeting to discuss financial sector development priorities and to receive feedback and guidance from key stakeholders on how to enhance FIRST's strategic relevance and impact. The insights gained from FIRST clients, donors, standard setters, and other financial sector development programs are instrumental in informing FIRST's ongoing strategy and sharpening its focus. FIRST invited the Consultative Group to brainstorm in the context of changing country and regional financial sector priorities and to provide specific guidance towards how FIRST can be strategically best positioned to contribute to reform agendas and attain tangible and sustainable results. This report is a synopsis of the messages given and lessons learned from presentations and discussions of the Consultative Group meeting.

The Consultative Group meeting was held on November 24, 2008 in Nairobi, Kenya. The meeting was chaired by Robert Woodbridge, the Director of GBRW Limited and a former FIRST Phase I Program Manager. Present were representatives from FIRST's donors; Swedish International Development Cooperation Agency (Sida), the Ministry of Foreign Affairs of the Netherlands, Canadian International Development Agency (CIDA), Department for International Development of the United Kingdom (DfID), the State Secretariat for Economic Affairs of Switzerland (SECO), the World Bank and the International Monetary Fund (IMF). FIRST also invited other donors, standard setters and partners to participate such as the International Organization of Securities Commissions (IOSCO), International Association of Insurance Supervisors (IAIS), representatives from the Making Finance Work for Africa Secretariat (MFW4A), and representatives from bilateral agencies such as the United States Agency for International Development (USAID), the Japan International Cooperation Agency (JICA), the European Investment Bank, and the German Technical Cooperation Agency (GTZ). Most importantly, FIRST recipients of technical assistance (TA) were invited from central banks, capital market authorities, and other regulatory and supervisory bodies. The program agenda and the list of participants can be found in Annex 1 and 2.

The Governor of the Central Bank of Kenya, Mr. Njuguna Ndung'u, gave the opening remarks. Governor Ndung'u discussed FIRST's role in developing financial sectors and touched on the benefits of the FIRST business model which is based on partnership with clients and is responsive to changing needs. The FIRST model, as assessed by the Governor, is even more relevant in the current international financial context, as it emphasizes smaller, rapid and timely TA that follows up on longer-standing financial sector diagnostics. The Governor's speech outlined the role envisioned for FIRST in the Africa region as one of an increased involvement in access to finance, legal and regulatory reform, credit and payment systems reforms.

The initial sessions of the meeting provided information on FIRST's structure, performance and project examples, which included: the Program Manager's review of the FIRST program objectives and principles; a report on the results of the client survey FIRST conducted in October 2008; and, a showcase of multiple projects implemented in Rwanda, Sierra Leone, Papua New Guinea and Chile. The projects presented by the recipients of assistance provided the Consultative Group with background on various types of projects that have been undertaken, and FIRST's contributions to reform programs. Following this introductory backdrop, the Consultative Group meeting participants divided into three groups to discuss: emerging reform priorities and areas of niche assistance suitable for FIRST; FIRST strengths, weaknesses and how best to reach out to clients; and, how to improve FIRST partnerships with standard setters and other donor programs. The groups reported back to the Plenary with their conclusions, which then enabled a dynamic roundtable discussion on how to maximize FIRST's impact and sharpen its strategic focus in its Phase II.

The results of the discussions from the break-out groups can be summarized as follows:

FIRST's contributions to reform programs. The survey results and the individual project presentations validated FIRST's role as an agile technical assistance provider that is quick, responsive, and outcome-oriented. Some areas of improvement that were pointed out were the necessity for more follow-up work and training to ensure effective outcomes and sustainability, appropriate consultant language skills and involvement of local consultants.

Emerging reform priorities and areas for niche assistance. There was a common agreement among the participants of the Consultative Group that strengthening legal, regulatory and supervisory frameworks has been and will continue to be important in financial sector development programs. New areas such as "crisis preparedness" are welcome and needed, but should not crowd out FIRST's main area of work. Access to finance remained an important area of development for clients, and should not be viewed as limited only to microfinance. Although FIRST is not involved in microfinance, its contributions to access to finance can be significant in areas related to legal and regulatory reform, assisting in the establishment of credit bureaus, and drafting microfinance development strategies. Additionally, it was agreed that FIRST could also work more in deposit insurance and help develop capital markets.

FIRST's strengths and weaknesses. FIRST's strengths were defined as: its ability to respond to clients' needs relatively flexibly and quickly; its growing brand recognition and gap filling role with regard to other donor programs; its access to World Bank and IMF expertise as well as a highly recognized roster of international consultants; its ease with application and procurement processes; and its various partnerships with other funding agencies and financial sector development programs. FIRST's weaknesses were defined as: limitations with project scope because of adherence to small- to medium size and short-term project selections; inconsistent response time; limited follow-up project work; lack of client involvement in consultant selection; high staff turn-over; limited dissemination of best practices; delays in project implementation times; uncertainty of future funding; and limited project monitoring when projects are managed by the World Bank staff.

Areas of niche assistance. The participants agreed that FIRST was structured to assist in many areas of financial sector development. However, the key niche was its ability to follow up on the recommendations that emerge from the Financial Sector Assessment Programs (FSAP) and Reports on the Observance of Standards and Codes (ROSC).

Outreach to clients. In terms of outreach, the group expressed the need to have more information sharing on the part of FIRST, stronger links with donors' country offices, more visibility and direct contact with clients, and increased usage of local consultants.

Working effectively with standard setters and other donors. Coordination of financial sector development programs is highly important for effective results. FIRST has a distinct role for FSAP and ROSC follow-up as well as a catalytic gap-filling role among all other donor programs. The Consultative Group meeting deemed it necessary that FIRST continue to support areas that complemented or enabled other larger donor programs. Standard setters are also significant partners, whose work could be facilitated by FIRST assistance in terms of self assessments and implementation of the principles they set.

The discussion following the break-out groups was instructive as recipients were able to air further opinions on what they felt were priority areas for FIRST. These were largely in line with the topics raised during the break-out groups but with greater specificity and detail.

This discussion led to several conclusions:

- FIRST should continue with its main line of work. Its core business should remain to strengthening of legal, regulatory and supervisory frameworks, and financial infrastructure. The Consultative Group agreed that FIRST has thus far been useful in these areas and that FIRST has the potential to further solidify its work;
- FIRST should continue to be innovative, and crisis preparedness would be an avenue to respond to the current international financial context. The Consultative Group agreed that helping institutions with crisis preparedness was in line with FIRST's objectives;
- Access to finance remains a priority for most countries, and there are many areas of access to finance where FIRST can have a positive impact, especially on the regulatory and supervisory side.

The overall conclusion of the meeting was that FIRST provides sound development assistance, and in its core areas, plays a significant role in strengthening financial sectors. FIRST can continue to improve in its delivery, and adapt to evolving financial environment and demands. The meeting was very positive in that it enabled FIRST to receive valuable feedback from its clients on their development needs, priorities, and areas in which FIRST can have more value-added contributions with better results.

II. Introductory Remarks and FIRST in Context

1. Governor's Opening Remarks

The opening remarks of the Consultative Group Meeting were delivered by Njuguna Ndung'u, the Governor of the Central Bank of Kenya. After acknowledging the importance of these high-level meetings between client countries and donors, the Governor spoke of the significant role FIRST plays.

Governor Ndung'u compared FIRST's role in FSAP follow-ups to "health solutions" offered after a "health-check". The Governor touched on the benefits of FIRST's business model which redefines development partnership of donors and recipient countries by working closely with recipient institutions to prioritize technical assistance activities that are consistent with country plans. He noted that FIRST's model disseminated results to boost project impacts and catalyzed long-term support from both development partners and recipient governments.

The Governor spoke of financial issues particular to Kenya and the Africa region, and acknowledged FIRST's work along with other donor programs in Kenya which enabled an increasing body of evidence supporting the causal link between financial sector development and economic growth and poverty reduction.

Governor Ndung'u suggested some areas where support from FIRST Initiative would be welcome in Kenya, which could also be applied to most of Sub-Saharan Africa. Accordingly, FIRST projects could focus on:

- **Enhancing the role of the government in the financial sector** to provide a legal, regulatory, and supervisory framework that promotes soundness and competition in the sector.
- **Reducing the existing deficiencies in the clearing and settlement mechanisms in national payment systems.**
- **Increasing access to credit** by promoting improvements in the operation of the government registries and the establishment of a legal and regulatory framework for the operation of credit bureaus that facilitate the much-needed information flow among credit-granting institutions.
- **Improving the financial legal environment** by advising on the drafting, implementation and application of the legislative and regulatory reforms.

In conclusion, the Governor stated that the issues focused on during this meeting were vital to African financial sectors at this crucial time of seeking solutions to the global financial crisis. In the wake of the ongoing global financial crisis, it is inevitable that there will be fundamental changes to the global financial architecture and the institutions that govern it, and partners such as FIRST Initiative will be called upon to quickly deploy technical assistance to help client countries prepare for and manage new challenges. Targeted technical assistance in the financial sector will support governments' efforts to deepen market-based economies which contribute to sustainable fiscal positions and improved allocation of resources. On that note, the Governor declared the Consultative Group Meeting open and wished the group fruitful deliberations.

2. Overview of FIRST

The Program Manager of FIRST, David Dellen, gave a brief overview of FIRST and its strategy. The strategy paper circulated to the Consultative Group to enable fruitful discussions is presented in Annex 3. Dellen outlined FIRST's role in financial sector development work, and its main areas of activity, which can be summarized as follows:

Background. FIRST is a multi-donor grant facility providing technical assistance to promote financial sector development. Launched in 2002 by the Canadian International Development Agency (CIDA), the Department for International Development of the United Kingdom (DFID), the International Monetary Fund (IMF), the Ministry of Foreign Affairs of The Netherlands, the State Secretariat for Economic Affairs of Switzerland (SECO), the Swedish International Development Cooperation Agency (Sida), and the World Bank, FIRST is guided by a Governing Council composed of senior representatives of its participating donors. FIRST is managed by a Program Management Unit based at the World Bank headquarters in Washington, D.C.

Mission. FIRST focuses on delivering top-quality technical assistance in the short to medium-term. It does so quickly, flexibly, and with a minimum of bureaucracy. FIRST has established a distinct role in financial sector development as a niche provider of small technical assistance projects.

Implementation. FIRST supports activities and interventions mainly in the public sector, principally by providing technical assistance to policy makers and regulatory bodies. Primary areas of activity have been: financial sector reform strategy and policy advice, advisory services to strengthen regulatory and supervisory frameworks, financial sector market development and institution building, risk management, and capacity building.

Recipients. Beneficiaries of FIRST assistance must operate in countries classified by the World Bank as low- or middle-income countries at the time project proposals receive final approval. Eligible applicants are policy makers, regulatory bodies, government agencies, and—under limited circumstances—quasi-public institutions such as self-regulating organizations and industry associations.

Partners. FIRST maintains strong links to the FSAP and ROSCs which are key diagnostic instruments jointly undertaken by the World Bank and IMF. These comprehensive assessments allow rational judgments about the priorities for financial sector development. Over time, these build cross-country evidence to provide coherent basis for action plans and follow-up technical assistance. FIRST has played and will continue to play a crucial role in implementing recommendations from these diagnostics.

FIRST leverages partnerships with other donors and organizations such as multilateral institutions, regional development banks, other regional bodies, including Making Finance Work for Africa (MFW4A). FIRST coordinates projects with international standard setters and other donors. These partnerships are especially important in dealing with the current financial crisis. FIRST's response to the ongoing global financial sector crisis involves financial contingency planning, simulation exercises, and crisis preparedness workshops.

3. Monitoring and Evaluation Survey

Following the overview of FIRST, Dilek Goncalves, the Knowledge Management Officer of FIRST, presented the report from an overall client survey FIRST conducted in September and October of 2008. The Client Survey Report is presented in Annex 4.

The objective of the survey was to obtain client views on the extent to which projects were client-demand-driven, the quality of project design, consultant selection and quality, project implementation, project results and sustainability, and FIRST as a donor. The survey was web-based and covering both Phase I and Phase II projects. The response rate was 28% (66 surveys completed out of 233). On the whole, the survey responses provided positive feedback on FIRST's performance to date.

In terms of recipient ownership of projects, this was defined as strong client buy-in and project objectives being high priority for governments. A majority (89%) of survey respondents agreed or strongly agreed that project objectives were high priority for government. Regarding the quality of project design, 98% of responding agreed that their projects were well designed. Other questions on project design (timeline of activities being realistic; deliverables clearly spelled out in the TOR) also had strongly favorable responses (92 – 98% agreed).

The quality of consultants, their performance, and advice received strongly positive feedback (86-90% agreed). Only 78% of respondents agreed, however, that they had sufficient input into consultant selection. Most comments were positive (12/20); areas for improvement were familiarity with local conditions, appropriate language skills, and more interaction between consultants and local specialists.

On the subject of project implementation and outputs, 83% agreed or strongly agreed that overall implementation proceeded well. 78% agreed or strongly agreed that they were able to adjust the project as needed. Some 80% of respondents agreed that the project's outputs had been delivered. Comments on factors that helped or hindered the outcomes provided a consistent message: clients need further support and training. First projects started the reform process, but many needed a second phase to complete assessments, to transfer knowledge, or to further develop capacity after the projects have closed. Consistent with this, while 94% of respondents who commented on sustainability agreed that project results could be sustained, some 60% thought that further external support was needed. Thus, sustainability would depend heavily on continued involvement of donors, including FIRST.

FIRST got high marks from clients as a donor; 89% - 97% of survey respondents agreed that: FIRST had quick response time, was helpful in the project concept and design phase and monitored the project effectively. 92% indicated that they would approach FIRST again; 73% agreed that FIRST was a niche player, delivering a product that would be difficult to get from other donors. According to the survey results, FIRST compared favorably to other donors in the financial sector. 79% agreed FIRST was faster to react, 84% felt like a partner, 68% agreed FIRST undertook smaller projects, and 62% agreed FIRST provided better consultants.

Some recommendations from the surveys were:

- **Process improvements:** Providing a greater role for clients in consultant selection was emphasized. This will have to be weighed against maintaining or improving efficiency of the project approval and start-up time. Consultants also need to have the appropriate language skills;
- **Project design:** Written comments emphasized additional training needs; thus, project design should ensure adequate training is included; and,
- **Long-term view of reform and follow-up:** The single most important message from written comments was the importance of follow-up. FIRST should consider putting in place a systematic process for assessing further client needs.

IV. FIRST's Contribution to Reform Programs

Four of the Consultative Group participants presented FIRST projects implemented in their countries. These presentations helped to contextualize FIRST work. The presented projects varied regionally and sectorally so as to give a broad overview and show the breadth of FIRST operations. They also demonstrated how successful programs could be implemented in diverse environments, and the lessons learned as a result of these projects.

1. FIRST project in Papua New Guinea

Mr. Salamo Elema, the Insurance Commissioner at the Department of Treasury in Papua New Guinea, presented the FIRST funded project in Papua New Guinea. The government of Papua New Guinea sought to move from a traditional solvency-margin regime to a risk-based capital rule for insurance companies operating within its territory. A risk-based system would ensure a better-managed insurance market in which solvency rules more closely matched the risk profile of individual insurers. The decision to implement a risk-based capital project was in line with the government's financial sector reforms and with international standards. The purpose was to develop a risk-based capital regime for the non-life

insurance sector in Papua New Guinea so as to construct a regulatory capital structure that is more risk based, and to conform to the IAIS Insurance Core Principles.

In project implementation, a consultative document was prepared and released to ensure that everyone started with a common understanding. Some technical refinements were made following the consultation. The consultants then developed draft parameters and tested the impact of the proposed new system on individual companies using insurance commission data. The risk-based capital formula, as applied in Papua New Guinea, led to increases in the capital requirement, but the increases did not exceed the capital that companies actually held. As a result, there was no need for transitional arrangements. Finally, the consultants assisted in converting the proposals into a draft that the Office of the Insurance Commission (OIC) could adapt to the local regulatory system, adopt, and implement. In this phase of the project, the OIC staff were trained to assess companies under the new system. Many members of the staff had worked collaboratively with the consultants throughout the project; additional training included all staff and provided a deeper understanding of the new system.

Some of the weaknesses of the risk-based model are that it is not possible to measure the 'riskiness' with precision and the reliability of the output depends significantly on the reliability of the valuation of balance sheet items. Apart from the risk-based capital as a useful regulatory tool, there are many other regulatory powers and controls. Further projects will examine and update other items collected under the statutory reporting arrangements to ensure that sufficient, reliable and consistent information is captured, and establish an electronic reporting model to facilitate timely production of relevant statistical information to be available for the public. This will include industry level and entity-specific information and provide the Regulator's Office an efficient means of conducting simple trend analyses and other types of analysis on individual companies.

The industry was initially wary of the project because they feared that it might lead to an increase in capital requirements and limit their flexibility to adjust their business profiles. When the final formula and transition process were outlined, the sector was very accepting. As a direct result of the FIRST project, the OIC can now better assess company risk profiles and solvency, and its credibility has been greatly enhanced.

2. FIRST's Contribution to Reform Programs in Chile

Francisco Silva, Head of Project Management and Strategic Development, Securities and Insurance Regulator in Chile, presented some of the FIRST projects in Chile. The basis for these projects was various diagnostics, and analytical studies. An FSAP provided a diagnosis of the Chilean financial sector as the starting point for FIRST Initiative interventions. The securities, insurance, and pension fund markets were analyzed by several teams of experts. As a result of this analysis, a set of recommendations were delivered. The Chilean government defined priorities among the recommendations, and some of them needed the help of advisors with experience and skills not available in Chile. FIRST endorsed five priorities: the strengthening of regulation for pension funds; the implementation of a risk-based supervision model in the securities industry; the adoption of international financial records standards for securities market; a road map solvency council in the insurance industry; and the implementation of a model of supervision of the Chilean insurance industry.

The first project undertaken was the strengthening of the regulation of pension funds. The Chilean Congress has passed a law that included the two main recommendations of the FIRST project. The first one was a change of investment regime that would normally be more flexible and create a technical advisory board whose mission would be to help the superintendence of pension fund that regulates

investment regime in pension funds. The second recommendation was the change of supervisory framework oriented to adopt risk-base supervision. As a consequence of this project, a change in the organizational structure of the regulator was accomplished. The second project aimed at implementing risk-based supervision in the securities industry. The third project developed the adoption of international financial standards for securities and insurance markets. The fourth project was a road map for attaining solvency controls in the insurance industry.

As a consequence of these five projects, risk-based supervision models are applied in different markets in the financial sector in Chile today, and will be applied during the next two years. This has improved the efficiency of the supervision in the financial sector. Also, the adoption of the international financial standard reports provided more information for enterprises, and improved the information for investor decisions in Chile. These reforms improved the efficiency in the market and self-regulation of the financial sector.

3. Projects Financed by FIRST in Rwanda

FIRST Initiative financed four projects in Rwanda. These were presented by Angelique Kantengwa, the Director of Banking Supervision at the National Bank of Rwanda. The first project was the development of a microfinance credit bureau; the second was connecting banks and service providers; and the third one was a financial sector development plan in two phases.

Rwanda requested FIRST's assistance in order to enforce compliance of microfinance institutions to a new regulation. The project was to create a credit bureau in the Central Bank to centralize information. FIRST identified the information system and database required for the information center, defined the work processes, implemented the process, and provided mentoring support for the first few months of operations of the new information center. As a result, fewer microfinance institution (MFI) failures are expected. Also, improved regulatory capacity at the Central Bank for supervising MFIs and access to the portfolio of every MFI are significant project benefits.

The second project was concerned with connecting bank and service provider. The rationale of this project was to link banks and service providers in payment of invoices directly from client accounts to the accounts of the service providers, which are all domiciled at the banks. The project's expected output was a functional and technical specification of this linkage between the client and the service provider, connection of bank and service provider, and some training and regulations. Due to some internal issues, and poor communication with the consultant, the project was shelved until 2008 when the National Bank of Rwanda, and the payment system company rejuvenated the project, using one bank.

The last project, implemented in two phases, was the financial sector development plan. In 2005, Rwanda had an FSAP, which recommended the addressing of certain weaknesses. The government of Rwanda launched the Financial Sector Development Plan (FSDP) as a comprehensive reform agenda in order to not only address these weaknesses, but also to develop a strategy to strengthen the financial sector. FIRST Initiative helped finance two elements of this FSDP development. The first one was a diagnostic of the current regulatory, supervisory, and financial framework which took into account the work already carried out by the FSAP. The second financing was the mentoring for a period of six months, with a technical expert who oversaw the implementation of the process and system.

4. FIRST Funded Projects in Sierra Leone

Nathanial Wellington, Advisor to the Governor of the Bank of Sierra Leone, spoke of the FIRST projects in his country. Firstly, FIRST helped the Central Bank of Sierra Leone to put together a book-entry system. Sierra Leone sought to have a Central Bank-controlled account, through which the commercial banks could access information and data. The first phase of the project was to review the existing systems. The second phase was to implement this control account through which the trading of the commercial banks could be effected. The aim was to revisit the tax legislation to have a uniform system because the book-entry system operated on the basis of all entities being taxed, which might be faulty. There was some difficulty in implementing the system due to gaps in the tax policy. The Central Bank of Sierra Leone has reached an agreement with the tax authorities to revisit the tax policy, and the FIRST consultant can now finish the project.

The second project with FIRST was the supervision of non-bank financial institutions. The project aimed to develop the supervisory strength of the Bank of Sierra Leone with regard to non-bank financial institutions. FIRST performed a diagnosis and prepared operational manuals.

The third FIRST project was the development of a road map for capital market development. In Sierra Leone there is a lopsided financial system, where the money market dominates, and there is very little capital market activity. FIRST recommended a framework for capital market development, necessary laws, education of the public, and development of the technical capacity. The project was successfully undertaken jointly by a consultant and the local personnel.

More recently, a project has been approved, following a 2006 FSAP. FIRST Initiative developed a road-map for the implementation of the FSAP recommendations for the Central Bank. Sierra Leone is working with FIRST towards the development of a Financial Sector Development Program (FSDP), a comprehensive program for the financial sector, covering various areas of commercial banking, microfinance, community banking, and capital markets. The overall evaluation is that the FSDP is a success, with full ownership and participation of key stakeholders, clarity of the action plan and institutional responsibility, and the political will to implement the FSDP.

V. Areas of Strategic Focus for FIRST

After the individual project presentations, the Consultative Group was divided into three break-out sessions to engage further in depth on various topics. The first group discussed emerging reform priorities and areas where FIRST could offer niche assistance. The second breakout group discussed FIRST's strengths and weaknesses and how FIRST could do better in reaching out to current and prospective clients. The third group discussed how FIRST could work with standard setters, and how FIRST could continue to be catalytic and complementary to other donor programs. These break-out groups reported to the plenary after lunch, where the representatives from each group gave a summary of the issues brought up by their group.

1. Emerging Reform Priorities

Some major areas of priority identified by the break-out groups for FIRST interventions are presented below:

Regulation and supervision. Technical assistance on regulation and supervision of the financial sectors should remain as the core area of engagement for FIRST. This area encompasses a wide range of activities, among which are: putting in place a regulatory infrastructure for the entire financial sector, implementing risk-based supervision, and helping build capacity for risk-based supervision and consolidated supervision. Separate regulatory frameworks for microfinance supervision and increased capacity to regulate microfinance institutions need to be developed as well as regulation and supervision of the NBF sector (particularly insurance and pensions) which should continue to be a priority. The overarching theme was that supervision and regulation, reinforcing capacity and helping rethink the regulatory architectures are significant development work on which FIRST should continue to focus.

Access to finance. Access to finance remains a priority area. A concern was that within the context of the global financial crisis, focus will prematurely shift while some access issues need to remain in the center stage. The microfinance sector needs support as MFIs are still having difficulties with securing funding. In the past few years there has been a lot of interest in equity participation by many private funds in the microfinance institutions. Now this seems to be drying up. In terms of access, this is a big issue, because microfinance institutions are facing an uphill task to raise funds, both with wholesale funds they were getting from commercial banks, but also with equity participation from private equity funds. Microfinance needs to work more efficiently. The question is how FIRST can support MFI's to work more efficiently with the right infrastructure. Although the Consultative Group to Assist the Poor (CGAP) plays a dominant role in the area of microfinance, it does not give advice on necessary institutional development and legislative support. Some policy approaches for transforming non-government organizations into fully fledged MFIs are a priority which might be addressed by FIRST.

What is crucial to FIRST's mandate is that access to finance is not limited to microfinance. However, there are many players in the field of access to finance and FIRST will not aspire to crowd them out. Product development in access to finance is a role that FIRST might envisage. Financial literacy is also an area within projects that FIRST should integrate as part of a commitment to access to finance. A reduction in the costs of accessing financial services through a better understanding of micro borrowers would also be beneficial.

Deposit insurance. An area of development that has become very important, especially with the current crisis, is helping countries build reliable deposit insurance systems. Ensuring that deposit insurance is in place, has the right incentive structure, and the right governance are very important aspects for stable banking systems. FIRST should be able to assist countries with developing reliable deposit insurance systems.

Crisis preparedness. FIRST can play an increasingly important role in the area of crisis preparedness. Assistance with stress-testing is valuable, and FIRST should finance follow-up activities to implement the results of stress-testing and help build supervisory capacities. A crucial product is crisis simulations, which may fall into the assistance category as an after-stress-testing activity.

Financial infrastructure. Regarding financial infrastructure, support for the development of payment and settlement systems needs to continue. Clearing and settlement infrastructure for securities markets and the development of credit bureaus remain areas of priority for client countries, and are key sub-themes under financial infrastructure. Financial literacy is very important, but is not a niche for FIRST. Financial literacy should be increased through knowledge sharing and dissemination incorporated in the project design.

Capital market development. With regards to capital market development, the relevance of requests for money and bond market development were discussed. Both areas were considered to be covered by the International Finance Corporation (IFC). In the interest of not substituting other donors' work, FIRST should refrain from being involved in equity market development. However, there is a need to understand some of the impacts of capital flows in and out of a given country, and FIRST can help develop the right tools, and instruments for money market development. Also, FIRST can be involved in establishing risk management architectures, and helping regulators of the central banks manage risk and establish corporate governance in securities markets.

2. FIRST's Strengths and Weaknesses

The second break-out group discussed the strengths and weaknesses of FIRST in terms of project design, delivery, operation and efficiency. They also discussed particularities of FIRST such as "niche assistance" and how this materializes into projects.

FIRST's main strengths were identified as:

- Flexible response. The group pointed out that one of the greatest advantages of FIRST was its ability to address a host of financial sector issues in various innovative ways, and to meet the differing needs of countries.
- Gap filling. This aspect of FIRST was considered a considerable strength; recipients appreciated the ability to have recourse to FIRST for smaller projects not covered in larger projects or programs financed by other donor.
- Ready access to World Bank/IMF expertise. This refers to the particular working relationships between the financial sector experts within the Bank and IMF and FIRST Project Officers when preparing project applications, supervising quality, and/or managing certain projects.
- Access to international service providers. The quality of consultants has remained very good in both Phases I and II. FIRST's roster of experienced firms and individual consultants and quick access to this high-level expertise enable quick procurement and top quality delivery.
- Standardized application. The format of the application and the enquiry is known to many recipients who have become familiar with FIRST projects, and it is commonly agreed that FIRST project application process was not onerous.
- Growing brand recognition. This signifies that dissemination and outreach efforts are effective. This might also be linked to its closer collaboration with the World Bank and the IMF.
- Opportunity to formalize relationship with other funders. FIRST established formal and informal partnerships with other donors and donor programs that are active in financial sector development to enable project coordination, referral and cooperation.

FIRST's main weaknesses include:

- Focus and scope. In some cases, projects can be limited in scope and may have to be revisited during implementation.
- Inconsistent response time. The time between the receipt of project proposal and approval can vary from project to project significantly depending on the design and requirements of each project.
- Post project updates/follow-ups of results and future funding sources. According to the group, FIRST could do better in follow-up work. Many projects need a second phase to bring reform programs into full fruition.

- Need to involve recipients in the selection of consultants. The choice of consultant is often without significant knowledge or input from the recipient. Client involvement in consultant selection strengthens ownership and, in many cases, implementation of the project.
- Staff turnover and contact points. The trend in FIRST has been rapid staff turnover and slow staff build-up which has made building continuous rapport between clients and the PMU difficult.
- Lessons learned, dissemination. The models, lessons and practices from other projects should be made available to potential recipients.
- Project monitoring, implementation team effectiveness. The PMU is viewed to be insufficiently involved with overseeing projects that are managed by the non-PMU World Bank staff. But more than that, there was discussion on how to perhaps organize teams around project implementation, where stakeholders involved in the project, are expected to talk to each other to arrive at a better level of implementation. Sometimes disconnects or miscommunications occurs at the level of technical leadership and project management, and between recipient and consultants.
- Level of future resources. The uncertainty of future donor funding impacts FIRST's sustainability as a technical assistance providing program.
- Planned versus real duration of projects. FIRST has had quite a few projects which needed to be extended since their delivery timeframes were originally underestimated. The short-term project delivery expectation might be difficult to maintain, and should not limit project design and/or approval. There is a six to 18-month rule, but often there are projects that go over the expected duration, and that is, to some extent, questionable in the business model.

The group also discussed areas in which FIRST Initiative offers “niche” assistance. Some of the specifics of “niche” assistance discussed were as follows:

- Should FIRST do “everything”? Either on its own or by partnering with other donors, FIRST is able to deliver assistance on a wide range of financial sectors. However, expectations should be managed well, and priority areas of work should be favored.
- FIRST will continually reflect on the changes in demand for assistance that can be gauged from FSAP and ROSC's.
- FIRST could help with the formulation of strategies which could then be also supported by other donors.

Some very positive feedback was provided on the lessons learned and dissemination, mostly regarding recipients' access to project deliverables undertaken by other countries. In seeing the annual report, projects might be of interest to other partners, but there is little access to what might be replicated.

In terms of outreach to clients there is a need to improve in-country networks and presence, coordination with Making Finance Work for Africa and, in general, financial sector reform programs for ongoing and pipeline projects of FIRST. There should be a better tool to network with experts on the ground and other donors, and especially those that are involved in the financial sector development programs. There are varying groups of stakeholders for the financial sector, and it would be useful to have PMU staff attending at donor coordination meetings.

FIRST needs to maintain its market niches, while at the same time not losing its innovative spirit. The crisis preparedness agenda has been effectively responding to changing conditions, and this flexibility is helpful. FIRST needs to link with local think tanks to share knowledge for best practices dissemination. And finally, there is a need for increased visibility and direct contact of the PMU with the clients and the recipients. This goes from participating in meetings to actually helping in implementation and assisting the recipient to prepare applications for FIRST.

FIRST has, thus far, implemented some positive and constructive work in terms of outreach but could improve in several key areas which include:

- Improving in-country networks and presence, for example through mapping with MFW4A for financial sector reform programs and on-going and pipeline projects;
- Linking PMU staff to in-country stakeholder committees for financial sector development;
- Establishing an advisory panel inclusive of recipients to support CG process; and,
- Increasing visibility/direct contact with clients.

3. Coordination, Partners and FSAP Follow-up

The third break-out group discussed the ways FIRST is involved with other donors and programs such as: partners within the World Bank, FIRST's role in FSAP follow-up, program coordination with its own donors on the Governing Council, other donor and international standard setters, and its partnership with MFW4A.

Local knowledge. There is a need for FIRST to work very closely, when appropriate, with donors' local offices since they have better knowledge of government priorities and ongoing development programs. While working on projects in a country during roll-out, stakeholders should be informed, and FIRST should build into consultants' terms of reference an explanation of the work at the most basic level to other ongoing donor programs, so that the relevance can be foreseen and as a consequence enjoy more active cooperation. The Consultative Group would like to see a greater involvement of local consultants. The expression of interest FIRST requested from local consultants did not have the kind of results that were hoped for. A new approach to mobilize local consultants is regarded as a very important priority.

Donors. The role of FIRST Initiative is to assist in implementing financial sector assistance, either on its own, or by partnering with other donors. FIRST can also broker projects for other donors by channeling proposals that cannot be undertaken by FIRST. Additionally, FIRST could engage in the formulation of strategies that would be implemented by other donors. The issue here is having an overall view of what donor programs are active in which countries. Donors need to have a mapping of who is doing what. If FIRST facilitated this mapping to some extent, it would be very useful.

Making Finance Work for Africa. The Making Finance Work for Africa Secretariat is an important partner in coordinating financial sector technical assistance in Africa. They may turn out to be a very effective broker for putting all these development efforts together, and in terms of channeling some of the demands that do not fall within FIRST's mandate.

Standard setters. Significant partners for FIRST are standard setters. Both standard setters present in the Consultative Group meeting, IAIS and IOSCO, asserted that they were under-resourced. They not only set core international principles, but are constantly working with their members to endorse and assess against these principles, and to implement any changes that are needed to embed the principles into their regulatory and supervisory structures. There is a demand for MOUs, which will increase the ability for knowledge sharing and harmonization on the regulatory and supervisory front with their respective principals. A very important part of their engagement with members is, therefore, assessments, some of which are self assessments. While some of these assessments are funded by the countries concerned, some cannot be funded because of financial constraints. Therefore, FIRST assistance at this stage is very important. Also, there is a significant need for technical assistance to help with the follow-up implementation, where FIRST can be highly instrumental.

FSAP and ROSC follow-up. There was a general agreement that FIRST should continually be involved in the implementation of FSAP and ROSC recommendations. However, FSAP recommendations usually

need more detailed scoping to translate them into an implementation plan. There may also be some intermediate steps which might require mobilizing some of the country and/or regional. FIRST can be effective in formulating FSAP action plans and mobilizing stakeholders where appropriate.

Once FIRST is involved in financial sector development action plans that emerge from FSAPs, there may be opportunities to engage multilateral donors for support since most of FSAP implementation programs can have high price tags, and can last multiple years. FIRST could mobilize the expertise that donors require at different stages. There is definitely a role for FIRST in preparatory, planning, and feasibility stages. Subsequent implementation tends to be large projects which would exceed FIRST capabilities, but at the very least FIRST could be playing a catalytic role in the chain of events.

Other partners. Regional organizations can also make excellent partners. For instance, regional organizations of central banks tend to more readily gain acceptance from the central banks of the region, whether they're funded by FIRST or someone else. They would therefore be a good source of clients and partners in terms of implementing broader themes across regions.

VI. Discussion

The afternoon discussion focused on elaborating on the issues that were raised during the break-out groups and was aimed at providing feedback to FIRST on how to maximize impact with a sharpened strategic focus. This discussion was important in terms of wrapping up the discussions of the day and summarizing the strategic priorities and areas for further improvement as recommended by the Consultative Group for Phase II operations.

The concluding discussions are summarized under the following broad topics:

Importance of legal, regulatory and supervisory framework assistance. Although there is currently demand for crisis preparation work by FIRST recipients, the “bread and butter” of FIRST has been supporting strong regulatory frameworks, whether for microfinance, capital markets, insurance or any other area of financial sector. Crisis or not, what is most detrimental to clients is when they find themselves constrained by existing legislation that need revisions or legislations that are yet to be formulated and enacted. Also building the capacity for supervision, risk management and corporate governance is proven to have significant impact in establishing robust financial sectors. FIRST has thus far provided substantial development assistance in the area of regulatory and supervisory frameworks, and this is what ultimately defines FIRST branding.

The Consultative Group cautioned FIRST about not overstressing its funding for projects that have limited impact; the priority should be given to projects related to strengthening legal, regulatory and supervisory frameworks. If the level of funding increases in the future, FIRST can play a more dominant role in other areas as well. However, if there are constraints, then the primary focus should be supervisory frameworks and legal infrastructure. The Consultative Group asserted that there was perhaps too much emphasis placed on financial crisis preparedness, whereas FIRST should be strengthening areas which might mitigate the effects financial crises such as corporate governance and regulation.

Access to finance and microfinance in particular. Access to finance can be one of the areas whereby FIRST can have some interventions without becoming a specific microfinance player. The Consultative Group asserted that, in terms of a strategy, FIRST needs to be careful not to try to define the strategy

through the deficiencies of the general strategic architecture that exist in access to finance. Access to finance is the most heavily funded area in financial sector development. In Africa alone, 40 agencies with \$1.8 billion in funding committed to Africa are implementing access to finance programs. The rest of the financial sector agenda roughly attracts \$200 million. There will always be a temptation for clients of microfinance to resort to FIRST because it is an efficient and effective program.

Microfinance issues that can be addressed by FIRST relate to advising on legal and regulatory frameworks. In a couple of countries, in response to a FSAP financial sector development plan, the recommendations did indeed address microfinance as one of the areas that the countries should work on. However, these countries, in most cases, did not have substantive laws to support the implementation. They might rely on banking laws, which have enabling clauses, to come up with guidelines. Usually, the regulatory frameworks are too rigid, and not flexible enough to enable more players to come into existence. The needs of microfinance in terms of regulation and supervision could be addressed by FIRST. There is substantial development work that can be implemented in this area as access continues to be a key issue in client countries.

Some clients may also need assistance with the assessment of their microfinance sector. FIRST could facilitate the building up of infrastructure by carrying out studies, making recommendations on how the legal and regulatory framework for microfinance and access to finance could be improved. The Consultative Group suggested that FIRST could undertake various studies with this scheme, making recommendations on the kind of credit enhancement schemes that enable formal financial institutions and commercial banks to channel their funding through microfinance institutions, which would ultimately be accessible to more borrowers. It's a facilitative role, whereby conclusive results can emerge from action plans that are funded by FIRST. This could trigger actions on the part of policy makers to attract formal institutions for movement of funds from the formal financial sector to the microfinance sector.

Crisis simulation exercises. The international financial crisis and FIRST's contributions to crisis preparedness was discussed in depth by the Consultative Group. The Group expressed interest in stress-testing assistance and crisis simulation exercises. Even those with small markets need preparation for the global crisis, and for those who have stress testing mechanisms in place, the concept of crisis simulation seemed important in further preparedness. Just by following a regular regime of stress testing, countries might avoid some of the problems arising from a financial crisis. Quite a few client countries had undertaken stress testing but could not manage the risk of their international correspondents or ensure that banks were reliable. FIRST could help clients prepare for future crises, and help them deal with the excess liquidity in their systems.

In Africa in particular, the first round effects of the international financial crisis have not yet been significant, but the second-round effects are likely to be more so. This will take the form of increasing loan losses, perhaps foreign exchange losses, reductions in revenues associated with fees and transactions. Certainly the banks in Africa are going to come under stress, and that means that supervisors need to be particularly vigilant and double their efforts to have a full understanding of the undercurrents of financial systems on a real-time basis. It is worthwhile for supervisors to think through worst case scenarios even if their banks haven't failed yet. Well before banks actually collapse, authorities need to be prepared for facilitating capital flows into their systems or for moving institutions into stronger hands. Foreign banks may be operating in those markets as subsidiaries, and they may also come under stress. Contingency planning is viewed as a step that can be taken by supervisors in Africa in this regard. It requires proactiveness and a sharp awareness on the part of local supervisors.

Another idea discussed for crisis simulations was doing them regionally. For instance, regional workshops in Africa would group countries where there are networks of banks. The benefit of that is not

only getting the supervisors talking to each other, but also understanding systemic issues regionally as well as institutionally.

VII. Conclusions

The Consultative Group Meeting's purpose was to engage with FIRST client countries, receive their feedback on program performance and reframe FIRST's mandate based on the needs and input of its clients. Client countries were able to share and discuss areas of reform that FIRST should focus on, and identify further possibilities for financial assistance in the financial sector.

The Chair, Robert Woodbridge, summarized the key points from the meeting as follows:

Project delivery. In terms of delivery modes, the message from the meeting was that the flexible, short-to medium-term, small-size project approach is the right one for FIRST. However this approach may bear difficulties in terms of follow-up and broader capacity-building needs. The strategy in this case should be to leverage all other resources/donors and not spread FIRST too thinly.

The Monitoring and Evaluation Framework allows for better documenting of FIRST's achievements and best practices that emerge from FIRST projects. These lessons learned should feed into FIRST operations as well as be disseminated to the clients and other donors for knowledge sharing.

Outreach and effective donor coordination are a shared responsibility. The stakeholders of the Governing Council and donors need to work through their own networks, and continue promoting FIRST. In terms of partnerships, the initial work with the standard setters has been promising. Standard setters have a very important role to play in financial sector development; however, they are, to some extent, under-resourced. A partnership between FIRST and the standard setters is mutually beneficial. Partnership with regional organizations such as Making Finance Work for Africa and Center for Latin American Monetary Studies (CEMLA) in Latin America is equally important in gaining an understanding of regional issues, regional integration efforts, and assistance that has a wider regional reach.

Core work. The focal area of regulation and supervision has always been FIRST's strongest theme since inception. Although crisis preparedness may have received heightened attention, it remains only one priority amongst many. FIRST cannot solely focus on banking because of the current crisis. FIRST has been involved and will continue to support other areas such as insurance, capital markets and pensions. The PMU will pick up on the points which were raised from the client survey, particularly those points relating to follow-up work. Follow-up assistance is in FIRST's interests just as much as the interest of recipients of technical assistance since FIRST would like to ensure that the technical assistance provided has positive outcomes and is sustained.

Going forward. In Phase II, FIRST should continue to speak to its strengths, be responsive to clients' needs, continue to cultivate partnerships, ensure its projects are complementary, and secure their fit within the overall financial sector reform programs of the client countries.

Some of the main points arising from the day's discussions in terms of reform priorities and new areas were:

- FIRST should continue in its core business, that is strengthening legal, regulatory and supervisory frameworks and financial infrastructure. FIRST has performed well in these areas, and it should continue to do so;
- Given the innovation ambition of FIRST, and responding to the current context, the new line of crisis preparedness work seems to have good client reception. In the context of the current crisis, there are only limited things FIRST can do. FIRST can be neither a crisis management nor a crisis resolution tool. But in terms of helping institutions prepare for crisis management, it is a line of business that fits FIRST's mandate, and the workshops which have been discussed would be the right forum and opportunity to take this work further.
- The third priority was to keep the access to finance area high on the agenda, bearing in mind that there are many players and there is limited niche for FIRST, which is the regulatory and supervisory work.

The Consultative Group meeting closed after the concluding remarks made by the Chair of the Meeting, Robert Woodbridge, and those of the Chair of the Governing Council, Jean-Luc Bernasconi.