FIRST aims to support economic growth and poverty reduction in low- and middle-income countries by promoting robust and diverse financial sectors.
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Statement from the Chair of the Governing Council

On behalf of FIRST donors, I am pleased to present the annual report for the 2020 fiscal year. During its nearly 20 years of operations, FIRST has funded more than 800 projects in 120 countries around the globe, deploying more than US$190 million in supporting tailored technical assistance projects to strengthen financial sector stability, build inclusive financial systems, and deepen financial markets—including, crucially, at a time of heightened uncertainty created by the COVID-19 pandemic. Moreover, FIRST projects have helped catalyze more than US$1.8 billion of additional funding from other sources to implement successive reforms.

In addition to country-specific assistance, FIRST has supported 23 knowledge products worth US$5.5 million to disseminate international good practices in financial sector development. This document takes a different tack from previous annual reports in that it focuses specifically on some of the knowledge generated through those interventions. Successfully managing knowledge is essential for FIRST to achieve its goals and objectives, particularly in the longer term. Beyond country-specific interventions, the legacy of the work FIRST supports rests with its ability to share and propagate the ideas that will help beneficiary countries broadly, beyond current assistance recipients. This is of special relevance now that FIRST is expected to wind down at the end of its current implementation phase, in December 2021.

As highlighted in the report, the knowledge generated through these projects has been intended to propose solutions to both long-standing and emerging policy challenges, based on lessons learned from prior technical assistance interventions and the distilling of contributions to debates about the setting of critical regulatory and supervisory standards. Much of this work comes at a crucial time for policy makers when the impact of the COVID-19 pandemic has yet to be fully reflected in financial sectors and economies around the world. In particular, the crisis has highlighted the need for sound and deep financial markets in times when liquidity is scarce; the need for agile regulators to be able to react to changing circumstances; the need to deal with COVID-related financial risks, as non-performing loans are expected to rise (as exceptional support measures are rolled back)—all this while being careful not to stifle an incipient recovery. Of relevance is the work related to public credit guarantee schemes, which have played an important role in the response to the crisis in keeping the “lights on” for private enterprises and have served to leverage a significant amount of World Bank financing. My hope remains that a significant part of this work will contribute to the design and adoption of policies that will serve to enhance the resiliency of financial sectors around the world. Financial stability is after all at the core of FIRST’s mandate.

Beyond the direct effects of the pandemic, recent global developments validate the emphasis put by FIRST on new and emerging policy challenges as part of its revamped strategy (FIRST 2.0), particularly as we move into a post-COVID world and need to build back better. Recent massive and disastrous climate events—in both low- and
high-income countries—leave no doubt that climate change has become the most pressing issue of our times, particularly for the most vulnerable and uninsured, even in richer countries. The Green Finance Program supported by FIRST is expected to catalyze and serve as a springboard for new and concrete policy initiatives globally in the area. Similarly, the reality is that, despite recent positive steps, much remains to be done in closing the financial services gap for underserved groups, particularly women entrepreneurs. The work supported by FIRST in properly regulating and supervising the delivery of financial service solutions (fintech) provides, for example, an opportunity not only to enhance access to finance for women but other underserved vulnerable groups that have been sorely affected by the pandemic. FIRST’s support of these leading-edge programs will not only support the direct beneficiaries of World Bank and International Monetary Fund technical assistance but will also amplify best practices to a wider group of policy makers and stakeholders.

Rosmarie Schlup
CHAIR OF GOVERNING COUNCIL
HEAD OF MACROECONOMIC SUPPORT, ECONOMIC COOPERATION AND DEVELOPMENT
STATE SECRETARIAT FOR ECONOMIC AFFAIRS (SECO), GOVERNMENT OF SWITZERLAND
Statement from the Program Manager

I think few of us anticipated the extent to which the COVID-19 crisis would affect our lives, both at work and at home. The unprecedented impact of the COVID pandemic called for a commensurate response. Those of us involved with FIRST, much like our other colleagues at the International Monetary Fund and the World Bank Group, have made the most of this challenging situation to play our part. Aside from our usual emphasis on quality at entry and the delivery of results for our development partners, we have specifically tried to support teams in delivering projects that would translate into knowledge that would provide durable lessons for policy interventions beyond direct country beneficiaries. That is the main goal of this report—to take stock of those interventions that could guide policymakers in the future in creating the conditions and the enabling environment for the establishment of sound, resilient, and inclusive financial sectors.

Beyond the response to the crisis, FIRST-supported interventions have also looked to deal with the challenges emerging in a post-COVID world, some of which had been anticipated at the time of the endorsement of the FIRST 2.0 strategy. These relate to the impact of climate change on country financial sectors, and thus on national economies, and the regulatory and supervisory implications of technological change in the delivery of financial services. With respect to climate change, recent events have shown that severe climate events are becoming more frequent and powerful in magnitude, which calls for action, among other things, for regulators to put in place measures to mitigate their impact on financial sectors and facilitate the promotion of greener investments. As for the digitization of financial services, while the benefits are quite clear, including in expanding financial services to the most underserved parts of society, such technological advances also might present challenges to financial stability and the integrity of national banking sectors. The report delves into some of the interventions and lessons learned teams have designed and come up with to assist local authorities in dealing with these emerging issues, with the overarching goal of building back better.

As we move into the final year of the FIRST Initiative’s operations, I would be remiss if I did not take this opportunity to recognize the contributions so many have made during the course of nearly two decades. As I have emphasized, more than having FIRST acting simply as a paybox, our intention has always been to deliver quality projects with the goal of providing measurable results for our partners and beneficiary countries. Of course, the environment over the last two years has not been very conducive or supportive of this goal, making it difficult to work together with colleagues in identifying and implementing proper interventions and solutions for our clients. Nevertheless, from our side at the Program Management Unit, I can only say that we have held steadfast to our dedication to quality and achieving results, even if at times it meant that project proposals went unfunded.

Carlos Piñerúa

PROGRAM MANAGER

FINANCIAL SECTOR REFORM AND STRENGTHENING INITIATIVE
The FIRST Initiative’s Legacy of Knowledge

This year’s report highlights some of the most relevant knowledge work generated from 2015 to 2020 over the course of FIRST’s Phase III, focusing on innovative ways to deal with both long-standing and emerging policy challenges. It ranges from work based on lessons learned in engaging beneficiary countries through advisory policy services to the synthesis of general principles to guide policy design and implementation.

This report provides a sample of specific work related to best practices (including setting new standards) that have been distilled from actual practical technical assistance engagement, which aims to give policy makers and regulators a roadmap toward durable reforms. The report further highlights product deliverables that have come to inform country interventions by both the World Bank and the International Monetary Fund (IMF).

The lessons learned and guidance are all designed with the goal of easing the path toward creating more resilient and inclusive financial markets. They also include emerging guidance designed to deal with more current policy challenges, such as issues related to technological change, climate change, and mainstreaming gender.
USING LESSONS LEARNED TO DEVELOP BEST PRACTICES

The FIRST Lessons Learned Series shares valuable technical and functional insights on the most important lessons learned from FIRST-funded projects and discusses some of the key challenges faced in common areas of reform in emerging market and developing economies (EMDEs). Lessons learned are often a vehicle to launch discussion on new reforms for policy makers and stakeholders.
How to Make Financial Sector Development Strategies Work: Success and Failures

Context

A financial sector strategy is an essential tool to guide and accelerate the development of a country’s financial sector. The lessons presented in this note outline important factors that make financial strategies particularly effective. The lessons are based on FIRST’s experience in financial sector development strategy projects over the past 10 years. FIRST sent the survey to 15 countries, 9 of which responded: Botswana, Côte d’Ivoire, Lesotho, Liberia, Maldives, Mozambique, Rwanda, the Seychelles, and Sierra Leone. The note is a compilation of responses and lessons from the survey.

Content

The reality is that results with financial sector strategies have been mixed. In some countries, the strategies have been quite successful in catalyzing reforms, securing follow-up technical assistance and additional funding for implementation, and ultimately achieving the objectives. In other countries, the strategies have not been as successful because of a lack of political will and buy-in from all stakeholders.

A well-designed strategy, when implemented, can have a multiplier effect. It crowds in not only domestic resources but also external resources and support. With a clear strategy and road map laid out, the private sector and development partners know where they are likely to find government commitments and priorities and hence how they can participate. This knowledge translates into better public and private sector collaboration.

Ownership is a key factor. The government should demonstrate ownership of the strategy, which should be supported by high-level officials in all key arms of government and key stakeholders in the private sector and civil society. Achieving such ownership requires broad consultation throughout the design process, and transparency to achieve results. Beyond this critical aspect, the survey showed that there are five key lessons/factors that have proved critical to making the strategy a success.

Five Key Lessons

1. Meet the prerequisites: Fundamentals include a reform-minded government; a strong champion; and an honest assessment of the capacity to absorb needed technical assistance.

2. Institutionalize the process: High-level committees and technical committees can help in this regard.

3. Formulate a good, solid strategy: A high-quality team with technical expertise and sound diagnostics are needed to formulate a vision that is linked to a broader national strategy and is based on reality and suitability. A roadmap delineating clear priorities, timelines, and lines of accountability should be established, along with measurable targets and performance indicators.

4. Ensure ownership by stakeholders: Extensive consultations should be undertaken with stakeholders, and high-level buy-in attained.

5. Disseminate and monitor for better implementation: The strategy should be disseminated through domestic and external channels. Rigorous monitoring should be conducted through a dedicated secretariat.

Conclusions

A financial sector strategy is a crucial tool to guide and accelerate development of a country’s financial sector. A properly designed and implemented strategy can catalyze many reforms supported by public and private sector stakeholders and development partners, in a transparent and sustainable manner. The lessons learned that are presented in this note outline important conditions that make financial sector strategies effective. They are based on the experience of the FIRST Initiative as it worked in this field over the 10 years before the note’s publication. A crucial lesson relates to the perpetual challenge of trying to garner ownership of the reform agenda while being selective on the reforms that are achievable given limitations in absorptive capacity.

Context

The application of International Financial Reporting Standards (IFRS) accounting policies across central banks differs depending on the mandate of the central bank and the capacity of the accounting profession in the specific jurisdiction. The objective of this guide is to provide central banks with a model set of IFRS-compliant financial statements to be used as a handbook by central banks in developing or improving their external reporting. An analysis of international practices, such as those undertaken in preparing these model statements, may help address questions about the structure of the statements themselves as well as the organization of the note disclosures.

Content

This guide contains guidance that is based on a combination of country cases and expert knowledge provided by a panel of central bank accountants. The guide takes into consideration academic literature, relevant international standards, and central bank reporting practices worldwide. The model statements were developed based on research conducted by the IMF along with participants of 12 central banks that are IFRS-compliant or soon to be compliant. The research included a review of 20 publicly available English-language IFRS-compliant financial statements from countries around the world, as well as the IFRS themselves and work of the International Accounting Standards Board (IASB). In most cases, the reference financial statements covered financial periods ending December 2018 or early 2019 because these applied the most up-to-date IFRS, including the adoption of IFRS 9—Financial Instruments.

Conclusions

This is the first comprehensive and meaningful description of IFRS accounting policies, including disclosures of financial risks that central banks are exposed to. The intended audience for the guide is quite broad, given that about 25 percent of central banks use IFRS and another 25 percent look to IFRS for further guidance. The easy-to-follow structure of the guide will also be of interest to central bank board members, audit committees, and operational and accounting staff. External stakeholders, such as ministers of finance and legislators, will find the guide useful in further developing their understanding of the finances of a central bank’s operations. The guide will support central bank efforts in settling with their external auditor compliance differences between central bank operations and those of commercial banks, an outcome that should enhance the consistency of reporting across central banks. The model statements are not meant to be interpreted as the definitive application of IFRS for a central bank but rather as guidance as to the types of formats and disclosures that should be considered when a central bank reports under IFRS.

World Bank Crisis Simulation Exercises: What is at Stake in Coordinating and Making Decisions in a Crisis

Context

Financial crises can cause public panic and, if systemic, can take an economy down a negative spiral. Liquidity dries up, and bankruptcies follow. Managing a financial crisis requires speedy actions before the effects become systemic. Knowing what information to share, when, and with whom, both among a jurisdiction’s official channels and with the public, is critical because that decision can exacerbate the crisis or moderate it. A financial crisis cannot be managed merely by one institution; it requires coordination and collaboration among key stakeholders. In such a stressful and unpredictable environment, how might the authorities in charge of managing financial crises be better prepared to handle the situation? Crisis simulation exercises can be a powerful tool.

Simulation exercises are used in various industries from aviation to health care. Pilots and surgeons alike underwent many hours in simulations before they are deemed ready to serve the public. Through countless simulation exercises, they, along with their respective teams, practice doing their jobs, thus dealing with various critical situations to gain a certain comfort level so that they do not panic when they face similar situations. The same idea underlies the World Bank’s financial sector Crisis Simulation Exercises (CSEs).

In these exercises, financial sector authorities with responsibilities for financial sector surveillance, regulation, supervision, stability, crisis management, and resolution gather to practice decision making in the face of a financial crisis. The process starts with the World Bank team and the authorities constructing a plausible crisis scenario. FIRST has been mobilizing the delivery of CSEs for financial sector regulators since 2009.

Content

The World Bank’s CSEs aim to provide an opportunity for the authorities to practice communication, coordination, and decision making in crisis situations in their given framework. Facilitators use scenarios that are built to fit the jurisdiction’s unique circumstances because realities and concerns vary by country. The exercise is dynamic. The prewritten messages are only factual triggers for the participants—the full story of the scenario depends on what the participants do with the information received. Participants in the CSEs may be the central bank (the governor’s office, board of directors, financial stability unit, supervision department, and market operations department), ministry of finance, deposit insurance agency, and/or the nonbank financial supervisory authority, depending on what operation applies to each country.

Six Key Lessons

The experience of delivering nearly 30 exercises has yielded six key lessons that authorities might find useful in their efforts to prepare for and manage a potential crisis:

1. Awareness of information asymmetry is important and may lead to more information sharing.
2. The same information can be interpreted differently by different parties.
3. Clear understanding of respective roles and mandates is often missing.
4. Handling the problem depends on the individual and collective behavior of everyone involved.
5. Human elements play a bigger role than crisis management plans.
6. No two major crises are similar, so exercises should be held regularly.

Conclusions

Crisis simulation is an important exercise to practice communication, coordination, and decision making. By participating in simulations, authorities are better prepared when an actual crisis occurs. In the chaos of the crisis, problems such as information asymmetry and lack of communication and coordination only magnify and exacerbate the situation. Human elements play a bigger role than do solid crisis management plans. No matter how good the crisis management plan is, it is only a tool as good as the people using it. CSEs allow the important human components to put their tools to the test and hone their skills at handling a crisis—a stress test on themselves.
Challenges in Building Effective Deposit Insurance Systems in Developing Countries

Context

The global financial crisis of 2008 heightened the need for countries to strengthen their financial safety nets. It underscored the importance of depositor confidence in the financial system and the key role that a deposit insurance system (DIS) plays in maintaining that confidence. As an immediate response to the 2008 global financial crisis, some countries quickly increased coverage levels and some guaranteed all deposits for a limited time. Following the crisis, many countries also established new DISs, and many made significant changes to strengthen existing DISs, including revising their mandates to allow the DIS to finance certain resolution actions, strengthening funding arrangements and shortening reimbursement time frames. FIRST responded to the increasing demand for technical assistance to strengthen DISs. Over the decade after the global crisis, FIRST funded 16 projects around the world that directly related to establishing or strengthening deposit insurance. The technical assistance provided by FIRST covered a range of objectives, including (a) strengthening the legal and regulatory framework of a DIS; (b) developing methodologies to set the target fund ratio; and (c) supporting institutional capacity building in areas such as public awareness and depositor reimbursements.

Content

When designing a new DIS or reforming an existing one, governments must ensure that certain preconditions for an effective deposit insurance framework are met and also need to make critical policy choices relating to its design, on the basis of their individual country context. Such choices will have a significant bearing on the effectiveness of the DIS. These design features include determining the (a) appropriate mandate; (b) correct institutional setup; (c) level and scope of coverage; (d) adequacy of funding; and (e) timeliness of depositor reimbursements. The global financial crisis tested and exposed the strengths and weaknesses of some of these important design features. That experience has created increased demand by policy makers for support to reform and strengthen DISs around the world.

Seven Key Lessons

After a decade of FIRST-funded DIS projects, several key lessons have been learned. This note addresses the seven most important lessons learned and some of the key challenges in developing countries:

1. Deposit insurance is not a “cure” for weak banks.

2. A DIS is only as strong as the safety net in which it operates.

3. Mandates of other safety net members should not be duplicated.

4. Operational independence is more important than institutional independence.

5. An effective deposit insurance system is not free.

6. Preparing for payout is no small task.

7. The framework should not be static and should be subject to regular reviews.

Conclusions

The 2008 financial crisis underscores the fact that a DIS can play an important role in reducing the likelihood of bank runs and maintaining financial stability by working in tandem with the other elements of the financial sector safety net. However, developing countries must exercise caution in determining when and how to implement a deposit insurance framework. Experience has shown that implementing a DIS in a weak environment will likely undermine the effectiveness of the scheme. Therefore, it is crucial that policy makers fully understand and take steps to meet the identified preconditions. Rushing to put in place a DIS will likely lead to implementation failures and harm to the credibility to any similar effort in the future. Furthermore, there is no one-size-fits-all approach to establishing a DIS. Countries must adapt design features suited to their unique context to prevent unintended consequences, such as the increase of moral hazard. In this regard, technical assistance support should also be designed to adapt to local legal and capacity frameworks. Once a DIS is established, the authorities must regularly reassess the framework to ensure that its public policy objectives are still in line with its operating environment. This will enable the DIS to become a central pillar of the financial safety net and a key enabler of financial stability.

Strengthening Safeguards in Bank Resolution Frameworks in Emerging and Developing Countries

Context

Experiences in the management of financial crises have confirmed how important effective bank resolution regimes are in preserving financial stability. However, effective bank resolution frameworks—which are set up in alignment with the principles expressed in the Key Attributes for Effective Resolution Regimes issued by the Financial Stability Board (the Key Attributes)—require strong safeguards to ensure both the public interest and third-party rights are adequately protected during resolution actions. Where safeguards for creditors are too weak, private sector interest in financial activity may erode. Yet where safeguards for creditors are too strong, financial stability may be compromised when unviable financial institutions cannot swiftly be resolved. Thus, the safeguards of the Key Attributes not only relate to safeguards for the rights of shareholders and creditors of a failing bank, but also serve to ensure financial stability through the soundness and effectiveness of a bank resolution framework.

Effective banking resolution regimes are critical to financial safety nets and are a key driver of stability and resilience in the health of the banking sector. This report provides guidance to address key challenges experienced by emerging market and developing economies (EMDEs) in implementing safeguards in bank resolution frameworks. The guidance draws on the Key Attributes to formalize a range of good practices for effective bank resolution frameworks. Whereas the Key Attributes focus on global, systemically important financial institutions and the safeguards for their effective resolution, the objective of the guidance is to provide key considerations for tailoring safeguards for effective bank resolution regimes in EMDEs, where the resolution of domestic, systemically important banks may have a substantial impact on financial stability.

Content

This report highlights the importance of safeguards in building effective bank resolution regimes and the challenges faced by EMDEs in implementing the same. It includes an assessment of the current state of safeguards in the bank resolution regimes of 12 countries across 6 regions: Indonesia and Singapore (East Asia and Pacific); Russia and Ukraine (Eastern Europe and Central Asia); Argentina and Colombia (Latin America and the Caribbean); Morocco and Tunisia (Middle East and North Africa); India and Sri Lanka (South Asia); and Ghana and Nigeria (Sub-Saharan Africa). It was prepared to inform the design of technical assistance projects and to provide policymakers with some insights as to the key challenges and
possible solutions in implementing reforms to strengthen bank resolution frameworks.

The paper analyzes the specific requirements of each safeguard necessary for resolution frameworks. It then surveys the main features of existing safeguards across a sample of countries that have undergone bank resolution actions. The presence of the safeguards in each jurisdiction must be determined by reviewing multiple parts of their respective legislation, such as whether the regime respects the creditor claim hierarchy and the scope of the judicial review safeguard outlined under the Key Attributes.

Conclusions

While the notion that the resolution authority needs to have some level of legal protection to be independent seems to be well established within the countries surveyed, the extent of protection of shareholders’ and creditors’ rights appears to vary widely. Based on the survey results, it appears that the general interest principle, as a justification for taking extraordinary measures by the resolution authority, is not widely accepted across EMDEs. Therefore, significant work is still necessary in many countries to introduce an efficient legal framework for bank resolution.

This paper highlights how implementing an efficient resolution framework for banks requires taking a broader perspective on applying general principles of a country’s legal and judicial regime when introducing the safeguards. In this respect, EMDEs considering the introduction of a resolution framework for banks should pay attention not only to the safeguards as stated in Key Attribute 5. In particular, to be able to strike an appropriate balance between resolution objectives and contractual rights, they should also take into account the need for operational independence of the resolution authority, the legal protection of its staff and that of the staff of the bank under resolution, and the adequacy of the judicial review framework for administrative actions.

This survey of country cases highlighted how this balance still poses challenges in many jurisdictions. While a clear creditor hierarchy is present in most cases, the bank resolution regimes do not appear to allow for a modified hierarchy for the case of depositors or the depositor insurance fund in such a way that would render the process most efficient while supporting financial stability. In addition, while countries with exceptions to the pari passu principle are rare, they run the risk that some resolution tools, such as purchase and assumption transactions, will be suboptimal. Furthermore, adjudication procedures for appeals against actions of the resolution authority typically strongly protect shareholder rights against actions by state agencies. All these considerations suggest that, inherently, rights of creditors and owners appear to be more strongly protected than those of depositors and, more generally, than the public interest in financial stability across EMDEs.
National Development Financial Institutions: Trends, Crisis Response Activities, and Lessons Learned

Context

In recent years, there has been a renewed interest in the policy role of national development financial institutions (NDFIs), particularly their role in providing countercyclical lending and financing sustainable development. The academic literature has justified the efficacy of NDFIs on several grounds: (a) NDFIs often address existing market failures, such as coordination failures; (b) NDFIs help crowd in private investment as well as finance long-term infrastructure projects, or any other large investment projects; (c) They finance projects that the private sector is unwilling or unable to finance, for example in such underserved sectors as agriculture and small and medium enterprises (SMEs), or in sectors that produce positive externalities but that are not financially profitable, such as projects in education or the environment; (d) Procyclical lending of state-owned banks and NDFIs might also compensate for a credit crunch in private lending during a recession. These benefits are often challenged by negative views on the governance of their operations, including serving as unfair competition for commercial banks and crowding out private investment, as well as providing support to objectives of political elites. Despite these governance concerns, NDFIs, especially development banks, are experiencing a revival, with 74 new development banks being established between 2010 and 2020, and both the European Commission and the United Nations expressing strong support for establishing new development banks. In 2018, national development banks accounted for 6.5 percent of global banking assets.

Content

While comprehensive impact evaluation studies on NDFI interventions are scarce, this review of NDFI operations and organizational features in several countries provides valuable insights on both the upside and downside of NDFI interventions, and the features of NDFIs that appear to be more effective. The review supplements scarce information on economic performance with an assessment of how NDFIs actually conduct operations compared to good practices.

For this purpose, the paper makes use of the guidance note for the assessment of State-Owned Financial Institutions (SOFIs) under the World Bank Integrated State-Owned Enterprises Framework, which relies on a comprehensive approach that evaluates the functional and economic

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9 In this paper, NDFIs are represented by development banks (DBs), publicly owned non-bank institutions that provide credit for developmental purposes, and partial credit guarantee (PCG) funds.
Nine Key Lessons

Following the methodology of assessing the performance of SOFIs under the World Bank Integrated SOE Framework, the paper identifies nine lessons learned and illustrates how they are implemented in practice in different country cases:

1. Identify the unmet needs and factors preventing private sector involvement and consider all public policy interventions available, beyond provision of public sector funding, to address the problem.

2. Set up a mandate or mission statement for the NDFI focused on complementing the private sector and crowding in private investors to provide financial solutions to identified underserved segments or projects while preserving financial sustainability.

3. Design NDFI facilities focused on servicing credit-constrained borrowers to ensure additionality.

4. Develop a range of instruments to leverage private sector funding.

5. Use direct provision of preferential lending sparingly when large positive externalities can be justified. Ensure that subsidies (when necessary) are channeled in a transparent and nondistortionary way.

6. Operate the institution as a financial sector company, not as a public agency.

7. Ensure that the institution is effectively managed by aligning performance incentives with the objectives of the institution through effective corporate governance, risk management, and mechanisms to evaluate the performance of the NDFI.

8. Ensure that the NDFIs are properly supervised by the financial supervisory agency and that the institution operates in a level playing field.

9. When the environment is not conducive to NDFI effectiveness, raise funds in international capital markets by operating in the second tier.

Performance of SOFIs, as well as their operational environment. The approach aims to compensate for data deficiencies in evaluating the economic performance of the institution by looking at what the SOFI does and how it operates, as indirect indicators of efficiency. The functional assessment evaluates the rationale for NDFI operations, potential alternative policy interventions, and the consistency between the NDFI objectives and its operations. The economic performance assessment looks at the financial performance and economic impact of the SOFI’s operations. The financial performance is measured by the return on equity net of subsidies and assesses the risk-adjusted profitability through stress tests. The operational environment assessment looks the regulatory framework in which the NDFI operates, its corporate governance and risk management capabilities, and its monitoring and evaluation function. The approach is based on insights on what has worked well and what has not from more than 30 years of World Bank experiences supporting NDFIs through advisory and lending operations.

Conclusions

A review of NDFI operations and organizational features in several countries provides valuable insights on both the upside and downside of NDFI interventions and features of NDFIs that improve their effectiveness.

10 https://worldbankgroup.sharepoint.com/sites/gsg/CGFR/Pages/iSOEF-07152019-114541.aspx
Expanding Coverage of Good Quality Private Pensions

Context

Around the world, greater economic wealth and security, longer lives, and smaller families have increased the need to better secure old-age pensions. The United Nations estimates that, by 2050, the share of the world’s population over age 65 will have doubled from 10 percent to 20 percent, with 80 percent of the elderly—nearly 1.3 billion people—living in low-income countries. Despite this likely increase, the coverage of contributory pensions is still low in many countries, including those countries that already have an aging population.

Well-structured pension systems with a mix of public and private provisions contribute directly to the World Bank twin goals of reducing poverty and increasing shared prosperity.

Achieving those objectives requires high pension coverage that provides adequate income and that is efficient, sustainable, and secure. Pension funds can also be an important source of domestic long-term capital to fund investment and growth in businesses, housing, and infrastructure. Thus, pension reform is central to broader financial sector development.

Demographic aging, poor administration, early retirement, and unaffordable benefits continue to increase the urgency of pension reform. Expanding pension coverage is a global challenge because failure to plan proactively will mean rising old-age poverty and unsustainable burdens on public finances.

Content

FIRST projects have assisted policy makers in implementing national strategies and have focused on private pensions for both the formal and informal sectors. Whereas the broad objectives of pension reform are the same—to expand coverage of adequate, safe, more efficient, and sustainable pensions—the policy prescriptions differ across developed and developing countries, particularly given the differing levels of informality in labor markets. Furthermore, multiple interventions tailored to the specific country context are required.

FIRST projects have been largely successful in achieving their desired outcomes and positive impacts. They have often catalyzed additional funding to support larger reform. FIRST projects have typically assisted countries in the following areas:

- Reviewing, designing, and reforming pension frameworks:
  - Pension policy frameworks, including those to address fiscal impacts
  - Legal, regulatory, and taxation frameworks, including investment regimes
- Providing technical assistance for:
  - Building capacity for supervision, including governance aspects, particularly for investment strategy and management by pension funds

Lessons Learned Series

[Image of Lessons Learned Series]

Seven Key Lessons

Several lessons learned have emerged from these engagements and can be used as a guide for many other countries:

1. Reforms should focus on improving long-term outcomes.
2. Pension-specific risk-based supervision is paramount to maintaining security.
3. Good governance underpins good fund performance and risk management.
4. The right market structure increases efficiency.
5. Expanding coverage to informal workers and tackling gender inequality requires multiple channels.
6. Pro-poor incentives can support increased coverage.
7. Financial education initiatives must be simple and frequent.

- Improving pension market structure and dynamics, including distribution and access
- Developing coverage using multiple channels developed in line with the local labor market.

Conclusions

Securing old-age income is an urgent priority for countries globally. Expanding pension coverage and improving the quality of pension systems is therefore a critical development goal. FIRST has supported the pension reform efforts of many governments.

FIRST pension projects have evolved to focus on a multidimensional approach to improving the desired outcomes. Improvements in one part of the system can be undone by weaknesses elsewhere, so projects increasingly focus on improving legislation, regulation, and governance as well as market structure and supervision.

Going forward, the greatest challenges lie in two areas. The first challenge is to leverage innovations in ID and information technology improvements in financial inclusion to broaden access to pensions for the informally employed and the many women previously excluded from pensions. The second challenge is to translate pension assets into long-term investments for the benefit of members and the economy. This effort will likely require interventions not only in the pension system but also in the capital market.
GUIDANCE ON ADAPTING TO NOVEL CHALLENGES AND INNOVATIVE FINANCIAL MARKET DEVELOPMENTS

Rapid and innovative developments in the financial markets and the overall economy often require financial sector policy makers and supervisors to address novel challenges in the absence of existing systems. The COVID-19 pandemic has accelerated a number of developments, including large-scale uptake of digital financial services. The need to address critical issues on climate change is also accelerating green finance and other developments. The guidance supported by FIRST in these areas is intended to harness and distill the leading approaches, including their pluses and minuses, in implementing appropriate policy and regulatory reforms.
Global Experiences from Regulatory Sandboxes

Context

The demand for digital financial services has increased significantly in recent years. Fintech plays a key role in meeting this demand by leveraging technology to bring digital financial services to previously underserved populations. These technological innovations have been met with policy responses that have the potential to create new opportunities for fintech firms through targeted regulatory approaches while balancing the potential risks to consumers and firms. One such approach is the “regulatory sandbox,” which provides room for experimentation while guiding the development of new regulations and embracing the use of emerging technologies.

Regulators worldwide have adopted the regulatory sandbox as a means of providing a dynamic, evidence-based regulatory environment to test emerging technologies. Using country case studies and analysis of operations and outcomes of fintech sandboxes globally, this report highlights the benefits, challenges, and lessons learned from the implementation experiences of 73 unique fintech sandboxes in 57 countries. The intention is to provide key insights for policy makers looking to establish a new fintech sandbox or to evaluate an existing one. The report details evolving concepts and key lessons for emerging markets and developing economies (EMDEs), where 70 percent of the studied fintech sandboxes were created.

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The emerging trends and key findings in this report have been structured using the themes of country context; sandbox design; and impact at the level of the institution, market, and individual firms.

Main Take-Aways from the Evidence

- **Assisting policy makers’ decisions and effecting regulatory change.** While early evidence suggests that sandbox programs can result in regulatory change, interviews with some policy makers suggest that such change can be attributed to the open engagement between regulators and innovators. Sandboxes are not necessarily uniquely positioned to test all innovations, but they are useful where empirical evidence is needed to support policy development. They can be beneficial where regulatory requirements are unclear or missing or create barriers to entry disproportionate to the risks. Sandboxes can also help build consensus among different stakeholders needed to endorse or support broader regulatory change.

- **Benefitting regulatory institutions.** Sandboxes offer value to policy makers
looking to increase their understanding and capacity to facilitate and regulate a range of fintech innovations, particularly where existing policy frameworks can be tested against new technologies and business models. Sandboxes can also help build internal capacity with respect to different fintech innovations and provide a structured process through which to strengthen dialogue and interaction with the industry.

- **Promoting financial inclusion.** While some examples show how sandboxes can be linked to financial inclusion mandates and potentially encourage innovations that reduce barriers to inclusion, evidence is limited overall to suggest that a sandbox with an explicit financial inclusion objective can have a greater impact than a general fintech sandbox. Part of the reason for this dearth of evidence could be the limited time that these sandboxes have been in operation. However, when sandboxes are implemented properly and used to encourage consumer-focused products and services, they can potentially strengthen the broader financial system.

- **Assisting private sector firms.** While sandboxes are often open to both regulated and unregulated firms, some fintech firms have attributed the ability to access markets to their participation within a sandbox. Moreover, some evidence shows that a sandbox has reduced time to market for some firms.

- **Fostering partnerships in the market.** Sandboxes can help attract and develop marketplace partnerships or investors either directly through the design of a sandbox or indirectly through firms that gain legitimacy from the sandbox. Specific design features that can encourage partnerships include partnership requirements between a fintech firm and a licensed firm for eligibility to participate in the sandbox, as well as close association with industry accelerators that can provide advice and mentorship from more established players.

- **Strengthening competition.** Policy makers have reported mixed results when assessing whether a sandbox has led to an increase in competition in their respective markets. While a sandbox can encourage competition and lower barriers for smaller firms to enter the market, it can also create an unequal playing field between firms admitted to the sandbox and those not admitted.

- **Enabling development of the fintech market.** When they operate within a strategic framework that enables fintech and alongside a set of fintech-driven initiatives, regulatory sandboxes can provide valuable insights to policy makers and enable innovation. For fintech to thrive, a multidimensional approach must be adopted, including a gap analysis of existing laws and regulations, combined with an open dialogue between regulators and the industry.

Taken together, the overall evidence from outcomes observed from fintech sandboxes suggests that they have several benefits for regulators as well as for the financial sector ecosystem as a whole. They can: (a) provide an evidence base on which to make policy decisions; (b) influence future supervisory methodology; (c) help define, create, or amend regulation; and, in some cases, (d) support the regulator's competition mandate. For firms, sandboxes have been shown to offer a faster route to market and a better understanding of the regulatory environment, but in some cases, sandboxes prolong regulatory uncertainty. From a more macro perspective, the indirect benefits include spillover effects into the overall fintech ecosystem, spurring consumer-centric products, and signaling that the market is open to innovation.
At the same time, establishing a sandbox can pose several risks, particularly when a sandbox is poorly considered and implemented. It can potentially pose unexpected burdens on regulators and promote risks such as creating unlevel playing fields in the market. Countries that have limited regulatory capacity and resources or a less pervasive fintech market may find it more challenging to replicate a sandbox approach, and a sandbox in such jurisdictions may be less appropriate. For instance, some jurisdictions have operated a sandbox in markets with little to no material fintech activity. As a result, few fintech companies have applied, and even fewer have entered the sandbox. In this scenario, budgetary, staff, and opportunity costs borne by the regulators may have outweighed the benefits offered by the sandbox.

Before embarking on creating a regulatory sandbox, authorities should step back and objectively review the environment in which they operate, including by thoroughly reviewing their legal enabling environment, specifically by considering their primary objective(s): increasing competition; fostering an environment for innovation; or increasing financial inclusion. Despite successes, implementing a sandbox is not always a suitable solution for unlocking financial innovation. Sandboxes are, however, a new regulatory instrument and have only been in operation for four years; hence, results are still emerging. When properly designed and implemented, sandboxes can be useful tools that provide valuable insights into fintech, but they are not the only mechanism that policy makers can use to foster financial innovation.
Using Digital Solutions to Address Barriers to Female Entrepreneurship: A Toolkit

Context

In the past decade, considerable progress has been made toward advancing women’s economic participation, with development institutions allocating resources and attention to promoting women’s employment and entrepreneurship. To support this effort, important new research has been undertaken and disseminated in reports describing which interventions demonstrably spur efforts to support women in starting and growing a business. The result has been more focused attention on evidence-based project design. However, implementers still struggle not only to understand what works to advance women’s income-generating activities but also to identify tools and approaches that are appropriate in a particular context.

Addressing these challenges is particularly important as the world struggles with COVID-19 and the economic fallout caused by reduced mobility and decreased contact between individuals. Female business owners have been hit particularly hard, given that they already faced greater restrictions than their male counterparts. During the pandemic, technology has come to play an even more central role in establishing and maintaining socioeconomic connections and can be an important tool in rebuilding more resilient, inclusive economies. Individuals starting and running small and medium enterprises (SMEs)—the engine of economic activity and employment—will need adequate and targeted support to adopt technology.

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Gender plays a central role in the work of all major development institutions, including the World Bank Group. For gender-related activities, policies, and programs to be designed and implemented effectively, it is necessary to equip policy makers and project teams with appropriate knowledge and instruments. This toolkit responds to this need: It is a practical guide to analyze, design, and measure the use of digital solutions to advance women’s entrepreneurship via projects and policy advice. It provides detailed instructions and resources to World Bank Group and non-World Bank Group teams for a thorough diagnostic process to unearth key constraints to female entrepreneurship and lays out recommendations for interventions illustrated by project examples. This may include, for example, recommendations to further women’s access to digital IDs or to implement online government services. It may also extend to specific interventions in a community, such as supporting women artisans to use e-commerce platforms and access online training.

The toolkit’s primary audience is World Bank Group project teams, but it can be useful for governments, donor agencies, nongovernmental organizations (NGOs), and private sector stakeholders.

Toolkit Resources

The toolkit includes the following resources:

- **Conceptual background and context** for teams to gain a basic understanding of the status of women in business and benefits and constraints they may encounter in playing an entrepreneurial role, with an overview of the role that technology can play in catalyzing women’s engagement.

- **A diagnostic method**, applied at the country level, that allows challenges to be identified under three overarching themes and four main constraints, as shown in the illustration. The diagnosis starts with a desktop review, aided by an automated data-generation tool, to understand the context in which female entrepreneurs and workers operate. An analysis guide can help interpret the data. The quantitative analysis is rounded out by field-based discussions and interviews to identify challenges and opportunities for women entrepreneurs. Discussion guides can help structure these conversations with stakeholder groups.

- **A matrix** for determining the most relevant and effective interventions to support women entrepreneurs and for selecting actions—including identification of common obstacles and proven interventions to address constraints—along with a menu of possible digital-based enablers within the four main constraint pillars. The matrix includes symbols indicating the level of effectiveness of each intervention, based on existing research and evidence.

- A set of minimum technical requirements (technology criteria) for the use of the proposed solutions and “Dos and Don’ts” to explore the feasibility of deploying digital solutions within the local context, including methods to identify and address potential obstacles to implementation.

- **Case studies** that offer practical examples of successful entrepreneurship projects focused on women who have employed digital enablers.

- **Monitoring and evaluation guidelines** for tracking and measuring the results of policy reforms and digitally enabled interventions, including a menu of indicators.
Green Finance Program

Context

Green investment globally falls short of what is needed to achieve international and domestic climate and sustainable development objectives. At the same time, an increasing number of developments are underway to mobilize different parts of the financial system to scale up green finance and address climate issues. These initiatives take place in the private and public space, or a combination of both. Developments include financial innovations such as loans linked to measures to promote sustainability, initiatives around results-based climate financing, and the establishment of international networks or partnerships to align with the Paris Agreement on climate change. Regulators have united as part of the Central Banks and Supervisors Network for Greening the Financial System. At the government level, the Coalition of Finance Ministers for Climate Action is paving the way for coordinated action on climate change by finance ministries across the globe. In addition, numerous initiatives are bringing together private sector financial institutions—including the world’s largest—committed to green their balance sheets and step up climate action.

Notwithstanding these initiatives, a significant financing gap remains, particularly in emerging market and developing economies (EMDEs). Estimates suggest an annual funding gap of approximately $2.5 trillion in EMDEs, most of which is in economic infrastructure. Public funding alone cannot finance the transformation that is required to address this. With countries struggling to meet their climate goals and adapt to the impacts from climate change, there is a need for increased domestic activity, focused on mobilizing private finance. Private financial markets are failing to deliver adequate, stable funding with sufficiently long maturities at reasonable cost in local currencies. Many developing countries have shallow, nascent capital markets, where long-maturity debt or equity is unavailable or extremely costly.

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The FIRST Initiative has supported several knowledge products to address the closing of the green finance gap.

The Sovereign Environmental, Social and Governance (ESG) Portal

The World Bank Group has been collaborating with investors and other market participants to provide financial markets with improved sovereign ESG data and analytics that increase transparency around countries’ sustainability performance. The Sovereign ESG Data Portal is part of the work supported by the Global Program on Sustainability (GPS), which aims to provide governments and investors with information and tools that improve their understanding of sustainability criteria, including through natural capital accounting. Providing improved ESG data to the financial sector is a key component of the Incentives pillar of GPS, which is led by the World Bank Group’s Finance, Competitiveness, and Innovation (FCI) Global Practice in collaboration with the World Bank Treasury, Country Credit Risk Group, and other groups. The initial version of the Sovereign ESG Data Portal addresses several objectives:

- Improve availability, use, and transparency of data. The platform provides a framework of ESG indicators, drawn from multiple sources and World Bank programs, as a single downloadable file. The database is available on the Sovereign ESG Data Portal; in the World Bank’s open data catalog; and

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14 https://datatopics.worldbank.org/esg/
for data scientists and developers, via an application programming interface (API). The dataset also includes policy indicators that investors may have not otherwise considered in their analysis.

- **Provide tools to improve understanding of available data.** The platform includes a set of on-site data visualization tools so users can view available data, explore trends in data, and access country-level profiles. The same Sovereign ESG dataset is available in the World Bank's Databank platform, which provides additional tools to create and share tables, charts, and maps.

- **Provide context for ESG data.** The World Bank's Sovereign ESG Data Framework incorporates data relevant to all 17 Sustainable Development Goals, and organizes data into themes the World Bank views as crucial for financial sector representatives to consider when assessing the contribution of investments or policies to sustainable development. The Sovereign ESG Data Platform also provides links to other World Bank data relevant to ESG considerations, such as data for the Human Capital and WAVES projects, along with a research library of relevant reports, blog posts, and other publications.
• **Better align investment with sustainable development and provide a framework for engagement.** The project aims to better align investors’ ESG analysis with key sustainable development policy indicators and analysis, increase data transparency, and support private sector investments in emerging markets. Using the Sovereign ESG Data Framework as a basis, investors can better engage sovereign issuers on ESG criteria and policies to improve sustainability. The portal can promote improved understanding of risks and opportunities in World Bank client countries, which may facilitate greater private investment.

**Working Paper on Greening Banks**

With financial support from the FIRST Initiative, World Bank Group staff has prepared a working paper related to the greening of financial institutions, with special emphasis on national development banks.

This working paper explores the following question: What is the role of greening public banks and green banks in greening the economy, and how can this be supported? The note intends to inform both World Bank staff and authorities, such as ministries or (local) governments. Within the World Bank Group, it seeks to give more prominence to the consideration of these models in stimulating the greening of economies; and it intends to provide a first-stage assessment framework to be used within existing World Bank practices, such as the Financial Sector Assessment Program (FSAP). Externally, it aims to create awareness of the opportunities regarding green bank models; provide authorities with the tools to assess the suitability of these models within local contexts; and catalyze the adoption of these models.

The working paper presents the following preliminary conclusions and recommendations:

• **The World Bank is in a unique position to raise awareness among governments about the key role green banks can play in scaling up private finance to meet climate and sustainable development goals.** The consideration of green bank models as a key tool to mobilize private capital could become a central component of the World Bank’s advisory services. For example, the World Bank could integrate the assessment framework set out in this note as part of its FSAP, thereby catalyzing the adoption of these models in emerging market economies. It could support the translation of climate goals into tangible investment objectives and provide governments with the tools to make...
green banks an integral part of domestic climate strategies.

- **The World Bank could explore other ways to use its expertise and convening power to advance the role of green bank models in stimulating the greening of economies.** For example, there may be value in further developing the assessment framework into a practical blueprint; execute a mapping exercise to assess where the main opportunities from a global perspective are; or bring together key actors to develop capacity building programs based on lessons learned from current models.

- **Governments can be key in providing the right incentives for climate-related investment** by giving domestic public finance institutions specific mandates that are aligned with domestic climate goals.¹⁷ Some national development banks have indicated that they would scale up climate-relevant investments only when a specific mandate or target was given by their governments. Sector-specific government mandates or investment quotas for renewable energy or energy efficiency could be viable tools to stimulate public banks to reallocate finance from business-as-usual investments toward developing climate-related markets. Government guarantees can reduce the cost of capital for national development banks for these types of projects.

- **National authorities are well placed to support public banks to access capital markets.** Finance ministries and central banks could play a role in facilitating (international) issuance of green bonds for green banks to diversify their funding sources. This could have the additional benefit of facilitating local capital market development.

- **It is important to recognize that green banks can overcome only certain barriers; an enabling policy environment for scaling up low-carbon and green investment is essential.** Governments need to provide signalling with regard to long-term and predictable climate policy goals and infrastructure planning. A credible carbon price, fossil fuel subsidy reforms, and well-established renewable energy incentives are necessary conditions for green banks to be effective.

### Working Paper on Extending Climate-related Financial Disclosures to Sovereign Bond Issuers

The second working paper promotes an initiative to extend climate-related financial disclosures to sovereigns. The Task Force on Climate-related Financial Disclosures (TCFD) was asked to develop voluntary, consistent climate-related financial disclosures that would be useful to investors, lenders, and insurance underwriters in understanding material risks. So far, TCFD has focused exclusively on firms and has established itself as the reference framework, driving evolution in financial regulations, business initiatives, NGO reports, and service providers offers.

There is a strong rationale to expand TCFD’s initial scope, focused on firms, to sovereign bond issuers.

- Sovereign bonds are the largest asset class and are a preferred investment of institutional investors around the world.
  - Acknowledging climate change as a threat to financial stability, the Network for Greening the Financial System (NGFS) has recently issued a statement “encouraging all companies issuing public debt or equity as well as financial sector institutions to disclose in line with the TCFD recommendations.”¹⁸

¹⁷ An example is the Australian government’s CEFC Investment Mandate Direction.

- There is growing evidence that climate risks can have a significant impact on the cost of sovereign funding. A recent report estimated that emerging market economies highly exposed to climate risk attract a premium on their sovereign bonds averaging 275 basis points. The findings suggest that those economies that are particularly exposed to climate change and have the greatest need for resilience investment are likely to face an increasing cost of capital, if current trends continue. Credit rating agencies have started implementing changes in their rating methodologies for sovereigns to better assess the impact of climate change on creditworthiness.

- Sovereigns have become issuers of green/climate bonds and are, therefore, strengthening their capacity to report to investors on their climate risk management strategies.

- Extending climate risk reporting to sovereigns could enable firms to better disclose their risks related to climate change. Despite TCFD's momentum, only 25 percent of firms that report in line with TCFD provide information for more than three of the eleven indicators.

- The extension of TCFD reporting to sovereigns would send a strong market signal about the financial materiality of climate change and the need for adequate corresponding financial disclosure.

20 These include S&P, Moody's, and Beyond Ratings, to name a few.
- The TCFD reporting system would support more specific climate risk management and financial disclosure by firms.

- Scenario analysis at the national level provided within sovereign TCFD reporting would provide firms with key missing information, addressing the problem firms currently face to find the right benchmarks and assumptions to support the sensitivity scenarios of their own activity as recommended by TCFD.

- The extension of TCFD reporting to sovereigns could then spread to state-owned enterprises (SOEs) and to local authorities, such as cities, municipalities, federal states, and regions, which are active players in the bond market.

- Climate change risk is material and investors need clarity on how it is addressed in sovereign policies, regulations, plans, strategies, and budgets. Following COP 15 and the Paris Agreement, countries have engaged in the process of disclosing their National Determined Contributions (NDCs), which describe national voluntary commitments to mitigate climate change. However, NDCs do not provide investors with the required information that would be useful for their decision making.

The key deliverable for this project will be a report that will include a framework and guidance for climate and nature-related reporting for sovereigns. The report will also provide information on how the framework and guidance builds on that of TCFD for firms. The report will be published as a World Bank report and contribute to the TCFD Knowledge Hub.
GUIDANCE TO STRENGTHEN INSTITUTIONAL POLICY FRAMEWORKS

Global standards and best practices have become a staple of financial sector development and reform. Beyond the high-level standards adopted as part of the FSAP program and by the Financial Stability Board, there is a recognized need for substantive guidance on reform steps that help policy makers achieve their objectives in establishing or adapting key financial sector institutions and infrastructure. The guidance supported by FIRST mines the deep experience of the IMF and the World Bank to manage large-scale initiatives.
Guidance Note for Developing Local Currency Bond Markets

Context

Deep and efficient domestic government debt markets help provide resilience to shocks in times of financial turbulence and convey multiple economic benefits. As the recent history of financial crises—including the COVID-19 pandemic—has shown, efficient local currency bond markets (LCBMs) can increase financial resilience by mitigating currency risk, often a source of financial distress. In addition, the development of LCBMs is a cornerstone of broader capital market development, helping to price risk appropriately, allowing players in financial markets to better manage their portfolios, and providing a more effective conduit for monetary policy. In turn, these factors help boost a country’s long-term economic growth potential.

Developing domestic debt markets is a complex process that requires multiple and interdependent policy actions. Though broad guidelines and general principles to develop LCBMs are readily available, their translation into specific reforms is a daunting task because it requires actions from a broad range of stakeholders, including the debt manager; central banks; regulators; the providers of trading, payment, clearing, and settlement systems; and other policy makers. As countries tend to be at different levels of development along these various dimensions, the further development of their LCBMs will be path-dependent and require a country-specific, customized approach.

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To anchor this approach, this guidance note provides a comprehensive and systematic framework for LCBM development. It fills a gap in the current literature by going beyond merely recommending best practices to fully recognizing the obstacles that hamper the implementation of LCBM reforms. It starts from a systematic assessment of the preconditions for success and the stages of market development along the typical six major building blocks of LCBM development: money market; primary market; investor base; secondary market; financial market infrastructure; and the legal and regulatory framework. Applying a series of specific indicators, the guidance note framework allows for (a) the identification of gaps in a country’s LCBM; (b) the assessment of a country’s stage of market development; and (c) the identification of possible peers that may provide replicable lessons.

The guidance note discusses commonly faced challenges and bottlenecks in the journey to efficient and deep LCBMs. In particular, it explores how to overcome difficulties in implementing some existing best practices. Experience points to the interdependent nature of the required development actions and the

need for supportive actions outside the narrow field of LCBM agents. The challenges discussed and accompanying policy guidance draw from the IMF and World Bank’s extensive technical assistance (TA) provision in this area, cross-country experience in LCBM development, and results from a recent survey of country authorities.

Conclusions

The work presented in this guidance note brings together the wide array of knowledge on this topic and is relevant to a variety of stakeholders. It systematizes the existing knowledge on the many issues related to the development of LCBMs and formulates a comprehensive approach to analyze them. The guidance note also provides a way to compile country experiences more easily, thereby facilitating the creation of a repository of information. This repository can be a powerful resource for country authorities that want to further develop their domestic debt markets and for technical assistance providers in this field. Technical assistance donors will also benefit because the guidance note can facilitate better implementation of recommendations and the monitoring of progress. Moreover, it will facilitate surveillance work by the IMF and World Bank teams, which can use the guidance note as a resource to identify relevant issues that need to be addressed to improve financial sector soundness and economic resilience.
Principles for Public Credit Guarantee Schemes for SMEs and Toolkit for Impact Evaluation

Context

Financial inclusion, particularly for SMEs, is widely recognized as a key driver of economic growth and job creation in all economies. In emerging market and developing economies, the largest proportion of jobs is often created in the SME sector. However, SME credit markets are notoriously characterized by market failures and imperfections, including information asymmetries. The constraints on credit to SMEs are driven by inadequacy or lack of recognized collateral, high transaction costs for small-scale lending, and perceptions of high risk, all of which lead to suboptimal allocation of credit. In emerging markets, most formal SMEs (between 55 and 68 percent) are unserved or underserved by formal credit institutions.

A common form of government intervention is a credit guarantee scheme (CGS). A CGS provides third-party credit risk mitigation to lenders with the objective of increasing access to credit for SMEs. This risk mitigation happens through the absorption of a portion of the lender’s losses on the loans made to SMEs in case of default, typically in return for a fee. The popularity of CGSs is partly due to the fact that they commonly combine a subsidy element with market-based arrangements for credit allocation, thereby leaving less room for distortions in credit markets than through more direct forms of intervention, such as state-owned banks.

CGSs can play an even more important role, especially in countries with weak institutional environments, by improving the information available on SME borrowers in coordination with credit registries; and building the credit origination and risk management capacity of lenders (for example, through technical assistance for the setup of SME units). Moreover, CGSs can be leveraged to provide countercyclical financing to SMEs during a downward economic cycle when risk aversion may be heightened and a credit crunch is likely to follow, much like the recent COVID-related crisis.

Content

In 2015, the World Bank Group and FIRST convened a global task force to develop a set of 16 principles for the design, implementation, and evaluation of public credit guarantee schemes. The flagship publication, Principles for Public Credit Guarantees for SMEs, was endorsed by all regional associations for public guarantee schemes and has become widely accepted as a global benchmark.22 These 16 principles have now been mainstreamed into World Bank Group country-level operations pertaining to partial credit

22 https://firstinitiative.org/reports/principles-public-credit-guarantee-schemes-smes-english
guarantees, particularly recent ones dealing with the impact of COVID-19 on financial sectors.

The Principles are a set of best practices for countries to establish, assess, and reform their CGSs to optimize their financial and economic additionality, outreach, and financial sustainability:

- They are intended to help countries deploy their CGSs to overcome small and shallow credit markets for SMEs, which are usually characterized by market failures and imperfections.

- They have been developed through a collaborative process, convening a task force of CGS regional associations, and through outreach to international bodies, including the European Central Bank, the Organisation for Economic Co-operation and Development, and the Institute of International Finance.

- They have been endorsed and adopted by all regional associations of CGSs and have become the benchmark for technical assistance in effectively and efficiently establishing and running public CGSs for SMEs around the world.

The 16 Principles cover four key areas that are critical to the success of CGSs:

- Legal and regulatory framework

- Corporate governance and risk management

- Operational framework

- Monitoring and evaluation.

Following the adoption of the Principles, FIRST and the World Bank developed the Toolkit for Impact Evaluation of Public Credit Guarantee Schemes for SMEs (2017). The goal was to help countries identify a set of uniform methodologies for assessing the financial and economic impacts of public CGSs as systematically and objectively as possible, which also helps to ensure comparability across time and countries.

The toolkit is intended to provide guidance to CGS managers, policy makers, and stakeholders on how to design and implement an effective and efficient CGS impact evaluation. It consists of 10 modules that provide sets of choices to decide which evaluation modalities to use; road maps for designing and implementing an impact evaluation; and a hierarchy of appropriate methods that fit the operational rules of CGSs. Finally, the toolkit touches upon some operational steps to implement an impact evaluation, such as collecting data; assembling the evaluation team; budgeting and timing the evaluation; and producing and disseminating the results. Since its introduction, the toolkit has been used in member country impact evaluations of two regional associations.

Conclusions

The publication of the Principles in 2015 and the follow-on toolkit in 2017 have provided a standard and methodology for expanding the use of credit guarantee schemes to help small and medium enterprises in emerging market and developing economies. It has been implemented by one regional organization (the Organization for Eastern Caribbean States, OECS) and in five countries (Antigua and Barbuda, Dominica, Grenada, St. Lucia, St. Vincent and the Grenadines).

23 https://openknowledge.worldbank.org/handle/10986/30514
Strengthening Financial Market Infrastructure—Considerations for Organizing Central Securities Depositories in Developing Markets

Context

Central securities depositories (CSDs) are a crucial element of capital markets and the broader financing of the economy. A CSD is defined as an entity that provides securities accounts, a securities settlement system, and central safekeeping services to market participants, which can be banks and other financial institutions. CSDs are critical for the effective implementation of monetary policy, the credibility of a government’s debt management program, the management of collateral, and the safety and efficiency of securities markets.

Content

The IMF developed a working paper to support country authorities in their process to decide on the optimal organization of CSDs in their country: in particular, whether securities should be kept in a single CSD or in multiple CSDs. The paper argues that the optimal model depends on the country’s specific circumstances and features, such as the size of its markets, the strength of private operators, and the level of market development. In their interactions with countries worldwide, the IMF and World Bank have noted that authorities in developing economies—in particular, central banks—may grapple with two questions: whether to pursue a single CSD to increase market efficiencies and benefit from economies of scale and scope; and whether to partake in the governance of the CSD as owner and/or operator.

There is no evident international best practice on how to organize CSDs at a national level. The paper presents seven considerations that authorities may contemplate in answering these questions and determining the best model for their country:

- Efficiencies through a single CSD
- Efficiencies through links between CSDs
- Efficiencies through competition among CSDs
- Promotion of public interests

• Sufficient financial resources and human resources
• Compliance with international standards
• Good reputation and integrity.

The seven considerations are supplemented by decision trees that are intended to guide authorities in finding the model that best fits their country.

Conclusions

The main recommendation is that authorities should strike the right balance between safety and efficiency considerations for securities markets. Although a single CSD can be the most efficient solution from a cost perspective, this option should be pursued only if there is a strong indication that the safety and soundness of the securities market are not at stake. In the same vein, although central banks may consider that owning and operating a CSD is not in their core mandate, a CSD can be owned and operated by private entities only if these entities have the capacity to address public interests. Otherwise, the central bank may be best placed to own and operate the CSD. Furthermore, three cornerstones underpin any decision about (re)organizing CSD functions: a sound legal framework; effective supervision and oversight; and cooperation and coordination among all stakeholders, both private and public.
Financial Summary and Operations at a Glance

Sources and Uses of Funds

Donor Contributions

All contributions received are converted into US dollars at the time of receipt. As of June 30, 2020, a total of US$90.6 million was pledged in trust fund (TF) agreements for Phase III, of which all have been paid in full. Following the exits of the UK Department of International Development (DFID) and the government of the Netherlands, the balance of US$2 million was returned to each of these donors.

For Phase IV, a total of US$17.3 million was pledged, of which US$13.2 million has been paid in.

TABLE 1a: PLEDGED DONOR CONTRIBUTIONS FOR PHASE III

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<th>CATALYTIC MIC (US$ million)</th>
<th>PROGRAMMATIC LIC (US$ million)</th>
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Note: All figures are rounded to one decimal point. LIC = lower-income countries; MIC = middle-income countries.

TABLE 1b: PLEDGED DONOR CONTRIBUTIONS FOR PHASE IV

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<thead>
<tr>
<th>DONOR</th>
<th>CATALYTIC LIC (US$ million)</th>
<th>CATALYTIC MIC (US$ million)</th>
<th>TOTAL AMOUNT (US$ million)</th>
<th>SHARE (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>BMZ (Germany)</td>
<td>0.6</td>
<td>0.6</td>
<td>1.1</td>
<td>6</td>
</tr>
<tr>
<td>SECO (Switzerland)</td>
<td>8.1</td>
<td>8.1</td>
<td>16.2</td>
<td>94</td>
</tr>
<tr>
<td>Total Contributions</td>
<td>8.7</td>
<td>8.6</td>
<td>17.3</td>
<td>100</td>
</tr>
</tbody>
</table>

Note: All figures are rounded to one decimal point. LIC = lower-income countries; MIC = middle-income countries.
Use of Funds

Tables 2 summarize projections for funding and project allocation as of June 30, 2020 for Phase III and IV. The numbers reflect current contributions, based on the signed agreements and projections for disbursements through the end of Phase III and IV.

Phase III

Of the total fund balance available for the Bank’s project allocation (US$70.9 million), US$64.2 million has been committed, under both the Catalytic and the Programmatic windows (Table 2a).

A total of US$14.0 million is estimated to be transferred to the Project Management Unit (PMU) and covers the costs through the end of calendar year 2020. Transfers to the IMF for Phase III projects total US$13.2 million and have been paid in full.

Phase IV

Of the total fund balance available for the Bank’s project allocation (US$14.1 million), US$6.2 million has been committed, under both the Catalytic and the Programmatic windows (Table 2b).

A total of US$3.6 million is estimated to be transferred to the Project Management Unit (PMU) and will cover the costs through the end of FY23. Estimated transfers to the IMF for Phase IV projects total US$3.5 million.

### TABLE 2a: FUNDING AND PROJECT ALLOCATION PROJECTIONS FOR PHASE III AS OF JUNE 30, 2020

<table>
<thead>
<tr>
<th>PROJECTION</th>
<th>CATALYTIC WINDOW</th>
<th>PROGRAMMATIC WINDOW</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>LIC</td>
<td>MIC</td>
<td>LIC</td>
</tr>
<tr>
<td>Current contributions(^a)</td>
<td>33.9</td>
<td>22.1</td>
<td>22.9</td>
</tr>
<tr>
<td>Admin fees(^b)</td>
<td>1.0</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Balance from Phase II projects</td>
<td>7.2</td>
<td>3.3</td>
<td>–</td>
</tr>
<tr>
<td>Total funds for Phase III</td>
<td>40.1</td>
<td>24.8</td>
<td>22.4</td>
</tr>
<tr>
<td>PMU(^c)</td>
<td>5.5</td>
<td>3.1</td>
<td>3.6</td>
</tr>
<tr>
<td>IMF(^d)</td>
<td>4.9</td>
<td>3.2</td>
<td>3.4</td>
</tr>
<tr>
<td>M&amp;E(^e)</td>
<td>0.2</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>10.6</td>
<td>6.6</td>
<td>7.0</td>
</tr>
<tr>
<td>Budget for Bank project allocation (net of administration fee, IMF share, PMU, and M&amp;E reserve)</td>
<td>29.4</td>
<td>18.2</td>
<td>15.4</td>
</tr>
<tr>
<td>Project allocation across windows (%)</td>
<td>42</td>
<td>26</td>
<td>21</td>
</tr>
<tr>
<td>Bank projects approved as of June 30, 2020</td>
<td>25.2</td>
<td>15.7</td>
<td>15.2</td>
</tr>
</tbody>
</table>

**Note:** LIC = lower-income countries; M&E = monitoring and evaluation; MIC = middle-income countries; PMU = Project Management Unit.

\(^a\) Amounts converted to US dollars based on average exchange rates from recent months. Contributions include only signed agreements.

\(^b\) Administration fee: A 2 percent fee structure was established under the Programmatic Window from inception. This 2 percent fee also became applicable to the Catalytic Window contributions as of November 2014, when all donors finalized their agreement to revised terms. Prior to November 2014, contributions received in the Catalytic Window were subject to a 5 percent fee.

\(^c\) Reserve for PMU cost through calendar year 2020. Includes both Knowledge Management and M&E staff.

\(^d\) Includes US$0.25 million transferred to the IMF for Phase III under the old Framework Administered Account (FAA) instrument.

\(^e\) IMF usage details are presented in table 4.

\(^f\) One percent of contributions (US$0.5 million) is reserved for M&E.
TABLE 2b: FUNDING AND PROJECT ALLOCATION PROJECTIONS FOR PHASE IV AS OF JUNE 30, 2020 (US$ million)

<table>
<thead>
<tr>
<th>PROJECTION</th>
<th>LIC</th>
<th>MIC</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current contributions†</td>
<td>8.7</td>
<td>8.6</td>
<td>17.3</td>
</tr>
<tr>
<td>Balance from Phase III projects</td>
<td>2.2</td>
<td>2.0</td>
<td>4.2</td>
</tr>
<tr>
<td>Total funds for Phase IV</td>
<td>10.8</td>
<td>10.6</td>
<td>21.4</td>
</tr>
<tr>
<td>PMU‡</td>
<td>1.0</td>
<td>2.6</td>
<td>3.6</td>
</tr>
<tr>
<td>M&amp;E‡</td>
<td>0.2</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Total</td>
<td>1.1</td>
<td>2.8</td>
<td>3.9</td>
</tr>
<tr>
<td>Budget for IMF approvals§</td>
<td>1.7</td>
<td>1.7</td>
<td>3.5</td>
</tr>
<tr>
<td>Budget for Bank project allocation</td>
<td>8.0</td>
<td>6.1</td>
<td>14.1</td>
</tr>
<tr>
<td>(net of administration fee, IMF share, PMU &amp; M&amp;E reserve)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Project allocation across windows (%)</td>
<td>56</td>
<td>44</td>
<td>100</td>
</tr>
<tr>
<td>Bank projects approved as of June 30, 2020</td>
<td>3.5</td>
<td>2.7</td>
<td>6.2</td>
</tr>
</tbody>
</table>

Note: LIC = lower-income countries; M&E = monitoring and evaluation; MIC = middle-income countries; PMU = Project Management Unit.

†. Amounts converted to US dollars based on average exchange rates from recent months. Contributions include only signed agreements.
‡. Reserve for PMU cost through FY23. Includes both Knowledge Management and M&E staff.
§. US$0.3 million is reserved for M&E.
§. IMF usage details are presented in Table 4.

In FY20, a total of US$8.9 million was disbursed against projects for Phase III, with the highest share in the Africa Region, representing 50 percent of total disbursements (Table 3a). Expenses against Knowledge Management (KM) projects total US$ 1.3 million.

In FY20, disbursements for Phase IV add up to US$2.5 million (Table 3b), with the highest share in the Africa region, representing 35 percent of the total disbursements (Table 3b).

TABLE 3a: PHASE III PROJECT DISBURSEMENTS FOR FY20 BY REGION

<table>
<thead>
<tr>
<th>WORLD BANK REGION</th>
<th>CUMULATIVE (US$ million)</th>
<th>SHARE (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>4.5</td>
<td>50</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>0.1</td>
<td>2</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>0.8</td>
<td>9</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>0.7</td>
<td>8</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>0.8</td>
<td>8</td>
</tr>
<tr>
<td>South Asia</td>
<td>0.7</td>
<td>8</td>
</tr>
<tr>
<td>Other*</td>
<td>1.3</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td>8.9</td>
<td>100</td>
</tr>
</tbody>
</table>

Note: All figures are rounded up to one decimal point.

* "Other" disbursements include Knowledge Management (KM) projects.
TABLE 3b: PHASE IV PROJECT DISBURSEMENTS FOR FY20 BY REGION

<table>
<thead>
<tr>
<th>WORLD BANK REGION</th>
<th>CUMULATIVE (US$ million)</th>
<th>SHARE (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>0.9</td>
<td>35</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>0.4</td>
<td>16</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>0.6</td>
<td>23</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>0.5</td>
<td>18</td>
</tr>
<tr>
<td>South Asia</td>
<td>0.2</td>
<td>8</td>
</tr>
<tr>
<td>Total</td>
<td>2.5</td>
<td>100</td>
</tr>
</tbody>
</table>

Note: All figures are rounded up to one decimal point.

The IMF has committed US$12.3 million to Phase III projects and disbursed US$10.9 million as of June 30, 2020 (Table 4).

TABLE 4: FINANCIAL SUMMARY DETAILS ON IMF FUNDS AND USAGE, PHASE III, SFA ONLY, FY20 (US$ million)

<table>
<thead>
<tr>
<th>IMF Subaccount Summary as of June 30, 2020</th>
<th>CATALYTIC</th>
<th>PROGRAMMATIC</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>LIC</td>
<td>MIC</td>
<td>LIC</td>
</tr>
<tr>
<td>Donor contributions based on current signed agreements</td>
<td>4.8</td>
<td>3.1</td>
<td>3.4</td>
</tr>
<tr>
<td>Transfer residual balance from Phase II–III (FAA to SFA)</td>
<td>0.0</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Total funding for Phase III</td>
<td>4.8</td>
<td>3.8</td>
<td>3.9</td>
</tr>
<tr>
<td>Funds transferred by the World Banka</td>
<td>4.8</td>
<td>3.8</td>
<td>3.9</td>
</tr>
<tr>
<td>Approved IMF projects</td>
<td>4.1</td>
<td>2.9</td>
<td>3.7</td>
</tr>
<tr>
<td>Rollover from Phase III to Phase IV</td>
<td>0.5</td>
<td>0.6</td>
<td>0.2</td>
</tr>
<tr>
<td>Total project expenses</td>
<td>4.1</td>
<td>2.9</td>
<td>3.0</td>
</tr>
<tr>
<td>Balance that can be committed based on total fundingb</td>
<td>0.2</td>
<td>0.3</td>
<td>-0.1</td>
</tr>
</tbody>
</table>

Note: FAA = Framework Administered Account; LIC = low-income countries; MIC = middle-income countries; SFA = Selected Fund Activities. In FY15, the IMF transferred management of FIRST resources into a subaccount under the SFA Framework Account. Upon the transfer, the prior FAA instrument was terminated. All figures are rounded to one decimal point.

a. Includes transfer of residual balances from FAA Phase II to III for US$1.2 million and does not include received contributions of US$0.25 million transferred to Phase III under the old (FAA) instrument, which was terminated on April 30, 2015.
b. Does not include interest earned.
TABLE 5: FINANCIAL SUMMARY DETAILS ON IMF FUNDS AND USAGE, PHASE IV, FY20 (US$ million)

IMF Subaccount Summary as of June 30, 2020

<table>
<thead>
<tr>
<th>FUNDS AND USAGE</th>
<th>LIC &amp; MIC</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Donor contributions based on current pledges</td>
<td>3.5</td>
<td>3.5</td>
</tr>
<tr>
<td>Transfer residual balance from Phase III</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td><strong>Total funding for Phase IV</strong></td>
<td><strong>5.0</strong></td>
<td><strong>5.0</strong></td>
</tr>
<tr>
<td>Funds transferred by the World Bank</td>
<td>3.5</td>
<td>3.5</td>
</tr>
<tr>
<td>Approved IMF projects</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td><strong>Total project expenses through June 30, 2020</strong></td>
<td><strong>1.0</strong></td>
<td><strong>1.0</strong></td>
</tr>
<tr>
<td><strong>Balance that can be committed based on total funding</strong>&lt;sup&gt;a&lt;/sup&gt;</td>
<td><strong>3.1</strong></td>
<td><strong>3.1</strong></td>
</tr>
</tbody>
</table>

*Note: LIC = low-income countries; MIC = middle-income countries

<sup>a</sup>  Does not include interest earned.

FIRST’s administrative arrangements provide for the agreement between the World Bank and IMF that, after May 1, 2020, the IMF’s proportional shares would be increased from 15 percent to 25 percent.
Overview of Operations, 2013–20

Table 6: Phase III Project Approvals by Region

<table>
<thead>
<tr>
<th>REGION</th>
<th>APPROVALS (number)</th>
<th>VALUE (US$ million)</th>
<th>DISTRIBUTION (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>76</td>
<td>37.8</td>
<td>48</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>13</td>
<td>5.6</td>
<td>7</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>21</td>
<td>8.8</td>
<td>11</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>29</td>
<td>8.3</td>
<td>11</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>28</td>
<td>9.6</td>
<td>12</td>
</tr>
<tr>
<td>South Asia</td>
<td>16</td>
<td>6.8</td>
<td>9</td>
</tr>
<tr>
<td>Global</td>
<td>14</td>
<td>2.6</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>197</td>
<td>78.4</td>
<td>100</td>
</tr>
</tbody>
</table>

Table 7: Phase III Project Approvals by Window (Excluding Knowledge Products)

<table>
<thead>
<tr>
<th>WINDOW</th>
<th>APPROVALS (number)</th>
<th>VALUE (US$ million)</th>
<th>DISTRIBUTION (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Catalytic</td>
<td>163</td>
<td>48.7</td>
<td>64</td>
</tr>
<tr>
<td>Programmatic</td>
<td>18</td>
<td>26.9</td>
<td>36</td>
</tr>
<tr>
<td>Total</td>
<td>181</td>
<td>75.7</td>
<td>100</td>
</tr>
</tbody>
</table>

Figure 1: Phase IV Portfolio by Theme

- Inclusion: 36%
- Long-term Finance: 26%
- Stability: 38%

Figure 2: Phase IV Portfolio by Sector

- Banking: 36%
- Microfinance: 13%
- Capital Markets: 13%
- Central Bank Operations: 11%
- Payments: 10%
- Insurance: 7%
- Pensions: 6%
- Secured Transactions: 3%
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