



Technical Assistance Report

Project Number: 50002-001
Capacity Development Technical Assistance (CDTA)
July 2016

Nauru: Strengthening Financial Inclusion and Financial Sector Development (Financed by the Financial Sector Development Partnership Special Fund)

This document is being disclosed to the public in accordance with the ADB's Public Communication Policy 2011.

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 14 July 2016)

Currency unit	–	Australian dollar/s (A\$)
A\$1.00	=	\$0.7608
\$1.00	=	A\$1.3144

ABBREVIATIONS

ADB	–	Asian Development Bank
NFIT	–	national financial inclusion task force
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars, unless otherwise stated.

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CAPACITY DEVELOPMENT TECHNICAL ASSISTANCE AT A GLANCE

1. Basic Data		Project Number: 50002-001	
Project Name	Strengthening Financial Inclusion and Financial Sector Development	Department /Division	PARD/PLCO
Country	Nauru	Executing Agency	Asian Development Bank
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Finance	Banking systems and nonbank financial institutions		0.35
		Total	0.35
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Public financial governance	Effective gender mainstreaming (EGM)	✓
Knowledge solutions (KNS)	Knowledge sharing activities		
Partnerships (PAR)	Implementation Private Sector		
Private sector development (PSD)	Conducive policy and institutional environment		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	Yes	Nation-wide	High
Household targeting (TI-H)	Yes		
6. TA Category:	B		
7. Safeguard Categorization	Not Applicable		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		0.35	
Capacity development technical assistance: Financial Sector Development Partnership Special Fund		0.35	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		0.35	
9. Effective Development Cooperation			
Use of country procurement systems	No		
Use of country public financial management systems	No		

I. INTRODUCTION

1. The Government of Nauru requested the Asian Development Bank (ADB) to provide technical assistance (TA) to strengthen financial inclusion and financial sector development. The TA will (i) improve financial literacy among different market segments; (ii) enhance financial sector policy to enable the sector's development; and (iii) contribute to regional knowledge sharing.¹ The design and monitoring framework is in Appendix 1. The TA builds on previous ADB assistance, which helped the government establish a banking agent after more than 15 years without formal banking services on the island, and review the legal and institutional framework governing the sector.²

2. The TA fact-finding mission concluded in a memorandum of understanding outlining the proposed TA's agreed impact, outcome, outputs, implementation arrangements, cost, financing arrangements, and terms of reference. The TA was discussed with government agencies, private sector representatives, and development partners. The TA aligns with the Nauru National Sustainable Development Strategy, 2005–2020 and ADB's Interim Pacific Approach.³

II. ISSUES

3. Nauru is one of ADB's smallest members, with a population of about 10,000 and total land area of 21 square kilometers. The country's remoteness and small size translate into major development impediments, including weak institutional capacity, a narrow economic base, very limited private sector opportunities, and macroeconomic volatility. Nauru has a troubled financial history, including the mismanagement and collapse of the state-owned Bank of Nauru, which effectively ceased operations in 1998, and the Nauru Phosphate Royalties Trust, which was placed in receivership in 2004. Nauru was blacklisted by the Financial Action Taskforce, an inter-governmental body, in 2000 due to concerns over its offshore financial center (resulting in its closure in 2004 and the removal of Nauru from the blacklist in 2005). These events severely affected Nauru's financial reputation, both domestically and internationally, and this continues to impede financial inclusion and sector development.

4. Nauru's economy is undergoing major structural changes that heighten the imperative of strengthening financial inclusion and sector development. After collapsing in the late 1990s amid declining phosphate exports (Nauru's key historical income source), the economy is now experiencing a resurgence, with substantial windfall income from its regional asylum seeker and refugee program and increased fishing license revenue reflecting improvements in regional fisheries management. Many refugees (thus far about 850) have been integrated into the local community and could provide a substantial economic boost and help address local skill shortages. Improving financial inclusion and financial sector development are important elements in responding to these changes. Nauruan households are more flush with cash than they have been since the early 1990s.⁴ Underlying demand for financial services is, therefore, likely to be high. However, effective demand is mitigated by low financial literacy and the very limited range of financial services available on the island. Importantly, current household income levels could prove transitory, as Nauru's ability to sustainably generate income at such levels

¹ The TA first appeared in the business opportunities section of ADB's website on 6 July 2016.

² ADB. 2013. Technical Assistance for *Pacific Private Sector Development Initiative, Phase III*. Manila.

³ Government of Nauru. 2009. *Republic of Nauru: National Sustainable Development Strategy, 2005–2025*. Nauru (revised 2009); ADB. 2015. *Interim Pacific Approach*, 2015. Manila; and ADB. 2009. *ADB's Pacific Approach, 2010–2014*. Manila.

⁴ This reflects the country's economic resurgence, including a significant expansion in government outlays. Households have also been receiving large payments from the liquidation of the Nauru Phosphate Royalties Trust.

remains uncertain. As such, private saving and investment are critical to sustainability and enabling future consumption. Meanwhile, the refugee population also needs to be able to make use of financial services to support their livelihoods and successful economic integration.

5. Nauru regained access to formal banking services on the island in June 2015 after more than a decade and a half without such access since the Bank of Nauru's collapse. With ADB assistance, the government established a banking agent with the Bendigo Adelaide Bank. The government operates the banking agent, referred to locally as the Bendigo Bank. It offers a limited set of standard deposit-taking products to customers in Nauru, including transaction, savings, and term deposit accounts. Other ancillary services include ATM cards, debit cards (planned), phone and internet banking, and planned deployment of ready point-of-sale terminals with smartphone accessibility at certain locations. About 5,700 accounts have been opened, and significant further expansion is expected through government-led initiatives, including a planned cash transfer program for school-age children. The bank has a single office and five ATMs locate around the island. Given Nauru's small size, this means that most of the population generally has access to the bank's services.

6. Despite the rapid uptake of new bank accounts, about 90% are transaction accounts. Savings accounts represent only about 7% of total accounts, while term deposit accounts are barely in use. Account balances remain very low. Customers appear to be using the accounts primarily for receiving payments rather than for conducting transactions, managing personal finances, or accumulating savings. Although the average account balance is about A\$7,300, the median account balance is only A\$32. Most customers appear to use their accounts to receive salary and wage payments, but immediately withdraw the majority of their funds upon receipt. Transaction volumes, therefore, also remain low.

7. Low financial literacy is a key factor undermining greater uptake and more sophisticated use of available financial services. Nauru's long economic malaise from the late 1990s to 2007 and the absence of a functioning bank since the collapse of the Bank of Nauru in 1998 mean many Nauruans have limited familiarity with banking services and low financial literacy more broadly. Moreover, many still have some distrust of banks after the Bank of Nauru's collapse. However, this also presents Nauru with a unique opportunity to leapfrog from a cash-based system to a more modern system using digital financial services.

8. The introduction of a wider range of financial services, including digital finance products, is also a priority to support financial inclusion and economic development. For example, the business sector has demonstrated low interest in using existing services, as only 27 business transaction accounts and no business term deposit accounts have been opened. Bendigo Bank offers a limited set of deposit accounts, and these are restricted to making electronic transfers with accounts at Bendigo Adelaide Bank and at other Australian banks. International transfers to accounts outside Australia are prohibited, while the ability to make international transactions is limited (though the planned introduction of a MasterCard debit card should help address this). Other financial service providers are limited and include a Western Union money transfer agent and an agent for Dominion Insurance of Fiji. However, Dominion only provides services to Eigu Holdings, the state-owned company holding the agency agreement. With Nauru's economic resurgence, there is likely to be significant unmet demand for a wider range of services, such as insurance, wealth products, foreign exchange transactions, consumer and business lending, and trade finance. Improving internet and mobile phone coverage will also allow Nauru to leapfrog to digital finance approaches, including mobile banking. Digicel is the sole provider of mobile phone services and is interested in introducing mobile money products.

9. Improving access to a broader range of financial services will require addressing several issues. Most important is overcoming Nauru's poor financial reputation and limited industry knowledge about the potential local market, particularly given the current situation of low effective demand. Tightening international standards for anti-money laundering and combating terrorism financing are also major impediments to market development. If more services are to be made available, the government will need to establish an appropriate legal framework and develop a credible, though cost-efficient, regulatory and supervisory capability, including a well-balanced approach to digital financial services.

10. Nauru's financial sector regulatory regime is out-of-date; it does not provide an adequate basis for effective financial service licensing, regulation, and supervision; and there is no financial regulatory and supervisory body.⁵ To some extent, Nauru can rely on the regulation and supervision of foreign authorities. However, some degree of domestic capacity is still needed to cover residual concerns. For instance, foreign authorities will not generally regard the Nauru operations of a foreign institution as being of high risk to that institution. There is also the possibility that actual or potential financial service firms may not operate under the jurisdiction of any (or any acceptable) foreign authority. A staged approach to building Nauru's regulatory framework will be needed, given the limited domestic institutional capacity, and should be based on an assessment of the potential to introduce new financial services to the island.

11. The challenges facing Nauru are similar to many of the region's other small island economies, resulting from remoteness, small size, and weak institutions. Therefore, there is a need to develop approaches and solutions, including digital ones, that are tailored to the small island context.

III. THE CAPACITY DEVELOPMENT TECHNICAL ASSISTANCE

A. Impact and Outcome

12. The TA impact will be the improved ability of the local community to manage their finances to save and invest for the future. This will be measured by an increase in the range of financial services available and in use on the island and by the ratio of private credit extension to gross domestic product.

13. The outcome will be increased effective use of prudently regulated financial services by the Nauruan community. This will be measured by an increase in the average and median account balances at Bendigo Bank, the total deposits and the number of savings and term deposit accounts at the bank, and the submission of a new financial services bill to the Parliament.

B. Methodology and Key Activities

14. The TA will have three areas of activities aligned with three outputs. The government will establish a national financial inclusion task force (NFITF), chaired by the secretary of finance and including senior ministry officials and representatives from the community and business sector. The NFITF will guide, oversee, and help coordinate the TA activities. The NFITF will, in turn, receive support under the TA to help drive the overall policy agenda.

15. **Output 1: Improved financial literacy.** The TA will take a bottom-up approach, working directly with local partners who will take primary responsibility for delivering literacy activities.

⁵ ADB. 2014. *The Regulation and Supervision of Financial Institution in the Republic of Nauru*. Consultant's report. Manila.

The TA will draw upon ADB's financial literacy toolkit to design and support activities fit for the Nauruan context, with a focus on helping the local community (including the refugee population) progress to using digital financial services. The TA will support local partners to deliver financial education activities by helping design the activities and providing capacity building (e.g., train-the-trainer), technical support, educational materials, and financial support for activity costs as agreed. Local partners will make in-kind contributions, including staff time and the provision of facilities. Identified local partners include Bendigo Bank, the Ministry of Education, the Ministry of Home Affairs, district councils, youth councils, Digicel, and Connect (a private provider of community services). Including a variety of partners and approaches will allow the TA to reach different market segments, particularly disadvantaged groups at the bottom of the pyramid.

16. **Output 2: Enhanced financial sector policy framework.** The TA will assist the government to establish the NFITF and design its work program. It will conduct a financial services demand study to help the government and potential market entrants better understand the potential market and prioritize specific products for development. The demand study will assess potential demand for different financial services across various market segments (households, small businesses, larger businesses, state-owned enterprises, and the government), particularly focused on disadvantaged groups at the bottom of the pyramid and on digital financial services. The TA will work with the government, primarily the Ministry of Finance and the Ministry of Justice and Border Protection, to draft a financial services bill to provide the legal framework for sector regulation and supervision. A particular focus will be on identifying an appropriate model for the Financial Services Commission, given Nauru's small size and thin local capacity, addressing competition issues, developing a balanced approach to digital financial services, adequately addressing anti-money laundering and combating the financing of terrorism issues (taking into account the Anti-Money Laundering Act 2008), and ensuring gender sensitivity and avoiding any inadvertent provisions that could negatively affect women. This will build on the substantial work already completed under previous TA projects (footnotes 2 and 3).

17. **Output 3: Regional knowledge sharing.** The TA will leverage its impact by contributing to knowledge and practices in the Pacific region. This will include participating in regional forums (e.g., Digital Finance week), disseminating the TA results to regional networks, and contributing to the refinement of existing tool kits and sector guidance material. The TA will be able to contribute to regional knowledge on shifting from cash to digital services in rural and remote areas, determining demand for financial services in a weak private sector environment, and designing effective legal and institutional approaches to financial sector regulation and supervision in small island states.

C. Cost and Financing

18. The TA is estimated to cost \$400,000, of which \$350,000 will be financed on a grant basis by the Financial Sector Development Partnership Special Fund.⁶

19. The government will provide counterpart support in the form of government staff time to (i) contribute to the design and implementation of financial literacy activities, (ii) help coordinate other local stakeholders involved in output delivery, (iii) participate in the development of the draft financial services bill, and (iv) participate in selected regional forums and knowledge-sharing activities. The government will also provide office space, ground transport, and accommodation for consultants, as well as other secretarial assistance and in-kind contributions.

⁶ Established by ADB. Financing partner: the Government of Luxembourg.

D. Implementation Arrangements

20. ADB will be the executing agency. The Ministry of Finance will be the implementing agency. The NFITF, with ADB participation, will be the key forum to guide, coordinate, and determine the TA activities.

21. The TA will be implemented over 36 months, from July 2016 to June 2019. It will require about 7 intermittent person-months of international consulting input including (i) a financial inclusion specialist and team leader (5 person-months) and (ii) a financial regulation and supervision expert (2 person-months). The TA will also require a national consultant (finance specialist) for 7 person-months. The financial inclusion specialist and team leader will (i) assist the government to establish the NFITF and develop its initial work program; (ii) develop the financial literacy program and guide implementation; (iii) develop the methodology, guide implementation, and prepare the final report for the financial services demand study; and (iv) undertake activities to support regional learning and replication. The financial regulation and supervision expert will (i) prepare the draft financial services bill, including undertaking extensive consultations with the government and other stakeholders on the proposed content; and (ii) participate in knowledge-sharing activities, as required. The national financial specialist will (i) work with and support the NFITF, (ii) support the design and implementation of financial literacy activities, (iii) implement the financial services demand study, (iv) participate in knowledge-sharing activities as required, and (v) provide general on-the-ground support for the TA. Appendix 3 outlines the terms of reference for consultants.

22. Consultants will be engaged following ADB's Guidelines on the Use of Consultants (2013, as amended from time to time). ADB staff can be used as sector and thematic or technical experts and resource persons, and their travel-related expenses will be paid through the TA.⁷ All goods procured under the TA will follow ADB's Procurement Guidelines (2015, as amended from time to time). TA proceeds will be disbursed following ADB's *Technical Assistance Disbursement Handbook* (2010, as amended from time to time).

23. TA progress will be monitored against activities, outputs, and outcomes described in the design and monitoring framework. ADB will assist the government in sharing all results, good practices, and lessons through reports with other development partners, including through NFITF meetings and brown bag seminars in ADB's Financial Sector Development community of practice. These will also be disseminated through meetings, workshops, seminars, and ADB and other websites.

IV. THE PRESIDENT'S DECISION

24. The President, acting under the authority delegated by the Board, has approved the ADB administering technical assistance not exceeding the equivalent of \$350,000 to the Government of Nauru to be financed on a grant basis by the Financial Sector Development Partnership Special Fund for Strengthening Financial Inclusion and Financial Sector Development, and hereby reports this action to the Board.

⁷ ADB, Budget, Personnel and Management Systems Department, and Strategy and Policy Department, 2013. *Use of Bank Resources, Regional Technical Assistance and Technical Assistance vs Internal Administrative Expenses Budget*. Memorandum. 26 June 2013 (Internal)

DESIGN AND MONITORING FRAMEWORK

Impact the TA is Aligned with			
Improved ability of the local community to manage their finances to save and invest for the future.			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome Effective use of prudently regulated financial services by the Nauruan community increased	<p>a. 15% increase in average, median, and total account balances held by men and women at Bendigo Bank by June 2019.</p> <p>Baseline (April 2016): Average: A\$7,300 Median: A\$32 Total: A\$42 million (sex-disaggregated data to be collected at TA initiation)</p> <p>b. 20% increase in the number of consumer savings and term deposit accounts open at Bendigo Bank and held by men and women.</p> <p>Baseline (April 2016): Savings: 405 Term deposit: 18 (sex-disaggregated data to be collected at TA initiation)</p> <p>c. financial services bill is submitted to Parliament by June 2019.</p> <p>Baseline: N/A</p>	<p>a. Bendigo Bank monitoring report</p> <p>b. Bendigo Bank monitoring report</p> <p>c. Parliamentary entry recording introduction of draft law</p>	<p>Negative economic shocks cause a significant decline in household income.</p> <p>Political consensus on draft financial service bill is lacking.</p>
1. Financial literacy improved	<p>1. at least 1,000 people benefit from financial literacy activities by June 2019, comprising at least 50% female participants.</p> <p>Baseline: None</p>	partner reports	<p>Local partners lack capacity to effectively participate in and/or deliver activities.</p> <p>Government ministries have differing views on content of financial services bill and/or model for the Financial Services Commission.</p>
2. Financial sector policy framework enhanced	<p>2. draft financial services bill is endorsed by the Ministry of Finance by June 2018.</p> <p>Baseline: None</p>	copy of draft bill	Government officials

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
3.Regional knowledge sharing	3. government officials participate in selected regional forums on financial inclusion by June 2019, with at least 50% female representation. Baseline: None	government reports	lack time or interest to participate in the selected regional events.
Key Activities with Milestones			
<p>1. Improved financial literacy</p> <p>1.1 Prepare and submit initial work plan and methodology for developing the financial literacy program (Q3 2016).</p> <p>1.2 Conduct in-country mission to assess financial literacy gaps and needs, and identify potential partners and delivery approaches, documented in an inception report (Q3 2016).</p> <p>1.3 Deliver agreed activities with local partners (Q4 2016–Q2 2019).</p> <p>2. Enhanced financial sector policy framework</p> <p>2.1 Establish the national financial inclusion task force and agree on initial work program, documented in the inception report (Q3 2016).</p> <p>2.2 Conduct financial services demand study (Q4 2016).</p> <p>2.3 Undertake consultations for the financial services bill (from Q3 2016).</p> <p>2.4 Finalize draft financial services bill (Q1 2017).</p> <p>3. Regional knowledge-sharing</p> <p>3.1 Participate in selected ADB Digital Finance Week events (as held, 2016–2019).</p>			
Inputs			
<p>ADB: Financial Sector Development Partnership Special Fund: \$350,000</p> <p>Note: The government will provide counterpart support in the form of government staff time to (i) contribute to the design and implementation of financial literacy activities, (ii) help coordinate other local stakeholders involved in output delivery, (iii) participate in the development of the draft financial services bill, and (iv) participate in selected regional forums and knowledge-sharing activities. The government will also provide office space, ground transport, and accommodation for consultants, as well as other secretarial assistance and in-kind contributions.</p>			
Assumptions for Partner Financing			
Not applicable.			

ADB = Asian Development Bank, Q = quarter, TA = technical assistance.

Source: Asian Development Bank.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Amount
Financial Sector Development Partnership Special Fund^a	
1. Consultants	
a. Remuneration and per diem	
i. International consultants	140.0
ii. National consultants	40.0
b. International and local travel	30.0
c. Reports and communications	10.0
2. Training, seminars, and conferences	
a. Facilitators	10.0
b. Training program ^b	55.0
3. Surveys	20.0
4. Miscellaneous administration and support costs ^c	10.0
5. Contingencies	35.0
Total	350.0

Note: The technical assistance is estimated to cost \$400,000, of which contributions from the Financial Sector Development Partnership Special Fund are presented in the table above. The government will provide counterpart support in the form of government staff time to (i) contribute to the design and implementation of financial literacy activities, (ii) help coordinate other local stakeholders involved in output delivery, (iii) participate in the development of the draft financial services bill, and (iv) participate in selected regional forums and knowledge-sharing activities. The government will also provide office space, ground transport and accommodation for consultants, other secretarial assistance, and other in-kind contributions. The value of government contribution is estimated to account for 12.5% of the total technical assistance cost.

^a Established by ADB. Financing partner: the Government of Luxembourg.

^b At the time of design, it is anticipated that up to four training programs that incorporate various approaches will be implemented at venues provided by counterpart and local partners.

^c Includes minor costs for transportation, communication, and other administration.

Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. Objectives and Scope

1. The Pacific Liaison and Coordination Office of the Asian Development Bank (ADB) will coordinate the proposed capacity development technical assistance (TA). The TA will develop and implement financial literacy activities, undertake a financial services demand study, prepare a draft financial services bill, and support regional replication.
2. The required areas of expertise for the international consultants include financial literacy, financial inclusion, market sizing for financial services, and financial sector regulation and supervision. The national consultant should possess broad skills across these areas, as well as fluent Nauruan language capabilities and knowledge of the local Nauruan context for finance, education, and community outreach.
3. An outline of the broad terms of reference for each consultant is presented below.

B. Consulting Services Provided by ADB

1. **Financial Inclusion Specialist and Team Leader** (international, 5 person-months, intermittent)
 4. As team leader, the specialist will manage and coordinate the work of the other consultants, be responsible for meeting milestones and ensuring the timely submission of reports, and serve as the primary liaison point with ADB, the Government of Nauru, and local partners. The specialist will support the establishment and develop the initial work plan of the national financial inclusion task force, lead the process of designing TA financial literacy activities, and provide technical support and input to delivering financial literacy activities both in-country and from desk as circumstances require. The specialist will also develop the methodology for the financial services demand study, guide the finance specialist to implement the study, and lead the drafting of the study final report. The specialist will participate in regional forums and knowledge-sharing events as required by ADB. The team leader will report to ADB and the government, through the secretary of finance.
 5. The specialist will have at least bachelor qualifications in finance (or similar) with at least 10 years' experience in financial literacy and inclusion (including gender inclusion) in developing countries. Experience and knowledge of the finance industry in the Pacific islands will be highly desirable.
2. **Financial Regulation and Supervision Expert** (international, 2 person-months)
 6. The expert will be responsible for preparing the draft financial services bill, working under the team leader, and managing inputs from the finance specialist as required. The expert will undertake consultations with the government and other stakeholders on the proposed content of the draft law, particularly around the institutional model for the Financial Services Commission. The expert will participate in regional forums and knowledge-sharing events as required by ADB. The expert will report to the team leader.
 7. The expert will have at least bachelor qualifications in finance, law, or similar fields, with at least 15 years' experience in financial sector regulation and supervision, including legal and

institutional issues. Experience in the Pacific islands and/or small island states and knowledge of the finance industry in the Pacific islands will be highly desirable.

3. Finance Specialist (national, 7 person-months, intermittent)

8. The specialist will work closely with the international consultants to deliver the TA work program. The specialist will (i) work with and support the national financial inclusion task force; (ii) support the design and implementation of financial literacy activities; (iii) implement the financial services demand study; (iv) participate in knowledge-sharing activities, as required; and (v) provide general on-the-ground support for the TA. The specialist will assist and take part in missions by the international consultants and contribute to the preparation of written reports. The specialist will at times contribute to financial literacy activities in Nauru delivered by local partners. The specialist will report to the team leader.

9. The specialist will have at least bachelor qualifications in finance (or similar), be fluent in the Nauruan language, and possess extensive knowledge of the local context for finance, business, local customs, and community outreach and awareness.