Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 05-Feb-2020| Report No: PIDC28720

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Nepal	P173044	Finance for Growth (P173044)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
SOUTH ASIA	Jul 30, 2020	Finance, Competitiveness and Innovation	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Ministry of Finance	Ministry of Finance		

Proposed Development Objective(s)

Support the government of Nepal in its efforts to strengthen financial sector stability, diversify financial solutions, and increase efficiency and access to financial services.

Financing (in US$, Millions)

SUMMARY

Total Financing	100.00

DETAILS

Total World Bank Group Financing	100.00
World Bank Lending	100.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

Nepal has been successful in reducing poverty significantly. Nevertheless, Nepal remains one of the poorest countries in South Asia. It has a significant infrastructure deficit, with investment needs estimated at 10-15 percent of gross domestic product (GDP) annually for the next 10 years. There is limited capacity to spend efficiently and effectively, and future fiscal constraints could inhibit the Government of Nepal's ability to fully publicly finance infrastructure needs. In addition, the country needs to ramp up its resilience to climate change. However, the opportunity for reforms has significantly improved. A new constitution was approved in 2015 that restructured Nepal into a federal republic and, in 2018, a majority Government was elected with a strong mandate for reforms to spur sustainable investment, growth and jobs. To meet the country's aspirations to reach middle-income status by 2030, it will be critical to leverage a stronger, deeper and more efficient financial sector**.** However, Nepal's financial sector still faces multiple challenges and falls short in its role to support private investment and equitable growth.

The proposed operation will help relieve some of these constraints. The proposed US$100 million Finance for Growth Development Policy Credit is the first in a programmatic series of two operations spanning FY2021-22. **Pillar 1** seeks to strengthen financial sector stability with reforms focused on improving supervision of the banking sector and Nepal's compliance with the international standards for *Anti-Money Laundering and Combatting the Financing of Terrorism*. **Pillar 2** seeks to promote reforms that diversify financial solutions focused on disaster risk finance, the development of capital market instruments and the emergence of institutional investors. **Pillar 3** seeks to promote reforms that serve to increase the efficiency of and access to financial services with reforms focused on the retail payments system and digital payment services, as well as the credit infrastructure comprising of credit information reporting and secured transactions.

Relationship to CPF

The operation addresses key challenges detailed in the Nepal Systematic Country Diagnostic (SCD) and contributes to the FY19-23 Country Partnership Framework's second Pillar "private sector-led jobs and growth" and third Pillar "inclusion and resilience". The CPF's second Pillar identifies the importance of financial sector stability, inclusion and the provision of long-term finance. The CPS's third Pillar targets resilience to shocks and climate impacts and the enabling of more inclusive and sustainable growth. This operation will directly contribute to these Framework targeted outcomes.

C. Proposed Development Objective(s)

Support the Government of Nepal in its efforts to strengthen financial sector stability, diversify financial solutions, and increase efficiency and access to financial services.

Key Results

The targeted results of the first Pillar are: (i) improved compliance with at least two of the three Basle Core Principles #8 (supervisory approach), #9 (supervisory techniques and tools), and/or #10 (supervisory reporting), (ii) a minimum level of technical compliance related to selected Financial Action Task Force Recommendations as observed through the 2020 Asia-Pacific Group evaluation. **Targeted results for Pillar 2 are**: (i) The placement of disaster risk finance instrument(s) on the market, and (ii) the percent increase in the securities holdings of institutional investors. **Pillar 3 targeted results are:** an increase in the number of: (i) adults, disaggregated by gender, using transaction accounts to make electronic payments, (ii) individuals, disaggregated by gender, and firms enrolled with the CIB, and (iii) new registrations of security interests in the secured transactions registry.

D. Concept Description

The GON objectives for the financial sector were first outlined in the Financial Sector Development Strategy (FSDS) for 2016-21 and have been re-stated in the Minister of Finance FY2019/20 Budget Statement with its focus on continued reforms to ensure: (i) the stability of the financial system; (ii) deepening of financial sector services to the real economy via institutional and operational reforms, *inter alia*, to the Securities Board of Nepal; (iii) the establishment of a new national payment gateway that will, over time, allow for full inter-operability; and (iv) more inclusive access to financial services – with particular reference to provision of mobile, internet and branchless banking to remote areas. **The F4G series will support the Government efforts in these four areas.**

Under Pillar 1, Prior Actions support the Government and/or Regulatory Authorities': (i) approval of the revised onsite supervision manual, extending the onsite supervisory approach towards risk management and mitigation. The main roles of risk-based onsite inspection are to evaluate corporate governance and risk management at all levels and to evaluate the quality of the credit portfolio; (ii) issuance of a directive to establish the National Risk Assessment Working Committee. In the absence of a positive assessment the country would be found to be significantly deficient in the compliance and effectiveness against the Financial Action Task Force standards.

Under Pillar 2, Prior Actions support the Government and/or Regulatory Authorities': (i) endorsement of the Disaster Risk Financing Strategy, a critical step towards utilizing diverse financial instruments for liquidity against disaster and climate related shocks which could significantly reduce the fiscal impacts and reduce the gender and vulnerable group related impact incurred in the aftermath of a disaster; (ii) approval of regulations that will enable the development of alternative sources of finance that would provide enabling legal structures to encourage onshore and offshore capital mobilization, including provision of financial solutions for female entrepreneurs; (iii) enactment of amendments to the Securities Act, which enhances the powers of the Securities Board of Nepal to regulate, supervise and enforce the regulatory framework; (iii) amendments to the Securities Board of Nepal Employee Regulation, which will enhance its capacity to supervise and enforce the regulatory framework; (iv) revised investment guidelines for insurance companies, enabling the emergence of the insurance sector as an institutional investor.

Under Pillar 3, Prior Actions support the Government and/or Regulatory Authorities': (i) approval of the Retail Payments Strategy to create an enabling framework for the development and use of digital payment which will accelerate financial inclusion – particularly for the underserved segments of the population, including women; (ii) approval of the draft Credit Information Reporting Act, enhancing the availability, quality and security of information in the Credit Information Bureau leading to wider access to lower cost finance, including for Micro, Small and Medium Enterprises and female borrowers.

E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

Overall, the reforms supported by this operation can have indirect but long-term positive effects on the poor and those at the bottom 40 percent of the welfare distribution. The reforms supported through this operation's Prior Actions have the potential to unlock sources of private sector investment and foster more inclusive access to finance needed to end poverty and promote shared prosperity. Indirect but long-term positive effects from reforms detailed in Pillars 1 and 2 include: (i) a well supervised, stable and transparent financial sector that can mitigate costly financial crisis interruptions; (ii) the use of diverse financial instruments that can counter the negative effects of severe disasters; (iii) the development of the securities sector that can broaden access and support the productive sectors**.** The Prior Actions under Pillar 3 on the retail payments system and the credit information infrastructure provide the framework for expansion of financial access to underserved groups, including in rural areas and for Micro, Small and Medium-sized enterprises.

Environmental, Forests, and Other Natural Resource Aspects

Prior Actions supported by this operation are not expected to have a significant direct negative effect on the environment. Improved access to credit will benefit enterprises that are engaged in sustainable management and harvesting of natural resources - notably forests - providing jobs and eventually reducing activities that lead to forest degradation. New market-based financial instruments aimed to promptly address significant disaster risks will limit the negative impacts on the environment. However, increased access to finance can also lead to investments with more environmental risks. This will need to be monitored and effectively managed. The program also supports Prior Actions that enhance climate adaptation, including: (i) diversifying solutions for disaster financing that will improve the country's capacity to address severe infrequent disasters (e.g. large earthquakes) that could otherwise result in a prohibitive fiscal burden and delayed response time; (ii) increasing financial solutions that can foster investments in climate adaption and mitigation; (iii) increase digital financial solutions that make it possible to transfer funds electronically thereby contributing to lower carbon emissions, as well as the seamless provision of funds for disaster preparedness and emergency relief (i.e. adaptation gains through the digital payments infrastructure for use during climate related events).

CONTACT POINT

World Bank

Peter J. Mousley, Ilias Skamnelos
Lead Private Sector Specialist

Borrower/Client/Recipient

Ministry of Finance

Implementing Agencies

Ministry of Finance
Yuba Raj Khatiwada
Dr
yrkhatiwada@mof.gov.np

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leader(s):	Peter J. Mousley, Ilias Skamnelos

Approved By

Country Director:	Faris H. Hadad-Zervos	27-Feb-2020