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Report NO: PAD1576

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF

SDR 107 MILLION

(US$150 MILLION EQUIVALENT)

TO THE

PEOPLE'S REPUBLIC OF BANGLADESH

FOR A

MODERNIZATION OF STATE-OWNED FINANCIAL INSTITUTIONS PROJECT

JUNE 9, 2016

Finance and Markets Global Practice
South Asia Region

CURRENCY EQUIVALENTS
(Exchange Rate Effective June 7, 2016)

Currency Unit	=	Bangladesh Taka (BDT)
BDT 78.64	=	US$1
US$1	=	SDR 0.71

FISCAL YEAR
July 1 – June 30

ABBREVIATIONS AND ACRONYMS

AML	Anti-Money Laundering
ATM	Automated Teller Machine
BB	Bangladesh Bank
BCA	Bank Companies Act
BCC	Bangladesh Computer Council
BFID	Bank and Financial Institutions Division
BPR	Business Process Reengineering
CAR	Capital Adequacy Ratio
CASPR	Country Assistant Strategy Process Report
CBS	Core Banking Solution
CFT	Combating the Financing of Terrorism
CL	Component Leader
CPF	Country Partnership Framework
CPTU	Central Procurement Technical Unit
DPD	Deputy Project Director
ERP	Enterprise Resource Planning
FCB	Foreign Commercial Bank
FM	Financial Management
FSSP	Financial Sector Support Project
GAAP	Governance and Accountability Action Plan
GOB	Government of Bangladesh
GDP	Gross Domestic Product
GRS	Grievance Redress Service
HR	Human Resource
ICB	International Competitive Bidding
IFC	International Finance Corporation
IMF	International Monetary Fund
IRR	Internal Rate of Return
IT	Information Technology
IUFR	Interim Unaudited Financial Report
M&E	Monitoring and Evaluation
MD	Managing Director
MIS	Management Information System
MOF	Ministry of Finance
NCB	National Competitive Bidding

NPL	Nonperforming Loan
NPV	Net Present Value
OM	Operations Manual
PCB	Private Commercial Bank
PCU	Project Coordination Unit
PD	Project Director
PDO	Project Development Objective
PIU	Project Implementation Unit
PPA	Public Procurement Act
PPR	Public Procurement Rules
PSC	Project Steering Committee
ROA	Return on Assets
RTGS	Real-Time Gross Settlement
SCD	Systematic Country Diagnostics
SME	Small and Medium Enterprise
SOB	State-Owned Bank
SOCB	State-Owned Commercial Bank
SODB	State-Owned Developmental Bank
SOE	State-owned Enterprise
SOFI	Bangladesh Modernization of State-Owned Financial Institutions
TA	Technical Assistance
TOR	Terms of Reference

Regional Vice President:	Annette Dixon
Country Director:	Qimiao Fan
Senior Global Practice Director:	Gloria M. Grandolini
Practice Manager:	Niraj Verma
Task Team Leader:	Marius Vismantas and Shah Nur Quayyum

PEOPLE'S REPUBLIC OF BANGLADESH
Modernization of State-owned Financial Institutions Project

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PAD DATA SHEET

People's Republic of Bangladesh

Modernization of State-Owned Financial Institutions Project (P155363)

PROJECT APPRAISAL DOCUMENT

SOUTH ASIA

GFM06

Report No.: PAD1576

Basic Information			
Project ID P155363	EA Category C - Not Required		Team Leader(s) Marius Vismantas, Shah Nur Quayyum
Lending Instrument Investment Project Financing	Fragile and/or Capacity Constraints [ ]		
	Financial Intermediaries [ ]		
	Series of Projects [ ]		
Project Implementation Start Date 01-Sep-2016	Project Implementation End Date 31-Dec-2021		
Expected Effectiveness Date 01-Sep-2016	Expected Closing Date 31-Dec-2021		
Joint IFC No			
Practice Manager/Manager Niraj Verma	Senior Global Practice Director Gloria M. Grandolini	Country Director Qimiao Fan	Regional Vice President Annette Dixon
Borrower: People's Republic of Bangladesh			
Responsible Agency: Bank and Financial Institutions Division (BFID)			
Contact:	Mr. Md. Eunusur Rahman	Title:	Secretary
Telephone No.:	88029576013	E-mail:	Secretary.bfid@gmail.com

Project Financing Data(in US$, millions)					
[ ]	Loan	[ ]	IDA Grant	[ ]	Guarantee
[X]	Credit	[ ]	Grant	[ ]	Other

Total Project Cost:	200.00	Total Bank Financing:	150.00
Financing Gap:	0.00		

Financing Source	**Amount**
BORROWER/RECIPIENT	50.00
International Development Association (IDA)	150.00
Total	200.00

Expected Disbursements (in US$, millions)

Fiscal Year	2017	2018	2019	2020	2021	2022				
Annual	10.00	30.00	30.00	35.00	35.00	10.00				
Cumulative	10.00	40.00	70.00	105.00	140.00	150.00				

Institutional Data

Practice Area (Lead)

Finance & Markets

Contributing Practice Areas

Cross Cutting Topics

[ ] Climate Change

[ ] Fragile, Conflict & Violence

[ ] Gender

[ ] Jobs

[ ] Public Private Partnership

Sectors / Climate Change

Sector (Maximum 5 and total % must equal 100)

Major Sector	Sector	%	Adaptation Co-benefits %	Mitigation Co-benefits %
Finance	Banking	100		
Total		100		

☑ I certify that there is no Adaptation and Mitigation Climate Change Co-benefits information applicable to this project.

Themes		
Theme (Maximum 5 and total % must equal 100)		
Major theme	Theme	%
Financial and private sector development	State-owned enterprise restructuring and privatization	50
Financial and private sector development	Corporate governance	30
Financial and private sector development	Other Financial Sector Development	20
Total		100

Proposed Development Objective(s)
The proposed project development objective is to contribute to the modernization, transparency, and efficiency of state-owned banks.

Components	
Component Name	**Cost (US$, millions)**
Supporting SOB Business Process Reengineering	15.00
Supporting IT Modernization of SOBs	173.00
Supporting institutional development of SOBs and MOF in enhancing ownership oversight and corporate governance framework	7.00
Project Implementation and Monitoring	5.00

Systematic Operations Risk-Rating Tool (SORT)	
Risk Category	**Rating**
1. Political and Governance	High
2. Macroeconomic	Moderate
3. Sector Strategies and Policies	Substantial
4. Technical Design of Project or Program	Substantial
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and Social	Low
8. Stakeholders	Moderate
9. Other	
OVERALL	Substantial

Compliance		
Policy		
Does the project depart from the CAS/CPF in content or in other significant respects?	Yes [ ]	No [X]
Does the project require any waivers of Bank policies?	Yes [ ]	No [X]
Have these been approved by Bank management?	Yes [ ]	No [ ]
Is approval for any policy waiver sought from the Board?	Yes [ ]	No [X]
Does the project meet the Regional criteria for readiness for implementation?	Yes [X]	No [ ]

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01		**X**
Natural Habitats OP/BP 4.04		**X**
Forests OP/BP 4.36		**X**
Pest Management OP 4.09		**X**
Physical Cultural Resources OP/BP 4.11		**X**
Indigenous Peoples OP/BP 4.10		**X**
Involuntary Resettlement OP/BP 4.12		**X**
Safety of Dams OP/BP 4.37		**X**
Projects on International Waterways OP/BP 7.50		**X**
Projects in Disputed Areas OP/BP 7.60		**X**

Legal Covenants

Name	Recurrent	Due Date	Frequency
Project Implementation Unit (PIU)		Two months after Effectiveness Date	Continuous (maintenance)

Description of Covenant
Not later than two months after the Effective Date, the Recipient shall establish and shall maintain throughout the Project implementation period, the PIU, with mandate, composition and resources satisfactory to the Association. (Section IA1 of Schedule 2 of the FA)

Name	Recurrent	Due Date	Frequency
Project Steering Committee (PSC)		Two months after Effectiveness Date	Continuous (maintenance)

Description of Covenant
Not later than two months after the Effective Date, the Recipient shall establish and shall maintain throughout the Project implementation period, the PSC, with a mandate, composition and resources satisfactory to the Association. (Section IA2 of Schedule 2 of the FA)

Name	Recurrent	Due Date	Frequency

PIU IT Specialist		Three months after Effectiveness Date	Continuous (maintenance)
Description of Covenant Not later than three month after the Effective Date, the Recipient shall hire an international IT specialist to the PIU, with qualifications, experience and terms of reference satisfactory to the Association. (Section IA3 of Schedule 2 of the FA)			
Name	**Recurrent**	**Due Date**	**Frequency**
PIU M&E Specialist		Two months after Effectiveness Date	Continuous (maintenance)
Description of Covenant Not later than two months after the Effective Date, the Recipient shall appoint a monitoring and evaluation specialist to the PIU with qualifications, experience and terms of reference satisfactory to the Association. (Section IA4 of Schedule 2 of the FA).			
Name	**Recurrent**	**Due Date**	**Frequency**
Bid Evaluation Committee for large value contracts	x		Continuous
Description of Covenant Prior to procuring any large-value contract of goods and/or services specified in the Procurement Plan, the Recipient shall establish, and therefore maintain throughout the period of implementation of the Project, a bid evaluation committee consist of Recipient's Staff and international/local procurement and IT experts (Section IA5 of Schedule 2 of the FA).			
Name	**Recurrent**	**Due Date**	**Frequency**
Annual Work and Financial Plan	x		Annual
Description of Covenant The Recipient, through its BFID, shall prepare and furnish to the Association for its approval, not later than May 31 of each year during the implementation of the Project, an annual work and financial plan (Section IB1 of Schedule 2 of the FA).			
Name	**Recurrent**	**Due Date**	**Frequency**
Audit Reports	X		Annual
Description of Covenant The Recipient shall submit financial statements for each fiscal year, audited by independent auditors, within six months of the end of the fiscal year (Section IIB3 of Schedule 2 of the FA).			
Name	**Recurrent**	**Due Date**	**Frequency**
Operations Manual	x		Continuous
Description of Covenant The Recipient shall carry out the Project in accordance with the arrangements and procedures set out in the Operations Manual (Section IC1 of Schedule 2 of the FA).			
Name	**Recurrent**	**Due Date**	**Frequency**
Carrying out Works	x		Continuous
Description of Covenant The Recipient shall ensure that any works carried out under the Project are carried out in accordance			

with the provisions and arrangements set out in the Operations Manual, including but not limited to screening criteria that limits such works to small-scale refurbishment at existing sites, and any such works are carried out under terms of reference satisfactory to the Association following its review thereof and, to that end shall duly incorporate the requirements of the Association's safeguard policies.

Conditions

Team Composition

Bank Staff

Name	Role	Title	Specialization	Unit
Marius Vismantas	Team Leader (ADM Responsible)	Lead Financial Sector Specialist		GFM06
Shah Nur Quayyum	Team Leader	Financial Sector Specialist		GFM06
Tanvir Hossain	Procurement Specialist (ADM Responsible)	Senior Procurement Specialist	Procurement	GGO06
Alexander S. Berg	Team Member	Senior Financial Sector Specialist	Bank Governance	GFM1B
Amir Munir	Team Member	Senior IT Officer, Program Management II	IT solutions	ITSCR
Bridget Rosalind Rosario	Team Member	Program Assistant	Team Support	SACBD
Jorge Luis Alva-Luperdi	Counsel	Senior Counsel	Legal	LEGES
Danielle Malek Roosa	Counsel	Senior Counsel	Legal	LEGES
Mehar Akhter Khan	Team Member	Program Assistant	Team Support	SACBD
Aza Rashid	Team Member	Program Assistant	Team Support	GFM06
Mohammed Atikuzzaman	Team Member	Financial Management Specialist	FM assessment	GGO24
Nadia Sharmin	Environmental Specialist	Environmental Specialist	Environmental safeguards	GSU18
Sabah Moyeen	Safeguards Specialist	Senior Social Development Specialist	Social safeguards, citizens engagement	GSU06
Satish Kumar Shivakumar	Team Member	Finance Officer	Loan Terms, Disbursement Letter	WFALN
Aquiles Almansi	Peer Reviewer	Lead Financial Sector Specialist	Peer Review	GFM1A
Ilias Skamnelos	Peer Reviewer	Lead Financial	Peer Review	GFM03

		Sector Specialist		
Sunita Kikeri	Peer Reviewer	Program Manager	Peer Review	GFM1B
Miquel Dijkman	Peer Reviewer	Senior Financial Sector Specialist	Peer Review	GFM1A
Martin Melecky	Peer Reviewer	Lead Economist	Peer Review	SARCE
Ulle Lohmus	Peer Reviewer	Senior Financial Sector Specialist	Peer Review	GFM02

Extended Team

Name	**Title**	**Office Phone**	**Location**

Locations

Country	**First Administrative Division**	**Location**	**Planned**	**Actual**	**Comments**
Bangladesh	Dhaka Rajshahi	Dhaka Division Rajshahi	**X** **X**	**X** **X**	The Borrower/Implementation Agency (MOF), and first-level beneficiaries of the project (State Owned Banks) are located in Dhaka. RAKUB bank is located Rajshahi.

Consultants (Will be disclosed in the Monthly Operational Summary)

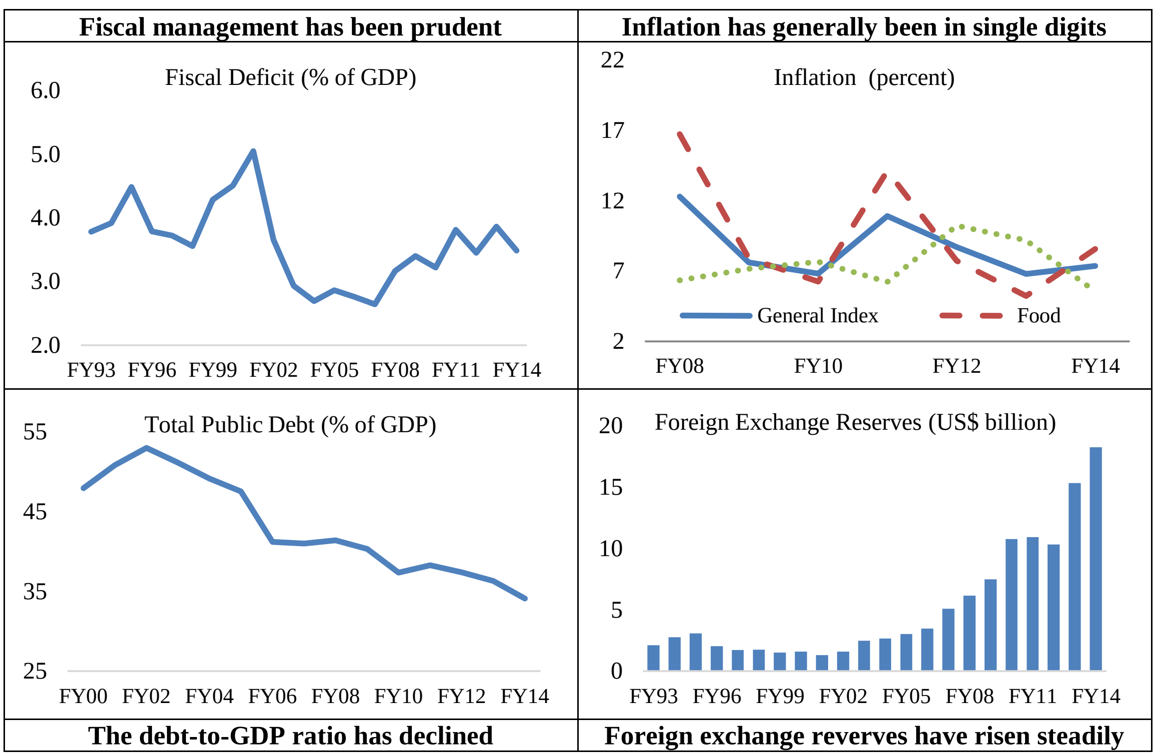
Consultants Required?	Consultants will be required

I. STRATEGIC CONTEXT

A. Country Context

1. **Generally prudent management of fiscal and monetary policy, and the resultant macroeconomic stability Bangladesh has enjoyed over the past decade, has served it well in its quest for higher growth.**[1] Bangladesh's per capita gross national income grew more than tenfold from around US$100 in 1972 to US$1,314 in 2015. Average annual gross domestic product (GDP) growth has been rising over the last three decades and grew by more than six percent a year on average during the past five years despite the adverse impacts of the global recession and natural disasters. Inflation was contained well below double digits most of the time. Bangladesh is the only country in South Asia with positive public savings. In addition, the overall budget deficit has been financed through prudent external borrowing that has kept the effective interest rate on public debt at less than five percent. Recourse to the monetary financing of the deficit has been used as a very short-term measure that has typically been quickly reversed. The public debt-to-GDP ratio declined throughout the last decade. Since adopting the floating exchange rate regime in 2003, the Bangladesh Bank (BB) has followed a market-based exchange-rate policy that ensured smoothing out exchange-rate volatility and building up foreign exchange reserves. Monetary policy allowed monetary aggregates to expand in line with growth in demand for credit in the private sector and price stability. Figure 1 presents several key macroeconomic indicators that have underpinned Bangladesh's macroeconomic stability.

Figure 1. Selected Macroeconomic Indicators



Source: Ministry of Finance (MOF), Bangladesh Bank, and International Monetary Fund (IMF).

[1] Bangladesh Systematic Country Diagnostic (SCD) 2015.

2. **The country has achieved very good progress since 2000 in reducing extreme poverty and boosting shared prosperity.** Based on the US$1.25 global poverty measure, the number of poor in Bangladesh fell from around 77 to 65 million—a drop of 12 million—at a rate that was 60 percent faster than in the rest of the developing world, excluding China. Increases in the share of the working population along with rising labor incomes were the two most important contributors to the decline in poverty over the past decade. Nevertheless, despite Bangladesh's remarkable development achievements, significant challenges remain in its quest to eliminate extreme poverty and boost shared prosperity. It remains one of the poorest countries in the region, with constrained public services and comparatively weak institutions, and though it has done fairly well in recent years, many others, for example, China, Sri Lanka, and Vietnam, have done much better[2].

3. **Performance of state-owned banks (SOBs) is an important factor toward maintaining good macroeconomic and fiscal management.** The SOBs in Bangladesh serve an important function of credit provision, employment generation, and financial inclusion to the underserved segments of the market, including but not limited to small and medium enterprises (SMEs), agriculture clients, and youth. Nevertheless, the balance sheets of SOBs are still weak—a consequence of the enduring impact of a series of financial scams and resultant loan defaults in the SOBs. The SOBs are under the recapitalization program of the Government of Bangladesh (GOB), which provided fresh capital in 2014–2015 and should continue in the medium term. The ease of access to finance in Bangladesh is constrained in part due to the inefficiencies of SOBs which own about 56 percent of total bank branches and have the deepest branch penetration across Bangladesh, including remote areas and villages.

4. **Building a strong and diverse financial sector that can cater to the needs of the growing economy is one of the essential ingredients in meeting Bangladesh's long-term development goals as well as supporting short- to medium-term growth.** Bangladesh will need to develop a financial sector that is stable, inclusive, and capable of providing efficient financial intermediation to the productive sectors of the economy, facilitating capital accumulation and investment to generate faster growth and ensuring that these developments can benefit citizens through better pensions and improved insurance products.

B. Sectoral and Institutional Context

Bangladesh Financial Sector Framework

5. **Banks dominate the financial system in Bangladesh** (including stock market capitalization) with around 60 percent of total assets as of end-2015. Among the 56 scheduled (licensed) banks operating in Bangladesh, there are six state-owned commercial banks (SOCBs), two state-owned specialized developmental banks (SODBs), nine foreign commercial banks (FCBs), and 39 domestic private commercial banks (PCBs), including eight Islamic banks. Table 1 highlights key banking sector indicators. In addition, there are four nonscheduled (non-licensed) specialized public banks, which operate under their individual laws.

[2] Bangladesh Systematic Country Diagnostic (SCD) 2015.

Table 1. Bangladesh Banking System (June 2015)

Category	Number of Banks	Number of Branches	Assets (US$, billions)	Asset-Share (%)	Loans (US$, billions)	Loans-Share (%)	Deposits (US$, billions)	Deposit-Share (%)
SOCBs	6	3,669	35.88	28.43	13.51	19.11	27.41	28.43
PCBs	39	3,982	79.83	63.24	51.35	72.61	61.76	64.04
FCBs	9	75	6.75	5.35	3.06	4.33	4.32	4.48
SODBs	2	1,405	3.77	2.99	2.79	3.95	2.94	3.05
Total	**56**	**9,131**	**126.22**	**100.00**	**70.71**	**100.00**	**96.44**	**100.00**

Source: Bangladesh Bank.
Note: PCB = Private Commercial Bank; FCB = Foreign Commercial Banks.

6. **A number of positive developments have taken place in the banking sector over the past two decades; yet many constraints remain in its provision of finance and access to financial intermediation.** A regional comparison indicates that Bangladesh is still behind most peers, except Pakistan (Table 2). Bangladesh lags behind India with regard to financial deepening and is well behind countries such as China and Vietnam. Capacity constraints, lack of diversity of products including long-term finance instruments, as well as underdeveloped insurance, pensions, and capital markets limit access to finance for households and enterprises. Financial intermediation remains modest, with a credit to GDP (banks and nonbank financial institutions) ratio of 42 percent in March 2015. The constraints nevertheless present substantial systemic development opportunities where SOBs are posed to play an important lead role.

Table 2. Indicators of Banking Activities for Selected Countries (2014)

Countries	M2/GDP	Bank Credit/GDP
China	193.0	141.8
India	76.8	51.1
Pakistan	40.1	15.3
Vietnam	127.5	100.3
Bangladesh	**62.8**	**41.9**

Source: World Development Indicators; World Bank and Financial Soundness Indicators, IMF.
Note: M2 = Money and Quasi-money.

7. **Access to credit has been identified as one of the top barriers for doing business in Bangladesh (Doing Business 2015).** Only 31 percent of adults in Bangladesh have access to a bank account (Findex 2014[3]). In addition, financial inclusion levels remain low for certain groups, including women, SMEs, and farmers. Insurance premiums are only 0.94 percent of GDP and only 10 percent of the country's workforce has access to formal pensions and total premiums are about 1 percent of GDP. All this means that sources of long-term financing—so critical to meet the country's infrastructure needs—are limited and constitute severe impediments to creating jobs, financing Bangladesh's crippling infrastructure deficit, and managing risks and vulnerabilities. Developing insurance and pensions markets, which become the key suppliers of sustainable long-term finance, is therefore critical.[4]

[3] http://datatopics.worldbank.org/financialinclusion/country/bangladesh
[4] This is being pursued in parallel through a project to build the insurance and private pensions markets, complemented by an accompanying proposed Programmatic Approach.

8. **SOBs -primarily the commercial banks but also to a lesser extent the developmental banks - remain an important group of banks in the system.** They hold close to 30 percent of the total banking assets and play a significant role in the system by channeling funds to the GOB's priority areas for development and providing banking services (access to finance) across the country using their large branch network. There are six SOCBs, which are fully or majority owned by the GOB, and two SODBs, which were established for specific objectives such as agricultural or industrial development. There are also two nonscheduled banks which the GOB intends to modernize alongside the SOCBs and SODBs. Table 3 provides a summary (legal status, size, and outreach) of these banks. Table 4 provides data on the SOBs' financial performance.

Table 3. Bangladesh SOBs (September 2015)

Bank	Mandate/ License	Branches	Deposits (BDT, billions)	Loans (BDT, billions)	Total Assets (BDT, billions)	Number of Staff
SBL	Commercial	1,207	752.91	334.48	1125.86	22,613
ABL	Commercial	932	411.95	235.72	536.93	13,556
JBL	Commercial	904	526.52	316.80	668.37	14,443
RBL	Commercial	554	249.43	133.51	286.63	5,775
BASIC Bank Limited	Commercial	68	129.51	122.57	162.85	2,181
BDBL	Commercial	38	21.85	15.45	51.30	850
BKB	Developmental	1,030	194.45	167.58	228.47	10,275
RAKUB	Developmental	400	29.87	43.95	63.40	3,627
Karmashangsthan Bank*	Nonscheduled	212	0.36	6.7	7.9	1,277
Ansar-VDP Unnayan Bank*	Nonscheduled	217	2.27	3.7	5.74	700
Total		**5,562**	**2,319**	**1,380**	**3,137**	**75,297**

Source: Bangladesh Bank.

Note: SBL = Sonali Bank; ABL = Agrani Bank Limited; JBL = Janata Bank Limited; RBL = Rupali Bank Limited; BDBL = Bangladesh Development Bank Limited; BKB = Bangladesh Krishi Bank; RAKUB = Rajshahi Krishi Unnayan Bank. *Data of these two banks are collected from the annual reports, and as of June 2015. There are also two other nonscheduled banks which are not part of the project.

Table 4. Key Performance Indicators of SOBs (June 2015)

Indicators (percent)	SBL	JBL	ABL	RBL	BKB	RAKUB	BDBL	Average Private Commercial Banks
Stability: Capital Adequacy								
Capital-to-risk weighted assets ratio by banks	4.90*	8.41*	10.17	7.53*	−35.21*	−3.16*	23.98	11.97
Asset Quality								
Gross NPL	27.63	12.38	22.20	12.17	25.37	22.02	40.65	6.09
Provisions to NPL ratio	44.61	66.53	53.02	57.70	58.56	35.41	42.04	57.07
Liquidity								
Cash reserve ratio or liquidity ratio	6.47	6.63	6.58	6.25	6.72	6.55	6.93	6.93
Fund Management								
Credit deposit ratio or	43.06	59.06	55.10	53.07	69.50	100.77	63.28	76.92

Indicators (percent) advance deposit ratio	SBL	JBL	ABL	RBL	BKB	RAKUB	BDBL	Average Private Commercial Banks
Profitability and Operational Efficiency								
Return on assets (ROA)	−2.11	0.90	0.50	0.20	−1.93	0.02	0.68	0.89

Source: Bangladesh Bank. BASIC Bank omitted intentionally as the GOB is not considering supporting it within the scope of the proposed project.
Note: SBL = Sonali Bank; ABL = Agrani Bank Limited; JBL = Janata Bank Limited; RBL = Rupali Bank Limited; BDBL = Bangladesh Development Bank Limited; BKB = Bangladesh Krishi Bank; RAKUB = Rajshahi Krishi Unnayan Bank; NPL = Nonperforming Loan.
*These banks have inadequate capital and are subject to the Government's recapitalization program

9. **The SOBs have not been performing to their full potential and present substantial opportunities for their institutional strengthening and development.** The GOB fully intends to continue addressing the deficiencies, which have led to the ongoing underperformance of the SOBs. Some of the core reasons for the underperformance are listed below.

- **Governance.** The governance of SOBs calls for improvements to reach observance with accepted good practices, including on appointing directors to the boards of the SOBs. An expected result is that all decisions would be taken with the full interests of the banks in mind, avoiding cases of insider dealing and large losses which have occurred in the past. Boards should include independent, qualified, and reputable professionals with unquestionable integrity. Strong boards will cause the banks to better contribute to financial intermediation and growth and broader development goals. The BB Guidelines 2010 for bank directors include 'Fit and Proper Test Criteria' for the nomination of directors along with their responsibilities and power, but these criteria are yet to be implemented fully.

- **Supervisory oversight.** The BB still lacks full authority over the SOBs, although its powers have recently been increased by amendments of the Bank Companies Act (BCA). Specialized nonscheduled banks are outside the purview of the BCA and BB's regulatory perimeter.

- **Unsustainable pricing of some financial products.** As part of the implementation of the GOB's development policies and program, the SOBs provide some services or products to their clients without margin or at 'no cost', without mechanisms for loss or cost recovery.

- **Risk management.** The absence of a comprehensive risk management policy in the SOBs makes it difficult to detect and handle fraud and other extraordinary cases. The implementation of the respective BB guidelines is in early stages in the SOBs.

- **Automation and management information system.** Automation and management information system (MIS) in the banks need to be upgraded. In spite of the previous reform initiatives, the SOBs have been slow toward adopting banking services based on information technology (IT) and MIS. There have been comprehensive programs in the financial sector for the last several years to establish the Real-time Gross

Settlement (RTGS) system and the National Payments Switch, computerization of the head offices and branches of all banks, electronic banking services, online corporate banking service, electronic fund transfer, automated teller machine (ATM), and Internet banking. Nevertheless SOBs are behind other banks in adopting the programs. This is not only affecting their efficiency and profitability but also their internal controls, giving rise to opportunities for fraud, for example, through delayed or incomplete data aggregation and submission for managerial control and decisions. These banks are also highly exposed to cyber security risks and the recent heist at the BB—which has stronger systems than the SOBs—is a pointer to the acute needs of SOBs in this regard.

- **Internal control.** Absence of IT adds challenges to the internal control function. The SOB internal control departments are inadequate. This is mainly due to the incentive structure which prevents hiring of qualified professionals for this function and also deficient data.

- **Transparency and accountability.** Most SOBs have weak business processes, inadequate accounting and auditing practices, and weak compliance procedures, with low levels of financial and nonfinancial disclosure. Many of these problems stem from the lack of a clear performance monitoring system to ensure accountability and responsibility for performance, particularly of the board and the chief executive officer/managing director (MD).

- **Human resource policy.** Human resource (HR) development has been a neglected issue in the SOBs. The HR departments of the SOBs remain inadequate and powerless to take decisions on recruitment and promotion, including due to a lack of capacity.

The Challenge - Importance of Fixing SOBs

10. **A number of SOBs are significant financial institutions because of their size, outreach, developmental impact, and interconnectedness.** Performance of the SOBs as a group is significant for financial stability in Bangladesh; furthermore, their underperformance has a meaningful fiscal impact. These banks are systemically important not only with regard to assets but also due to their widespread retail presence, which is crucial for financial inclusion. Governance and management systems, including risk management, internal controls, and credit appraisal of the SOBs have been improving but need to be further enhanced to mitigate the risk of suboptimal loan and investment decisions. Their overall operations need to be automated to enhance data integrity and security, internal efficiency, and competitiveness.

11. **The SOBs have a deep branch penetration across Bangladesh, including in many rural areas, making them well poised to play an important role in promoting financial access.** In Bangladesh, the intensity of financial deepening has been low, outreach of banks remained limited, and the scope of lending has thus been fairly narrow. The microfinance institutions/nongovernmental organizations and Grameen Bank are the dominant institutions providing access to credit to over 86 percent of the (mostly small and micro) borrowers. The SOBs nevertheless play a vital role in providing lending and non-lending banking services to the rural areas (and across the country) and for development purposes. With regard to the rural-urban

divide, credit advanced by the SOCBs and PCBs is mostly concentrated in the urban areas, while the SODBs have a relatively larger share in rural areas.

12. **Financial sector infrastructures such as the National Payment Switch and the RTGS system cannot become fully functional and effective unless the SOBs are connected and part of the processes**. The BB has completed implementation of the National Payment Switch and the RTGS system and it already has Banking Data Warehouse and online return/report submission systems for the scheduled banks. However, lack of technological capacity of the SOBs has held back the full functionality or effectiveness of these systems. The SOBs are also unable to provide mobile banking services to its widespread clientele. This poses a constraint to the GOB's financial inclusion agenda.

13. **There is a significant demand for long-term financing by firms, conservatively estimated at US$1.5–2 billion per year just for the export market (World Bank market study, 2014).** The supply of such funding by the market lags behind significantly.[5] The SOCBs are slightly ahead of other banks in the system in this lending segment. Improvements in their capacity to better manage data and risks, coupled with access to long-term borrowings will further strengthen them as leaders in the long-term lending segment, trailblazing ways for other banks to expand this segment.

14. **Addressing deficiencies in owning, managing, and regulating the SOBs presents massive opportunities.** This has been the case both in countries which eventually privatized most banks (for example, in Central and Eastern Europe in the 1990s; in South Asia, Pakistan is an example) and in many countries which maintained some of their banks in state ownership. The explicit and implicit government support, trust toward them by the savers, and enhanced governance and performance would allow the SOBs to expand their long-term funding operations and become core providers of such funding. The SOBs can be at the forefront of expanding financial inclusion in Bangladesh and are well placed to further pursue the unfinished agenda of inclusion. Furthermore, stronger SOBs would reduce vulnerabilities in the financial system and open the market to more competition, benefiting financial sector consumers and the broader economy. Reforms in SOBs can serve as a catalyst for similar reforms across the state owned enterprise (SOE) universe, as has happened in many emerging/developing markets. Better governed SOBs would reduce the pressure on the government with regard to: (a) allocating time and efforts in running them; and (b) regular infusions of capital in supporting their inefficient operations. Importantly, stronger SOBs with appropriate incentives would be able to support the GOB's developmental agenda and allow the Government to achieve its social objectives at a lower overall cost than currently is the case.

15. **Conversely, the monetary and social costs of inaction on the SOB agenda would undoubtedly prove to be very high.** Many countries have made large budget outlays year in, year out toward recapitalizing their inefficient and loss-making public banks. Bangladesh, too, has a multiyear program of SOB recapitalization which, current situation left unchanged, would

[5] The limited supply of foreign exchange-based long-term financing that exists is typically for the topmost large firms in the country and is provided by the overseas business units of domestic banks (which use short-term resources to lend up to five years and thereby run the risk of downstream problems arising out of asset liability mismatches and rendering such supply risky, with growth constraints and potentially unsustainable) and to a lesser extent by foreign banks and institutions.

continue into the long term and eventually result in higher public debt without substantial improvements in SOB performance. Mismanaged SOBs frequently lead to systemic crises which have significant repercussions for the entire economy and require many years to clean up, and even in the best-case scenario, would likely have a retarding effect on the growth of the economy on account of underperforming SOBs. Improving the governance of the SOBs needs to continue, keeping the current momentum going; lack of continuous action would overturn important gains achieved during the past few years. Investments in automation and capacity would help ensure the opportunities are realized.

SOB Modernization Initiative

16. **The GOB strongly intends to address undercapitalization and inefficiencies of the SOBs on a priority basis.** It is already in the process of modernizing these banks with increasingly automated banking and business processes, strong risk and credit management systems, and an effective internal control mechanism to ensure transparency and accountability in these banks. However, more needs to be done. The expected improvements would lead to a more sustainable and efficient SOB performance, supporting the GOB in the implementation of the country's developmental objectives.

17. **SOB modernization is an identified priority of the GOB, as highlighted in its 7th Five-Year Plan.** A number of initiatives have already been taken during the past few years by the GOB to improve governance and financial position of the SOBs. The GOB has decided to automate and modernize the banks' business and transaction processes; upgrade their risk management, credit process, and internal control mechanisms; and develop capacity of staff. Such automation and modernization will lay the foundation for stronger governance and accountability of the SOBs. The SOBs have started implementing core banking solutions (CBS) across their branches. The GOB now plans to retain services of an international consulting firm to: (a) review the existing MIS of the SOBs and produce a high-quality IT strategy and a comprehensive systems implementation plan in line with international best practices; and (b) review the business processes of the banks, including an in-depth assessment and testing of existing risk management practices, internal control systems, and lending processes of the SOBs. The advisory services will complement the banks' ongoing efforts to improve efficiency, effectiveness, and transparency, including through the automation of branch networks, IT modernization, and deployment of Enterprise Resource Planning (ERP) solutions and enhancing cyber security. The assessment should propose how the lending process, risk management, internal controls, and all associated systems can be reengineered to strengthen the SOB's performance and transparency and increase their compliance with regulations and international good practices. Going forward, performance of the SOBs will continue to be strengthened through closer oversight of the BB.

18. **Legal and regulatory framework has been improved during the past years.** The GOB amended the BCA in 2013 to enhance BB's authority over the SOCBs. The SOCBs are now legally fully under regulatory and supervisory control of the BB. This includes MOUs between the BB and the SOCBs for gradual reduction of NPLs through stronger and measurable recovery efforts by the latter. The BB has the authority to take punitive measures against the SOCB management and has already started to exercise it, creating a precedent in 2014 by firing the MD of an SOB for the irregularities found in the bank's loan portfolio. The BB also announced in 2015 that the central bank would appoint observers to the boards of directors of the SOBs in case of deterioration of internal governance over their financial operations. During 2015, the BB

appointed one such observer. The BB nevertheless lacks authority to remove board members of the SOBs.

19. **Corporate governance in the SOBs has not kept pace with developments in the private sector and is waiting for meaningful improvements.** The board members are often appointed by not fully observing accepted good practices, perpetuating a constraint for establishing strong governance in these banks. The BB's fit and proper test is applied to the selected candidates but the test is rather lenient. While the BB needs to tighten its fit and proper criteria (or perhaps develop a separate one for the boards of SOBs), the Bank and Financial Institutions Division (BFID) has appointed retired civil servants as chairmen of SOB boards to reduce political influence on the boards. This has helped improve the quality of the boards. On the selection of the chief executive officers/MDs of SOBs, fit and proper criteria are now applied more forcefully by the BB in accepting the BFID's recommendations, and there are examples of the BB not accepting proposed candidates. Selection of strong and respected professionals to the boards of the banks remains a core aspiration on the way to good governance. The BB has issued a code of corporate governance for the banking sector, but the code needs to be further improved. Furthermore, enhancement of auditing standards is now required to establish a reliable monitoring and reporting of performance of the banking sector.

20. **The BFID has also set up an arrangement to closely monitor and control the performance of SOBs.** All the SOBs are now required to enter into a performance agreement with the BFID, whereby the management and the boards of the banks are responsible and accountable for achieving certain performance targets (capital adequacy ratio (CAR), non-performing loans; NPL level, automation, cash recovery, growth control) set up by the BFID. The chairman and MD/chief executive officer of each bank signs the agreement which is then monitored by the BFID against the agreed benchmarks. The performance targets include: (a) adoption of a stronger credit policy and credit risk management policy; (b) formulation of an internal control and compliance policy for each bank; (c) prudent credit growth ceilings (an indicative target under the program), differentiated according to each bank's performance and financial soundness, to remain in place while the SOCB corporate governance and credit risk management are improved; (d) improvement of asset quality and recovery of bad assets; and (e) timely completion of audit. The BFID needs further capacity development to strengthen the performance benchmarks, the monitoring mechanism, and a system of ensuring compliance.

21. **In the past couple of years, the SOBs submitted their recapitalization plans and strategies to the GOB.** The recapitalization is to take the form of annual capital injection by the GOB from the budget and also through enhanced efficiency and profitability of the SOBs. The GOB has already injected BDT 50 billion in FY14 and further BDT 55 billion in FY15. The authorities remain committed to further gradual capital injections to the SOBs up until FY17. It is estimated that a total additional capital requirement for the SOBs is around BDT 110 billion, or US$1.4 billion. The five banks which require additional capital are Sonali, Janata, Rupali, BKB, and RAKUB.

22. **The GOB does not have immediate plans to privatize or merge the SOBs but such measures may be considered in the future.** Recently, the MOF has indicated that up to 40 percent of the ownership in the SOCBs could be divested. No specific timeline has been announced, and indeed, any divestment remains a function of strengthening the banks' performance and attractiveness to investors.

Theory of Change

23. **The ultimate objective of the GOB is to rationalize its ownership in the banking sector to a point where the number, size, and reach of the SOBs will be commensurate with the policy objectives of the GOB to the banking sector.** At that point, allocation of state capital to the banks would reach an optimal level, given the policy objectives. Currently, the GOB finds itself as an owner of a number of financial institutions, including the SOCBs and SODBs, as a legacy of the earlier nationalization and restructuring of the banking industry. While the entire system is considered overbanked (including by the regulator), the same argument can also be applied to the state-owned sector where, in addition to the scheduled SOCBs and SODBs, the GOB also owns a few nonscheduled (non-licensed) policy banks. There are alternative pathways toward reaching the ultimate objective, ranging from radical (immediate divestment, mergers) to gradual. Given constraints in the country's political economy, capacity, and market absorption for rapid divestment of the banks, the authorities are of the view that they would continue owning the current SOBs for the time being but would put considerable efforts and resources in improving their performance, financial standing, and long-term viability. This in turn is expected to: (a) improve achievement of the objectives placed by the GOB on the SOBs in the medium term; (b) move the banks from the position of relative weakness to a position of relative strength, compared to other market participants and regional and global peers, in governance, operations, and financial standing; and (c) provide much stronger opportunities for successful divestment and rationalization of the banks in the medium to long term, once the needed improvements are implemented and start bearing fruit.

24. **The GOB now requires support, both technical and co-financing, for its SOB strengthening program.** The Bank will provide support to the Government's program to modernize the SOBs by establishing more effective risk and credit management systems and internal control processes, and implementing an end-to-end automation solution for their transactions and all business processes.

25. **The proposed project is expected to increase stability and depth of the financial sector.** Subpar performance of the SOBs poses a threat to financial sector stability; therefore, modernizing and improving their performance would help prevent costly outcomes to the Bangladeshi taxpayers. Project activities will enhance efficiency and competitiveness of these banks and also support better governance and management and data integrity. The project will also stimulate innovations in the financial sector by supporting the development of new products such as more technology-enabled services by the SOBs.

Value Added of Bank's Support for Financial Sector Development

26. **The recently Board-approved Financial Sector Support Project (FSSP - P150938) supports Bangladesh's efforts to develop the financial sector,** by strengthening financial market infrastructure; improving regulatory, supervisory, and sector developmental capacity of the BB; and building the market for and scaling up long-term finance, especially to exporters and manufacturing firms to spur competitiveness, investment, and growth. Before that, the Bank has played a leading role in the development of the financial sector in Bangladesh and has been a long-term partner to the authorities on financial sector policy dialogue and to all the relevant stakeholders (including bankers, bank associations' leaders, and other development partners). The Central Bank Strengthening Project, which closed in December 2012, achieved noteworthy

results, and the Bank has also provided four technical assistance activities to the BB over time, including anti-money laundering/combating the financing of terrorism (AML/CFT) capacity building, payment system development, contingency plan development, and development of a financial projection model. The Bank also had supported the microfinance sector through different engagements, including lending and innovations partnering with *Palli Karma Shahayak Foundation* (PKSF) to develop and grow the sector for its efficiency and outreach.

27. **The proposed project complements FSSP activities** by addressing issues around the SOBs' weak systems and capacities, which directly affect their ability to demonstrate strong financial performance and require significant investments and assistance, which the Bank's project and implementation support will be able to provide. The project will also enhance the capacity of the BFID to act as a strong owner of state-owned financial institutions in its portfolio. Lastly, the partnership between the GOB and the Bank in this area enhances the probability that the program for strengthening SOBs will remain on track and be sustained.

28. **The Bank will leverage its broad and deep international experience on banking regulation and supervision, corporate governance, managing public banks, and financial and IT infrastructure development.** In addition to funding assistance, the technical oversight and knowledge inputs from the Bank that would accompany project implementation will benefit the country's capacity to implement projects. The importance of implementation support has been particularly emphasized by the BFID.

C. Higher Level Objectives to which the Project Contributes

29. **The operation is well aligned with the Country Partnership Framework for Bangladesh for FY16-20 discussed by the Board on April 5, 2016 (**Report 103723-BD**).** Specifically, the project contributes to achieving the CPF objective 1.5 on increasing financial intermediation, under the Growth and Competitiveness focus area. The objective is set to be achieved, among other efforts, through building a sounder and more stable financial system, developing sustainable sources of long-term financing, deepening financial inclusion, and improving performance and governance of the SOBs. The project will also contribute to the overarching goal of the CPF of strengthening governance of public institutions and increasing transparency and efficiency of service delivery by the public sector. The Systematic Country Diagnostic for Bangladesh (October 2015) also identifies the financial sector as a critical constraint, and its development a fundamental priority, for overall growth, job creation, and poverty reduction in the country.

30. **The project is also in line with Bangladesh's 7th Five-year Plan for FY16–FY20.** The plan emphasizes private enterprise development for sustainable growth and job creation. The project also complements ongoing and planned financing engagements, including the FSSP (P150938), the Investment Promotion and Financing Facility (P089382), the proposed Bangladesh Insurance and Private Pension Market Development Project (P156823), and a programmatic approach on advisory services and analytics, the Bangladesh Financial Sector Development Project (P156131).

31. **Overall, the project will support building a stronger financial sector.** The latter will contribute to macro-financial stability and facilitate improved financial intermediation, thus promoting inclusive growth and contributing to the World Bank Group's twin goals of reducing

poverty and increasing shared prosperity. SOBs have a deep branch penetration across Bangladesh, including in rural areas, making them well poised to intensify financial deepening and inclusion, expand outreach of banking services, and offer financial services to all, especially the unbanked population of the country.

II. PROJECT DEVELOPMENT OBJECTIVE

A. PDO

32. **The proposed project development objective (PDO) is to contribute to the modernization, transparency, and efficiency of state-owned banks**.

33. **By attaining this objective, the project will support Bangladesh's efforts to develop the financial sector and enhance its stability.** By modernizing the SOBs, the GOB aims to achieve: (a) a more stable financial system; (b) better access to finance in the society; (c) improved governance of the SOBs; and (d) lower fiscal outlays to recapitalize them. This will prepare the banks for potential consolidation and/or privatization by enhancing their value and attractiveness to potential investors. The planned activities complement those undertaken by the recently approved FSSP that focus on strengthening BB.

34. **The project will address the identified weaknesses of the SOBs in the areas of risk management, internal control, financial reporting, and resource management (including planning for staff training).** It will also lead to improved bank data quality, developing better financial reporting and enhancing internal resource management and control. If successfully implemented, the project has a strong potential to change the way the banks manage and use market and internal data to support delivery of their main business functions. More specifically, the SOBs are expected to enhance their institutional capacity to: (a) better monitor and manage various risks in their daily operations; and (b) capture all the economic activities relating to their operations and provide timely financial information to meet the needs of stakeholders both inside and outside the SOBs.

B. Project Beneficiaries

35. **The primary project beneficiaries include: (a) the SOBs, their management and staff, and their depositors/members; and (b) the GOB as the owner and provider of equity capital of the concerned SOBs.** Secondary beneficiaries and stakeholders, which have interest in a successful outcome and impact of the proposed project include the overall financial system and markets and the institutions and banks therein; core pillars of financial sector infrastructure (for example, National Payment Switch, RTGS system, Banking Data Warehouse, Credit Information Bureau); the BB as the regulator and supervisor of the banking sector; private firms in Bangladesh, mainly large- to mid-size firms including exporters, and some small and medium enterprises and firms in sectors that are crucial for growth; rural farmers and all others who live on agriculture or agro-based industries and benefit from financial services of the SOBs; and the unbanked population of the country, including women, pensioners, and population segments which come under the GOB's social safety net programs.

C. PDO Level Results Indicators

36. The proposed results indicators are as follows (see Annex 1 for a complete list):

- **SOB Automation.** The transaction and business processes of all the SOBs participating in the project are automated (measured by CBS and ERP implementation by number and percentage of branches).

- **SOB Transparency and Governance.** This would be measured by the extent of compliance of the participating SOBs with the BB's: (a) Risk Management Guidelines; (b) Credit Management Guidelines; (c) Corporate Governance Guidelines; and (d) Internal Audit requirements (substantially compliant/partially compliant/noncompliant).

- **SOB Efficiency.** Cost efficiency of the banks is improved (measured by share of operating costs over revenues).

III. PROJECT DESCRIPTION

37. **The project intends to provide funding for long-term investments by SOBs toward their modernization through improved governance, better IT systems, business process reengineering (BPR), and better decision making and operational processes.** Advisory assistance to the banks and the MOF (as the representative of the owner) - on the decision-making and operational processes, improved governance, and change management - would complement the investments in physical IT infrastructure.

38. **The project proposes a sequenced approach.** First, the SOBs will undergo BPR whereby consultancy services will be provided to them to review and improve internal processes and workflows. Concurrently with the BPR, the consultants will assess recapitalization plans for those SOBs which require additional capital and will recommend options to the BFID. This phase is expected to be done during the first 12 months of the project. IT investments are expected to largely follow, starting in the second year of the project once the important IT diagnostic exercise (implemented under a parallel FSSP project during CY2016) will result in bank-specific strategies, implementation plans, and detailed procurement packages ready for bidding. The investments will continue throughout years 2–5 of the project. The SOB governance improvement activities—assessments and implementation of recommended reforms—will start at the outset of the project and continue throughout its duration, in parallel with the BPR and IT modernization activities. Some flexibility in the approach will be retained as the IT diagnostic exercise and market/risk environment may suggest or necessitate different schedules during the implementation of the project.

39. **The SOBs are expected to benefit substantially through implementation of the project and business process reengineering (BPR) and IT modernization components in particular**. A successful BPR is expected to result in higher return on investments/return on assets (ROA)/return on equity as more staff get deployed to productive areas of business, with stronger training and incentives. In addition, the advisory activities related to the improvement of banking sector governance will ultimately contribute to the overall performance of the financial sector by establishing a stronger discipline among banks and a culture of compliance to ensure financial stability and soundness supporting the overall economy.

A. Project Components

40. **The proposed project will include the following four components (Annex 2 provides further details):**

- Component 1: Supporting SOB Business Process Reengineering
- Component 2: Supporting IT Modernization of SOBs
- Component 3: Supporting Institutional Development of SOBs and MOF in Enhancing Ownership Oversight and Corporate Governance Framework
- Component 4: Project Implementation and Monitoring

Component 1: Supporting SOB Business Process Reengineering (IDA financing US$15 million)

41. This component will provide consultancy support to the SOBs for a comprehensive BPR—from internal control and accounting to credit appraisal system, risk management, and transaction processing—that is a prerequisite for an automated modern banking environment. BPR will strengthen and modernize the banks' internal processes, workflows, and business planning approaches. Importantly, BPR will also cover development of cyber security rules, processes, and protocols, which will be supplemented by required software and hardware under Component 2.

42. BPR will, for the most part, precede development and implementation of new IT solutions in the SOBs. The new IT solutions will then be adapted to the updated processes and workflows. BPR is a fundamental rethink and redesign of existing business practices with a purpose of achieving significant improvements in critical measures of corporate performance such as cost, quality, service, and speed.

43. For those SOBs which require additional capitalization by the GOB, the BPR exercise will add an additional module which will assess the banks' recapitalization requirements and provide options on capital allocations.[6]

Component 2: Supporting IT Modernization of SOBs (IDA financing US$125 million)

44. Component 2 will support purchase and implementation of the modernized IT architecture with relevant software and hardware solutions in the SOBs, supported with appropriate technical assistance. The full requirements for the new IT architecture will be determined through the IT diagnostic exercise (under the FSSP). The component will also support the SOBs in improving their basic IT infrastructure in parallel with the implementation of key systems (such as CBS, ERP, and AML). This may include establishing sound technical infrastructure (for example, power, electrical, server cooling, cyber security, and Internet services) to support centralized

[6] It is estimated that a total additional capital requirement for the project SOBs is around BDT 110 billion, or US$1.4 billion. The five banks which require additional capital to fully meet BB capital regulations of 10 percent CAR are SBL, JBL, RBL, BKB, and RAKUB.

processing, branch connectivity, an enterprise wide e-mail system to support communication across the organization, PC/hardware penetration, and so on.

45. A key element of the modernization program of SOBs also includes business process automation and deployment of alternate delivery channels, such as ATM network, POS terminals, debit/credit card, Internet banking, ERP, and loans system. These systems will be built on strong CBS platforms. Although all banks have embarked on a centralized CBS implementation, there is a lack of basic technical infrastructure to sustainably support this initiative and provide uninterrupted business process. Furthermore, exposure to basic automation such as e-mail and enterprise wide intranet will help prepare the current workforce for automated business processes down the road.

46. Enhancing cyber security will have an important role in the overall SOB automation. Cyber security solutions—hardware and software—will complement workflows and processes developed in Component 1 and will be part and parcel of Component 2. They will come integrated in the packages with the banking operations IT solutions. IT training programs to retool the existing workforce and prepare them for a fully automated business environment will be developed and implemented under the component.

Component 3: Supporting Institutional Development of SOBs and MOF in Enhancing Ownership Oversight and Corporate Governance Framework (IDA financing US$7 million)

47. Under this component, the project will provide advisory support to all the banks participating in the project and the MOF as the agency exercising ownership rights of the banks on improving the framework within which the ownership rights are exercised and banks are governed. The adoption of international good practices in the corporate governance of the SOBs will increase accountability and transparency, leading to improved performance and the achievement of various social goals and mandates and complement the activities under Components 1 and 2. SOB governance and ownership strategy will also be developed to capture a long-term approach to SOB ownership by the GOB. The project will involve various consultancy and training activities and will address/strengthen the five key pillars of good corporate governance for state-owned financial institutions:

- The policy and legal framework for SOB governance
- Ownership capacity of the BFID of the MOF
- Capacity of the SOB boards to oversee the banks
- Transparency of the banks including the role of the board audit committees and the quality of external audits
- Internal control, internal audit, and compliance functions, including establishment or strengthening as the case may be of the AML/CFT functions and procedures

48. The Project will follow a three-phase approach to improve the governance of the SOBs. Phase I will result in a baseline assessment of governance in the SOBs and will include a legal review of the founding documents of each of the banks, a review of the BFID policies and procedures, and needs assessment of capacity within the BFID. Phase II will implement the capacity-building program identified in Phase I, including tasks focused on the legal framework, SOB mandates and ownership policy, development of governance and ownership strategy, and

strengthening boards. Phase III will include follow-up of governance reviews and board evaluations to assess progress.

Component 4: Project Implementation and Monitoring (IDA financing US$3 million)

49. This component will provide support for the monitoring and coordination of project activities undertaken by various beneficiary institutions. It will also help develop a strong monitoring and evaluation (M&E) system to be used by the Project Implementation Unit (PIU) and other stakeholders to assess implementation progress, and implement the Governance and Accountability Action Plan.

B. Project Cost and Financing

50. The lending instrument will be an investment project financing (IPF), with an implementation period of five years. Project costs will be financed by an IDA credit of US$150 million equivalent and a GOB contribution of US$50 million equivalent (the latter will go toward SOB investments in IT modernization (CBS frameworks) and support for PIU/project implementation). The total allocation for the CBS part under IDA financing is SDR4.95 million. Details of the allocation will be provided in the OM. The outcome of the IT Diagnostics will further guide the allocation. Counterpart contributions would be tracked through Interim Unaudited Financial Reports (IUFRs).

51. The table summarizes the project costs and proposed financing arrangement.

Project Components	Project Cost, US$, millions	IDA Financing, US$, millions	% Financing
1. Supporting SOB Business Process Reengineering	15	15	100
2. Supporting IT Modernization of SOBs	173	125	72
3. Supporting Institutional Development of SOBs and MOF in Enhancing Ownership Oversight and Corporate Governance Framework	7	7	100
4. Project Implementation and Monitoring	5	3	60
Total Project Costs	200	150	75

C. Lessons Learned and Reflected in the Project Design

52. **The project has factored in lessons learned from previous and ongoing operational work in Bangladesh and elsewhere, in particular, on reforms in the financial sector and IT modernization.** The project components and their sequence reflect lessons that IT modernization should be preceded by establishment of good processes and workflows, so as to not entrench outdated processes (for example, in loan underwriting, financial and risk management, internal controls and audit, and personnel management) in the new IT architecture design which would yield poor results. Furthermore, many banking sector reforms and, in particular, state bank reforms observed in different countries clearly suggest that fundamental improvements, such as adequate capitalization, efficient processes, and strong governance have to be done before or at least in parallel to operational IT improvements. Without strong fundamentals in the institutions being modernized, modern IT architecture alone cannot be expected to achieve optimal results.

The GOB program - and, the project, therefore - goes beyond the IT investments and capital injections to also include the strengthening of systems and procedures and governance, as well.

53. **Public bank reforms are often prone to delays due to the large size, significant nonperforming assets, governance, inadequate skills mix of bank staff, and so on.** Bangladesh, too, has a long history of state bank reforms which did not always achieve the intended high-level objectives. The project considered this in setting an achievable development objective and implementation sequence. On project implementation, the GOB, as the owner, will have much stronger SOBs which are better governed and ready for new operational and development challenges. This will give the GOB more flexibility and a better choice of options to pursue further reforms in the SOB sector.

54. **Procurement and installation of large and complex IT systems often takes substantial time and is prone to unplanned delays (for example, inadequate bids, failed negotiations, rebidding, and implementation delays).** The project design addressed the issue by: (a) emphasizing homogeneity of the new IT tools and solutions to be installed in the SOBs—all banks receiving the same solutions with minimal customization to unique circumstances of individual banks—so as to achieve economies of scale and reduce the number of procurement packages; and (b) optimizing the implementation of the IT modernization component by bringing the best mix of IT and IT procurement skills available (IT staff from the BB, Bangladesh Computer Council, BCC, and SOB) into a special PIU subunit to handle procurement and installation. Finally, it is expected that around the midterm review of the project, there will be a specialized IT company established for the sole purpose of serving the SOBs so as to further contribute to coordination of IT investments in the banks and consolidate and reduce the cost of maintenance of the new IT frameworks.

55. **The Bangladesh Central Bank Strengthening Project (Credit No. 3792-BD), which supported the BB's automation program, provided important lessons** such as the need to: (a) pay early attention to the detailed technical design and Procurement Plans for IT equipment; (b) identify appropriate consultant services to support project implementation; (c) establish a strong and well-staffed PIU with qualified fiduciary, technical, and project implementation experience; (d) define clear implementation arrangements for key project beneficiaries; (e) identify quantifiable financial and other results indicators upfront to monitor project performance; and (f) formulate a detailed M&E framework with quantifiable targets. All these lessons have been addressed and incorporated into the proposed project. A Procurement Plan has been prepared and technical design, already substantially researched and assessed during project preparation, will be further detailed by the ongoing IT diagnostics of the SOBs under the FSSP project. Appropriate implementation consultants are expected to be identified early in the project implementation. A strong PIU is an important pillar for every WBG-supported project, and BFID is committed to maintain a well-structured and staffed PIU for this project, too. Implementation arrangements, indicators, and the M&E framework have been prepared and reflected in the Operations Manual.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

56. **The BFID of the MOF will be the executive division of the GOB for the project.** It will also act as the implementing agency, set up a fully staffed and equipped PIU, and will be

responsible for overall project implementation. All funds for project activities will flow through the BFID.

57. **A Project Coordination Unit (PCU) has been formed by the BFID.** It is chaired by the additional secretary in charge of banking and comprises members from the BB and the concerned SOBs to support the preparation of the project. The PCU will be dissolved and a new Project Steering Committee (PSC) will be established once the project is approved and effective. The PSC will provide the project with overall guidance and monitoring functions and will attend to inter-ministerial issues.

58. **The project will be managed by a Project Director with adequate and relevant knowledge and experience who will either be hired from outside the GOB at a market rate or be appointed by the GOB in accordance with its existing policy.** The PD will be the head of the PIU located in the BFID. Each component of the project will be managed by a Component Lead (CL). The PD and CLs will be supported by a dedicated Deputy Project Director (DPD) at the rank of a joint secretary or a project manager hired from the private sector with market remuneration, and this DPD is expected to have adequate experience and competence in managing complex public sector projects and/or automation projects with change management. The DPD will coordinate and monitor the activities of the various implementing departments and teams of participating SOBs and their technical consultants. The PIU will hire staff as needed, including procurement, financial management (FM), M&E experts. The PIU will also coordinate with the other regulators and stakeholders in the financial sector such as BB, Bangladesh Securities and Exchange Commission, and banking associations. Annex 3 contains more information on the key responsibilities of the PIU.

59. **Implementation support to manage IT systems implementation in all the SOBs will be anchored in a dedicated IT unit of the PIU, comprising staff from the BB, SOBs, and possibly the BCC.** Additionally the PIU could engage a consulting firm to help oversee the IT framework development and rollout. The PIU will also focus on implementing a shared services model in line with the recommendations of the IT diagnostics exercise. In the later phase of the project the viability of a central IT organization to service all banks (for example, a separate IT company owned jointly by the GOB and SOBs) will be assessed and implemented if appropriate. If this activity is assessed to be viable, the project could be restructured to accommodate it.

60. **The BFID has the capacity to implement the project and has a track record of implementing a state-owned banks reform project** (Enterprise Growth and Bank Modernization Project, P081969) involving multiple SOBs and other donor-funded projects, for example, for modernizing the capital market and ensuring fiduciary and other compliance during implementation. With adequate arrangements and necessary technical support provided to the BFID through Component 4, the BFID will be able to implement the project effectively with full authority on behalf of the GOB. The proposed project is expected to be implemented concurrently with the proposed Insurance and Private Pension Market Development Project where the BFID will have a role as a key financial sector policy-making agency. The BFID will also be engaged by virtue of exercising ownership rights in state-owned institutions involved in the insurance and pension project. It will be important to leverage synergies of the two projects toward supporting capacity development of the BFID. At the same time, both projects will have to ensure that implementation tasks required under the projects will not result in duplicative activities for the BFID and the PIU.

61. **The Project Operations Manual (OM) has been prepared.** It further details the implementation arrangements and provides guidance to the PIU on the procedural aspects of the project.

B. Results Monitoring and Evaluation

62. **A strong M&E framework to systematically track inputs, outputs, and outcomes is integrated into the various components of the project and has been discussed and agreed with the BFID.** The PIU will establish standard formats with baseline information and data and guidelines for data collection and report updates of M&E to the PSC and the Bank. The PIU will be responsible for overseeing and coordinating this process. The PSC will provide strategic policy guidance and oversight of the project implementation.

63. **The Bank will evaluate progress on the proposed indicators through regular reporting by the PIU and through implementation support visits, including the midterm review.** The midterm review is expected to be around the 30th month of project implementation and will assess implementation progress. The PIU will submit quarterly reports, with results for output and outcome indicators, and semiannual FM reports. A project audit will be undertaken annually in line with the terms of reference (TOR) included in the Operations Manual (OM). In addition, a beneficiary feedback mechanism has been integrated into the project and will be monitored during implementation through an indicator on citizen engagement. The PIU will need to be adequately staffed and resources allocated to ensure the provision of monitoring data. An M&E specialist will be recruited by the PIU to help plan and manage this work, while building capacity within the BFID. Further details are provided in Annex 3.

64. **The project will have gender-disaggregated client satisfaction surveys as one of the project results indicators.** In addition, a third-party firm will be hired as part of the M&E activities to conduct similar satisfaction surveys with the primary and secondary level beneficiaries specifically identified in section II (paragraph 35). Special attention will be given to small and medium enterprises and firms in sectors that are crucial for growth; rural farmers and all others who live on agriculture or agro-based industries and benefit from financial services of the SOBs; and the unbanked population of the country, including women, pensioners, and population segments which come under the GOB's social safety net programs, to assess improvements in service delivery due to the implementation of the project. The surveys will be administered at project start (baseline), mid-term and project closing. The surveys will also capture suggestions for improvement from the particular beneficiary groups. Feedback from the surveys would be factored into project implementation.

C. Sustainability

65. **The BFID is committed to modernizing and improving the SOBs by investing in their end-to-end automation and BPR as a public good.** It is also committed to strengthening the overall banking sector governance and its own capacity to monitor and ensure efficient internal control in the SOBs. The BFID has established SOB recapitalization program and performance management agreements with each SOB. The BB is also intent on strengthening the regulatory and supervisory framework for the banking sector, as it has complied with the requirements of the IMF's Extended Credit Facility Program in this regard (including on prudential standards,

establishing performance contracts with SOBs through memoranda of understanding). The BFID is determined to fully capitalize all the SOBs over time and ensure full compliance of the SOBs in meeting regulatory requirements through effectively enforcing the performance agreements that it signs with each of the SOBs. The project design includes comprehensive advisory support in these areas.

66. **The BPR, IT modernization, and governance improvements are expected to embed in the SOBs good-practice processes, workflows, and risk management and corporate governance arrangements.** They will be backed up by modern IT tools, which will position the banks for a long-term, sustainable, and viable development, whether still publicly owned or partially or fully divested by the state. Experience with similar large-scale organization restructuring and IT investment projects suggests that they entail substantial change management efforts by the beneficiary institutions and result in meaningful transformational outcomes.

67. **Sustainability nevertheless depends on a number of key factors.** The factors include: (a) regular upgrades and development of IT infrastructure and systems within the SOBs; (b) successful BPR, that is, modern and efficient business processes established and fully operationalized with necessary policies and manuals in place or in effect to suit the automated banking and business environment (and to become competitive in the market); (c) SOBs meet all the key prudential requirements and remain fully solvent with adequate solvency (capital); and (d) improved governance in the banking sector, and in the SOBs in particular, with a strong regulatory and supervisory framework. These factors have also been considered in the project's assessment and mitigation for risks in the long term.

V. KEY RISKS

A. Overall Risk Rating and Explanation of Key Risks

68. **Key risks have been identified and rated in the Systematic Operations Risk-Rating Tool presented in the project data sheet.** The overall risk of the project is rated Substantial because of high political and governance risks; substantial risks associated with the sector strategy and policy framework and institutional capacity for implementation and sustainability; and substantial technical design and fiduciary risks.

69. **The high political and governance risk arises from the possibility of potential changes in policy commitment and reforms.** Since the project directly supports the GOB priority agenda for financial sector development, as highlighted in the 7th Five-year plan, it is not anticipated that the GOB will reverse its support for the objectives and activities proposed under the project. Furthermore, the proposed project is designed in close consultation with the BFID of the MOF, BB, and senior management teams of the concerned SOBs where a strong leadership is in place, a momentum for reforms exists, and the activities planned under the project are fully owned by the concerned parties. Events such as the recent heist where large amounts were stolen from the BB only highlight the importance of automation and of strengthening the SOBs, and it is likely that the resolve of the authorities to address these gaps has become stronger.

70. **The rating of substantial for risks associated with sector strategies and policies stems from an insufficient clarity around the GOB's long term strategy for addressing the key issues undermining the SOBs.** At this juncture, there is a clear determination of the GOB to

upgrade the banks in the ways presented in this project. However, there is less clarity on the next steps, such as defining ownership purpose and strategy, criteria for measuring banks' commercial and operational success and developmental impact. The project will address the risk by supporting development, under Component 3, of a coherent SOB ownership and management strategy, including measures of their performance

71. **The risk associated with institutional capacity for implementation and sustainability is rated substantial** because BFID may not have sufficient qualified personnel for core project activities, even though it has a track record of effective implementation of donor- and IDA-financed projects. A PCU with dedicated staff (to be supplemented with capable and qualified consultants during project implementation) is already established to mitigate this risk. The BFID has committed to contributing the necessary resources to provide stronger oversight of state-owned financial institutions.

72. **The substantial technical design risk is due to the number of project activities which will apply to the banks and the sequence which will need to be followed to ensure successful implementation.** The IT packages will take their full shape only after the IT diagnostics, which itself will be done under the auspices of another project. Implementation of the IT solutions will also be substantially influenced by the outcomes of the BPR under Component 1. Banks which require reviews of their recapitalization options will add additional implementation complexity. Implementation of all components, sequentially and concurrently as the case may be, will present a substantial change management challenge to the boards, management, and staff of the SOBs, which will need to be carefully managed and tracked by the BFID and the project's PIU. The risk will be mitigated by the PIU retaining a qualified implementation consultant firm which will support them in managing the project. The project also has adequate time allocated for implementation, which will provide flexibility to react to unexpected issues due to the demanding technical design.

73. **The substantial fiduciary risk stems from lack of procurement and FM personnel available at the PIU.** This risk would be mitigated through the hiring and training of required staff to undertake these fiduciary functions. Procurement of similar nature (for example, IT equipment) will be coordinated by the PCU based on bidding documents to acquire software and hardware that would have been developed by an earlier in-depth assessment of all institutions. Leveraging lessons from the BB which has developed such capacity, could be considered through membership in the PCU.

Governance and Accountability

74. **A detailed Governance and Accountability Action Plan (GAAP) has been prepared with the goal of strengthening management control over the project, reducing potential risks, and ensuring complete realization of project objectives.** It outlines specific responsibilities of the BFID to facilitate effective and appropriate use of the funds for the project and maintain good governance in the management and implementation of project activities. The key elements of the GAAP are: (a) measures to safeguard procurement and FM, (b) measures to ensure coordination among different banks and between the GOB and BFID for effective implementation of the project, and (c) measures to establish an efficient IT procurement management. The detailed GAAP is presented in Annex 6.

75. **The BFID will need to pay considerable attention to maintaining transparency in the project-related processes and decision making and ensuring access to information.** The details of this proposed project will be available on the BFID's website (http://www.bfid.gov.bd).

VI. APPRAISAL SUMMARY

A. Economic and Financial (if applicable) Analysis

76. **Financial analysis indicates a strong likelihood for reasonable returns on the Government's proposed investments into SOBs.** In summary, under highly conservative assumptions of no asset growth for the SOBs, high discount rate (10 percent), and a slow incremental increase in ROA by the SOBs as a result of the operational modernization (starting with 0.1–0.3 percent increase in year 1, increasing by 0.2 percent in the subsequent years), the project payback period is in the range of 6–8 years. Annex 5 provides further details.

77. The table below summarizes the project's NPV and IRR scenario analysis.

Scenarios	Initial Increase in ROA Year 2020 (%)	Annual Increase in ROA Years 2021–2028 (%)	Asset Growth Years 2021–2028 (%)	Discount Rate (%)	NPV	IRR (%)
Pessimistic	0.10	0.10	0	10.00	(16)	8.010
Baseline	0.20	0.30	3	6.75	481	33.13
Optimistic	0.30	0.40	6	5.00	1,130	45.70

78. **The NPV and IRR have been calculated for all three scenarios.** Only in the pessimistic scenario, with a very low likelihood of occurrence, the NPV turns out slightly negative, while the IRR remains slightly below the discount rate. In the baseline and optimistic scenarios, the NPV and IRR are strongly positive. Once again, these assumptions are highly conservative, and not all benefits are directly considered. Overall, the scenario analysis suggests a positive outcome and impact of the intended project investments. They should subsequently raise the market value of SOB equity, giving the banks a stronger competitive edge.

79. **Sensitivity of the financial analysis is moderate.** A number of risk factors facing the SOBs – e.g., local or global economic slowdown, operational or cybersecurity risk events, - could decrease their revenues, income, and capital. Lower than the conservatively estimated returns, especially in the initial years of the project, could reverse the gains achieved from more transparent and efficient project-supported operations.

80. **Initial assessments and economic analysis early in the project preparation suggested that the project design should minimize large IT investments pursued separately by individual SOBs.** The SOBs had already undertaken meaningful investments in CBS, yet each of the SOBs procured the solution individually, missing the benefit a uniform solution and a centralized procurement process could have generated. Furthermore, non-trivial amount of customization of the separately procured CBSs has taken place in the SOBs, further reducing opportunities for a closer IT integration and related benefits. Significant economies of scale could

be achieved through a centralized procurement of large (and costly) IT solutions and then their distribution and uniform application in the SOBs. The agreed design reflects this approach.

81. **The financial analysis performed during the preparation of the project can be relatively easily performed at regular intervals, to revalidate or challenge earlier assumptions.** The calculations require periodically reported performance indicators of the SOBs, in particular revenues, costs, profitability, capital and other such main aggregates. Attribution of the project activities to financial performance of the banks, and the project's impact on the key performance indicators of the SOBs would also require more qualitative approach, implementable through discussions with SOB management, including the banks' CFOs. If deemed appropriate (depending on the disbursements and achievements of the project by that time), a thorough review of the original financial analysis could be performed during the mid-term review, including the attribution analysis

82. **The proposed project's impact on the borrower's fiscal situation is expected to be strongly positive.** Currently, the strongest fiscal impact caused by the SOBs as a group is their continuous recapitalization needs which are partially, and insufficiently, met by the budget. The recapitalization is important in bringing the capital-deficient banks to prudential compliance (or lesser non-compliance, as the case may be); however the long-term impact and sustainability of the recapitalization would be jeopardized if the banks continued their inefficient/loss making activities. The project will provide meaningful fiscal support by entrenching - through investments into better processes, tools, and governance - a more efficient performance of the SOBs which will allow the banks to better leverage the existing and new capital toward higher risk-based returns and increased self-sufficiency. Eventually, self-sufficiency of the SOBs should eliminate recapitalization needs to the most extent, turning the SOB group into a net budget contributor.

B. Technical

83. **The rationale for the agreed technical design is strong.** The SOBs have been identified with substantial weaknesses in their governance, processes, and technological proficiency. The weaknesses through the years have led to substantial financial losses in some banks, necessitating large budget outlays to recapitalize the banks. Lessons from other similar episodes suggest that SOBs cause large losses to taxpayers if they are allowed to perpetuate inefficient operations. Furthermore, only comprehensive solutions can sustainably change the entrenched low-level performance of the banks. The proposed project design seeks to address the situation comprehensively and sequentially tackling the main weaknesses of the SOBs. The project will, first, address the operational/process weaknesses which will then be strengthened by a new modern IT framework. Simultaneously, governance improvements will be implemented throughout the project tenure. These components will cover the most pressing needs identified by the Government for transforming the SOBs into modernized and self-sustaining financial intermediaries. As such, the SOBs will able to serve the needs of the market in an efficient manner and become budget contributors rather than dependents. High standards, delivered by: (i) world-class external advisory support; and (ii) WBG expertise with transforming state-owned financial institutions, on the governance side in particular (e.g., diagnostic tools, WBG and OECD guidelines and principles for SOE governance), will be applied during the project.

C. Financial Management

84. **The BFID of the MOF is a relatively new structural unit established in 2010.** Based on the assessment of its FM capacity the risk is assessed as Substantial. The main drivers of this risk are limited experience of the BFID in managing IDA-funded projects. Several risk-mitigating measures have been incorporated into the design of FM arrangement; a number of additional measures will also be undertaken during implementation to improve overall FM capacity (see Annexes 3 and 4). The BFID has no outstanding issues on compliance with audit covenants under existing or closed projects. There is an outstanding audit report for a different division of the MOF under a trust fund-financed project. This is being followed up, and the audit report is expected shortly.

85. **The BFID PIU will appoint an experienced consultant (FM Specialist), with qualifications acceptable to the Bank, to lead and coordinate FM activities under the project.** The FM specialist will support the project by maintaining strong budgeting practices, internal controls, fund reconciliations, and other relevant FM/accounting functions, including coordination with the other fiduciary staff at the PIU. In the area of FM there will be two more positions, one for an accountant and one for an IT officer for dealing with administrative and operational budget management at the PIU, respectively. The PIU will be responsible for FM of all project funds, and there will be no transfer of funds to the SOBs. Internal audits of the project will be carried out annually. The Office of the Comptroller and Auditor General will conduct an annual audit of the project's financial statements.

86. **The key project accounting functions for which the PIU would be responsible are as follows:** (a) budget preparation and monitoring; (b) payments for eligible project expenditure to SOBs/third parties; (c) disbursement of project funds to various agencies according to the approved work plan; (d) maintenance of books and bank accounts; (e) cash flow management, including advance reconciliation among designated and operating accounts; (f) consolidation of financial reports and submission to the GOB, Bank, and other stakeholders; (g) preparation of a Withdrawal Application to claim funds from the Bank; and (h) assistance to an external auditor and ensuring appropriate follow-up of audit.

D. Procurement

87. **The fiduciary assessment indicates a Substantial risk in procurement administration.** Risks are due mainly to the challenges of implementing a significant number of IT contracts following International Competitive Bidding (ICB) methods on time. Internal control, documentation, information dissemination, contract administration including delivery follow-up, payments, complaints handling, and the like also need to be strengthened for IT procurements. Several measures will need to be introduced to minimize procurement risks during project implementation, as described in Annexes 3, 4 and 6.

88. **All information pertaining to bidding and procurement above specified thresholds, per Public Procurement Rules (PPR), will be published on the Central Procurement Technical Unit (CPTU) website.** In addition, the BB will publish procurement information on its own website. For large value procurement, MOF will: (i) set a tight time line for the procurement process; (ii) prepare thorough terms of reference (TOR) for the Bid Evaluation Committee (BEC); and (iii) establish strict confidentiality arrangements for bid evaluation. The BEC will consist of

Borrower's staff and international/local procurement and IT consultants. BEC will provide quality assurance of the bidding process and implementation of these large value contracts.

89. **A Procurement Plan covering all major procurement has been prepared for the entire duration of the project.** This plan will be made available on the Bank's external website. The Procurement Plan will subsequently be reviewed and updated semiannually in consultation with the Bank. The Bank's review of selected contracts will be determined on the basis of estimated value thresholds, which may be revised upward as procurement performance improves.

E. Social (including Safeguards)

90. **Despite high levels of poverty, political turmoil, and frequent natural disasters, Bangladesh stands out as the exemplar in South Asia with its impressive gains in gender equality.** One of the most dramatic transformations in the past decade has been the enhanced role of women in the economy. The female labor force participation rate has increased rapidly, from 25 percent in 2000 to 34 percent in 2013, and is expected to rise further in the coming years. Nongovernmental organizations played an important role in mobilizing women to use microcredit and generate self-employment, and the fast-growing readymade garments industry proactively recruited female workers to their factories. The total number of employed women nearly doubled between 2003 and 2013 and gender wage differentials narrowed. Challenges remain for further increasing the participation rate and self-employment and reducing wage differentials. Access to finance by women is one of the ways to address the challenges, and SOBs, as they modernize, stand to provide better access to women. The project will have gender-disaggregated client satisfaction surveys as one of the project results indicators.

F. Environment (including Safeguards)

91. **The project is rated Environmental Category C according to OP 4.01 due to minor environmental impacts.** It had its climate and disaster risk screening during preparation. While Dhaka is prone to floods, with at least a moderate exposure, their impact on banks has not been major with regard to financial losses. Nevertheless, the banks have to make adequate disaster recovery and business continuity arrangements in preparation for future floods which will occur with a high degree of certainty. With adequate preparation and disaster recovery or business continuity arrangements in place, the potential impact of future floods on banks should be low. With regard to the effect on outcomes or service delivery, the new IT investments and stronger capacity of state bank owners, managers, and staff would allow for smarter ways of running the banks and more efficient management of resources. The new MIS, data quality, and risk management techniques would also allow better preparation for and adaption to various risks and eventualities, including the regularly occurring floods.

92. **Any works under the Project shall carried out be in accordance with the provisions and arrangements set out in the Operations Manual.** They will include, but not be limited to, screening criteria that limits such works to small-scale refurbishment at existing sites. Any such works shall duly incorporate the requirements of the Bank's safeguard policies.

G. World Bank Grievance Redress

93. **Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS).** The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

Annex 1: Results Framework and Monitoring

Country: Bangladesh

Project Name: Modernization of State-Owned Financial Institutions Project (P155363)

Results Framework

Project Development Objectives						
PDO Statement						
The proposed project development objective is to contribute to the modernization, transparency, and efficiency of state-owned banks.						
These results are at	Project Level					
Project Development Objective Indicators						
		Cumulative Target Values				
Indicator Name	Baseline	YR1	YR2	YR3	YR4	End Target (YR 5)
Bank automation CBS (Number)	2,663	–	–	4,000	–	5,006
Bank automation CBS (percentage share)	40	–	–	76	–	90
Bank automation ERP (Number)	0	–	–	2,630	–	5,006
Bank automation ERP (percentage share)	0	–	–	50	–	90
SOB transparency and governance (Text)	Partially compliant	–	–	Partially compliant with clear progress from baseline	–	Substantially compliant
SOB efficiency (Percentage)	60.00	–	–	50.00	–	40.00
Intermediate Results Indicators						
		Cumulative Target Values				
Indicator Name	Baseline	YR1	YR2	YR3	YR4	End Target (YR 5)
Return on assets (Percentage) - (Core)	0.70	–	–	0.85	–	1.00
Percentage of project-supported institutions that are reporting on this indicator (Percentage - Subtype: Supplemental) - (Core)	100.00	–	–	100	–	100.00
SOB IT strategic plans adopted (Percentage)	0	–	–	80.00	–	100.00

Automation of SOB transactions (Percentage)	30.00	–	–	40.00	–	80.00
SOB user/client accounts (number)	15,000	–	–	17,000	–	20,000
Operating costs (Percentage)	70.00	–	–	65.00	–	50.00
Customer satisfaction, disaggregated by gender (Number)	50.00	–	–	65.00	–	85.00
SOB staff trained in CBS and ERP usage (Percentage)	0.00	–	–	30.00	–	100.00
Formal supervisory board appointment criteria and procedures for SOBs adopted (Yes/No)	No	–	–	Yes	–	Yes
Corporate governance and supervisory board evaluation guidelines implemented (Yes/No)	No	–	–	Yes	–	Yes
BPR successfully completed (Percentage)	0	–	–	100	–	100
SOBs compliant with MOUs/performance agreements with the BFID (Text)	Partially compliant	–	–	Partially compliant	–	Substantially compliant

Indicator Description				
Project Development Objective Indicators				
Indicator Name	Description (Indicator Definition and so on)	Frequency	Data Source/ Methodology	Responsibility for Data Collection
Bank automation CBS	The transaction and business processes of the SOBs participating in the project are automated, measured by the number of SOB branches with CBS implemented and the percentage of branches with CBS compared to total branches.	Semiannual	Banks	BFID/PIU
Bank automation ERP	The transaction and business processes of the SOBs participating in the project are automated, measured by the number of SOB branches with ERP solution implemented and the percentage of branches with ERP compared to total branches.	Semiannual	Banks	BFID/PIU
SOB transparency and governance	This indicator measures the extent to which Participating SOBs are compliant with the BB's (a) Risk Management Guidelines, (b) Credit Management Guidelines, (c) Corporate Governance Guidelines, and (d) Internal Audit requirements (categorized as Non-compliant, Partially compliant, or Substantially compliant). Substantial compliance will mean that banks are expected to comply most of the time with most of the major applicable guidelines in the above areas (refer also to OM).	Semiannual	BB	BFID/PIU

SOB efficiency	This measures the ratio of operating costs against revenues.	Semiannual	BB	BFID/PIU
Intermediate Results Indicators				
Indicator Name	Description (indicator definition and so on)	Frequency	Data Source/ Methodology	Responsibility for Data Collection
Return on assets/equity	ROA (Equity) = Annual After Tax Profits/Average Assets (Equity) over the Period ROA (Equity) reflects that organization's ability to deploy its assets (equity) profitably. This indicator is used for commercial purposes in situations that do not receive subsidies. The optional ‘breakdown’ tab can be used to report by institution.	Annual	BB, banks	BFID/PIU
Percentage of project-supported institutions that are reporting on this indicator	This indicates the percentage of project-supported institutions that are reporting on the “Return on assets/equity” indicator			
SOB IT strategic plans adopted	This indicator measures whether SOBs have adopted medium-term strategic IT investment plans	Annual	Banks	BFID/PIU
Automation of SOB transactions	Percentage of automated transactions	Annual	Banks, BB	BFID/PIU
SOB user/client accounts	The indicator measures growth of client/user accounts	Annual	Banks	BFID/PIU
Operating costs	Share of operating costs in the total cost structure	Semiannual	Banks, BB	BFID/PIU
Customer satisfaction, disaggregated by gender	Customer satisfaction with the SOB's services as measured by annual surveys	Annually	Banks	BFID/PIU
SOB staff trained in CBS and ERP usage	Share of SOB staff trained in using CBS and ERP solutions	Semiannual	Banks	BFID/PIU
Formal supervisory board appointment criteria and procedures for SOBs adopted	This indicator measures whether formal board appointment criteria and procedures for state banks have been adopted	Annual	BB, banks	BFID/PIU
Corporate governance and supervisory board evaluation guidelines implemented	This indicator measures whether corporate governance guidelines/board evaluation procedure have been developed and adopted	Annual	BB, banks	BFID/PIU
BPR successfully completed	This indicator measures whether BPR has been completed	Annual	Banks	BFID/PIU
SOBs compliant with MOUs/performance agreements with the BFID	This indicator measures the extent of SOBs’ compliance with MOUs/performance agreements with the BFID (see also OM) (categorized as Non-compliant, Partially compliant or Substantially compliant)	Annual	BFID, BB, banks	BFID/PIU

Annex 2: Detailed Project Description

BANGLADESH: Modernization of State-Owned Financial Institutions project

1. The proposed project will have four components, and the costing details are presented in Table 2.1.

Table 2.1. Costs by Component

Description	Total Financing (US$, millions)
Component 1: Supporting SOB Business Process Reengineering	15
Component 2: Supporting IT Modernization of SOBs	173
Component 3: Supporting Institutional Development of SOBs and MOF in Enhancing Ownership Oversight and Corporate Governance Framework	7
Component 4: Project Implementation and Monitoring	5
Contingencies (physical and financial) are built in to the component cost	**–**
Total Project Cost	**200**

2. The following sections describe in detail the components and subcomponents of the project.

3. The project intends to provide funding for long-term investments by SOBs toward their modernization through better IT systems and better decision-making and operational processes. Advisory assistance to the banks and the MOF as the representative of the owner—on the decision-making and operational processes, improved governance, and change management—will complement the investments in physical IT infrastructure. Details on the proposed components of the project are in the following paragraphs.

4. The project will support the GOB's ongoing SOB restructuring plan and efforts and help the authorities by providing a foundation for advancing the bank resolution strategy. The ultimate objective of the GOB is to rationalize its ownership function in the banking sector to a point where the number, size, and reach of the SOBs is commensurate with the policy objectives attached by the GOB to the banking sector. At that point, allocation of state capital to the banks would reach an optimal level, given the policy objectives. Currently, the GOB finds itself as an owner of a number of financial institutions, including the SOCBs and SODBs, as a legacy of the earlier nationalization and restructuring of the banking industry. While the entire system is considered overbanked (including by the regulator), the same argument can also be applied to the state-owned sector where, in addition to the scheduled SOCBs and SODBs, the GOB also owns a few nonscheduled (non-licensed) policy banks.

5. There are alternative pathways to reach the ultimate objective, ranging from radical (immediate divestment, mergers) to gradual, taking shape over time. Given the constraints in the country's political economy, capacity, and market absorption for rapid divestment of the banks, the authorities are of the view that they will continue owning the current SOBs for the time being, but will invest considerable efforts and resources in improving their performance and financial standing. This in turn is expected to (a) improve achievement of the objectives placed

by the GOB on the SOBs in the medium term; (b) move the banks from the position of relative weakness to a position of relative strength, compared to other market participants and regional and global peers, with regard to governance, operations, and financial standing; and (c) provide much stronger opportunities for successful divestment and rationalization of the banks in the long term, once the currently needed improvements are implemented and start bearing fruit during the next several years.

Project Components

6. Project activities will broadly focus on the following areas: (a) review and redesign of SOB's internal tools, processes, workflows, reporting lines and overall structure for risk management, credit process (including internal rating systems and internal scoring systems as necessary), internal controls, and SOB governance arrangements; (b) SOB automation—introduction of automated (IT-based) tools and systems for risk management; loan origination, monitoring and collection; internal audit, compliance and internal controls; and (c) capacity building—SOB staff training on the new tools and practices, as well as core competencies (for example, credit underwriting, risk management, and customer accounts management). Options for an optimal level and mode of capitalization will also be developed under the project for those banks which currently are in the GOB recapitalization program (which itself is outside the project scope).

Table 2 2. Proposed Sequencing of Project Activities (by year/quarters)

	2016				**2017**				**2018**				**2019**				**2020**				**2021**			
	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4
IT diagnostics																								
BPR and capitalization options																								
IT procurement																								
IT implementation																								
Corporate governance																								
PIU																								

7. **BPR** will involve consultancy support under Component 1 to review and redesign internal tools, workflows, processes, reporting lines, and overall structure for risk management, credit process (including internal rating systems and internal scoring systems as necessary), internal controls, and relevant staff training on the new tools and practices as well as core competencies (for example, credit underwriting). It will also involve developing options for an optimal level and mode of bank capitalization for those banks that are in the GOB bank recapitalization program. The component is expected to be completed within 12 months from the project's effectiveness.

8. **IT investments** will be based on the IT diagnostics which will be completed in 2016. The IT diagnostics will result in IT development strategies for each SOB and IT procurement packages, including hardware and software, modern transaction processing devices, IT security, AML/CFT systems, and completion of local area networks/wide area networks. IT procurement is expected to be complex and take about 12 months from the project's effectiveness. The

implementation/deployment of the selected vendors and will start shortly upon completion of the procurement stage, at some point in 2017.

9. Advisory work on improving corporate governance of SOBs will be fully implemented for all SOBs covered by the project. It will also include a substantial training allocation. Finally, Component 4 will provide requisite funding for the PIU in support of capable implementation and coordination of the project at the BFID. Both Components 3 and 4 are expected to commence implementation immediately after the project's effectiveness.

Component 1: Supporting SOB Business Process Reengineering (IDA financing: US$15 million)

10. The SOBs in Bangladesh have improved their operations and processes during the past years; however, further significant improvements are required to bring them to a level where they would be able to sustainably compete at national and international stages with regard to operational speed and efficiency, risk and cost management, business planning, resource allocation, quality of governance and decision making, and so on. A thorough review and upgrades in the workflows and processes are essential, particularly before the major investments into the new IT systems are made. Component 1 will provide consultancy support to the SOBs for a comprehensive BPR—from internal control and accounting to credit appraisal system, risk management, HR management, and transaction processing—that will be a prerequisite for an automated modern banking environment. Importantly, BPR will also cover development of cyber security rules, processes, and protocols which will be supplemented by required software and hardware under Component 2.

11. Significance of BPR can hardly be overstated. Generally it is part of broader change management efforts, which many forward-looking institutions now make an ongoing rather an occasional activity, given the pace of change in the competitive environment. BPR has a strong potential to lower operating costs; improve quality of products, services, and business planning of a bank; and lead to a more stable financial market and value improvements of the BPR subjects. A well-planned BPR grounded in a thorough up-front analysis optimizes processes and allocates resources where they can generate the highest investment value. There are numerous examples around the world, including the reported 60 percent of the Fortune 500 companies in the United States, which undertook the exercise shortly after the introduction of BPR as a management strategy in the 1990s.

12. BPR, for the most part, is expected to precede development and implementation of the new IT solutions in SOBs to strengthen and modernize the banks' internal workflows and processes. The theory and practice of BPR (and Business Process Management—BPM—another discipline of corporate management sometimes considered a successor to BPR) suggests that IT is basically an enabler of value-adding workflows and processes, while institutions often fail in these efforts by skipping BPR and applying IT solutions to redundant processes which do not enhance value. Development of the new IT solutions to support existing processes risks entrenching some of the current inefficiencies and dated workflows and practices of the SOBs, for example, in transaction processing, loan underwriting, business planning, overall financial and risk management, internal controls and audit, and HR management. Given that the CBS implementation in the SOBs has already started, their rollout should be managed in a way which

will minimize customization and leave maximum space for the workflow and process changes as part of the BPR exercise.

13. Successful BPR will require substantial efforts of qualified management consultants who will be hired under the project by the BFID and SOBs. Such consultants will engage with the banks which are considered ready for the modernization, as explained earlier, and will deliver their recommendations and schematics for the new workflows, processes, and decision making in the SOBs to the management of banks and the BFID early in the project implementation. The BPR exercise is expected to entail economies of scale similar to the IT modernization described later in Component 2, for example, the same consultancy firm/consortium could be engaged to deliver unified approaches in the SOBs, with least customization. The BPR consultants should be engaged under the project early on and potentially provide their inputs toward the IT solution procurement packages.

14. Component 1 will also provide options to the BFID for bringing the required regulatory capital of some of the SOBs. There are a few banks among the SOBs which are in the GOB's recapitalization program and require new capital injections. Separate modules under the BPR exercise for these banks will be developed, highlighting various options that the GOB could avail and the fiscal costs associated with these options.

15. The SOBs, which are adopting modern systems such as CBS and ERP for enhancing their efficiency and transparency in their business processes will need to change their manual business processes and redesign all their business processes to establish modern systems. Under this component, focus will be given on rethinking, restructuring, and streamlining business structure, processes, workflows, management systems, and external relationships through which value is created and delivered. BPR will involve the concurrent redesign of processes, organizations, and their supporting information systems (CBS and ERP) to achieve significant improvement in time, cost, quality, and customers' regard for the banks' products and services.

Component 2: Supporting IT Modernization of SOBs (IDA financing: US$125 million)

16. SOBs largely lack clear IT strategies and detailed systems implementation plans in line with their business priorities, except the RBL, which seems to have a basic three-year automation plan. Developing a strategic medium-term plan is a critical first step for any organization to embark on a comprehensive modernization program driven by automation of its business processes. This will be accomplished through the proposed study under the FSSP that is being implemented by the BB which is expected be completed in the summer of 2016. In the meantime, SOBs should continue to formulate overall IT strategies for their respective organizations in light of their business priorities (and then complete them with the support from the FSSP consultants). Component 2 of the project will provide support in implementing and further upgrading IT strategies and plans for the SOBs.

17. Project activities will focus on the following: (a) review and redesign of internal tools, processes, reporting lines and overall structure for risk management, credit process (including internal rating systems and internal scoring systems as necessary), internal controls; (b) automation—introduction of automated tools and systems for risk management; loan origination, monitoring and collection; internal audit, compliance and internal controls; and (c) capacity

building—staff training (for example, training of trainers) on the new tools and practices, as well as core competencies (for example, credit underwriting).

18. Enhanced cyber security of SOBs' data and systems will be an integral of the project outputs and impact. Cyber security solutions will come in the integrated packages with the IT solutions for the banks' operations. Specifically, the solutions could fall into the following five domains: (a) Identify - internal and external operating environment factors; (b) Protect - physical facilities, data and systems through access control rules, technology, training, and maintenance; (c) Detect - events and anomalies through continuous security monitoring and detection techniques; (d) Respond - planning, communications, analysis, and mitigation; and (e) **recover** - planning, continuous improvements, and communications.

19. Currently, nine SOBs have programs and annual targets on CBS implementation, which is being monitored by the BB. Their current status is provided in Table 2.3. Ansar-VDB does not have such targets yet.

Table 2.3. CBS implementation in branches of the SOBs

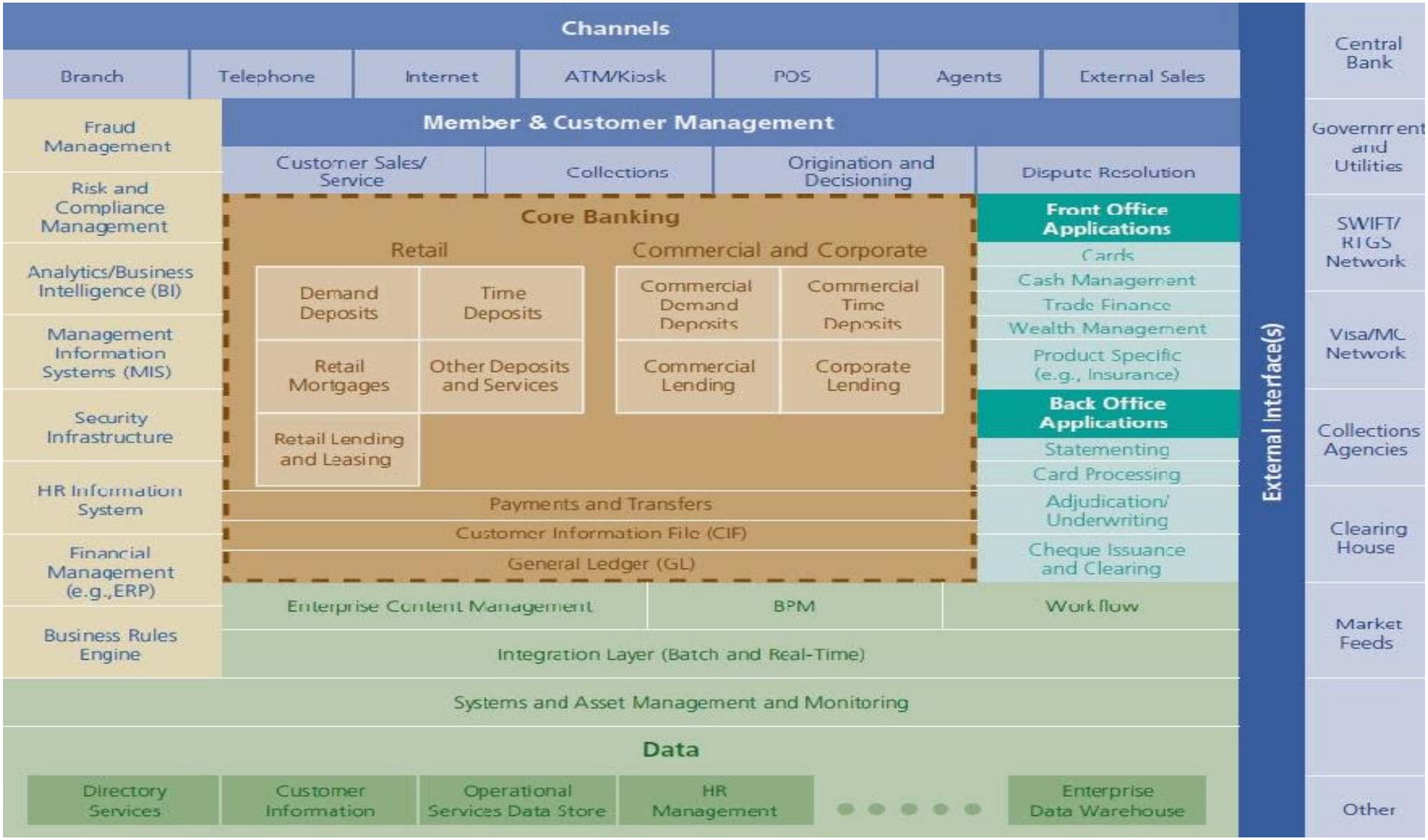
Bank Name	Total Branches	No. of Branches under CBS - mid-May 2016	Remaining No. of Branches
SBL	1,207	635	572
JBL	904	531	373
ABL	932	928	4
RBL	554	330	224
BKB	1030	105	925
RAKUB	400	0	400
BDBL	38	38	0
Karmashangsthan Bank	212	28	184
BASIC Bank Limited	68	68	0
Ansar-VDP Unnayan Bank*	217	0	217

20. The SOBs have already started implementation of the CBS. This is being done before developing the strategic medium-term plans; nevertheless, given the progress already achieved with the CBS implementation and the fact that it is part of the MOUs between the SOBs and the BFID/BB, it should continue. However the banks should review and minimize the amount of customization of their respective CBSs. An over-customized CBS, which is excessively adapted to the existing bank structures and processes, carries risks of entrenching the existing dated processes and practices, higher operational and maintenance costs, lower flexibility for scaling-up or benefiting from upgrades of standardized CBS solutions in the future, and lesser effectiveness of the proposed BPR exercise under Component 1. In addition, data migration is on a critical path given the many disparate systems deployed across a vast branch network of the SOBs; therefore, a sound data migration strategy and plan should be put in place as soon as possible. The SOBs as a group have missed out on an opportunity to implement a single CBS which could have resulted in significant acquisition and maintenance cost savings—not to mention reduced implementation timelines and technical and business process knowledge which could have been shared across these institutions.

21. There is a strong rationale to rely on tested practices and economies of scale when it comes to implementing basic IT infrastructure to support the modernization program across the multiple SOBs. Rather than building separate data centers and disaster recovery sites by each bank individually, the SOBs can maintain a shared data center and disaster recovery site. Similarly, shared alternate delivery channels can be established to service all banks.

22. The component will also support the SOBs in improving their basic IT infrastructure in parallel with the implementation of key systems (such as CBS, ERP, and AML). This may include establishing sound technical infrastructure (for example, power, electrical, server cooling, and Internet) to support centralized processing, branch connectivity, an enterprise wide e-mail system to support communication across the organization, and personal computer/hardware penetration. Although all banks have embarked on a centralized CBS implementation, there is a lack of basic technical infrastructure to sustainably support this initiative and provide an uninterrupted business process. Furthermore, exposure to basic automation such as e-mail, and enterprise wide intranet will help prepare the current workforce for automated business processes down the road. IT training programs to retool existing workforce and prepare them for a fully automated business environment will be developed and implemented under the component. Data security and prevention of cyber risks will constitute a very important part of the component, given a number of previous banking sector cases where banks had lost substantial amounts of money because of exposure and inadequate management of such risks.

Figure 2.1. Proposed IT and Systems Architecture for SOBs



23. A key element of the modernization program of SOBs includes business process automation and deployment of alternate delivery channels, such as ATM network, POS terminals, debit/credit card, Internet banking, ERP, and loans system. These systems will be built on solid CBS platforms, therefore, a phased approach is advisable. At present SOBs are using third-party ATM networks and credit/debit card systems with a very low penetration and availability of these essential banking delivery channels. The current loan processing system is entirely manual and therefore prone to errors and fraud. In addition, an enterprise wide ERP system is nonexistent in all banks, rendering essential financial and administrative processes to be manual. While Component 1 of the project will provide support in reviewing and redesigning the internal tools and processes of SOBs, Component 2 will support implementation of alternate delivery channels in a phased manner to provide essential banking channels to customers; deployment of an ERP system to automate critical financial and administrative functions. As SOBs move to an automated environment, they need to establish sound information security guidelines and deploy tools to protect financial and customer data. Component 2 will allocate adequate resources for this purpose.

24. Training will be an important aspect of Component 2 and of the entire project. Generally, there will be two groups of SOB staff in need of training and other capacity-building activities. The first is IT staff of the banks. They will need to receive specialized training on the new IT systems to be able to maintain and service them. Such training is expected to be mostly provided by vendors of Component 2. The second group is the remaining SOB staff who will be users of the new systems. Their training is expected to be provided by a combination of resources of Component 2 vendors (training the trainers) and local training agencies such as the Bangladesh Institute of Bank Management.

Component 3: Supporting Institutional Development of SOBs and MOF in Enhancing Ownership Oversight and Corporate Governance Framework (IDA financing: US$7 million)

25. Under this component, the project will provide advisory support to all the banks participating in the project and the MOF as the agency exercising ownership rights of the banks and other financial institutions on improving the framework within which the ownership rights are exercised and banks are governed.

26. Many of the weaknesses in the SOB sector are due to weaknesses in corporate governance and management practices. Key weaknesses identified during the project preparation include the following:

- Weak boards of directors, which apparently overlooked some of the recent scams that involved large losses in a couple of banks
- Lack of formal board appointment criteria and procedures for state banks
- Lack of corporate governance policies for state banks
- Nascent internal control and internal audit functions

27. The adoption of international good practices in the corporate governance of SOBs will increase accountability and transparency, leading to improved performance and the achievement of various social goals and mandates and complement the activities under Components 1 and 2. The project will address the five key pillars of good corporate governance for state-owned financial institutions and will strengthen

- the policy and legal framework for SOB governance;
- SOB ownership capacity of the BIFD of the MOF;
- capacity of the SOB Boards to govern the banks;
- transparency of the banks including the role of board audit committees and the quality of external audits; and
- internal control, internal audit, and compliance functions, including establishment or strengthening as the case may be of the AML/CFT functions and procedures.

28. Project preparation identified a three-phase approach to improve the governance of the SOCBs and SODBs, that will be supported by the project:

29. **Phase I** will result in a baseline of assessment of governance in the state banks, using standard Bank Group methodology. Phase I will include a legal review of the founding documents of each of the banks, a review of the BFID policies and procedures, and needs assessment of capacity within the BFID. A capacity-building program will be developed following the assessments.

30. **Phase II** will implement the capacity-building program identified in Phase I. Key tasks are expected to include the following:

- Establishing a clear legal framework for the banks and the overall framework (as necessary)
- Setting/clarifying mandates for each bank
- Working with selected banks to develop or clarify their strategies, as needed
- Developing an ownership policy for the BFID
- Developing or upgrading board charters, codes of conduct, and other key bank policies
- Setting clear criteria for board members, and establishing a transparent board appointments process
- Developing corporate governance/board evaluation procedures
- Upgrading the current MOU system
- Developing a board training program in several topics
- Strengthening internal controls and key functions
- Capacity building in Finance and Internal Audit Departments.

31. **Phase III** will include follow-up of governance reviews and board evaluations to assess progress.

32. The abovementioned component activities will serve as key inputs and drivers for SOB governance and ownership strategy which will be developed to capture a long-term approach to

SOB ownership by the GOB. At this juncture, there is a clear determination of the GOB to upgrade the banks in the ways presented in this project. A coherent ownership approach or strategy will be established under the project.

33. Training will also be an important aspect of the component. There will be several groups in need of training and other capacity-building activities. These include the boards of the state banks, the staff of the BFID, and key staff in the banks (including board secretaries and internal audit departments). All training is expected to be provided by a combination of specialized vendors (training the trainers) and local training agencies such as the Bangladesh Institute of Bank Management. An initial workshop shall be carried out as soon as possible after project effectiveness, to present a detailed picture of the governance component, introduce international good practices in SOB governance, and begin developing a shared vision for the implementation of the project.

Component 4: Project Implementation and Monitoring (IDA financing: US$3 million)

34. This component will provide support for the monitoring and coordination of project activities undertaken by various beneficiary institutions. It will also help develop a strong M&E system to be used by the PIU, to be established by the BFID) and other stakeholders to assess implementation progress. In addition to the statutory staff overseeing FM, procurement, and M&E, capacity of the PIU for a successful coordination of the project will need to be ensured by having staff/consultants skilled in IT, corporate governance, banking, and legal matters. Engaging staff from BB IT and regulation/supervision/banking policy teams and potentially other agencies (for example, Bangladesh Computer Council) on a full-time or part-time basis will be considered. The component will finance operational expenses, including fees of consultants, equipment, and vehicles as required by the PIU for effective implementation of the project, as well as consultancy expenses for supporting the PIU in performing its functions. The component will also support implementation of the GAAP.

Annex 3: Implementation Arrangements

BANGLADESH: Modernization of State-Owned Financial Institutions project

Project Institutional and Implementation Arrangements

1. **Organization responsible for the project.** The BFID of the MOF will be the executive/nodal division of the Government for the project and responsible for representing the Government of the People's Republic of Bangladesh on the project. It will also act as the implementing agency and set up a fully staffed and equipped PIU and will be responsible for overall project implementation, and all funds flow for project activities will be through the BFID.

2. **Policy and overall guidance.** A PCU has already been formed by the BFID chaired by the additional secretary in charge of banking and comprising members from the BB and the concerned SOBs to support the preparation of the project. It is expected that the PCU will be converted to a PSC once the project is approved and effective. The PSC will provide the project with overall guidance and monitoring functions and will attend to inter-ministerial issues. The PSC will be chaired by the secretary of BFID; and it will include at least a deputy governor of the BB and senior representatives (joint secretary or above) from the Finance Division, Economic Relations Division of the MOF, Implementation Monitoring and Evaluation Division and Socio-Economic Infrastructure Division of the Planning Commission, MDs of SOBs, and such other entities as the PSC may decide.

Project Administration Mechanisms

3. Responsibility for project management will be entrusted to an experienced Project Director with adequate and relevant knowledge and experience who will either be hired from outside the GOB at a market rate or be appointed by the GOB in accordance with its existing policy. This PD will lead the PIU located at the BFID, and considering the roles and responsibilities of the PD to manage nine beneficiaries/SOBs and respective project activities therein for overall project implementation, it is expected that the PD will have sufficient administrative authority from the BFID over those banks. Each component of the project will be managed by a CL who is at deputy secretary rank. The CLs will be responsible for the implementation of his/her respective component (the OM carries a summary description of their roles) and will coordinate closely with other concerned departments of the BB in the implementation of the project.

4. For each component, there will be component coordinators in the PIU, who will be responsible for coordinating the activities under concerned components. The PIU will also include an M&E expert to be hired under the project. The PIU will also hire support staff as needed, especially one procurement consultant, one FM specialist, an IT advisor, and one banking expert. The PD and CLs will be supported by a dedicated DPD at the rank of a joint secretary or a project manager hired from the private sector with market remuneration, and this DPD is expected to have adequate experience and competence in managing complex public sector projects and/or automation projects with change management. The DPD will coordinate and monitor the activities of the various implementing departments and teams of participating SOBs and their technical consultants. The consultants will work under the direct supervision of

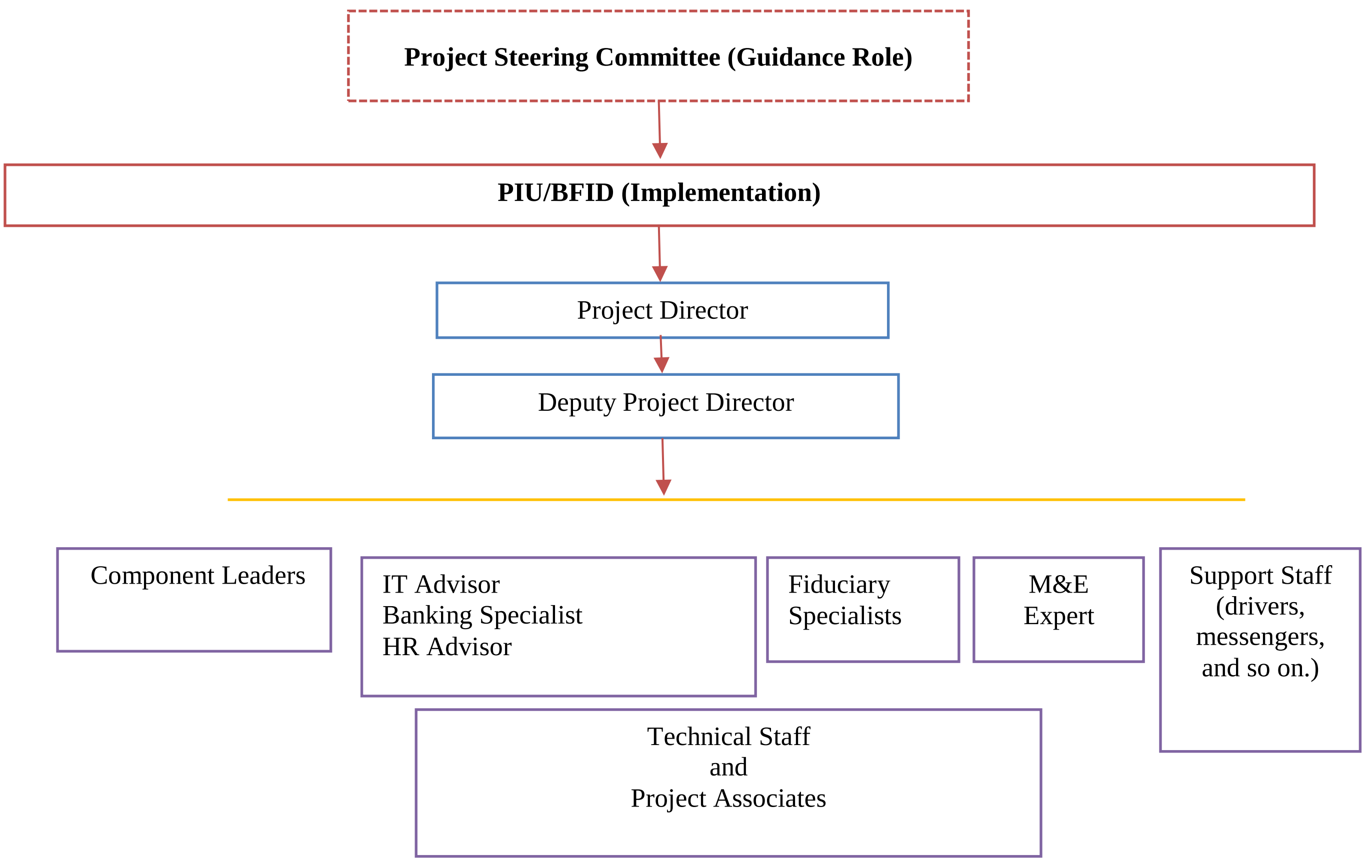
the PD, DPD, and CLs. The PIU will also coordinate the overall project implementation with financial sector regulators (BB and Bangladesh Securities and Exchange Commission) and with banking associations for implementation of selected advisory activities.

5. The PIU will be in charge of overall project coordination as well as overseeing the FM, procurement, reporting, M&E, audit, public information, and related functions. Paragraphs below provide more information on the key responsibilities of the PIU.

6. The PIU will also hire part-time technical specialists, as required, to support the BFID in the implementation of the main components. The PIU will be staffed adequately and will support implementation of the four components and implementation of the overall project.

7. To provide support to the BFID's technical teams implementing Component 1, a number of technical experts and consultants will be hired. To assist the BFID in implementing the BPR under Component 2, one or multiple (depending on the FSSP's IT and business process assessment of the SOBs) consulting firms will be hired through single-stage ICB based on quality and cost. In addition, an IT advisor and one banking expert will be hired for the BFID for the initial three years to help the BFID strengthen its capacity and better perform its ownership role. Also, for HR capacity building and carry out a training needs assessment and a training plan for SOB staff, an HR advisor will be hired to support the HR development activities of the SOB under Component 3 of the project.

Figure 3.2. Project Implementation Arrangement



8. The PIU will be responsible for the overall procurement and contract management under the project. The proposed IT organization will be used as the PIU's technical support in procuring IT systems/infrastructure and will distribute and service the proposed IT solutions and related contract management. For the effective implementation of the components, the PIU will coordinate among participating and implementing departments of SOBs and ensure development of an appropriate regulatory and policy environment, if required, through appropriate channel(s) during implementation. The concerned departments or units of SOBs will take the responsibility for implementing the activities in their purview. The participating SOBs will be project beneficiaries and will remain accountable to the BFID for their part of implementation tasks through either a Participating Agreement or Subsidiary Loan Agreement with the BFID, as the GOB decides. However, no funds will be transferred to the SOBs under the project.

9. The Project Operations Manual (OM) further details the implementation arrangements and provides guidance to the PIU on the procedural aspects of the project.

Fiduciary - Procurement and Financial Management

Fiduciary Capacity

10. Based on the assessment of MOF's fiduciary capacity, the procurement risk of the project is substantial. Though the MOF has experienced procurement staff, the procurement risks are mainly due to implementation of a significant number of high-value IT contracts following ICB methods on time. Internal control, documentation, information dissemination, contract administration including delivery follow-up, payments, complaints handling, and the like also need to be strengthened for IT procurements. Several measures will need to be introduced to minimize procurement risks during project implementation.

11. The BFID of the MOF is a relatively new structural unit established in 2010. Based on the assessment of its FM capacity the risk is assessed as Substantial. The main drivers of this risk is limited experience of the BFID in managing IDA-funded projects. Several risk-mitigating measures have been incorporated into the design of FM arrangements, and a number of additional measures will also be undertaken during implementation to improve overall FM capacity. The PIU will be responsible for FM of all project funds, and there will be no transfer of funds to SOBs.

Planning and Budgeting

12. **Planning.** A Procurement Plan covering all major procurement has been prepared for the entire duration of the project. It will be made available on the Bank's external website. The Procurement Plan will be updated by the MOF, at least annually, to reflect actual implementation needs in consultation with the Bank.

13. **Budgeting.** A project budget for the Modernization of State-Owned Financial Institutions (SOFI) Project will be maintained for the entire term of the project, and detailed budgets for each fiscal year on each project component and cost category will also be produced to provide a framework for FM monitoring purposes. The annual budget will be prepared on the basis of the Procurement Plan and any other relevant annual work plans. These budgets will be monitored periodically to ensure actual expenditures are in line with the budgets, and to provide input for

necessary revisions. Given that resources are scarce and earmarked, it is important to stay within the budget and to ensure that cost and physical performance are well synchronized. Failure to stay within budget could result in unnecessary costs.

Internal Control

14. **Filing and record keeping.** The MOF, SOBs, and other participating entities will preserve all procurement records and documents in accordance with provisions of the Public Procurement Act 2006 (PPA 2006) and the OM as applicable. These records must be made readily available on request for audit, investigation, or review by the GOB and the Bank. All project-related documents must be filed separately to facilitate internal and external audits, as well as reviews by the Bank.

15. **Controls.** The BFID was spun off from the Finance Division of the MOF and started its activities in January 2010. Considering the relatively young age of the BFID, the financial procedures at the PIU (which will be housed in the BFID) should include adequate internal controls to provide reasonable assurances that (a) operations are being conducted effectively and efficiently; (b) financial and operational reporting are reliable; (c) applicable laws and regulations are being complied with; and (d) assets and records are safeguarded. At a minimum, the procedures should include the following measures:

(a) Reliable personnel with clear responsibilities
(b) Segregation of duties:
    (i) Separation of operational responsibility from recordkeeping responsibility
    (ii) Separation of the custody of assets from accounting
    (iii) Separation of the authorization of transactions from the custody of related assets
    (iv) Separation of duties within the accounting function
(c) Adequate financial records management system with complete audit trail
(d) Physical safeguards - use of safe, locks, guards, limited access, and access by authorized persons to provide security for program assets
(e) Independent check - the procedures should be made subject to random independent reviews by internal auditors

16. The project will use dedicated software to account for project transactions and all transactions must follow Government review and approval procedures. Such controls have been reviewed and found satisfactory.

Internal Audit

17. Internal audit is a control that functions by examining and evaluating the adequacy and effectiveness of other controls throughout an organization. Internal audits of the project must be carried out on a yearly basis during the life of the project. The first audit will be due within three months after the end of first year of implementation. In each case, the project must submit the internal audit reports to the Bank within 15 days from the receipt of the report. The internal audit activities should include prepayment audits as well as appraisals of the financial, operational, and control activities in the sector. The responsibilities of the internal auditors should include

reporting on the adequacy of internal controls, the accuracy and propriety of transactions, the extent to which assets are accounted for and safeguarded, and the level of compliance with financial procedures and GOB laws and regulations. The TOR for the internal audits would be prepared by the FM specialist and must be submitted to the Bank for concurrence.

Oversight Arrangements/External Audit

18. The Foreign-aided Projects Audit Directorate of the Office of the Controller and Auditor General will conduct an audit of the project's annual financial statements within six months from the end of the fiscal year. The PIU and the PD will be responsible for audit follow-up and for taking remedial actions. Meetings to resolve audit objections must be held within three months of the receipt of the external audit report from the Foreign-aided Projects Audit Directorate.

Financial Management Considerations in the Fiduciary Assessment

19. **Staffing.** The BFID PIU will appoint an experienced consultant (FM specialist), with qualifications acceptable to the Bank, to lead and coordinate FM activities under the project. The FM specialist will support the project by maintaining strong budgeting practices, internal controls, fund reconciliations, and other relevant financial functions including coordination with the other fiduciary staff at the PIU. In the area of FM there will be two more positions, one for an accountant and one for an IT officer for dealing with administrative and operational budget management at the PIU, respectively.

20. **Fund flow and disbursement.** There will be a separate Designated Account for IDA in the form of a Convertible Taka Special Account in a commercial bank acceptable to the Association. The Designated Account must be opened and maintained in a financial institution acceptable to the Bank on terms and conditions acceptable to the Bank. To be acceptable to the Bank, the financial institution proposed by the borrower should generally meet all the following requirements: (a) be financially sound; (b) be authorized to maintain the Designated Account in the currency agreed between the Bank and the borrower; (c) be audited regularly and receive satisfactory audit reports; (d) be able to execute a large number of transactions promptly; (e) be able to perform a wide range of banking services satisfactorily; (f) be able to provide a detailed statement of the Designated Account; (g) be part of a satisfactory correspondent banking network; and (h) charge reasonable fees for its services.

21. The Designated Account will be used by the PIU of the BFID solely for financing all components of the project. Disbursement to the Designated Account will initially be –based on Statements of Expenditure, that is, on the basis of advances and replenishments. After one year of implementation, the Bank will review the quality of FM performance and may convert the disbursement modality to one based on IUFRs, including a six-monthly forecast of fund requirements.

22. **Accounting policies and procedures.** The accounting policies and procedures of the project will be governed by the existing GOB system outlined in the Project Accounting Manual of the MOF. The PIU will have the primary responsibility to maintain an FM system, including adequate accounting and financial reporting, to ensure that they provide to the Bank and the GOB accurate and timely information regarding project resources and expenditure. All

project-related transactions, that is, all sources (IDA and GOB) would be accounted for separately in the PCU following double-entry book-keeping principles and on a cash basis.

23. The key project accounting functions for which the PIU will be responsible are as follows: (a) budget preparation and monitoring; (b) payments for eligible project expenditure to participating financial institution/third parties; (c) disbursement of project funds to various agencies according to the approved work plan; (d) maintenance of books and bank accounts; (e) cash flow management including advance reconciliation among designated and operating accounts; (f) consolidation of financial reports and submission to the GOB, Bank and other stakeholders; (g) preparation of Withdrawal Applications to claim funds from the Bank; and (h) assistance to external auditor and ensuring appropriate follow-up of the audit.

24. Table 3.1 below provides the breakdown of the IDA Credit by disbursement categories.

Table 3.1 Disbursement Categories

Category	Amount of the Credit Allocated (expressed in SDR)	Percentage of Expenditures to be Financed (inclusive of Taxes)
(1) Goods, works, non-consulting services, consultants' services, Incremental Operating Costs and Training Costs for the Project (except for Part 2(a)(ii))	102,050,000	100%
(2) Goods, non-consulting services and consultants' services for Part 2(a)(ii) of the Project	4,950,000	100%
TOTAL	107,000,000	

Procurement Considerations in the Fiduciary Assessment

25. A detail procurement capacity assessment of BFID has been done and the current risk rating of the agency is "substantial". The number of procurement packages expected to cover all the purchases under the project as well as the project procurement plan has been prepared.

26. Total procurement under the project will be around US$159 million, out of which goods will be about US$140 million and consulting services of individuals and firms will be about US$19 million. Procurement will be be carried out in accordance with the World Bank's "Guidelines: Procurement of Goods, Works, and Non-Consulting Services under IBRD Loans and IDA Credits & Grants" dated January 2011 and revised July 2014 (Procurement Guidelines) and "Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers" dated January 2011 revised July 2014 (Consultant Guidelines), as well as the specific provisions stipulated in the financing agreement. A general procurement notice (GPN) for all major procurement to be financed by the proposed project will be published on the Bank's external website and the United Nations Development Business (UNDB).

27. **Procurement of goods and works.** Except as otherwise agreed in the Procurement Plan, procurement of goods and works will follow ICB procedures. Procurement of goods and works with an estimated value that is less than the ceiling stipulated in the Procurement Plan may follow National Competitive Bidding (NCB) and shopping procedures. Direct Contracting may be allowed under special circumstances with prior approval of the Bank. NCB contracting will be carried out under the Bank's Procurement Guidelines, following procedures for the Open Tendering Method of the Bangladesh Public Procurement Act (PPA, 2006, including the first amendment in 2009) and the Bangladesh Public Procurement Rules, 2008 (PPR 2008) (as amended in 2009), using standard bidding documents satisfactory to the Bank. For the purpose of NCB contracting, the following shall apply: (a) post-bidding negotiations shall not be allowed with the lowest evaluated or any other bidder; (b) bids should be submitted and opened in public in one location immediately after the deadline for submission; (c) lottery in the award of contracts shall not be allowed; (d) bidders' qualifications and experience requirements shall be mandatory; (e) bids shall not be invited on the basis of percentage above or below the estimated cost, and contract award shall be based on the lowest evaluated bid price of compliant bid from eligible and qualified bidder; and (f) single-stage two-envelope procurement shall not be allowed.

28. **Procurement of non-consulting services.** Except as otherwise agreed in the Procurement Plan, procurement of non-consulting services will follow ICB procedures. Procurement of non-consulting services having an estimated value less than the ceiling stipulated in the Procurement Plan may follow NCB procedures.

29. **Selection and employment of consultants.** The following methods will apply for selection of consultants: Quality- and Cost-Based Selection, Quality-Based Selection, Selection under a Fixed Budget, Selection based on Consultants' Qualification, Least-Cost Selection, and Single-Source Selection. Single-Source Selection (consultants) may be allowed under special circumstances with prior approval of the Bank. Short lists of consultants for services estimated to cost less than US$500,000 equivalent per contract may be composed entirely of national consultants. The Procurement Plan will specify the circumstances and threshold under which specific methods will be applicable.

30. **Staffing:**

- **Procurement focal person.** The MOF shall nominate a procurement focal point for the project. The appointed focal point must have sound knowledge in procurement and have formal training, both on the Bank's Guidelines as well as on the PPA and PPR. The focal point will support the MOF in day-to-day procurement follow-up and preparation of periodic procurement reporting. This focal person will be a mandatory member of all evaluation committees for procurement implemented by the MOF.

- **Technical focal person.** The MOF shall nominate an IT focal point for the project. The appointed focal point must have sound knowledge in IT systems and reasonable experience in international IT procurement. This technical focal point will take necessary IT procurement training on Bank guidelines. The IT focal point will support MOF in day-to-day technical support related to IT procurement. This focal person will be a mandatory member of all evaluation committees for IT procurement implemented by the MOF.

31. **Web page for procurement information.** All information pertaining to bidding and procurement above the specified thresholds, per PPR, must be published on the Central Procurement Technical Unit (CPTU) website. In addition, the BB will publish procurement information on its own website. This information must include invitations to bid, bid documents, and requests for proposals (wherever applicable); latest information on Procurement Plans and contracts; status of evaluations once completed; contract award information; and information covering the poor performance of contractors, suppliers, and consultants, including a list of debarred firms. The website will be accessible to all bidders and interested persons equally and free of charge.

32. **High value IT procurement.** It is expected that there will be several large value procurement processes, with amounts in the range of US$10-30 million. For this procurement MOF will: (i) set a tight time line for the procurement process; (ii) prepare thorough terms of reference (TOR) for the Bid Evaluation Committee (BEC); and (iii) establish strict confidentiality arrangements for bid evaluation. The TOR of such BEC and detailed procedure would have to be satisfactory to the Bank. A BEC will be appointed by MOF and will consist of Borrower's staff and international/local procurement and IT consultants (one procurement and one technical). Selection of the bid evaluation members would have to be satisfactory to the Bank. BEC will provide quality assurance of the bidding process and implementation of the contracts specified in the Procurement Plan. Its tasks will include carrying out the procurement process which would include short listing of consultants, pre-qualification of contractors and suppliers, review and issuance of bidding documents/requests for proposal, evaluation of bids/proposals and recommendation of award. The procurement consultant of a BEC should have sound knowledge in international procurement.

33. **Independent evaluation by the Bank.** The major contracts will be reviewed by the Bank thoroughly and as needed; an independent consultant will be recruited to review such contracts at various stages of evaluation and award and to evaluate proposed changes in the contract.

34. **Publication of award of contract.** The MOF will publish contract award information within two weeks of contract award on its own website, as well as on the United Nations Development Business Online and CPTU websites. The following information must be included: contract package number, advertisement date, number of bid documents sold, number of bids submitted along with names of bidders, bid prices as read out at bid opening, name and evaluated price of each bid, number of responsive bids along with name of bidder, name of bidders whose bids were rejected and brief reasons for rejection of bids, name of the winning bidder and the price it offered, and proposed completion of date of contract, as well as a brief description of the contract awarded.

35. **Prior review of procurement decisions.** IDA's prior review of procurement decisions will be governed by appendix 1 of the Bank's Procurement Guidelines. For each contract to be financed by the credit, the monetary threshold for prior review and post review will be identified in the Procurement Plan. During the first 18 months of the project, IDA will carry out a prior review of the following contracts (to be updated based on the procurement performance of the

MOF: (a) all contracts for goods and non-consulting services following ICB and direct contracting procedures irrespective of estimated cost; (b) all contracts for goods and non-consulting services following NCB procedures estimated to cost US$1,000,000 or above; (c) all contracts for consultant services following Single-Source Selection procedures, irrespective of estimated cost; (d) all contracts for firms estimated to cost US$500,000 or above; and (e) all contracts for individuals estimated to cost US$200,000 or above. In addition, all TOR for consultants will be subject to the Bank's review, irrespective of the prior review status of the contract.

36. **Post review by the Bank.** The Bank will conduct a fiduciary post review of procurement and FM on a sample basis. The sample size will depend on risk and efficiency. This review will be on an annual basis and will cover the contracts implemented by the MOF and other financial institutions.

37. **Procurement complaints.** In addition to the grievance redressal mechanism which is in place, for procurement-related aspects, the MOF will establish a system for managing complaints, including a database for recording, monitoring, and following up on all procurement activities. The Bank must be notified of any complaints to ensure transparency in the resolution process.

Environmental and Social (including safeguards)

38. Despite high levels of poverty, political turmoil, and frequent natural disasters, Bangladesh stands out as the exemplar in South Asia with its impressive gains in gender equality. One of the most dramatic transformations in the past decade has been the enhanced role of women in the economy. The female labor force participation rate has increased rapidly, from 25 percent in 2000 to 34 percent in 2013, and is expected to rise further in the coming years. Nongovernmental organizations played an important role in mobilizing women to use microcredit and generate self-employment, and the fast-growing readymade garments industry proactively recruited female workers to their factories. The total number of employed women nearly doubled between 2003 and 2013 and gender wage differentials narrowed. Challenges remain for further increasing the participation rate and self-employment and reducing wage differentials. Access to finance by women is one of the ways to address the challenges, and SOBs, as they modernize, stand to provide better access to women. The project will have gender-disaggregated client satisfaction surveys as one of the project results indicators.

39. **Citizen Engagement.** The project will have gender-disaggregated client satisfaction surveys as one of the project results indicators. In addition, a third-party firm will be hired as part of the M&E activities to conduct similar satisfaction surveys with the primary and secondary level beneficiaries specifically identified in section II (paragraph 35). Special attention will be given to small and medium enterprises and firms in sectors that are crucial for growth; rural farmers and all others who live on agriculture or agro-based industries and benefit from financial services of the SOBs; and the unbanked population of the country, including women, pensioners, and population segments which come under the GOB's social safety net programs, to assess improvements in service delivery due to the implementation of the project. The surveys will be administered at project start (baseline), mid-term and project closing. The surveys will also

capture suggestions for improvement from the particular beneficiary groups. Feedback from the surveys would be factored into project implementation.

40. The project is rated Environmental Category C according to OP 4.01, due to minor environmental impacts.

41. The project also had its climate and disaster risk screening conducted during preparation. While Dhaka is prone to floods, with at least a moderate exposure, their impact on banks has not been major with regard to financial losses. Nevertheless, the banks have to make adequate disaster recovery and business continuity arrangements in preparation for the future floods, which will occur with a high degree of certainty. With adequate preparation and disaster recovery/business continuity arrangements in place, a potential impact of future floods on banks should not exceed low impact. In terms of the effect on outcomes/service delivery, the new IT investments and stronger capacity of state bank owners, managers, and staff will allow for smarter ways of running the banks and more efficient management of resources. The new MIS, data quality, and risk management techniques will also allow better preparation for and adaption to various risks and eventualities, including the regularly occurring floods.

42. Any works under the Project shall carried out be in accordance with the provisions and arrangements set out in the Operations Manual, including but not limited to screening criteria that limits such works to small-scale refurbishment at existing sites. Any such works shall duly incorporate the requirements of the Bank's safeguard policies.

Monitoring and Evaluation

43. A strong M&E framework is essential to systematically track inputs, outputs, and outcomes for the various components of the project. The proposed framework and indicators will be discussed with the BFID (see Annex 1).

44. The PIU at the BFID will establish standard formats with baseline information and data, guidelines for data collection, and report updates of M&E to the PSC. The PIU will be responsible for overseeing and coordinating this process. The PSC will provide strategic policy guidance and oversight of the project implementation.

45. The Bank will evaluate progress on the proposed indicators through regular reporting by the PIU and through implementation support missions, including the midterm review. The midterm review is expected to be in month 30 of implementation. The PIU will submit quarterly reports, tracking output and outcome indicators, and semiannual FM reports. A project audit will be undertaken annually in line with the TOR included in the OM. In addition, a beneficiary feedback mechanism to be integrated into the project will be monitored during implementation through an indicator on citizen engagement

Annex 4: Implementation Support Plan

BANGLADESH: Modernization of State-Owned Financial Institutions Project

Strategy and Approach for Implementation Support

1. The Bank will support the implementation of the project and provide the technical advice necessary to facilitate the achievement of the PDO.

2. The project will have several high-value contracts, as a centralized procurement of common IT infrastructure and services—IT systems and goods, distribution, and servicing will be followed for all the SOBs. The bidding documents of all major IT and BPR contracts will be prepared by the BFID with support of an international consulting firm hired under the FSSP, and ready for tendering before the project gets approved by the Bank Board. The Bank task team for project preparation has provided necessary inputs and advice—both technical and fiduciary—to the BFID in this important project preparatory exercise, completion of which is one of the readiness filters of projects for Board submission. The BFID has already formed a PCU to support the project preparation.

3. Throughout the project duration, the Bank team will closely monitor the project on semi-annual implementation support missions. During the implementation support missions, the Bank will ensure that the financial arrangements agreed on are respected and will assess if any additional training or support is needed. The Bank team will review and clear the audit TOR, review the audit reports and Interim Financial Reports received, and provide its feedback on time. The project team will also be responsible for reviewing all prior review procurement contracts.

4. Technical assistance support under the project will largely be provided by consultants, and the Bank team will review their TOR and the deliverables and engage in reviewing the technical assistance performance during implementation support missions.

5. The Bank's implementation support will follow a risk-based approach. At least two implementation support visits will be carried out annually, with additional visits if needed. The audit reports and the interim and annual financial statements, respectively, in addition to the management letter, will be reviewed on a regular basis by the Bank FM specialist, and the results or any issues will be followed up during implementation support visits. It is proposed that project task leadership will, to the extent possible, also be shared between a headquarters staff member and a country office-based staff member. Also, during the Bank's implementation support missions, the project's FM and disbursement arrangements will be reviewed to ensure compliance with the Bank requirements and to assess the FM performance for the Implementation Status and Results Report.

6. The Bank's fiduciary team, which is currently based in Dhaka, will advise and support the BFID in FM and procurement. The PIU at the BFID will be in charge of all the procurements and contract management under the project, and its staff will receive training and capacity-building support under other core public FM and procurement programs financed by the Bank. Both the PIU and BFID staff will be provided specific training on issues such as Bank procurement and strengthening financial controls, including internal audit.

Implementation Support Plan

7. The Bank implementation support team will consist of technical specialists from its Finance and Markets Global Practice, as well as specialists in operations, procurement, FM, safeguards, and M&E. The external communications specialist will advise on the project's communications strategy.

8. Technical specialists will review project documents, including TOR, bidding documents, and consultant reports. They will also conduct site visits to assess progress in the field and consult with the financial sector stakeholders, including think tanks, on project implementation progress.

9. During project implementation, support will be provided, as indicated in Table 4.1 and Table 4.2.

Table 4.1. Implementation Support Plan

Time	Focus	Skills Needed	Resource Estimate (US$)	Partner Role
First 12 months	Fiduciary and safeguards management; operationalizing Components 1 and 2; M&E baseline communications; strategy and awareness building	Please refer to table 4.2.	180,000	
12–60 months	Project management and implementation support	Please refer to table 4.2.	170,000 per year	

Table 4.2. Skills Mix Required

Skills Needed	Number of Staff Weeks	Number of Trips	Comments
Financial sector specialist and task team lead	12	Minimum of two per year	Overall supervision and implementation support
Financial sector specialist and task team lead	10	Dhaka based	Overall supervision and implementation support
Banking sector specialist	8	Minimum of two per year	Will provide technical support in the implementation of Component 1
Bank IT infrastructure, including AML/CFT systems	10	Minimum of two per year	Will provide technical support in the implementation of Component 2
Corporate governance specialist	8	Minimum of two per year	Will provide technical support in the implementation of Component 3
Legal counsel	2	One per year as needed	Will provide legal support in the implementation
Fiduciary specialists	10	Dhaka based	Will support supervision

Annex 5: Economic and Financial Analysis

BANGLADESH: Modernization of State-Owned Financial Institutions Project

1. **The proposed PDO** is to contribute to the modernization, transparency, and efficiency of SOBs. It is planned to achieve the objective by investing in modernization of the banks' IT systems and improvements in bank operations through better processes and governance. These investments are expected to result in cost savings leading to higher efficiency. The IT modernization is also expected to lead to more regular, detailed, and reliable data of bank operations, which will be available to the bank management, boards, regulator, auditors, and the general public, thus resulting in more transparency of SOB performance.

2. **Methodology of the economic and financial analysis.** Due to the nature of activities financed under the project, a monetary value cannot be assigned to all benefits to calculate the project's net present value (NPV). Therefore a simplified yet conservative approach is used to arrive at the NPV and the internal rate of return (IRR).

3. **A few important caveats.** First, the projected life expectancy of benefits is far superior to the duration of the project. This means that most of the benefits will accrue after the completion of the project while most costs will be up front. Second, most of the project's benefits are not quantifiable, in particular for the capacity-building and governance component (Component 3). In light of the above, the analysis includes both a quantitative and qualitative discussion of the projects costs and benefits and concludes with a discussion on the rationale for public intervention and the value-addition of the Bank Group.

Mapping out the Project's Activities and Beneficiaries

4. **The project's direct beneficiaries are banks owned by the GOB.** They will be the main recipients of investments and advisory services financed through the project. The investments will mostly be IT solutions and hardware. The advisory services will deliver new processes, workflows, staff and managerial arrangements, governance approaches, decision-making flows and other social capital enhancements in the SOBs. These tangible investments and social capital improvements will result in more efficient and profitable operations of the SOBs and generate incremental returns on assets compared to status quo. These returns will be generated at a lower level of risk given that the banks' assets and capital will be better protected because of the improvements in operations and governance.

5. **Indirect beneficiaries will be customers of the SOBs:** (a) depositors and other creditors for whom the risks of entrusting their funds to the SOB will reduce and (b) borrowing clients who can expect to get a broader menu of products and services, delivered with higher efficiency and at lower costs compared to the current choice. Finally, all Bangladeshi taxpayers will benefit from a safer deployment of public equity investments in the banking sector and more efficient management of public assets by the GOB as the owner of the SOBs. Resulting benefits to the society at large are unquantifiable but certainly positive.

Rationale for Public Funding (for Overall Project)

6. **The main rationale for the GOB borrowing from IDA and investing these public resources in the banks is public ownership of the banks.** As any owner, the GOB has to stand behind the for-profit institutions it owns and protect against a loss and maximize efficiency of the public capital deployed in the SOBs. The GOB already has a multiyear SOB recapitalization program whereby additional equity is injected every year into those banks which lack adequate capital for regulatory purposes. Investing in modernization of the IT systems and enhancement of social capital in the SOBs extends the same rationale of (a) fulfilling ownership duties and (b) protecting public investments and making them more efficient. Counterfactual presents the GOB, as the owner of SOBs, with two options: either divesting itself from the banks and passing the ownership duties to private owners, or seeing its investments lose value and competitiveness because of insufficient capital and investments. The latter also has to consider increased risks of (a) regulatory enforcement actions because of violation of prudential ratios and (b) loss of value because of weak management systems, new scams, and cybercrimes to which the SOBs will become increasingly exposed and vulnerable unless critical upgrades in its IT systems and governance practices are made.

Value-addition of the Bank

7. **Value added of the Bank Group primarily comes from a long-term global experience in implementing integrated solutions for state-owned companies and financial institutions in particular.** The SOBs demand a complex and holistic approach in an attempt to improve their performance and governance. There are multiple stakeholders and variables in the optimization formula, including, but not limited to, board and management arrangements; structure of exercising ownership by the state; banks' processes and workflows; IT systems; decision-making flows; credit underwriting, risk management, and internal control enhancements; optimal level and mode of equity capital, including bank restructurings and mergers; solutions for resolving undercapitalized banks; determining mandates for the SOBs (particularly for specialized and development banks); addressing the burden of hidden social costs on the banks, and so on.

8. **In the case of Bangladesh in particular, the solutions required are of a high degree of complexity.** There are more than 10 banks in the state's ownership, some without proper banking licenses, some being specialized institutions, and some having major capital deficiencies and being technically insolvent, all having rudimentary IT systems at best, many operating at suboptimal levels of efficiency. Political economy of banking adds a layer of complication by virtue of insufficiently strong and arm's-length boards, high levels of NPLs, no clear strategy for divestments, and slow speed of recapitalizing SOBs. The Bank Group can provide superior value added to the GOB not only by extending long-term financial resources to finance the necessary investments in the SOBs but also by advising the GOB and banks on options for developing the banking sector in general and the SOB segment in particular, including optimization solutions amidst various constraints and considerations facing the authorities and bankers. In particular, the Bank Group brings superior expertise in procuring large IT solution packages, both with regard to the content of the solutions and the procurement process itself. Furthermore, the Bank Group brings its professional impartiality and globally informed technical approach as convening powers in the national deliberations on reforms, such as the SOB reform in Bangladesh.

Financial Analysis

9. **Financial analysis of the project was done using the expected actual investments and highly conservative estimates of project benefits.** The expected investments match the amounts and timing of expected IDA disbursements for 2016–2020, totaling US$150 million, which are increased by US$10 million per year to account for the GOB cofinancing. A total of US$200 million is therefore expected to be invested into SOB modernization and governance improvements during the project lifetime.

10. **As discussed above, some benefits extend to the society at large and are too complex to estimate.** The financial analysis therefore limits the benefits to incremental increases in SOB ROA. It is estimated that the benefits will extend for multiple years; for the purposes of the analysis, an 8-year period of 2021–2028 is used for generating the benefits, although it is likely that a part of the benefits from the project's investments will manifest itself before the completion of the project. No benefits resulting from positive spillovers to indirect beneficiaries (bank customers and taxpayers) are considered.

11. **Three scenarios are considered: pessimistic, baseline, and optimistic.** In the simplified approach, assumptions include (a) annual growth of total SOB assets, from the 2015 baseline of US$40.67 billion; (b) initial incremental increase in the ROA in 2021; and (c) incremental increases in ROA, attributable to the project's investments, during 2022–2028. There will be additional expenses for annual maintenance of the new IT systems; it is assumed that they will be more than covered by efficiency improvements and cost savings brought by the same systems, as well as better governance and operational processes of the SOBs.

12. **Discount rate also varies depending on a scenario.** A conservatively high discount rate of 10 percent is used for the pessimistic scenario, heavily discounting future incremental revenues. A rate of 6.75 percent is used for the baseline scenario. This rate reflects the current March 2016 key policy (repo) rate of the BB. Finally, the optimistic scenario presumes a further decrease of overall interest rate levels in Bangladesh and uses a rate of 5 percent in the calculation.

Table 5.1. Project NPV and IRR – scenario analysis

Scenarios	Initial Increase in ROA Year 2020 (%)	Annual Increase in ROA Years 2021–2028 (%)	Asset Growth Years 2021–2028 (%)	Discount Rate (%)	NPV	IRR (%)
Pessimistic	0.10	0.10	0	10.00	(16)	8.010
Baseline	0.20	0.30	3	6.75	481	33.13
Optimistic	0.30	0.40	6	5.00	1,130	45.70

13. **The NPV and IRR have been calculated for all three scenarios.** Only in the pessimistic scenario, with a very low likelihood of occurrence, the NPV turns out slightly negative, while the IRR remains slightly below the discount rate. In the baseline and optimistic scenarios, the NPV and IRR are strongly positive. Once again, these assumptions are highly conservative, and not all benefits are directly considered. Overall, the scenario analysis suggests

a positive outcome and impact of the intended project investments. They should subsequently raise the market value of SOB equity, giving the banks a stronger competitive edge.

Project Impact

14. **Weak governance remains the major cause of concern in the banking sector, and this has resulted in the current level of capital shortage of the SOBs.** Recent scams in the banking sector and global economic downturn contributed to a steady rise in NPLs, from 6.1 percent in December 2011 to 9.67 percent in June 2015. NPLs in particular grew in the SOBs which also carry significant social/developmental functions.

15. **The CAR of SOCBs, at 4.88 percent, is significantly below the regulatory requirement of 10 percent.** The undercapitalization of SOBs improved slightly this year due to the GOB's capital infusion into the banks in two consecutive years. Nevertheless, two SOBs continue to have negative capital/CAR, and a few others are undercapitalized, necessitating major further injections of new capital by the GOB. Overall banking sector efficiency showed a declining trend and profitability was mixed among banks. The flow of credit to the private sector remained low, leading to high liquidity of the banking sector and reducing the loan-deposit ratios of many banks. This equates to lower earning assets and overall profitability.

Table 5.2. CAR of Banks in Bangladesh

	June 2015*	December 2014	December 2013	June 2013	December 2012
SOCBs	4.88	9.00	10.81	1.23	8.13
PCBs	11.84	12.54	12.52	11.48	11.38
FCBs	24.14	22.67	20.27	20.34	20.56
SODBs	−18.07	−17.35	−9.65	−8.70	−7.85
Banking sector	10.27	11.35	11.52	9.12	10.46

Source: Bangladesh Bank Department of offsite supervision.
*Note:**According to BASEL III newly introduced standards.

16. **The operating cost of the state-run development banks has increased substantially during the last couple of years.** The SOCBs were able to maintain lower level of overheads, mainly due to their low level of staff expenses (staff salary is linked with government pay scale) and large asset volumes. Overall, the financial situation of SOBs calls for improvement. As it stands, the current capital shortage just to bring the banks to the minimum CAR level is US$1.4 billion. Supporting new growth will call for further capital increases. Continuous lack of profitability and proper governance will perpetuate capital injections, leading to uncomfortable fiscal costs.

17. **The project offers an obvious potential to alleviate the fiscal costs of SOBs.** First, the BPR and IT components stand to improve processes, workflows, business planning, technological solutions, and operational security, also reducing vulnerabilities to frauds, scams, and cyber threats. Second improvements in corporate governance, including clarification of bank mandates, would ensure sustainable business strategies and activities and their oversight. Finally, for the banks with capital shortages, the recapitalization options to be developed as part of the BPR exercise would seek to propose least-cost fiscal solutions for bringing the banks to statutory capital adequacy levels. All these efforts will lead to improvements in fiscal outlays for bank capital and SOB operational performance and profit generation for building up equity.

Table 5.3. Profitability and Operational Efficiency

	June 2015	December 2014	December 2013
Overhead cost to total assets (%)	1.61	1.60	3.22
SOCBs	1.14	1.02	2.57
PCBs	1.62	1.65	3.51
FCBs	3.25	2.02	3.00
SODBs	5.28	3.78	3.07

Source: Bangladesh Bank Department of off-site supervision.

Table 5.4. Profitability and Operational Efficiency (in percent)

	June 2015	June 2014	December 2013	June 2013	December 2012
ROA	0.47	0.61	0.90	0.61	1.16
SOCBs	−0.60	−0.09	0.59	0.60	0.75
PCBs	0.89	0.78	0.95	0.73	1.19
FCBs	3.05	3.48	2.98	3.44	3.78
SODBs	−1.50	−0.87	−0.40	−0.53	−0.04
NIM	0.71	0.73	1.33	0.86	2.19
SOCBs	−0.43	−0.40	1.82	0.00	0.81
PCBs	1.17	1.18	1.15	1.16	2.62
FCBs	1.31	1.34	1.96	1.89	4.44
SODBs	0.66	0.40	0.41	0.58	1.21
Interest rate Spread*					
SOCBs	3.72	3.58	–	3.66	4.06
PCBs	4.99	5.38	–	5.34	5.51
FCBs	7.22	7.98	–	8.59	8.76
SODBs	2.06	3.19	–	3.06	2.73

Source: Bangladesh Bank Department of off-site supervision.
Note: *As of October 31, 2015.

Annex 6: Governance and Accountability Action Plan

BANGLADESH: Modernization of State-Owned Financial Institutions Project

Introduction and Background

1. The overall objective of the GAAP is to highlight the risks associated with the SOFI Project and to delineate approaches to ensure effective and smooth implementation of the project through reducing potential risks. The GAAP will outline specific responsibilities of the BFID to facilitate effective and appropriate use of the funds for the project and maintain good governance in the management and implementation of project activities. The key elements of the GAAP are (a) measures to safeguard procurement and FM, (b) measures to ensure coordination among different banks and between GOB and BFID for effective implementation of the project, and (c) measures to establish an efficient IT procurement management.

2. The GAAP assesses the governance and fiduciary risks envisaged in the context of Bangladesh during the project tenure. The GAAP is expected to be reviewed and adjusted as and when necessary during the project implementation period to reflect any emerging governance issues and/or to reinforce existing actions and add new ones. The Action Plan will be monitored regularly through the measures agreed upon with the implementing agency, as well as during the Bank implementation support visits.

Context for Risk Assessment

3. In recent times, Bangladesh has undertaken various initiatives with a view to improving the quality of governance and has managed to make progress in governance indicators. Based on the global indicators, it is deemed essential to continue the effort of improving governance as a key priority to achieve the development aspirations. The core governance systems are being underway for improvement through strengthening of core governance institutions. To combat corruption, legal framework under the Anti-Corruption Commission has been in place. Aiming to increase the transparency, the Right to Information Act 2009 has been enacted with a view to facilitate greater access of citizens to public documents. Massive automation initiatives have been taken to reduce people-to-people interactions to get public services. The National Integrity Strategy has also been adopted in 2014 to improve moral and ethics of the public servants in the country. Although Bangladesh has improved its governance culture to a great extent, there is still scope for improvement in the public sector governance. Pertinently, ensuring good governance in the implementation of this project would require an action plan to mitigate probable corruption and governance risks that are relevant to the project.

4. The project will directly support the GOB priority agenda for financial sector development, as highlighted in the 7th Five-year plan. It is anticipated that the GOB would continue its support for the objectives and activities proposed under the project. Furthermore, the proposed project is designed in close consultation with the BFID of the MOF, BB, and senior management teams of the concerned SOBs where a strong leadership is in place, a momentum for reforms exists, and the activities planned under the project are fully owned by the concerned parties.

Governance in Financial Sector

5. Financial institutions play a vital role of intermediation and serve the diverse financial needs of the growing economy such as Bangladesh. Magnitude of their role underscores the importance of governance in the financial sector. A number of initiatives have been taken to ensure good governance with particular focus on the accountability and transparency of the management in the financial sector of Bangladesh. Legislative framework related to the financial industry has been revised with a view to help improving governance and strengthen discipline in the financial system. Most of the business functions at the central bank have already been automated with the help of a vigorous IT infrastructure. Such automation ensured the financial discipline and enhanced governance in FM of the country as a whole. The BB undertook several measures to intensify financial sector supervision and to fortify financial sector governance. However, governance is an issue of continuous scrutiny and is addressed on a regular basis as and when required.

6. The modernization of SOFI project outcomes are designed to be realized through focusing on the following areas: (a) review and redesign of SOBs' internal tools, processes, workflows, reporting lines and overall structure for risk management, credit process (including internal rating systems and internal scoring systems as necessary), internal controls, and SOB governance arrangements; (b) SOB automation—introduction of automated (IT-based) tools and systems for risk management; loan origination, monitoring, and collection; internal audit, compliance, and internal controls; and (c) capacity building—SOB staff training on the new tools and practices, as well as core competencies (for example, credit underwriting, risk management, customer accounts management). The expected activities of the project will ensure good governance by enhancing integrity and transparency of the systems at the state-owned financial institutions.

Description of Governance Risks and Mitigation Actions

7. The following four areas of governance and accountability risks have been identified under SOFI: (a) project formulation and design; (b) project implementation and oversight; (c) procurement capacity, including contract management; and (d) FM capacity.

8. A number of governance risks/issues are associated with the implementation of the project. These risks are categorized under the four areas mentioned above. The GAAP matrix delineates mitigation actions for each of these issues, timeline for each action, and responsible official/agency for implementation. The GAAP matrix is presented below.

Disclosure of Project Information

9. The PIU at the BFID will upload all project-related information in its official website. They will also be updated regularly. A staff member of the PIU will be assigned as a designated information officer. Besides, the BFID and the PIU will ensure due diligence in all other information disclosure in the light of the Right to Information Act 2009.

GAAP Monitoring, Remedies and Sanctions

10. The Bank will apply sanctions according to its guidelines if it determines incidences of fraud, corruption, collusion, and coercive practices. These sanctions may include fines, blacklisting, suspension of disbursements, or ultimately cancellation with respect to that contract. The Bank will seek first to remedy cases of corruption through cooperation with the BFID. Information regarding such cases, where lessons are learned and funds are retrieved, will be widely disseminated.

11. The GAAP will be monitored regularly through indicators and reflected in progress reports by the implementing agency, as well as in Bank implementation supervision reports and aide memoires for supervision missions. The GAAP matrix will be used widely for monitoring purposes. Any 'early warning' indicators of governance and accountability risks will be monitored regularly so that corrective measures could be carried out promptly. A governance specialist will also be included in the Bank supervision team to strengthen the dialogue on the governance and accountability issues with the implementing agency.

12. The project will require intensive supervision by Bank staff. Supervision arrangements for this project, particularly for procurement and FM, are extensive. Throughout the project duration, the Bank team will closely monitor the project on semiannual implementation support missions. The Bank will also conduct regular monitoring between supervision missions.

13. The GAAP will be adjusted as necessary during implementation to reflect governance issues which may emerge and/or to add actions. Considering the project design and fund flow and oversight arrangements and subject to meeting the agreed GAAP, the implementing agency will have adequate systems to account and report for the project resources and expenditures accurately and ensure that the project funds are used for the intended purpose.

Table 6.1. GAAP – key aspects

Issues/Risks/Objective	Mitigation Actions/Features	Timeline/ Periodicity	Reporting Framework/Agency Responsible
A. Project Design and Formulation			
Ensure ownership and participation of the concerned stakeholders for successful implementation of the project.	Meeting with core project counterparts and stakeholders • for in-depth discussions; • to get the appropriate requirements and areas of cooperation; and • to finalize the project design and implementation arrangements. The BFID confirms taking all the necessary measures to prepare the project alongside the Bank and ensure its readiness for the project implementation.	Before approval of the project by the • Planning Commission, the competent authority of the GOB and • the Bank's Board of Executive Directors in June 2016.	BFID

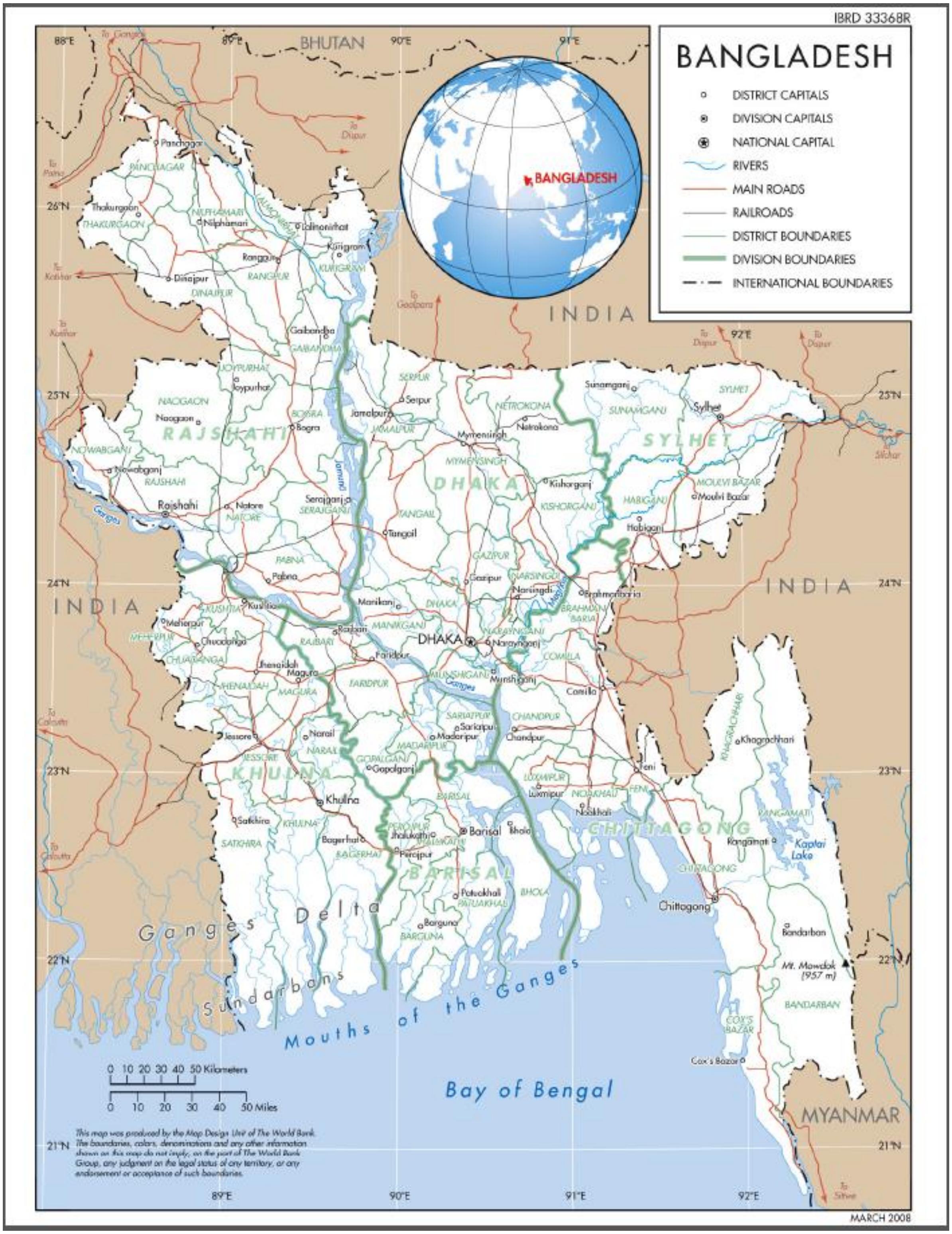
Issues/Risks/Objective	Mitigation Actions/Features	Timeline/ Periodicity	Reporting Framework/Agency Responsible
B. Project implementation and supervision			
Ensure timely guidance from appropriate authority to address the critical issues on policy and major implementation aspects of the project.	• A PSC will be formed chaired by the secretary of the BFID including one deputy governor of the BB, senior representatives from the Finance Division, Economic Relations Division, Implementation M&E Division and Planning Commission, the MDs of the concerned financial institutions. The PD will act as the member secretary to the PSC.	Meeting of the PSC will usually be convened on a semiannual basis. However, the PSC may meet anytime if required.	PD (SOFI)
	• Implementation of each component will be assigned to a CL who will give the overall guidance to the implementation team.	Will be assigned at the start of project implementation	PD (SOFI), PIU
Ensure smooth functioning of the PIU.	• Responsibility for project management will be entrusted to a PD who will be appointed by the GOB or hired from the market. • A full-time DPD will be appointed to carry out the project activities. • A PIU will be formed to carry out the duties for implementation of the project.	After necessary approval of the project	BFID
Ensure getting relevant approvals on time from the concerned GOB agencies.	As the PSC consists of senior members from all the concerned GOB agencies, if any approval needs special attention, it will be raised in the PSC meeting and intervention by the PSC members will help get approvals on time.	As and when required	PIU
Ensure proper M&E of the project achievements and implementation process.	• Engage an M&E specialist to support the PIU. • Develop a strong M&E framework with the help of an M&E specialist.	• Hiring expert: At the beginning of the project • Reporting: All required reports will be prepared on time	PIU, PD
Full cooperation of the concerned state-owned financial institutions under the project scope	• Coordination meeting will be arranged with all the financial institutions on a regular basis. Special meetings will be held as and when necessary. • There will be a senior-level official in each financial institution who will be responsible for ensuring implementation at that particular organization.	Throughout the project life	The PD will play the coordination role.
Ensure adequate and appropriate members	• The PIU will hire part-time technical specialists as required to support the	As and when necessary during	PD and PIU

Issues/Risks/Objective	Mitigation Actions/Features	Timeline/ Periodicity	Reporting Framework/Agency Responsible
and resources in the implementation teams for proper supervision/monitoring of subcomponents' implementation.	BFID in the implementation of the main components. • The PIU will be staffed adequately and will support implementation of the overall project. • To provide support to the BFID's technical teams, a number of technical experts and consultants will be hired and assigned to the proposed IT organization. • To assist the BFID in implementing the BPR under Component 1, one or multiple consulting firms will be hired. • One IT advisor and one banking expert will be hired for the BFID for the initial three years to help the BFID strengthen its capacity and better perform its ownership role. • For HR capacity building and carrying out a training needs assessment and a training plan for SOB staff, an HR advisor will be hired to support the HR development activities of the SOB.	the implementation	
C. Procurement Management			
Ensure an appropriate Procurement Plan is in place.	• A draft Procurement Plan covering all major procurement has been prepared for the entire duration of the project. • The Procurement Plan has been agreed upon between the borrower and the Bank and will be made available on the Bank's external website. • The Procurement Plan will be updated by the MOF, at least annually, to reflect actual implementation needs in consultation with the Bank.	Before the necessary approval of the project	BFID
Ensure procurement process in accordance with appropriate guidelines	• Procurement would be carried out in accordance with the Bank's Procurement Guidelines and Consultant Guidelines, as well as the specific provisions stipulated in the Financing Agreement. • PIU officials will be imparted suitable training to have adequate understanding of IDA procurement procedures, rules, and regulations and having good understanding in the Bank's Procurement Guidelines.	As and when necessary	PD

Issues/Risks/Objective	Mitigation Actions/Features	Timeline/ Periodicity	Reporting Framework/Agency Responsible
Ensure procurement related information and all documents will be made available on time in accordance with the procurement regulations.	• A General Procurement Notice for all major procurement to be financed by the project and Specific Procurement Notices will be published on time on the Bank's external website and United Nations Development Business in accordance with the procurement provisions.	As and when required	BFID PIU
Ensure completion of procurement processes in time.	• A detailed Procurement Plan and work schedule has been prepared to ensure a smooth flow of procurement under the project. Procurement processes will be carried out according to the Procurement Plan.	Throughout the project tenure	PD and PIU
Ensure transparency, accuracy, and efficiency in procurement process.	• The MOF shall nominate one designated procurement focal point for the project having sound knowledge in procurement and having formal training, both on the Bank's Guidelines as well as on the PPA and PPR. • The focal point will support the PIU in day-to-day procurement follow-up and preparation of periodic procurement reporting. • This focal person will be a mandatory member of all evaluation committees for procurement implemented by the MOF. • The MOF will appoint a Bid Evaluation Committee (BEC), including government staff and international/local procurement and IT consultants, to provide quality assurance of the bidding process and implementation of large value procurement processes. • All information pertaining to bidding and procurement will be made publicly available upon finalization of Procurement Plans through the website of the CP TU of the GOB.	Throughout the project tenure	PD and PIU
D. Financial Management			
Ensure correct recording of all transaction and balances and supporting the preparation of periodic and reliable financial statements.	• A project budget will be maintained for the entire term of the project. • Detailed budgets for each fiscal year on each project component and cost category will be produced to provide a framework for FM monitoring purposes. • These budgets will be monitored periodically to ensure actual	From the start of the project and during the entire project period	PD, PIU, and participating entities

Issues/Risks/Objective	Mitigation Actions/Features	Timeline/ Periodicity	Reporting Framework/Agency Responsible
	expenditures are in line with the budgets and to provide input for necessary revisions. • All procurement records and documents will be preserved in accordance with provisions of the PPA 2006. • These records will be made readily available on request for audit, investigation, or review by the GOB and the Bank. • All project-related documents will be filed separately to facilitate internal and external audits and reviews by the Bank. • The project will use dedicated software to account for project transactions and all transactions will follow Government review and approval procedures.		
Ensure appropriate processes for fund flow and disbursement.	• An FM specialist with suitable qualifications will be hired under the PIU to lead and coordinate FM activities under the project. • Disbursement of project fund will initially be –based on Statements of Expenditure. • Based on the quality of FM performance of the PIU, disbursement modality may be converted to one based on IUFRs including a six-monthly forecast of fund requirements.	During the entire project period	PD and PIU
Ensure proper control and risk management mechanism in project FM and make the financial statement reliable and consistent.	• Internal audits of the project must be carried out on a yearly basis during the life of the project. • The project will be under the purview of external audits (Foreign Aided Project Audit Department of the Office of the Controller and Auditor General of the GOB).	Every year throughout the project tenure	MOF, comptroller and auditor general

MAP



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BANGLADESH
DISTRICT CAPITALS
DIVISION CAPITALS
NATIONAL CAPITAL
RIVERS
MAIN ROADS
RAILROADS
DISTRICT BOUNDARIES
DIVISION BOUNDARIES
INTERNATIONAL BOUNDARIES
BHUTAN
INDIA
MYANMAR
BANGLADESH
RAJSHAHI
DHAKA
SYLHET
KHULNA
BARISAL
CHITTAGONG
DHAKA
Rajshahi
Dinajpur
Rangpur
Mymensingh
Sylhet
Khulna
Barisal
Chittagong
Comilla
Jessore
Cox's Bazar
Ganges Delta
Sundarbans
Mouths of the Ganges
Bay of Bengal
Kaptai Lake
Mt. Mowdok (957 m)
0 10 20 30 40 50 Kilometers
0 10 20 30 40 50 Miles
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