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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT PAPER

ON A

PROPOSED ADDITIONAL GRANT

IN THE AMOUNT OF SDR 7.6 MILLION
(US\$10.5 MILLION EQUIVALENT)

TO THE

EAST AFRICAN COMMUNITY

FOR A

FINANCIAL SECTOR DEVELOPMENT AND REGIONALIZATION PROJECT I

September 8, 2016

Finance and Markets Global Practice
Africa Region

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CURRENCY EQUIVALENTS
(Exchange Rate Effective as of July 31, 2016)

Currency Unit =
TZS 2186 = US\$1
SDR 0.72 = US\$1

GOVERNMENT FISCAL YEAR
July 1 – June 30

ABBREVIATIONS AND ACRONYMS

AF	Additional Financing
AML/CFT	Anti-Money Laundering / Combatting the Financing of Terrorism
ASA	Advisory Services and Analytics
BOU	Bank of Uganda
CAS	Country Assistance Strategy
CBK	Central Bank of Kenya
CDs	Council Directives
CMA	Capital Markets Authority
CMI	Capital Markets Infrastructure
CMIPC	Capital Markets, Insurance and Pension Committee
CSD	Central Securities Depositories
EAC	East African Community
EAPSA	East Africa Pension Supervisors Association
ERR	Expected Rate of Return
ESMID	Efficient Securities Market and Institutions Development
FCCL	Fiscal Commitment and Contingent Liability
FISF	Financial Inclusion Support Framework
FSAP	Financial Sector Assessment Program
FSDRP I	Financial Sector Development and Regionalization Project I
GDP	Gross Domestic Product
GIIF	Global Index Insurance Facility
GoT	Government of Tanzania
GP	Global Practice
IAIS	International Association of Insurance Supervisors
ICP	Insurance Core Principles
IDA	International Development Association
IFPPP	Infrastructure Finance Public Private Partnerships
IMF	International Monetary Fund

IOSCO	International Organization of Securities Commissions
IP	Implementation Progress
IRA	Insurance Regulatory Authority
IT	Information Technology
KRB	Kenya Roads Board
KWS	Kenya Wildlife Service
PAT	Project Administration Team
PDO	Project Development Objective
SACCOS	Savings and Credit Cooperative Society
SCFEA	Sectoral Council on Finance and Economic Affairs
SCLJA	Sectoral Council on Legal and Judicial Affairs
SME	Small Medium Enterprise
T&C	Trade and Competitiveness
TA	Technical Assistance
TWG	Technical Working Group
UFA	Universal Financial Access
WBG	World Bank Group

Regional Vice President:	Makhtar Diop
Country Director:	Ahmadou Moustapha Ndiaye
Senior Global Practice Director:	Gloria M. Grandolini
Practice Manager:	Irina Astrakhan
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ADDITIONAL FINANCING DATA SHEET

Africa

EAC Financial Sector Development and Regionalization Project I: AF (P160770)

AFRICA

GFM01

Basic Information – Parent				
Parent Project ID:	P121611	Original EA Category:	C - Not Required	
Current Closing Date:	30-Sep-2016			
Basic Information – Additional Financing (AF)				
Project ID:	P160770	Additional Financing Type (from AUS):	Scale Up	
Regional Vice President:	Makhtar Diop	Proposed EA Category:		
Country Director:	Ahmadou Moustapha Ndiaye	Expected Effectiveness Date:	01-Nov-2016	
Senior Global Practice Director:	Gloria M. Grandolini	Expected Closing Date:	30-Sep-2019	
Practice Manager/Manager:	Irina Astrakhan	Report No:	PAD2022	
Team Leader(s):	Smita Wagh			
Borrower				
Organization Name	Contact	Title	Telephone	Email
EAC	Dr. Enos Bukuku	Deputy Secretary General, Planning and Infrastructure	255272162100	ebukuku@eachq.org
Project Financing Data - Parent (Financial Sector Development & Regionalization Project I (FSDRP I)-P121611) (in USD Million)				
Key Dates				

Project	Ln/Cr/TF	Status	Approval Date	Signing Date	Effectiveness Date	Original Closing Date	Revised Closing Date
P121611	IDA-H6410	Effective	31-Jan-2011	14-Feb-2011	20-Jun-2011	30-Mar-2014	30-Sep-2016

Disbursements

Project	Ln/Cr/TF	Status	Currency	Original	Revised	Cancelled	Disbursed	Undisbursed	% Disbursed
P121611	IDA-H6410	Effective	XDR	10.50	10.50	0.00	10.21	0.29	97.28

Project Financing Data - Additional Financing EAC Financial Sector Development and Regionalization Project I: AF (P160770)(in USD Million)

Loan Grant IDA Grant

Credit Guarantee Other

Total Project Cost: 10.50 Total Bank Financing: 10.50

Financing Gap: 0.00

Financing Source – Additional Financing (AF)	Amount
IDA Grant	10.50
Total	10.50

Policy Waivers

Does the project depart from the CAS in content or in other significant respects? No

Explanation

Does the project require any policy waiver(s)? No

Explanation

Team Composition

Bank Staff				
Name	Role	Title	Specialization	Unit
Smita Wagh	Team Leader (ADM Responsible)	Senior Financial Sector Specialist	Technical	GFM01
Winter M. Chinamale	Procurement Specialist (ADM Responsible)	Senior Procurement Specialist	Procurement	GGO01
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Issa Thiam	Team Member	Finance Officer	Finance	WFALA
Jane A. N. Kibbassa	Team Member	Senior Environmental Specialist	Safeguards	GEN01
Shingira Samantha Masanzu	Counsel	Counsel	Legal	LEGAM
Thilasoni Benjamin Musuku	Team Member	Senior Financial Sector Specialist	Technical	GFM01
Extended Team				
Name	Title		Location	

Locations					
Country	First Administrative Division	Location	Planned	Actual	Comments
Rwanda		Republic of Rwanda			
Tanzania		United Republic of Tanzania			
Kenya		Republic of Kenya			
Uganda		Republic of Uganda			
Burundi		Republic of Burundi			
Institutional Data					
Parent (Financial Sector Development & Regionalization Project I (FSDRP I)-P121611)					
Practice Area (Lead)					
Finance & Markets					
Contributing Practice Areas					

I. INTRODUCTION

1. **This Project Paper seeks the approval of Executive Directors to provide Additional Financing (AF) for the East African Community (EAC) Financial Sector Development and Regionalization Project I (P121611-FSDRP I).** The original project was an IDA grant in the amount of US\$16 million equivalent approved by the Board on January 31 2011. The proposed AF seeks US\$10.5 million over a three year implementation period, so that the project will have had a cumulative life of 8 years and 8 months when it closes on September 30, 2019. In addition, this Project Paper includes a restructuring to (i) revise the results framework; (ii) revise disbursement estimates; and (iii) carry out changes to components and costs.

2. **Since June 2011, FSDRP I has supported the EAC Partner States further their financial sector integration agenda.** The US\$16 million IDA grant, implemented by a team at the EAC Secretariat in Arusha, has been utilized to facilitate institutional development to keep pace with the rapidly growing financial sector linkages among the Partner States. FSDRP I has assisted the EAC to move forward with legal and regulatory harmonization, linking financial market infrastructure, and institution building.

3. **During project implementation, the EAC economic integration agenda has taken on a greater urgency with the Partner States committing to a single currency by 2024, by signing the EAC Monetary Union Protocol in 2013.** The ambitious timeline for the milestones that make up the path to the single currency includes the establishment of the preliminary elements of a regional financial architecture by 2018. As this high-level agenda moves forward FSDRP I continues to serve as an important financing, policy, and convening instrument that allows the Partner States to better manage the risks and opportunities presented by closer integration in the financial sector.

4. **It is in this context that the EAC has requested AF for FSDRP I.** The activities supported by the AF will be consistent with the project development objective (PDO) of FSDRP I: to establish the foundation for financial sector integration among EAC Partner States. The AF will scale up the scope of existing activities in order to deepen the development effectiveness of the project and build on the momentum attained by focusing on the policy areas that have seen the most progress thus far. In particular, the AF will move the financial sector integration agenda forward in the EAC by (a) supporting the formulation and implementation of financial inclusion policies at the regional level; (b) furthering the harmonization of the legal and regulatory frameworks, and; (c) strengthening regional capacity to administer an increasingly interconnected financial sector.

II. BACKGROUND AND RATIONALE FOR ADDITIONAL FINANCING IN THE AMOUNT OF US\$10.5 MILLION EQUIVALENT

A. Regional and Sector Background

5. **The origins of the EAC can be traced back to the long history of trade, administrative, and socio-cultural ties between Kenya, Tanzania, and Uganda, stretching back nearly a century.** After earlier post-Independence efforts for closer integration ended

within a decade in 1977, the EAC in its present form was formally created via a treaty agreement between Kenya, Tanzania, and Uganda in 2000. In 2007, EAC membership was extended to Burundi and Rwanda. In March 2016 the EAC Summit comprising of the Heads of State approved South Sudan's application to join the EAC. The details of South Sudan's path to full participation are still to be fully known and the AF does not propose any activities for South Sudan.

6. **Since the signing of the EAC Treaty, the Partner States have committed to an increasingly ambitious high-level regional integration agenda, which as per the Treaty, will eventually culminate in a political federation.** Along this path, the EAC implemented a customs union in early 2005. Another significant milestone was achieved with the signature of the Common Market Protocol in November 2009 and then ratified by all Partner States in April 2010. The agreement envisages the phased liberalization of trade in financial services and the elimination of restrictions on the free movement of capital. Most recently, the EAC has signed the Monetary Union Protocol, which maps the path to the creation of a single currency by 2024. Among the pre-requisites for the Monetary Union, the Protocol includes the commitment to “integrate their financial systems and adopt common principles and rules for the regulation and supervision of the financial system.”

7. **Even as policy-makers commit to an increasingly closer regional economic community, the financial sector has, in some senses, been ahead of them in recognizing the potential of the regional market.** In the financial sector this is made obvious by the number of the banks that operate in more than one of the Partner States. The basis for today's banking integration in the EAC goes back to reforms undertaken in the 1990s, when Kenya, Tanzania and Uganda adopted policies to reduce government's share in the financial sector, allowing the market to play a more important role in resource allocation. These reforms paved the way for foreign bank entry into the region. Among the first banks to enter were Barclays, Stanbic, and Standard Chartered, while several other smaller foreign banks set up greenfield subsidiaries from the second half of the nineties onwards.

8. **At present, Kenyan banks dominate cross-border banking in the EAC.** Beginning in the early 2000s Kenyan banks have grown their presence in the region such that the Central Bank of Kenya (CBK) is home supervisor to eleven banks with cross-border banking interests in the EAC, of which three are foreign controlled banks. These banks have set up a substantial branch network in the region with over 300 branches in the EAC outside Kenya as of end December 2014. Inclusive of South Sudan, this constituted 36 percent of their total branch network (Table 1). More recently, Cooperative Rural Development Bank from Tanzania has also set up shop in Burundi, signifying a deepening of the cross-border banking links in the EAC.

Table 1: Kenyan Banks Foot-print in EAC, Branch Network in 2014¹

Institution	Burundi	Kenya	Rwanda	South Sudan	Tanzania	Uganda
Kenya Commercial Bank	2	182	11	19	12	14
Diamond Trust Bank	4	51			22	33
Commercial Bank of Africa		27			11	1
Bank of Africa		34			21	35
Guaranty Trust Bank		15	18			7
Equity Bank		154	11	11	9	31
I&M Bank		31	17		8	-
African Banking Corporation		11				4
NIC Bank		29			6	1
Cooperative Bank of Kenya				2		
Totals	6	534	57	32	89	129

Source: Kenya Bank Supervision Annual Report 2014

9. **The growing presence of cross-border banks has created a more competitive market structure in the smaller financial systems and introduced a range of products and services that would not have been otherwise available.** The issue of market scale is particularly relevant to retail products that banks offer where the margins may be small but revenues are expected from the widespread uptake of such products. An integrated regional market is more likely to generate this scale. However, for the smaller financial systems to benefit from their presence, it is necessary that the local markets have the capacity to absorb the spillovers from their presence. Hence, it is necessary that local markets continue with a skills-building program that fully allows them to benefit from financial sector integration.

10. **Similarly, the case for capital markets integration is also clear, in theory.** As most markets in the region are too small to be viable on a stand-alone basis, as illustrated in Tables 2-4, regional integration is a compelling solution.² Although Kenya's capital markets overshadow the other four Partner States combined, the data also highlights the potential of an integrated market. Regional integration is arguably the most expedient way to build a deeper and more

¹ The table excludes Imperial Bank which earlier this year was placed under receivership by the Kenyan supervisor after suspected fraudulent activity. The bank's Uganda operations were bought by the Tanzanian EXIM Bank.

² This also applies to Kenya, which is by far the largest capital market in the EAC and the third largest in Sub-Saharan Africa, after South Africa and Nigeria. Nonetheless, Kenya's market is far behind South Africa's and Nigeria's markets on the basis of market capitalization and number of listed companies on the exchange. As of December 2014, the Johannesburg Stock Exchange had a market capitalization of US\$934 billion (266.7 percent relative to GDP) and the Nigeria Stock Exchange had a market capitalization of US\$63 billion (11.2 percent of GDP). South Africa and Nigeria have 330 (as of July 2014) and 189 (as of December 2014) companies listed on their exchanges, respectively.

efficient capital market that can meet the region's long-term financing needs. Hence, it follows that all the countries in the region would benefit from combining their capital markets into a single integrated EAC market with the advantages of greater scale, efficiency and visibility with institutional investors. The alternative of building independent national markets and then bringing them up to scale is costly, time-consuming, and inherently disadvantageous to small financial systems.

Table 2: Listed Securities in the EAC, May 2014

	Burundi	Kenya	Rwanda	Tanzania	Uganda	Total
Total Equity	0	64	6	21	16	107
Cross Listed						
Equity	0	1	4	7	8	20
Corporate Bonds	0	14	2	4	5	25

Source: Rwanda CMA

Table 3: Size of Individual Capital Markets in the EAC, May 2014 (USD millions)

	Burundi	Kenya	Rwanda	Tanzania	Uganda	Total
Equities	-	25,393	1,931	12,800	6,218	46,342
<i>Domestic</i>	-	25,393	859	5,751	815	32,818
<i>Cross listed</i>	-	-	1,072	7,049	5,403	13,524
Bonds	10	11,314	92	2,914	928	15,258
<i>Govt</i>	10	10,541	69	2,889	879	14,388
<i>Corporate</i>	-	773	23	25	49	870

Source: Rwanda CMA

Table 4: Size of Individual Capital Markets in the EAC, May 2014 (% of GDP)

	Burundi	Kenya	Rwanda	Tanzania	Uganda	Total
Equities	-	41.8	24.1	26.7	22.6	31.6
<i>Domestic</i>		41.8	10.7	12	3	22
<i>Cross listed</i>		0	13.4	14.7	19.6	9
Bonds	0.4	18.6	1.2	7.0	3.4	10.4
<i>Govt</i>	0.4	17.3	0.9	6	3.2	10
<i>Corporate</i>	0	1.3	0.3	1	0.2	1

Source: Rwanda CMA

11. **In practice, the path to financial market integration has been quite uneven.** For instance, institutional investors, such as pensions and insurance companies, in the EAC do not have the necessary expertise to undertake cross-border investments even when faced with a viable project. Moreover, the uneven and unclear playing field created by gaps in the existing legal and regulatory framework is frequently cited by investors as being sufficiently risky so as to be a significant deterrent.

12. **The EAC Common Market Protocol Scorecard assessed the compliance of Partner States' laws and regulations with commitments under the Common Market Protocol to eliminate restrictions in order to achieve the free movement of capital, services, and goods.**³

This stock-taking exercise identified restrictions within each area that needed to be eased or eliminated for full legal compliance of the Protocol and noted that in many instances Partner States had introduced new restrictions or carried them over from older laws after the Protocol was ratified in 2010. For instance, all of the Partner States restrict inward investment from one another and the Scorecard identified 20 operations that need to be free of restrictions to enable the free movement of capital. Only two of the operations are free of restrictions and three of the Partner States have introduced at least 10 new restrictions since 2010.

13. **It is in this context that the EAC FSDRP I has supported the Partner States⁴ shore up their institutional framework and develop capacity;** such that they are better able to manage the risks of cross-border financial flows and at the same time ensure that the benefits of a wider range of products and services offered at competitive prices is made available to their people. The project has both supplemented and complemented the various national engagements of the World Bank Group (WBG) in the financial sector.⁵

B. Description of the Original Project and Performance

14. **The EAC FSDRP I, a US\$16 million IDA grant, was approved by the Board on January 31, 2011 and became effective on June 20, 2011.** The PDO is to establish the foundation for financial sector integration among EAC Partner States.

15. **The parent project has six components:**

(i) Financial Inclusion and Strengthening Market Participants: Activities under this component leverage the establishment of a single market and the benefits of scale associated with regionalization to make a broader range of formal financial services/products available to a more diversified client profile, including those that are currently unserved.

The activities in this component have achieved noteworthy progress in addressing both the agendas of financial inclusion and strengthening market participants. Policy papers on savings mobilization and mobile banking were prepared by the EAC Secretariat and approved by the Monetary Affairs Committee, following the approval of by the Sectoral Council on Finance and Economic Affairs (SCFEA). These two papers combined with the completed study on regional financial education will be used to prepare comprehensive recommendations on financial inclusion policy. Separately, the Pan-EAC Microfinance Technical Working Group (TWG), the creation of which the Project has supported, prepared

³ World Bank. East African Community Secretariat. 2014. *EAC Common Market Scorecard 2014: Tracking EAC Compliance in Movement of Capital Services and Goods*.

⁴ Burundi, Kenya, Rwanda, Tanzania, and Uganda.

⁵ Please see Annex 3 for a list of the various national projects in the EAC.

an EAC Microfinance Policy and implementation plan to guide the development of a harmonized legal and regulatory framework for microfinance. There were also many activities targeted at addressing the specific needs of the market participants and strengthening their capacity, particularly through the creation of a Pan-EAC Financial Services Providers Council, discussions on policy issues, and training on Savings Mobilization.

- (ii) **Harmonization of Financial Laws and Regulations:** Activities under this component support legal and regulatory harmonization in banking and accounting, securities markets, insurance, pensions, and investment funds critical to achieve an effective functioning of a single market in financial services.

The activities in this component have made remarkable progress in deepening legal and regulatory harmonization across the Partner States, particularly in the capital markets, pension, and insurance sectors. Presently, there are 20 Securities Market Council Directives (CDs) at various stages of development and passage. Seven CDs have been adopted by the Council of Ministers and gazetted by the EAC. These CDs are now at the stage where they will be transposed into national laws of the five Partner States. Another seven are under legal consideration by the Sectoral Council on Legal and Judicial Affairs (SCLJA) and will subsequently be sent to the Council of Ministers for adoption. Another two CDs have been approved by the Capital Markets, Insurance, and Pension Committee (CMIPC), the first stage of approval, and are under consideration by the SCFEA's Ministers of Finance. These will be submitted for legal consideration before proceeding to the Council of Ministers for approval. Four have been approved by the CMIPC and will be considered for approval by the SCFEA before proceeding on to the subsequent stages of approval.

The East Africa Pension Supervisors Association (EAPSA) and other stakeholders, with support from the Project including for the preparatory study, have developed the Pension Investment Principles. These principles were approved by the SCFEA Senior Officials and Coordination Committee and recommended for consideration at the Ministers Session. Separately, EAPSA has drafted a pension policy, an implementation strategy, and pension principles for the informal sector. The Pension Policy and Implementation strategy were approved by the CMIPC and will be brought up at a forthcoming SCFEA meeting. The pension principles on the informal sector and a study on the same are being revised before being submitted to the CMIPC.

Furthermore, an assessment of the insurance sector from a regionalization perspective was conducted. This contributed to the development of an EAC Insurance Policy and implementation strategy which have been approved by the CMIPC and are ready for consideration at the next SCFEA meeting.

(iii) Mutual Recognition of Supervisory Agencies: Activities under this component support the establishment of a system in which a financial institution or market intermediary licensed by the supervisory authority in one Partner State will be allowed to operate in all Partner States upon simple notification to the supervisory authority of the host State.

Under this component, the project has supported assessments against the International Organization of Securities Commissions (IOSCO) Principles and International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICPs), which identified priority areas for Partner States to develop, such as risk-based insurance supervision, in order to conform to international best practices and standards. All activities under this component have been successfully completed and one of the intermediate indicators⁶ under Component 3 has surpassed the targets.

(iv) Integration of Financial Market Infrastructure: Activities under this component support the establishment of an efficient market infrastructure, compatible at the regional level.

The activities in this component have primarily focused on developing Burundi's capital markets, demutualizing Uganda's stock exchange, automating the Rwanda Stock Exchange, and linking each of the Partner States' trading platforms and Central Securities Depositories (CSD) together through a new IT platform which will facilitate funds transfer, payments, clearing, and settlement. To date, draft bills for Burundi's capital markets and related enabling regulation have been prepared and will be circulated for stakeholder inputs before being progressed for enactment. Burundi is also receiving technical assistance in establishing its own Capital Markets Authority. The Capital Markets Infrastructure (CMI) IT system, which links the Partner States' trading platforms and CSDs together, has been purchased, delivered, and is in the process of being installed at the main and back-up sites. The implementation process was stalled from late 2014 to early 2015 due to Kenya's non-participation but has subsequently begun in four of the Partner States. Technical aspects of the installation and customization, as well as relevant trainings will be completed before the end of September 2016. With the completion of this activity, one of the intermediate indicators⁷ will be achieved.

(v) Development of Regional Bond Market: Activities under this component support the development of the government bond market in each Partner State, to ensure bond issuers in individual EAC Partner States having access to a deeper pool of liquidity in a single market. Subsequent to mid-term review and the restructuring of February 2014, the implementation of this component was taken over by the WBG Efficient Securities Market and Institutions Development (ESMID). With the contributions from the ESMID team, the project has supported the agenda to develop/grow the government and non-government debt markets, establish secondary markets, and build capacity among market participants.

⁶ The minimum compliance level with IAIS to be achieved by each country.

⁷ Number of capital markets CSDs linked.

(vi) Capacity Building: Activities under this component strengthen capacity at both the regional and the national level to ensure that the integrated market functions effectively and that economic agents in the region are aware of and able to realize the benefits from the process of integration.

Under this component, there have been a number of initiatives to build capacity within the EAC Secretariat, among regulators, and with market operators. The Secretariat has benefited from the influx of new technical expertise with the addition of staff to the Project Administration Team (PAT) and their contributions in the form of policy papers, harmonization of financial statistics, and the initiative to create a central database for financial flows. At the same time, there have been a number of capacity building workshops for public and private sector stakeholders from the Partner States in each of the financial sub-sectors. For instance, there have been workshops on pension and insurance principles, international best practices in microfinance, banking, payment and settlement, cross-border insurance operations, and statistics training among others. Consequently, some stakeholders have benefited from this training and were able to apply it in assessing subsequent sector-specific diagnostics. In Rwanda and Burundi, there is a dedicated effort to develop capacity with the creation of new financial sector curriculums and programs at Light University (Bujumbura) and University of Rwanda – College of Business and Economics (Kigali). The sub-sectoral committees and related working groups have endorsed the implementation strategy and are revising draft curriculums / programs. Furthermore, a TWG for the financial sector database is being formed to execute the roadmap for the database. In parallel, the Project has supported efforts to harmonize Monetary and Financial Statistics and Financial Soundness Indicators in collaboration with the IMF, and will proceed with developing an action plan to achieve harmonization. At this stage over a decade of historical data from various financial subsectors is being compiled by the PAT with input from the Partner States and will be published on the web. Among other uses, this data will be utilized to track the progress of EAC financial integration and the effort is in keeping with the EAC's groundwork for the implementation of the Monetary Union Protocol.

16. Reflecting the challenges associated with implementing a complex reform agenda involving five national authorities and significant capacity constraints on the ground, the project was plagued by severe implementations delays in the initial stages. Based on the analysis from the Mid-Term Review, the restructuring of the project in February 2014 entailed a 15-month closing date extension, revision of the results framework, and reallocation of funds between components. This restructuring was necessary to streamline the scope of the activities and facilitate achievement of the PDO. The delays in project implementation were primarily due to: (a) technical and procedural capacity challenges at the implementing agency, the EAC Secretariat, and; (b) excessively broad and complex project design. Following the addition of several technical staff to the PAT, streamlined internal processes at the EAC, and the restructuring, which addressed some of the complexities in the project's design with a more focused work plan derived very clearly from client demand, and a revised results matrix, the project's implementation progress improved steadily. Nevertheless, further extensions of the

project were necessitated to make up for the initial delays and to allow for a more realistic timeline for the consensus building process among Partner States, which is the key underpinning for progress under FSDRP I.

17. **The project has made notable progress since the first restructuring.** At present, 97 percent of project funds have been disbursed, and the PDO indicators have either been substantially met or exceeded. The PDO and Implementation Progress ratings are both set at Satisfactory (S). All stakeholders now view the project as an important instrument supporting financial sector integration in the EAC. Increasingly the project and the team of technical specialists supported by the project are playing a prominent role in coordinating assistance from other development partners as well. In addition, there is substantial compliance with key loan covenants including audit and financial reporting requirements.

18. **Important breakthroughs were achieved by the project subsequent to the restructuring especially in the area of long-term finance.** The project effectively supported the strengthening of the enabling environment for catalyzing long-term private investment to meet the vast development needs of the region, by creating a level playing field and growing investor confidence in cross-border transactions. Three key elements of this achievement are:

- **Council Directives:** The project has supported the development and adoption of CDs that harmonize the legal and regulatory framework for capital markets in the EAC. Seven such CDs have been gazetted by the EAC and another 13 are in the pipeline at various stages of approval. These CDs will create a level playing field and facilitate the flow of funds between Partner States. It is also worth noting that this is the first time that CDs have been used for non-administrative purposes in the EAC and domestication is binding once the CDs have been adopted. Thus the work done under the project has the additional externality of paving the way for an instrument of harmonization that can be used even beyond the financial sector.

The process of domestication of the gazetted CDs is already underway in the Partner States. Kenya has prepared draft amendments to their regulations towards this end and expect to send it to the National Treasury for approval and eventual gazetting in June. Similarly, Uganda amended its Capital Markets Authority Law in May 2016 to allow for the implementation of EAC Directives or related instruments. Rwanda and Tanzania are consulting with the relevant national authorities to move the process of domestication along. Rwanda expects the publication of the CDs by the end of June and the Capital Markets and Securities Authority in Tanzania has committed to ensuring the new Capital Markets Law has an explicit provision relating to CDs to ensure a speedier domestication process going forward. Burundian stakeholders are reviewing their draft legal and

regulatory framework, which is compliant with the EAC CDs, to move it through the national consultation and approval process.⁸

- **Interoperability of capital markets infrastructure (CMI):** The project has supported the purchase and installation of an IT system that links the stock exchanges and settlement and depository systems in the region. By lowering transaction costs the CMI will facilitate the flow of funds across borders.

As of May 26th, 2016 the process of on-boarding the Partner States is underway with the CMI systems “going live”. The EAC successfully tested functionality with the participation of the Dar es Salaam and Rwanda stock exchanges. The onboarding process will continue with Uganda and Burundi towards the end of August 2016. Kenya has maintained its previous stance as an observer and left the door open for participation in the future.

- **Pensions and Insurance:** The project has made significant progress in regionalization of the long-term institutional savings primarily through assessments and development of pension/insurance policies and implementation strategies. The regulators are also working to standardize investment principles so that investments made by pension funds and insurance companies can be treated as domestic within the EAC. This will go a long way towards pooling long-term savings in the region to meet the demand for scale investment projects.

19. **In addition, the project has supported institution-building in the EAC as the region moves towards the next stage of integration mainly via:**

- **Technical Experts:** The project supports a number of financial sector experts at the EAC with specializations in financial policy, research, data, and specific sub-sectors such as insurance, payments etc. The experts who are housed full-time at the EAC Secretariat in Arusha formerly worked either with the national regulators, private sector and/or academia. This arrangement is the precursor to the regional institutional setup that the EAC plans to put in place ahead of a single currency and plays a critical role in advancing the regional financial sector agenda via policy and position papers in consultation with their national counterparts.
- **Development and standardization of data:** In line with the objective of institution building, the project is supporting data collection, collation and standardization of data with a view to building a central database that maps intra-EAC positions and macro-financial data from all Partner States. Such data are a fundamental tool for improved regional oversight of an increasingly inter-linked financial sector and the requisite financial architecture.

⁸ Burundi does not have a capital markets legal framework currently. FSDRP I has supported the development of a draft legal and regulatory framework, taking into consideration the EAC CDs. While the support has been well-received there have been delays associated with election-related political disruption.

- **Standardized Curriculum for financial sector professionals:** In order to develop a pool of skilled financial sector professionals in the EAC, the project has supported the design of standardized curriculum in banking and insurance. This implementation of this curriculum will address one of the key constraints facing the expansion of reasonably priced financial services in the EAC- the scarcity of skilled professionals which pushes up salaries and overheads for financial institutions.

C. Lessons Learned from Original Project

20. **The design for the AF will closely adhere to the lessons learned from the five years of FSDRP I implementation.** In particular these lessons pertain to:

- **Balancing selectivity and a broad agenda:** Given the broad-based nature of financial sector integration it is not surprising that the agenda is complex and wide ranging. While the initial design of FSDRP I did mirror this complexity to a certain extent, the issues that arose during implementation made it apparent that this placed an undue burden on an implementing agency with capacity constraints. Hence, beginning with the first restructuring of FSDRP I, the scope of activities is restricted to the fastest moving parts of the larger financial sector agenda, as dictated by client demand. This principle will continue to guide the design and implementation of the AF and selectivity will be exercised even within broad areas of support. So, while the harmonization of investment guidelines for pension funds will be supported by the AF, the portability of pensions will be discussed further.
- **Ensuring buy-in from the Partner States:** As has been observed during the implementation of FSDRP I thus far, the agenda items that have shown the most progress are the ones where the Partner States have taken a lead. In keeping with this lesson, and especially as the activities under the AF center on implementation, which falls on the Partner States, various consultative forums that the project supports including TWGs will confer greater responsibility on the Partner States to lead the discussion and build consensus. Also towards the same end, the structure and location of the PAT will be revisited to allow for a more decentralized structure.
- **Managing operating costs:** The regional focus of the project and the importance of the consensus-building process among stakeholders has led to higher meeting costs than typically seen in a national project. To manage these costs more effectively but at the same time to ensure that the consultation process is adequate, the EAC will be encouraged to make greater use of its recently acquired video conferencing facilities that link the Secretariat to the Partner States. This will free up resources for the priority activities under the additional financing.

D. Rationale for Additional Financing

21. **EAC FSDRP I has thus far played an important role filling in the gaps in the legal, regulatory and, institutional framework at the regional level.** Given the low baseline regional institutional setup, it is not surprising that the bulk of the activities have, thus far, focused on outputs. The Project has supported a number of diagnostics in critical areas and has functioned most effectively as a convening instrument facilitating stakeholder consultations and consensus building on the path ahead.

22. **The AF seeks to leverage the momentum gained and lessons learned over the last five years of project implementation.** The AF will scale-up only those activities in Burundi, Kenya, Rwanda, Tanzania, and Uganda which have (a) made notable progress towards the higher-level objective of broadening and deepening the EAC financial sector thereby contributing meaningfully towards the project's PDO; (b) are a natural progression from activities previously supported by the project, and; (c) are supported by strong client priorities within the large financial sector integration agenda. Furthermore, these activities are consistent with the initial sub-sector assessment conducted for the parent project preparation and the Regional FSAP Development Module, 2013. As additional or complementary needs are identified, the task team will reach out to mobilize additional resources from within the WBG and also from other development partners.

23. **The AF is critical at this stage as project funds are nearly fully disbursed.** Further, the diagnostic work undertaken with support from the project offers viable roadmaps for further implementation. The EAC is well-placed to utilize additional IDA support in a way that would deepen the effectiveness and ensure sustainability of the progress under FSDRP I.

24. **The AF will focus very specifically on deepening the development effectiveness of the original project by moving the agenda forward along three key elements;**

- (a) **Adopting a regional approach to financial inclusion:** A regional approach to financial inclusion is intended to supplement, not substitute, national efforts to improve financial access. This is particularly true in regards to Kenya, Rwanda, and Tanzania's respective efforts towards greater financial inclusion as focus countries in the Universal Financial Access (UFA) 2020 initiative.⁹ The additional dimension arises from leveraging the connectedness of the local populations across borders. For instance, the EAC includes two countries that are the global leaders in the adoption of mobile technology to extend financial services to the unbanked, namely Kenya and Tanzania. But one has not seen an extension of this approach to cross-border retail payment transfers at a comparable scale.

⁹ The UFA 2020's goal is for adults globally to have access to a transaction account or electronic instrument to store money, send and receive payments as the basic building block to manage their financial lives. The WBG and fourteen other development partners pledged to support this objective.

Mobile money providers, who are quite aware of the potential linkages between peoples across national borders based on their monitoring of voice traffic, hesitate to offer scaleable cross-border products due to the gaps in the legal framework. Thus, creating a regional framework for mobile payments will open up a range of possibilities for informal traders and families with migrant workers to transact cashlessly.

- (b) **Harmonizing regional financial sector legal frameworks:** At the other end of the spectrum, lack of clarity in the legal framework is also the main reason cited by institutional investors for their wariness in undertaking cross-border investments. Non-transparent risks and high transaction costs of moving funds across borders have meant that long term savings have not been mobilized at the regional level to support large scale regional infrastructure. Creating a level playing field through legal and regulatory harmonization can serve as an effective tool for increasing investor confidence and mobilizing funding for the vast development agenda in the region.
- (c) **Building regional institutions:** As the financial sector in the EAC become increasingly interlinked, it is critical that regulators keep pace in their ability to monitor risks and manage contagion in the event of a financial crisis. FSDRP I has also served as an instrument to shore up institutional capacity at the regional level by placing technical experts at the PAT to coordinate the policy agenda as set forth by the Partner States. This institution building agenda will be continued and moved further along under the AF with the development of a standardized database that collates cross-border financial flows and provides an important tool to policymakers.

25. **These elements will contribute to the WBG’s twin goals of ending extreme poverty and boosting shared prosperity by creating a viable, robust regional financial sector that will serve the diverse needs of the private sector in ways that would not have been possible if these small financial systems operated within national confines.** Research has shown a causal positive relationship between financial development and economic growth (particularly working through the credit-to-firms channel) and a positive association with declines in income inequality.¹⁰ Higher levels of financial development cause a faster decline in the percentage of the population living below the poverty line,¹¹ and income inequality tends to fall more rapidly.¹² Responsible financial systems directly help the poor, for example, by making available formal saving vehicles and risk mitigation tools which allow them to take advantage of opportunities for advancement (e.g., education expenses), cope with adverse shocks (e.g., health expenses), and fund productive investments.

26. **While recognizing the opportunities presented by a well-developed regional financial system, it is also necessary to manage risks to ensure its effective functioning.**

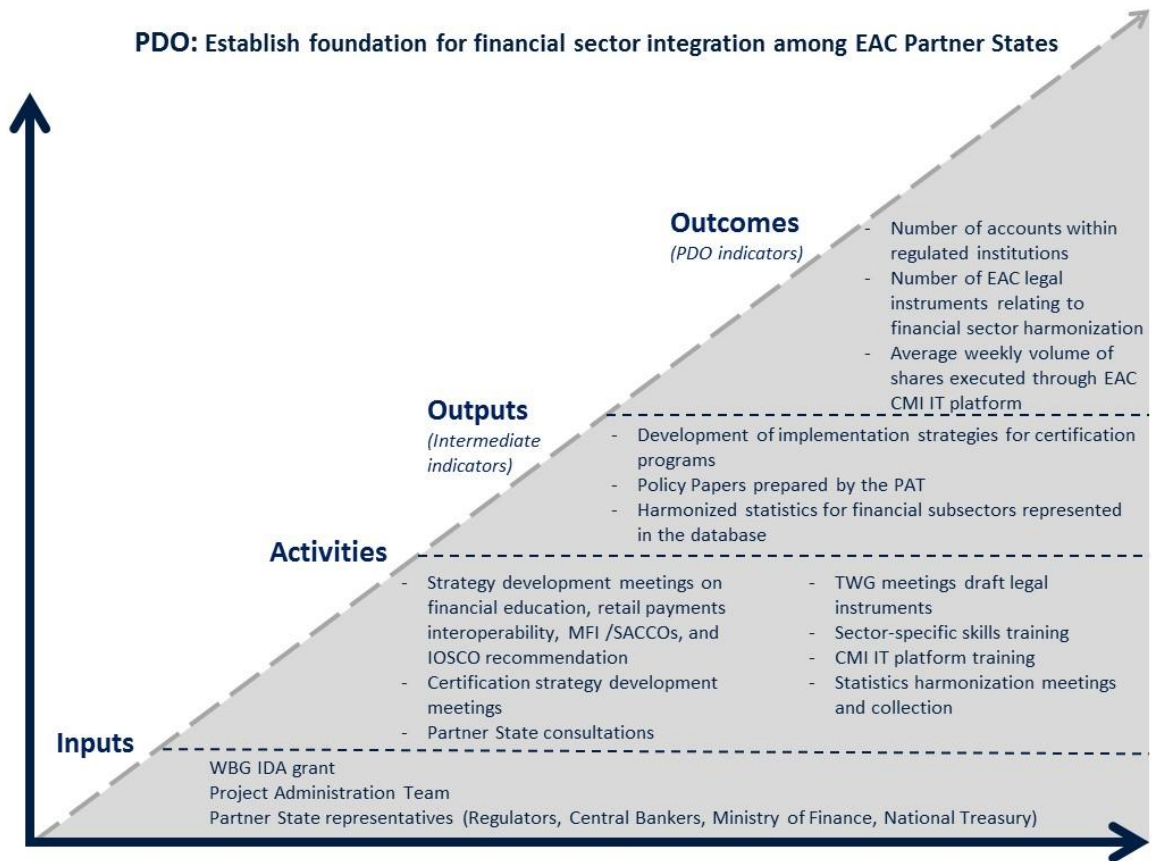
¹⁰ See “Who gets the credit? And does it matter? Households vs. firms lending across countries”, Beck et al, 2012, The B.E. Journal of Macroeconomics.

¹¹ Empirical evidence shows that a 10 percentage point increase in the ratio of private credit to GDP reduces the share of population living below the poverty line by 2.5-3 percentage points.

¹² “Finance, Inequality, and the Poor”, Beck et al, Journal of Economic Growth 2007.

Financial crises disproportionately hurt the poor, both through the direct loss of assets, and through the loss of jobs caused by lower economic growth. Financial crises can also cause negative impact for public finances if substantial public debt is added to the government’s ledger. The additional debt can lead to diminished budgetary scope for the provision of critical public services sorely needed by the poor.¹³ Therefore, strengthening financial institutions is also critical to the twin goals. In addition, long-term finance facilitates the critical infrastructure and capital investments needed to increase productivity and competitiveness.

27. The diagram below further illustrates this rationale, drawing the line from the planned activities to the eventual outcomes.



¹³ It was estimated that some 120 million people worldwide were pushed into poverty during the recent global financial crisis.

III. PROPOSED CHANGES

Summary of Proposed Changes	
The proposed additional financing will be used to scale up activities to deepen the development impact of the project. In addition, a restructuring will be undertaken to revise the results framework.	
Change in Implementing Agency	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Project's Development Objectives	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Results Framework	Yes [<input checked="" type="checkbox"/>] No [<input type="checkbox"/>]
Change in Safeguard Policies Triggered	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change of EA category	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Other Changes to Safeguards	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Legal Covenants	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Loan Closing Date(s)	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Cancellations Proposed	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Disbursement Arrangements	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Reallocation between Disbursement Categories	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Disbursement Estimates	Yes [<input checked="" type="checkbox"/>] No [<input type="checkbox"/>]
Change to Components and Cost	Yes [<input checked="" type="checkbox"/>] No [<input type="checkbox"/>]
Change in Institutional Arrangements	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Financial Management	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Procurement	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Change in Implementation Schedule	Yes [<input checked="" type="checkbox"/>] No [<input type="checkbox"/>]
Other Change(s)	Yes [<input type="checkbox"/>] No [<input checked="" type="checkbox"/>]
Development Objective/Results	
Project's Development Objectives	
Original PDO	
To establish the foundation for financial sector integration among EAC Partner States.	
Change in Project's Development Objectives	

Explanation:

There is no change proposed to the basic statement of the existing PDO. However, to be more realistic and specific about the activities the additional financing will support, a supplemental sentence will specify what is meant by foundation for the purposes of this project. It will read: For the purposes of this AF the “foundation of financial sector integration” refers to formulating a regional approach to financial inclusion, furthering legal and regulatory harmonization and building institutional capacity to manage the increasingly integrated financial sector in the EAC.

Proposed New PDO - Additional Financing (AF)

Change in Results Framework

Explanation:

Of the project’s original three PDO indicators, the one on cross-border payment transactions will be dropped. It is being replaced by an indicator that can be attributed more directly to activities that FSDRP I has supported. The new indicator, the volume of trades via the CMI system, is a measure of the utilization of the CMI system that has been procured and installed under the project, and also an indicator of its sustainability based on end-user fees. The other two PDO indicators are being retained, with their targets being revised upwards.

The intermediate indicators will be streamlined to reflect the streamlined scope of activities under the AF. Additionally those indicators that have been achieved, partially achieved, and/or where there are no activities planned that offer any further support, will be dropped.

The revised list of indicators is as follows:

PDO-level Indicators

For AF:

Number of accounts within regulated institutions (Continued)

Number of EAC legal instruments relating to financial sector harmonization (Continued)

Volume of shares executed through EAC CMI IT platform (New)

Marked for deletion:

Estimate of cross- border payment transactions. (Not achieved)

Estimate of cross border payment as a portion of EAC total international trade payments (Not achieved).

Intermediate-level Indicators

For AF:

Number of policy papers prepared by technical staff and presented to project Steering Committee (Partially achieved. Continued with updated targets)

Harmonized statistics for financial subsectors represented in the centralized database (Partially achieved. Continued with updated targets)

Development of implementation strategies for certification programs (New)

Marked for deletion:

Number of regional action plans developed to increase access to finance in EAC (Achieved)

Number of prudential indicators harmonized (Partially achieved, no further activities planned)

Minimum compliance level with IAIS to be achieved by each country (Achieved)

Minimum compliance level with IOSCO to be achieved by each country, except for Burundi which do not have Capital Market (Not achieved)

Number of CSDs linked (Will be achieved by September 30, 2016)

Total volume of national government bonds outstanding in the EAC region (Achieved)

Compliance

Covenants - Additional Financing (EAC Financial Sector Development and Regionalization Project I: AF - P160770)

Source of Funds	Finance Agreement Reference	Description of Covenants	Date Due	Recurrent	Frequency	Action
				<input type="checkbox"/>		

Conditions

Source Of Fund	Name	Type

Description of Condition										
Risk										
Risk Category							Rating (H, S, M, L)			
1. Political and Governance							Substantial			
2. Macroeconomic							Moderate			
3. Sector Strategies and Policies							Moderate			
4. Technical Design of Project or Program							Moderate			
5. Institutional Capacity for Implementation and Sustainability							Substantial			
6. Fiduciary							Moderate			
7. Environment and Social							Low			
8. Stakeholders							Moderate			
9. Other										
OVERALL							Substantial			
Finance										
Loan Closing Date - Additional Financing (EAC Financial Sector Development and Regionalization Project I: AF - P160770)										
Source of Funds						Proposed Additional Financing Loan Closing Date				
IDA Grant						30-Sep-2019				
Change in Disbursement (including all sources of Financing) Estimates										
Explanation:										
The original credit is 97 percent disbursed and is expected to be fully disbursed by September 30, 2016. To ensure uninterrupted implementation of FSDRP I, retroactive financing has been allowed to a maximum of US\$1 million in the interim from September 30, 2016 to the signing of the AF agreement. The revised disbursement estimates reflect the period of implementation of the AF.										
Expected Disbursements (in USD Million)(including all Sources of Financing)										
Fiscal Year	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Annual	2.00	3.50	3.50	1.50	0.00	0.00	0.00	0.00	0.00	0.00

Cumulative	2.00	5.50	9.00	10.50	0.00	0.00	0.00	0.00	0.00	0.00
Allocations - Additional Financing (EAC Financial Sector Development and Regionalization Project I: AF - P160770)										
Source of Fund	Currency	Category of Expenditure	Allocation		Disbursement % (Type Total)					
			Proposed		Proposed					
IDAT	USD	Goods, consultants' services, Training and Operational Costs for Parts 1(vii), 2(iii), 6 of the Project	10,500,000.00		100.00					
		Total:	10,500,000.00							
Components										
Change to Components and Cost										
Explanation:										
<p>The AF of US\$10.5 million equivalent will be allocated across three of the project's six original components and will also cover project management costs. The selective scale up is based on three main criterion (a) the activities deepen the development effectiveness by contributing to the achievement of the PDO, (b) the activities are a natural progression from activities previously supported by the project, and (c) there is strong client-demand.</p> <p>Additional activities under Financial Inclusion and Strengthening of Market Participants (Component 1) will include US\$2.56 million to scale up activities that support the implementation of three key diagnostics that were undertaken during the original project pertaining to (a) Financial Education; (b) Retail Payments Interoperability, and; (c) Banking and Insurance Certification Programs. TWGs comprising representatives from the Partner States will drive the consultative process of developing implementation strategies based on the recommendations from the diagnostic analysis and ensure that these strategies are launched at the national level. Recognizing that the financial systems in Burundi and Rwanda are less developed than those of the other Partner States, the AF will pay particular attention to skills development in these two Partner States by continuing collaboration with Light University in Burundi and the College of Business and Economics in Rwanda.</p> <p>Scaling up Harmonization of Financial Laws and Regulations (Component 2) will include US\$1.9</p>										

million in additional activities under this component to build on the momentum generated by the adoption of the CDs under the original project. The component will continue to support the capital markets CDs in the pipeline and also assist Partner States implement the recommendation of the IOSCO assessments completed under the original project. The AF will expand the methodology that led to the successful adoption of the capital markets CDs to include legal and regulatory harmonization in the pensions and insurance sectors. National regulators in these two sectors have already laid some of the groundwork that will be scaled up under the AF.

Additional activities amounting to US\$4.9 million under Institution Building (Component 3) will continue inter alia to support technical expertise at the EAC in areas of financial policy and research, pensions, payments, statistics etc. The experts were recruited under the original project and will continue their work under the AF for one additional year. For the final two years of the AF, the technical expertise will be decentralized to the Partner States so as to support the implementation phase. Effective operationalization of the CMI IT system will solidify one of the key development achievements of the original project. Hence the AF will support the training of end-users and other activities to ensure the increasing use and sustainability of the system. Working closely with the IMF, preliminary work has been initiated on building a database of standardized statistics that will also map intra-regional financial positions. This database will contribute to effective supervision of cross-border financial operations and fill an important gap hampering policy making. The name of this component will be changed from Capacity Building to Institution Building to better reflect the nature of the activities to be supported.

Project management fees and reimbursable expenses (Component 4) will amount to US\$1.1 million equivalent and will cover full-time fiduciary staff for three years. In addition, project management expenses will also cover the bi-annual meetings of the Steering and Executive Committees.

Current Component Name	Proposed Component Name	Current Cost (US\$M)	Proposed Cost (US\$M)	Action
Financial inclusion and strengthening of market participants	Financial inclusion and strengthening of market participants	1.74	4.30	Revised
Harmonization of financial laws and regulations	Harmonization of financial laws and regulations	2.33	4.23	Revised
Mutual recognition of supervisory agencies	Mutual recognition of supervisory agencies	0.70	0.70	No Change

Integration of market infrastructure	Integration of market infrastructure	3.75	3.75	No Change
Development of regional bond market	Development of regional bond market	0.00	0.00	No Change
Capacity building	Institution Building	7.20	12.10	Revised
	Project Management	0.00	1.10	New
	Total:	15.72	26.18	
Other Change(s)				
Implementing Agency Name				
Type		Action		
Change in Financial Management				
Explanation:				
<p>The financial management arrangements will remain the same as under the parent project. The financial management assessment of the additional finance is based on the last financial management implementation support mission for the main credit, which indicated satisfactory on the overall project financial management arrangements. The project is in compliance with the required financial covenants in terms of maintaining satisfactory financial management arrangements, submission of quarterly IFRs and annual audit reports. The last two project audit reports received clean opinions and there is no overdue audit report.</p> <p>The financial management arrangements meet the Bank's minimum requirements under OP/BP10.00. The financial management arrangements are adequate to provide, with reasonable assurance, accurate and timely information on the status of the project as required by IDA, and will continue to be used.</p>				
Change in Procurement				
Explanation:				
<p>There are no changes proposed in the arrangements for carrying out procurement activities. Any new procurement under the additional financing would be carried out in accordance with the</p>				

World Bank's Guidelines: Procurement of Goods, Works and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by World Bank Borrowers dated January 2011 (revised July 2014); and Guidelines: Selection and Employment of Consultants under IBRD and IDA Credits & Grants by World Bank Borrowers dated January 2011 (revised July 2014); Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants dated October 15, 2006 and revised in January 2011 (the Anti-Corruption Guidelines); and the provisions stipulated in the Legal Agreement.

Change in Implementation Schedule

Explanation:

The additional financing includes a three year extension of the project implementation period.

Appraisal Summary

Economic and Financial Analysis

Explanation:

In keeping with the original project appraisal document and given the difficulties associated with calculating a credible ERR for technical assistance loans in general, this project paper will not include an detailed economic and financial analysis.

As with the parent project, the AF will support activities that strengthen the enabling environment for the effective functioning of an integrated regional financial market. Both at the national and regional level the elements of this environment are publically provided goods with strong externalities that justify their public financing. In addition, there is a clear rationale for the WBG to support this very important agenda. As has been evidenced during the implementation of FSDRP I thus far, the project has worked as an instrument to mobilize not just funding, but also the technical skills and convening power of the WBG.

Technical Analysis

Explanation:

The technical design of this project draws heavily from three main sources; (a) the original project appraisal which included a detailed analysis of the various sub-sectors, (b) the EAC FSAP Development Module conducted in 2013/14, and (c) the lessons learned during the course of project implementation.

The original project appraisal included a detailed technical analysis of the various sub-sectors and the issues identified have not changed significantly. The key technical findings were reinforced during the EAC Development Module FSAP conducted in 2013. Most of the activities included

under the additional financing can be traced to the findings of these two documents. For instance, the certification programs in banking and insurance designed to increase the supply of skilled financial sector professionals are motivated by interest spreads analysis that indicate that in the EAC countries high interest rates are significantly attributable to high salaries and overheads arising from this scarcity. The lack of a standardized database mapping cross-border financial flows within the region was another gap that was highlighted by this analysis.

During the current appraisal the consultations focused on identifying and agreeing on the priorities of the various stakeholders so that a streamlined list of activities can be drawn from what remains a vast unfinished agenda for financial sector regionalization.

Social Analysis

Explanation:

Not applicable.

Environmental Analysis

Explanation:

Not applicable.

Risk

Explanation:

The overall risk rating of the project is maintained at Substantial.

The overall risk rating is driven largely by Political and Governance risk and the risk associated with Institutional Capacity for Implementation and Sustainability, both of which are rated Substantial. In the context of a regional project which is implemented through a process of consensus building among the five Partner States these two elements of the overall risk profile can have a disproportionate impact on the achievement of the PDO.

During the course of the implementation of the project thus far, wide-reaching consultations have been employed to resolve issues related to mitigating these risks. The Steering and Executive Committees, with representation from all the Partner States, will continue to serve as an effective forum for discussions in the face of issues related to one or more Partner States. More frequent meetings of these committees are planned under the AF using videoconferencing when feasible.

The project will also continue to address the issue of capacity of the implementing agency by continuing to support technical staff, specialized in the various areas of focus under the AF.

ANNEX 1: RESULTS FRAMEWORK AND MONITORING (ADDITIONAL FINANCING)

Project Name:	EAC Financial Sector Development and Regionalization Project I: AF (P160770)	Project Stage:	Additional Financing	Status:	FINAL
Team Leader(s):	Smita Wagh	Requesting Unit:	AFRVP	Created by:	Andrea Vasquez-Sanchez on 19-Jul-2016
Product Line:	IBRD/IDA	Responsible Unit:	GFM01	Modified by:	Andrea Vasquez-Sanchez on 28-Jul-2016
Country:	Africa	Approval FY:	2017		
Region:	AFRICA	Lending Instrument:	Investment Project Financing		
Parent Project ID:	P121611	Parent Project Name:	Financial Sector Development & Regionalization Project I (FSDRP I) (P121611)		

Project Development Objectives

Original Project Development Objective - Parent:

To establish the foundation for financial sector integration among EAC Partner States.

Results

Core sector indicators are considered: Yes

Results reporting level: Project Level

Project Development Objective Indicators

Status	Indicator Name	Core	Unit of Measure		Baseline	Actual(Current)	End Target
Revised	Number of accounts within regulated institutions (Banks and deposit-taking MFIS (Number)	<input type="checkbox"/>	Number	Value	57.37		75.00
				Date	21-Jul-2016		30-Sep-2019
				Comment			

Revised	Number of EAC legal instruments relating to financial sector harmonization in the EAC (Number)	<input type="checkbox"/>	Number	Value	14.00		25.00
				Date	21-Jul-2016		30-Sep-2019
				Comment			
Revised	Average weekly volume of shares executed through EAC CMI IT platform (Number)	<input type="checkbox"/>	Number	Value	118,000.00		266000.00
				Date	21-Jul-2016		30-Sep-2019
				Comment			
Marked for Deletion	Number of EAC legal instruments relating to financial sector harmonization	<input type="checkbox"/>	Number	Value	0.00	14.00	15.00
				Date	31-Mar-2011	31-May-2016	30-Sep-2016
				Comment			
Marked for Deletion	Estimate of cross border payment transactions	<input type="checkbox"/>	Amount(USD)	Value	3.95	5.90	7.40
				Date	31-Mar-2011	30-Jun-2015	30-Sep-2016
				Comment			
Marked for Deletion	Number of accounts with regulated institutions (banks, MFIs)	<input type="checkbox"/>	Number	Value	24.70	57.37	48.20
				Date	31-Mar-2011	31-Dec-2015	30-Sep-2016
				Comment			
Intermediate Results Indicators							
Status	Indicator Name	Core	Unit of Measure		Baseline	Actual(Current)	End Target
Revised	Development of implementation strategies for certification programs (Number)	<input type="checkbox"/>	Number	Value	0.00	0.00	2.00
				Date	21-Jul-2016		30-Sep-2019
				Comment			

Revised	Number of policy papers prepared by the PAT	<input type="checkbox"/>	Number	Value	7.00		10.00
				Date	21-Jul-2016		30-Sep-2019
				Comment			
Revised	Harmonized statistics for financial subsectors represented in the database (Number	<input type="checkbox"/>	Number	Value	3.00		5.00
				Date	21-Jul-2016		30-Sep-2019
				Comment			
Marked for Deletion	Comp 1: Number of regional action plans to increase access to finance in the EAC	<input type="checkbox"/>	Number	Value	0.00	2.00	3.00
				Date	30-Dec-2010	31-May-2016	30-Sep-2016
				Comment			
Marked for Deletion	Comp 2: Number of Prudential indicators harmonized	<input type="checkbox"/>	Number	Value	0.00	67.00	66.00
				Date	31-Mar-2012	31-May-2016	30-Sep-2016
				Comment			
Marked for Deletion	Component 3A: IAIS: Minimum compliance level with IAIS to be achieved by each country	<input type="checkbox"/>	Percentage	Value	28.00	35.00	33.00
				Date	31-Mar-2011	30-Sep-2014	30-Sep-2016
				Comment			
Marked for Deletion	Component 3B: IOSCO: Minimum compliance level to be achieved with IOSCO principles	<input type="checkbox"/>	Percentage Sub Type Supplemental	Value	57.00	57.00	70.00
Marked for Deletion	Comp 4: Number of capital markets CSDs linked	<input type="checkbox"/>	Number	Value	0.00	2.00	4.00
				Date	31-Mar-2011	31-May-2016	30-Sep-2016
				Comment			

Marked for Deletion	Comp 5: Total volume of national bonds outstanding in the region	<input type="checkbox"/>	Amount(USD)	Value	9.04	15.20	18.00
				Date	31-Mar-2011	31-Dec-2015	30-Sep-2016
				Comment			
Marked for Deletion	Comp 6A: Number of policy papers prepared by the PAT and presented to the FSDRP I Steering Ctte	<input type="checkbox"/>	Number	Value	0.00	7.00	8.00
				Date	31-Mar-2011	31-May-2016	30-Sep-2016
				Comment			
Marked for Deletion	Comp 6B: Number of research papers prepared by PAT and presented to the FSDRP I Steering Committee.	<input type="checkbox"/>	Number Sub Type Supplemental	Value	0.00	3.00	5.00
				Date			
				Comment			
Marked for Deletion	Comp 6C: Number of financial subsectors represented in the database developed by FSDRP PAT	<input type="checkbox"/>	Number Sub Type Supplemental	Value	0.00	3.00	4.00
				Date			
				Comment			

Indicator Description

Project Development Objective Indicators				
Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection
Number of accounts within regulated institutions (Banks and deposit-taking MFI's) (Number)	Number of accounts in institutions licensed by central banks	Annual	Central Banks of EAC Partner States	FSDRP PAT

Number of EAC legal instruments relating to financial sector harmonization (Number)	Number of EAC legal instruments (council directives or bills) for the capital markets, pension, insurance, and microfinance sectors, that are presented to Sectoral Council on Finance and Economic Affairs, Council of Ministers for submission to EALA;	Annual	EALA Records/ Council of Ministers Reports	FSDRP PAT
Average weekly volume of shares executed through EAC CMI IT platform (Number)	Volume of shares is the total quantity of shares or contracts for all the securities transacted through the EAC CMI IT platform. The measure is a weekly average.	Annual	FSDRP PAT	FSDRP PAT

Intermediate Results Indicators

Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection
Development of implementation strategies for certification programs	Number of finalized implementation strategies for certification programs (banking and insurance)	Annual	Regulatory Authorities & FSDRP PAT	FSDRP PAT
Number of policy papers prepared by the PAT	Number of Policy papers prepared by the PAT and presented to FSDRP Steering Committee	Annual	FSDRP PAT	FSDRP PAT
Harmonized statistics for financial subsectors represented in the database	Number of financial subsectors represented in the database developed by PAT members.	Annual	FSDRP PAT	FSDRP PAT

ANNEX 2: MATRIX OF PROPOSED ACTIVITIES

Activity	Activity Total
Component 1: Financial Inclusion and Strengthening Market Participants	
Implementation of financial education study recommendations	
Implementation of diagnostic study recommendations for the studies on interoperability of card switches and cross border mobile banking/payments	
Implementation of EAC insurance certification programs	
Implementation of EAC banking certification programs	
Support to capacity building to support the financial sector regionalization activities	
C1 Total	2,566,500
Component 2: Harmonization of Financial Laws & Regulations	
Regionalization of EAC Microfinance and SACCOs policy framework	
Development and implementation of EAC securities regionalization legal framework	
Development of policy and harmonization of legal and regulatory framework for the EAC pension sector	
Legal and Regulatory framework for insurance sector	
Implementation of study recommendations on compliance with International Organization of Securities Commissions (IOSCO) and International Association of Insurance Supervisors (IAIS) principles	
C2 Total	1,903,250
Component 3: Institution Building	
Support to Burundi to establish capital markets	
IT equipment and software for centralized database for financial	
IT system for CMI	
CMI Staff	
Technical Staff	
Implementation of the roadmap towards establishing an EAC financial sector database	
Support for harmonization and compilation of monetary, fiscal and financial statistics	
C3 Total	4,938,250
Component 4: Project Management	
Fiduciary Staff	
Operating costs (Support to executive & steering committee meetings, audit, administrative costs and goods)	
C4 Total	1,092,000
AF Total	10,500,000

ANNEX 3: SUMMARY OF NATIONAL FINANCIAL SECTOR WBG PROJECTS

Each of the country programs are embedded in F&M’s framework and focus areas of: i) Financial stability and integrity (GST1); ii) Financial access and inclusion (GST2), and; iii) Long-term finance and risk management (GST3). The projects listed below are all ongoing.

Country	Lending	ASA
Burundi	Financial & Private Sector Development	
Kenya	Infrastructure PPP	Financial Sector Innovation
	Financial Sector Support Project	County PPP Opportunities
		Kenya Capital Markets Transactions
		Strengthening & Deepening of Capital Markets
		Agricultural Insurance TA
		Bond Market Development
Rwanda		Strengthening Financial Stability
		Financial Inclusion Support Framework
		GIIF ACRE Africa
		Bond Market Development
		Africa Leasing Facility II
Tanzania	Housing Finance + Additional Financing	Commodity Exchange TA
		Private Sector Competitiveness
		GIIF ACRE Africa
		Credit Bureau Program
Uganda		Strengthening Financial Stability
		Bond Market Development

* WB projects, IFC projects

BURUNDI

Financial and Private Sector Development¹⁴: This lending project supports the modernization of financial sector regulations and the business enabling environment.

KENYA

Financial Sector Support Project: This lending project contributes to the Government of Kenya’s financial sector development strategy addressed in its Vision 2013, which identifies its

¹⁴ In FY15, the project was managed under T&C; however, earlier this year the decision was taken to give the project lead to F&M.

key objectives to be i) improving stability, ii) enhancing efficiency in the delivery of credit and other financial services, and iii) improving access to financial services products for a much larger number of Kenyans. The Project supports the Central Bank of Kenya, National Treasury, Insurance Regulatory Authority, Retirement Benefits Authority, Capital Markets Authority, SACCOs Regulatory, and the Attorney General.

Infrastructure Finance PPP (IFPPP): The objective of the IFPPP I lending project is to strengthen the enabling environment and generate a pipeline of bankable PPP projects. Activities include: support the reform of government bond markets building blocks given their role as a price benchmark for long-term assets and in developing instruments to hedge interest rate and foreign exchange risk for long-term and foreign investors, support of institutional framework and regulatory reform, preparation of PPP pipeline transactions preparation, and improvement of fiscal commitment and contingent liability (FCCL) framework associated with the PPP projects.

Strengthening and Deepening of Capital Markets: The TA aims to develop a robust regulatory framework and institutional arrangements, strengthening investor protection, and deepening market products and services.

Kenya Capital Market Transactions: The objective of the TA is to simultaneously provide technical assistance to two sub-nationals, the Kenya Roads Board (KRB) and the Kenya Wildlife Service (KWS) to raise local currency debt finance through issuance of bonds.

Financial Sector Innovations: This ASA supports the development of important initiatives on *housing finance* and *SME finance*:

- Housing Finance: following on the delivery of the Housing Finance Solutions Policy note (FY16) and dissemination, a detailed feasibility study on the development of a mortgage liquidity facility and a subsidy buy-down program will be delivered in FY17.
- SME Financing of Receivables: WBG support to this innovation in SME financing will continue into FY17. With the first transaction in FY16 in the pharmacy sector, two additional sectors will come on line, construction and agribusiness financing. An impact evaluation of the program is being planned.

Agricultural Insurance TA

- Crop and Livestock Pilots: This TA supports the GoK in their goal of having extended both livestock and crop insurance by October 2016.
- IFC's Global Index Insurance Facility (GIIF): GIIF supports ACRE to provide insurance to approximately 133,000 Kenyan maize, coffee, and wheat farmers each year.

County PPP Opportunities in Kenya: This TA provides capacity building to scale up and strengthen the implementation of the IFPPP program at the county level.

ESMID East Africa II – Bond Market Development (multi-donor trust fund): The objective of this project is to support implementation of a regional capital market in East Africa, including Kenya, which will facilitate more financing for sectors where long-term local currency funds are necessary such as housing and infrastructure.

The project will contribute to:

- Improving the bond issuance process by streamlining issuance requirements and capacity building of regulators.
- Improving secondary market structure for trading bonds to improve liquidity and broaden market participants including banks, brokers and interdealer brokers.
- Development of government bond market development strategy and roadmap to benchmark development of the regional market.
- Development of a professional investor base and broaden investment guidelines.
- Increasing issuance of bonds.

RWANDA

Strengthening Financial Stability (FIRST-funded): The program supports the strengthening of the legal and regulatory framework and supervisory capacity of the financial sector as well as Rwanda's crisis preparedness, resilience, and financial stability. Focus areas for the TA include updates to the laws and regulations for the banking and insurance sectors and a new legal and regulatory framework for pensions. The program also supports the introduction of deposit insurance, the establishment of an Emergency Liquidity Facility, and new crisis preparedness mechanisms. It also provides significant capacity building and training for Central Bank staff in the areas mentioned above as well as AML/CFT.

Financial Inclusion Support Framework (FISF TF): The program contributes to increasing the availability, usage, and quality of financial services for individuals and MSMEs in Rwanda. It provides TA, advisory services, and capacity building for policy and regulatory reforms as well as financial infrastructure development, and other support measures in five main areas: (i) MSME Finance; (ii) Consumer Protection; (iii) Financial Literacy; (iv) Payment Systems & Financial Infrastructure; and (v) Monitoring & Evaluation.

GIIF – ACRE Africa (EU-funded): The objective of this project is to support ACRE Africa to expand access to index insurance for small scale farmers in Kenya, Rwanda, and Tanzania by providing ACRE with capacity building and premium support grants. GIIF supports ACRE Africa to provide insurance to approximately 126,500 Rwandan farmers each year.

ESMID East Africa II – Bond Market Development: The objective of this project is to support implementation of a regional capital market in East Africa, including Rwanda, which will facilitate more financing for sectors where long-term local currency funds are necessary such as housing and infrastructure.

Africa Leasing Facility II: The Africa Leasing Facility II program aims to increase access to finance for micro, small, and medium enterprises in Sub-Saharan Africa by developing a sustainable leasing framework in order to make leasing a viable alternative financing tool for SMEs.

Specifically, ALF II in Rwanda seeks to:

- Help promote leasing legislative and regulatory reforms;
- Contribute to the increase of leasing transactions;
- Increase access to financial services by helping small business owners and SMEs gain access to leasing knowledge and information to finance their equipment needs;
- Provide leasing business advisory support to banks and non-bank financial institutions in Rwanda; and
- Implement a leasing advisory exit strategy by program end.

TANZANIA

Housing Finance Project and Additional Financing: The original housing finance project has been instrumental in kick-starting a mortgage finance market. The additional financing (AF) for the project was approved by the Board on February 24, 2015 and it will build upon the current success while focusing on reaching lower income levels through a Housing Microfinance Facility.

Tanzania Commodity Exchange Technical Assistance¹⁵: This project provides just-in-time TA to the GoT with the establishment of the commodity exchange and strengthening the Warehouse Receipt System. Under this TA, cross-regional experience in setting up commodity exchanges available at the WBG has been mobilized and leveraged to provide support to the GoT. The first contract (cashew nut) is expected to be traded on the exchange in September 2016. The project is closely coordinated with the Agriculture GP.

Tanzania Private Sector Competitiveness Project- Access to Finance Component. The component of the T&C led project in the amount of US\$10 million supports a number of financial sector interventions in order to improve access to finance in Tanzania. The activities include capital markets development, support with the establishment of commodity exchange, improvement of consumer protection, strengthening of financial infrastructure and other related activities.

Credit Bureau Program (SECO-funded): This is part of the Africa Credit Bureau regional program. The objective of the program in Tanzania is to help stakeholders develop a viable and effective credit reporting system by providing technical support to the Bank of Tanzania, supporting the establishment and operation of at least one private credit bureau, and promoting

¹⁵ This activity is complemented by the TF-019066 for the Tanzania Maize Program (IFB, USD 72,500, closed in December 2015) – TTL Panayotis N. Varangis.

education and public awareness on the importance of credit bureaus and new credit reporting regulations.

GIIF – ACRE Africa (EU-funded): The objective of this project is to support ACRE Africa to expand access to index insurance for small scale farmers in Kenya, Rwanda, and Tanzania by providing ACRE with capacity building and premium support grants. GIIF supports ACRE Africa to provide insurance to approximately 17,000 Tanzanian farmers each year.

UGANDA

The Finance and Markets GP is currently engaging with the Bank of Uganda (BoU), the Ministry of Finance, Planning, and Economic Development, and the Country Management Unit to develop a broad and strategic program to support the financial sector in Uganda for the coming CPF period (FY17-21).

Strengthening Financial Stability (FIRST-funded): The objective of the technical assistance program is to strengthen the legal, regulatory, institutional and supervisory framework of Uganda's financial sector and to contribute to Uganda's financial sector stability. This will be measured by the enhanced compliance levels to relevant international principles for the key pillars of Uganda's financial system, namely the deposit insurance and bank resolution system, pension sector, and insurance sector. The support program started its implementation in March 2016. It is comprised of four components. Component 1 (Support for Systemic Risk Identification) provides assistance to the BoU to enhance monitoring capacity to detect systemic threats to stability. Component 2 (Strengthening of Financial Sector Safety Nets) provides assistance to the BoU to review and strengthen the BoU's financial crisis management plans; strengthen the bank resolution framework towards resolving banking crises in a manner that promotes the public interest in financial stability and results in the overall lowest cost to society; and establish the Deposit Protection Corporation. Component 3 (Strengthening Pensions Oversight and Expanding Coverage) aims to provide assistance to the pension regulator to strengthen regulation and oversight of the pension sector and expand pension coverage. Component 4 (Strengthening Regulation and Supervision of Insurance Sector) will support drafting of the Insurance Policy, pertinent Insurance regulations for the Insurance Act, provide capacity-building of IRA on the new regulations as well as risk-based supervision and capacity building of the IRA on insurance industry reporting.

ESMID East Africa II – Bond Market Development: The objective of this project is to support implementation of a regional capital market in East Africa, including Uganda, which will facilitate more financing for sectors where long-term local currency funds are necessary such as housing and infrastructure.

ANNEX 4: STATUS OF EAC COUNCIL DIRECTIVES

	Council Directive	Status
1.	Public Offers for Equity Securities	Approved by Council of Ministers and gazetted by EAC Secretariat
2.	Public Offers for Debt Securities	Approved by Council of Ministers and gazetted by EAC Secretariat
3.	Public Offers for Asset Backed Securities	Approved by Council of Ministers and gazetted by EAC Secretariat
4.	Collective Investment Schemes	Approved by Council of Ministers and gazetted by EAC Secretariat
5.	Admission to a Secondary Exchange	Approved by Council of Ministers and gazetted by EAC Secretariat
6.	Corporate Governance for Securities Market Intermediaries	Approved by Council of Ministers and gazetted by EAC Secretariat
7.	Regional Listings in the Securities Market	Approved by Council of Ministers and gazetted by EAC Secretariat
8.	Licensing of Market Intermediaries	Approved by CMIPC and SCFEA. Under consideration by SCJLA.
9.	Investor Compensation Schemes	Approved by CMIPC and SCFEA. Under consideration by SCJLA.
10.	Takeovers and Mergers	Approved by CMIPC and SCFEA. Under consideration by SCJLA.
11.	Investor Education and Protection	Approved by CMIPC and SCFEA. Under consideration by SCJLA.
12.	Anti-Money Laundering in the Securities Market	Approved by CMIPC and SCFEA. Under consideration by SCJLA.
13.	Self-Regulatory Organizations	Approved by CMIPC and SCFEA. Under consideration by SCJLA.
14.	Conduct of Business for Market Intermediaries	Approved by CMIPC and SCFEA. Under consideration by SCJLA.
15.	Securities Exchanges	Approved by CMIPC and

		SCFEA Session. To be presented to Council of Ministers.
16.	Central Securities Depositories	Approved by CMIPC and SCFEA. To be presented to Council of Ministers.
17.	Regulated Activities	Approved by CMIPC and SCFEA. To be presented to Council of Ministers.
18.	Real Estate Investment Trusts	Approved by CMIPC and SCFEA. To be presented to Council of Ministers.
19.	Corporate Governance for Issuers of Securities to the Public	Approved by CMIPC and SCFEA. To be presented to Council of Ministers.
20.	Credit Rating Agencies	Approved by CMIPC and SCFEA. To be presented to Council of Ministers.

Additional legal instruments will be developed for the insurance, pensions, and microfinance sectors. The specific topics for each sector will be determined by the respective Technical Working Groups after the overall policies and implementation plans have been approved by the EAC governing bodies. In pensions, the instruments will likely focus on harmonization of taxation rules. In insurance, the instruments that are consistent with the key topics of Insurance Core Principles will be developed.

ⁱ CMIPC = Capital Markets, Insurance, and Pension Committee, SCFEA = Sectorial Council on Finance and Economics Affairs, SCJLA = Sectorial Council on Judicial and Legal Affairs.