Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 29-Nov-2021| Report No: PIDC33256

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Nepal	P176881	Nepal Finance for Growth DPC (2 of 3) (P176881)	P173044
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
SOUTH ASIA	Mar 24, 2022	Finance, Competitiveness and Innovation	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Nepal	Ministry of Finance		

Proposed Development Objective(s)

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

Financing (in US$, Millions)

SUMMARY

Total Financing	150.00

DETAILS

Total World Bank Group Financing	150.00
World Bank Lending	150.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

Nepal's economy has been hit hard by the global outbreak of COVID-19, increasing the risk of falling into poverty and raising macro-financial risks. While GDP growth averaged 7.8 percent between FY2017-19, it contracted by 2.1 percent in FY2020 and it is estimated to grow modestly by 1.8 percent in FY2021. Six months into the first national lockdown, 25 percent of workers reported permanent job loss and 46 percent of employed workers reported earnings losses. With a negligible scale up of social assistance in response to these shocks in 2020, the risks of increased poverty and longer-term inequality remain high. In addition, country's exposure to climate variability and extreme events is high, currently accounting for an estimated loss of 1.5 to 2 percent of the GDP. Risks from climate change and COVID-19 reinforce each other, reducing capacity of the private sector to mobilize finances to respond to natural disaster and health crisis and support resilient recovery. A new government took over on July 13, 2021 following about two years of political turmoil and the reinstatement of parliament for a second time in five months. A common minimum program was announced by the coalition government on its policies and programs though challenges remain in keeping the coalition intact till the remaining term of parliament which ends in 2022.

The proposed operation supports Government's efforts to counter the impact of the COVID-19 pandemic, enhance resilience and return the economy on a recovery path in compliance with FY22 Budget statement and the Green, Resilient, Inclusive Development (GRID) framework. The bedrock for this will be the stability of the financial sector. This will need to be combined with policies and associated initiatives to address constraints to the development of a deeper, more efficient, inclusive and innovative financial sector that can mobilize resources for economic growth, local entrepreneurship promotion, and job creation. The proposed US$150 million Finance for Growth (F4G2) Development Policy Credit is the second in a programmatic series of three operations. The policy actions under Pillar I build greater resilience into the financial system by supporting the institutional capacity of the NRB to oversee the banking sector and by promoting the incorporation of environmental and social risks in banks' lending decisions. Pillar II opens capital, insurance, and disaster risk markets and fosters new financial product innovations, and Pillar III extends financial inclusion and more generally improves ease of business-to-business and household-to-business transactions, particularly for women and the more vulnerable.

Relationship to CPF

The operation is consistent with Pillars 2 and 3 of the World Bank Group Country Partnership Framework (CPF) FY19-23. The CPF's second Pillar "Private sector-led jobs and growth" identifies the importance of (i) financial sector stability, including concerns of underfunded safety nets, ever-greening of bad loans, and vulnerability to exogenous shocks, (ii) financial inclusion of those disadvantaged by geography, gender, ethnicity, and income levels, including via digital channels, and (iii) the provision of long-term finance via development of insurance and capital markets. Further, the CPF's third Pillar "Inclusion and resilience" targets resilience to shocks and climate impacts and the enabling of more inclusive and sustainable growth. The F4G DPC will directly contribute to these CPF targeted outcomes.

C. Proposed Development Objective(s)

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

Key Results

The targeted results of the Pillar 1 are: (i) improved compliance with at least two of the three Basle Core Principles #8 (supervisory approach), #9 (supervisory techniques and tools), and/or #10 (supervisory reporting), (ii) a minimum level of technical compliance related to selected Financial Action Task Force Recommendations as observed through the 2020 Asia-Pacific Group evaluation. **Targeted results for Pillar 2 are**: (i) placement of disaster risk finance instrument(s) on the market, (ii) increase in the securities holdings of institutional investors, and (iii) increase in the financing through capital contribution and credit received by private equity and venture capital companies. **Pillar 3 targeted results are:** an increase in the number of: (i) adults, disaggregated by gender, using transaction accounts to make electronic payments, (ii) individuals, disaggregated by gender, and firms enrolled with the CIB, (iii) new registrations of security interests in the secured transactions registry, and (iv) increase in international borrowing by banks and financial institutions. A new indicator covering climate risk related prior actions is introduced as increase in the percentage of listed companies (plus all other Class A banks) reporting physical and transitional climate risk.

D. Concept Description

The longer-term development agenda of Nepal is guided by the Socio-Economic Development Strategy (2030) and the 15th Five-Year Periodic Plan (FY20-FY24), with the main objectives being reiterated in the FY22 Budget Statement. The current FY20-FY24 Periodic Plan stresses the requirements for higher economic growth, including investment climate and financial sector reforms to crowd in greater private finance flows. FY22 Budget statement states COVID-19 mitigation, with more attention to green, resilient, inclusive growth as the main priority of the Government of Nepal (GoN). The key priorities for financial sector management are scattered around ensuring financial stability and transparency, development of capital markets and insurance sector, and digitalization of financial services. Both the FY22 Budget statement and the GRID framework (2021) recognize the interrelationship between COVID-19 recovery, poverty, inequality, climate change, and environmental degradation and seek to address these interrelationships simultaneously and systematically. F4G series will support the Government efforts in these areas, including a strong focus on supervision and disclosure of climate-related financial risks.

Under Pillar 1, Prior Actions support the Government and/or Regulatory Authorities' in: (i) amendment of the NRB Offsite Supervision Manual, operationalization of the Supervisory Information System, and issuance of an updated guidance on ESRM requiring banks and financial institutions to identify, assess and manage environmental and social risks to which their commercial clients are exposed that will improve the identification and mitigation of the climate-related transition and physical risks, (ii) institutional AML/CFT risk profile assessment for all banks and onsite supervision inspections on at least two banks identified as high risk, and (iii) approval of the 2021-2026 Nepal Financial Sector Development Strategy (FSDS) in line with the GoN GRID framework with a specific new focus on climate resilience and climate finance.

Under Pillar 2, Prior Actions support the Government and/or Regulatory Authorities' in: (i) approval of the implementation plan for market-based financial instruments under the DRF Strategy, based on a cost-benefit analysis of financial instrument options, (ii) approval of an amendment to the regulation to the "securities registration and issue" regulation (#2073BS) pertaining to listed issuers' disclosure on ESG, focusing on climate change, issued by SEBON, and (iii) adoption by the NIB of regulations related to asset-liability management and solvency capital requirements and regulation/directive on disclosure on climate-related risks.

Under Pillar 3, Prior Actions support the Government and/or Regulatory Authorities' in: (i) amendment of the Unified Directives to reflect an improved interest rate regime conducive to international borrowing, (ii) approval by the NRB of regulations to achieve interoperability for payment transactions using transaction accounts, enable new models for digital payments, enable the growth of agent networks and explicitly ban exclusivity arrangements for agent networks, and rationalize customer fees and charges, and (iii) issuance of the NRB circular directing BFIs to deploy Corporate Social Responsibility funding for financial literacy programs and to provide financial literacy training with targeted interventions to women towards addressing the gender gap.

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

Poverty and Social Impacts

The Nepal Light Poverty Assessment 2021 highlights several threats to poverty reduction including exposure to natural disasters which will increase with climate change, and a high rate of vulnerability of falling back into poverty in response to economic disasters and shocks. Reforms supported in the F4G operation, notably under Pillars II and III, will contribute to closing some of the remaining gaps in financial inclusion impacting the bottom 40%, women, youth, and small enterprises. The benefits would accrue through improved access to financial services, subject to their accessibility and affordability – which can be facilitated through increased financial literacy, and to the extent that the proposed reforms are able to support firm entry and growth at scale. The retail payments system reforms will provide the enabling base to reach these disadvantaged and isolated groups with fast-developing digital financial and associated online commercial services. These initiatives will take on added importance in the context of disasters, such as the COVID-19 crisis and landslides, and the reduction of access to more traditionally delivered financial and non-financial services. The scale-up and rollout of these digital and, over time, new disaster risk financing (DRF) products will help business recovery and growth and reduce vulnerabilities in the face of future disasters and/or the recurrence of lock-down measures. The NRB's Financial Literacy Framework and the most recent directive in the deployment of Corporate Social Responsibility funds, with a focus on women as a key target group, will serve a critical role during the COVID-19 recovery phase and the longer-term inclusion agenda.

Environmental, Forests, and Other Natural Resource Aspects

Prior Actions supported by this operation are not expected to have a significant direct negative effect on the environment. The operation's focus on supporting improvements in the financial markets' management of climate risks – both physical and transitional – may have positive indirect effects on natural resources, which are consequently also protected from climate risk. Climate-resilient investments may also include nature-based solutions, which have positive environmental effects aside from their intended purpose of increasing climate-resilience. In addition, the supported reforms that diversify financial solutions for DRF will improve the country's financial capacity to address: (i) frequent weather-induced disasters, such as floods, landslides and inundation, and (ii) severe infrequent climate-related disasters, such as glacial lake outburst floods, that could otherwise result in a prohibitive fiscal burden and delayed response time. Insurance sector reforms have the potential to reduce vulnerabilities to climate shocks and improve the ability to recover and reconstruct property affected by natural disasters. Enhanced market disclosure of climate risks will also enhance the visibility and urgency in managing these risks and pave a way for the introduction of green taxonomy, green loan principles and incentives for green lending to accelerate low-carbon investments in Nepal.

CONTACT POINT

World Bank

Peter J. Mousley
Lead Private Sector Specialist

Borrower/Client/Recipient

Nepal

Implementing Agencies

Ministry of Finance
Madhu Kumar Marasini
Secretary
madhu.marasini@mof.gov.np

FOR MORE INFORMATION CONTACT

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

APPROVAL

Task Team Leader(s):	Peter J. Mousley

Approved By

Country Director:	Patchamuthu Illangovan	22-Dec-2021