

Management Response to IED's Sector-wide Evaluation on ADB's Finance Sector Operations, 2011–2021

On 18 November 2022, the Director General, Independent Evaluation Department, received the following response from the Managing Director General on behalf of Management:

I. General Comments

1. Management welcomes the Sector-Wide Evaluation of ADB's Finance Sector Operations, 2011–2021 (the report) from the Independent Evaluation Department (IED). The evaluation findings are important and timely and reaffirm the critical role and potential of the finance sector in the operations of ADB by bringing about systemic change including mobilizing capital to finance climate action and support inclusive growth. Management acknowledges the work of IED as well as its consultations with relevant departments during the evaluation process but would like to highlight the following observations on the report.

2. **Cross-cutting nature of the finance sector.** The finance sector is an important and comprehensive enabler across all sectors and themes of ADB. Examples include utilization of the financial intermediation loan to strengthen the financial access for smallholder farmers and agricultural value chain operators, access to green and resilient affordable housing for low-income households, and mainstreaming disaster risk financing at city level. The sector also supports market development including a diversified mix of financial products, helping crowd in private capital, including de-risking initiatives through guarantees, syndication, and blended finance. Given its cross-cutting nature, ADB has been resolutely pursuing the One ADB collaboration in all sectors. This point should be highlighted in the report. A One ADB approach is more than just identifying complementarities between sovereign and nonsovereign operations. It is also about the collaboration that the finance sector has been actively pursuing through participation in agriculture and food security, health, urban, climate change, and disaster risk financing projects.

3. **Deepening partnerships with international organizations.** The observance of international financial standards is critical to ensure well-regulated financial sector development to ensure stability. Recognizing this need, ADB is deepening partnerships with international organizations like the International Monetary Fund (IMF) and Bank for International Settlements (BIS), and international standard-setting bodies such as International Association of Insurance Supervisors (IAIS), and International Organization of Securities Commissions (IOSCO).

4. **Stronger recognition of disaster risk financing.** During the IED evaluation process, it was explained that disaster risk financing programs should not be viewed solely as a public financial management activity. These involve a toolbox of instruments, including insurance and reinsurance, to improve financial preparedness and resilience of governments, businesses, and households in developing countries in the region. The financing programs also include upstream work like financial sector reform, investment programs, product design, and customer literacy, in which the finance sector has worked closely with operations departments. ADB has adopted a suite of new products and approaches to support disaster risk finance, e.g., contingent disaster financing under policy-based loans, parametric insurance, crop insurance, coral reef insurance, and insurance pools. The report should recognize the role of the finance sector in innovative disaster risk financing.

5. **Enabler for medium- and long-term financing.** The report rightly highlights the need for development of capital markets to support long-term investment. However, access to long-term

finance via diversified sources remains challenging, particularly for small and medium enterprises (SMEs) as capital markets are constrained by macro-financial challenges. The size of capital markets is small, and they are sensitive to external shocks. With an underdeveloped institutional investor base, they are unlikely to address the demand for long-term finance in the near to medium-term which is critical to mitigating currency and asset-liability mismatches. A more balanced perspective recognizing the role of financial intermediaries in developing member countries (DMCs) with less developed financial systems needs to be elaborated. Financial intermediation is not limited to channeling funds through large banks but also nonbank financial intermediaries, institutional investors, and new digital platforms for wider outreach.

II. Management Response to the Recommendations

6. Recommendation 1. ADB's new finance sector directional guide should further recognize the differentiated Asia and Pacific socioeconomic and operational context for finance sector development and prioritize policy reform and program support for (i) the promotion of sustainable financial inclusion and innovative digital finance, (ii) the creation of an enabling environment for private sector participation, and (iii) the development of robust capital markets to help deepen and diversify sources of funding to leverage local savings for long-term green finance needed to achieve smooth energy transition and climate-resilient infrastructure.

Management agrees. A differentiated approach is crucial to address multiple and divergent finance sector development challenges. Furthermore, the economic environment has been changing rapidly, bringing new challenges and opportunities for DMCs, such as the coronavirus disease (COVID-19) pandemic, rapid technological changes, and climate change. The Finance Sector Directional Guide (FSDG) will recognize the latest developments across DMCs linked to COVID-19 recovery, food security, increased digital penetration, and the differentiated socioeconomic and operational context for supporting the seven operational priorities of Strategy 2030 in the finance sector operations of ADB.

The FSDG suggests key areas of operational focus for the finance sector. Among these are (i) enhancing support to emerging areas such as financing aligned with the Sustainable Development Goals (SDGs), including climate change, and green and blue financing; (ii) promoting long-term finance and quality infrastructure; (iii) leveraging digital technology to deliver financial services for financial inclusion; (iv) expanding financing to micro, small and medium-sized enterprises (MSMEs) and women; (v) establishing frameworks for disaster and epidemic risk financing; and (vi) strengthening the finance sector foundation.

7. Recommendation 2. In future CPSs for countries with substantial finance sector operations, ADB should highlight how support for finance sector strategy interventions, both public and private, in the areas of capital market development, foundation for financial sector development, regional financial cooperation and integration, and financial stability and integrity, benefit from cross-sector and thematic considerations and aligns with Strategy 2030 operational priorities; CPSs need to be complemented with appropriate metrics for tracking ADB's results that include sovereign, nonsovereign, and knowledge contributions to expected outcomes.

Management agrees. Finance sector activities are well discussed and brought out during country programming. The regional and private sector operations departments recently

started to undertake more coordinated work in the country partnership strategy (CPS) process. The review needs to be more explicit on how One ADB initiatives have worked in certain regions and countries as compared with others.

The CPS Results Framework, updated with the issuance of new guidelines in November 2021, will strengthen country program performance monitoring due to improved alignment with the SDGs. In addition, the CPS has a stronger linkage with the Corporate Results Framework and greater flexibility to accommodate changes during the midterm update, besides improving reporting with a scorecard methodology.

8. Recommendation 3. Adjusting for country context and as a part of its focus on digital finance, ADB needs to prioritize early-stage advocacy work and regulatory oversight interventions that will result in policies that can promote innovation in the provision of finance and risk management products, credit information sharing, consumer protection, and equality of access to financial services for underserved communities.

Management agrees. The Fintech Policy Toolkit has highlighted that responsible and inclusive digital finance ecosystems require the right mix of enabling policies with well-designed foundational infrastructure.¹ In addition, introducing digital technology to finance sector requires investing in complementing factors such as human resources, new institutions, and efficient and internationally compatible legal and regulatory frameworks.

The FSDG also will identify leveraging digital technology to deliver financial services for financial inclusion as one of its six operational focus areas (see para. 6). ADB will continue to help policymakers in DMCs evaluate the enabling factors and adopt policies for the digitalization of finance sector. It will also assist these countries, in collaboration with the Digital Technology team, in designing and building digital infrastructure and legal and regulatory frameworks through technical assistance for capacity building, and private sector investments in digital financial services.

9. Recommendation 4. ADB should accelerate mobilization of private sector finance through the expanded use of structured guarantee products, insurance, and blended finance; and enhance partnerships with institutional investors in addressing infrastructure financing gaps in DMCs.

Management agrees. The private sector mobilizes resources for development, creates jobs, and helps drive innovation and efficiency in DMCs. Given the limited fiscal space in many DMCs, its role is critical in supporting the large need for infrastructure finance and climate finance, as well as trade finance, MSME finance, and disaster risk financing. With the new operating model,² ADB will strengthen its work to scale up the private sector investments. ADB will catalyze private operations through guarantees, risk transfer instruments, blended finance, and advisory services.

In line with Strategy 2030, expanding private sector operations is one of the six guiding principles of the FSDG. ADB will strengthen private sector operations through loans to financial institutions, direct equity investments, investments in private equity and venture

¹ ADB, 2022. *Fintech Policy Tool Kit for Regulators and Policy Makers in Asia and the Pacific*. Manila; ADB. 2016. *Financial inclusion in the Digital Economy, Manila*.

² ADB. 2022. *Organizational Review: A New Operating Model to Accelerate ADB's Transformation Toward Strategy 2030 and Beyond*. Manila

capital funds, and technical assistance while ensuring profitability and commercial sustainability.³ Further, streamlining business processes by enabling sovereign backed financial market development operations to enhance non-sovereign transactions will help generate more significant synergies, besides recognizing the complementarity of both windows. ADB will enhance partnerships with institutional investors and platforms like the Glasgow Financial Alliance for Net Zero to promote sustainable and quality infrastructure financing.

10. **Recommendation 5. ADB should, as part of its organizational review roll out, ensure bankwide finance sector staffing and institutional arrangements address issues of fragmentation and accountability in the finance sector as a whole; inconsistent coordination and collaboration between sovereign operations and NSOs; skills gaps in sovereign operations, NSOs, and resident missions; and identified knowledge gaps.**

Management agrees. Management acknowledges the need to address fragmentation and accountability in all sectors, including the finance sector. To address this issue, Management has proposed a new operating model (footnote 2), which was endorsed by the Board on 28 October 2022 and will become effective in the second quarter of 2023. This includes consolidation of staff working in the finance sector currently in the regional departments and the Sustainable Development and Climate Change Department (SDCC) into a bank-wide finance sector office.

FSDG will address issues related to building skills and resources in emerging areas, achieving quality finance operations through cross-sector and thematic collaboration and the One ADB Approach. As highlighted in paras. 2 and 3, it will promote effective collaboration with international organizations such as the IMF, BIS, and the Network of Central Banks and Supervisors for Greening the Financial System. This can enhance the expertise of the finance sector staff, helping to keep up with the latest market developments and enhancing coordination with other important market players.

³ ADB. 2019. *Operational Plan for Private Sector Operations 2019–2024*. Manila.