REVIEW OF 2011 FINANCIAL SECTOR OPERATIONAL PLAN

REVIEW OF 2011 FINANCIAL SECTOR OPERATIONAL PLAN

Creative Commons Attribution 3.0 IGO license (CC BY 3.0 IGO)

© 2017 Asian Development Bank
6 ADB Avenue, Mandaluyong City, 1550 Metro Manila, Philippines
Tel +63 2 632 4444; Fax +63 2 636 2444
www.adb.org

Some rights reserved. Published in 2017.

ISBN 978-92-9257-827-5 (Print), 978-92-9257-828-2 (e-ISBN)
Publication Stock No. TCS178795-2
DOI: <http://dx.doi.org/10.22617/TCS178795-2>

The views expressed in this publication are those of the authors and do not necessarily reflect the views and policies of the Asian Development Bank (ADB) or its Board of Governors or the governments they represent.

ADB does not guarantee the accuracy of the data included in this publication and accepts no responsibility for any consequence of their use. The mention of specific companies or products of manufacturers does not imply that they are endorsed or recommended by ADB in preference to others of a similar nature that are not mentioned.

By making any designation of or reference to a particular territory or geographic area, or by using the term “country” in this document, ADB does not intend to make any judgments as to the legal or other status of any territory or area.

This work is available under the Creative Commons Attribution 3.0 IGO license (CC BY 3.0 IGO) <https://creativecommons.org/licenses/by/3.0/igo/>. By using the content of this publication, you agree to be bound by the terms of this license. For attribution, translations, adaptations, and permissions, please read the provisions and terms of use at <https://www.adb.org/terms-use#openaccess>

This CC license does not apply to non-ADB copyright materials in this publication. If the material is attributed to another source, please contact the copyright owner or publisher of that source for permission to reproduce it. ADB cannot be held liable for any claims that arise as a result of your use of the material.

Please contact pubsmarketing@adb.org if you have questions or comments with respect to content, or if you wish to obtain copyright permission for your intended use that does not fall within these terms, or for permission to use the ADB logo.

Notes:

In this publication, “\$” refers to US dollars.

ADB recognizes “China” as the People’s Republic of China, “Korea” as the Republic of Korea, “Kyrgyz” as the Kyrgyz Republic, and “Vietnam” as Viet Nam.

Corrigenda to ADB publications may be found at <http://www.adb.org/publications/corrigenda>

CONTENTS

EXECUTIVE SUMMARY	vi
01 INTRODUCTION	ix
02 THE RELEVANCE OF FINANCE SECTOR DEVELOPMENT IN ASIA AND THE PACIFIC	2
03 REVIEW OF THE FINANCIAL SECTOR OPERATIONAL PLAN AND REVIEW METHODOLOGY	6
04 REVIEW OF FINANCE SECTOR OPERATIONS	10
A. Finance Sector Operational Performance	11
i. Sovereign Finance Sector Operational Performance	12
ii. Nonsovereign Finance Sector Operational Performance	16
B. Alignment of Sector Operations with the Finance Sector Operational Plan	16
i. Finance Sector Operations	16
ii. Country Partnership Strategies	18
iii. Project Classification system	19
iv. Performance Indicators	19
C. Technical Assistance in Finance Operations	20
D. Knowledge Management and Partnerships	21
i. Knowledge Management	21
ii. Knowledge and Financing Partnerships	22
E. Effectiveness of ADB's Institutional Arrangements	23
i. Capabilities, Skills, and Resource Requirements	23
ii. Products and Financing Modalities	24
F. Lessons Learned	25
i. Project Appraisal and Design Phase	25
ii. Project Implementation Phase	26
iii. Knowledge Management	27
iv. Institutional Changes	27
05 FINANCE SECTOR DEVELOPMENT IN ASIA AND THE PACIFIC	30
A. Development Landscape	31
B. Sector and Subsector Strategies as Anchors of Medium-Term Policy Engagement	35
06 RECOMMENDATIONS AND CONCLUSIONS	44
APPENDIXES	
1 Finance Sector Operational Plan Results Framework	63
2 Finance Sector Group Action Plan	65
3 Measures to Improve Finance Sector Operational Performance 2011–2015	67
4 Finance Sector Operations Under Review	69
5 Partnerships	73
6 Selection of Finance Sector Flagship Events and Publications 2011–2015	77
7 Finance Sector Operational Performance Review: Summary of Key Lessons	78
8 National Finance Sector Strategies	82
9 Anti-Money Laundering and Combating Terrorist Financing	84
10 ADB Operations in the Finance Sector	85
11 Figures on Economic and Finance Sector Landscape in Developing Member Countries	89

LIST OF TABLES, FIGURES, AND BOXES

TABLES

1	Performance of Finance Sector Sovereign Operations by Financing Modality, 2010–2015	13
2	Finance Sector Operational Areas of Focus	46

FIGURES

1	Share of Finance Subsectors of Total Finance Sector Lending, 2011–2015	17
2	Finance Sector Work Program and Budget Framework: Finance Subsectors as Share of Total Finance Sector Lending (2017–2019)	42
3	ADB’s Finance Sector Development Operations	45

BOXES

1	Financial Sector Operational Performance: Sovereign Operations by Ratings Criteria	14
2	Financial Sector Operational Performance: Nonsovereign Operations	15
3	Microfinance Risk Participation and Guarantee Program	18
4	Tracking Climate Finance in the Finance Sector	28
5	Wide Diversity in Finance Sector Development Challenges and Reform Needs	32
6	Islamic Finance in Asia	36
7	Digital Finance Boosts Financial Inclusion	39
8	Disaster Risk Finance as a Tool for Financial Sector Development	40
9	RBL Bank of India—Equity Investment and Loan	41

ABBREVIATIONS

ADB	– Asian Development Bank	PRC	– People’s Republic of China
ASEAN	– Association of Southeast Asian Nations	PSOD	– Private Sector Operations Department
DMC	– developing member country	PVRs	– project validation reports
FSOP	– Financial Sector Operational Plan	SDG	– Sustainable Development Goal
GDP	– gross domestic product	SME	– small and medium-sized enterprise
IMF	– International Monetary Fund	TA	– technical assistance
MTR	– Midterm Review	WPBF	– Work Program and Budget Framework
PCRs	– project completion reports	XARRs	– extended annual review reports

Vice-President	B. Susantono, Knowledge Management and Sustainable Development
Director General	C. Locsin, Sustainable Development and Climate Change Department (SDCC)
Senior Director	G. H. Kim, Sector Advisory Service Cluster, SDCC
Team leader	L. Schou-Zibell, Technical Advisor (Finance), SDCC
Team members	F. Emmanuel, Advisor, Operations Services and Financial Management Department A. Chatterjee, Principal Financial Sector Specialist, SDCC J. Farinha, Senior Financial Sector Economist, Central and West Regional Department (CWRD) S. Shinozaki, Financial Sector Specialist (SME Finance), SDCC S. Kim, Financial Sector Specialist, SDCC R. Borres, Economics Officer, SDCC V. Clemente, Operations Assistant, SDCC
Peer Review Finance Sector Committee	K. Bird, Director, Southeast Asia Department (SERD) B. Carrasco, Director, South Asia Department C. Engstrom, Director, Private Sector Operations Department X. Fan, Regional Director, Pacific Department (PARD) R. Hartel, Director, CWRD Y. Qian, Director, East Asia Department N. Akamatsu, Senior Advisor, SDCC D. Binns, Director, Office of Anticorruption and Integrity H. Everett, Senior Country Specialist, PARD E. Ginting, Director, Economics Research and Regional Cooperation Department H. Hong, Principal Budget and Management Services Specialist, Budget, Personnel, and Management Systems Department T. Hoschka, Assistant Treasurer, Treasury Department (TD) T. Kanai, Senior Advisor, Office of Cofinancing Operations A. Mohammed, Assistant General Counsel, Office of the General Counsel (OGC) S. Parvez, Principal Planning and Policy Economist, Strategy and Policy Department R. Poddar, Principal Treasury Specialist (Institutional Coordination), TD A. Siackhachanh, Senior Advisor concurrent Practice Leader (Financial Sector), SDCC S. Schuster, Principal Financial Sector Specialist, SERD H. L. Wang, Advisor, Office of Anticorruption and Integrity M. Yamawaki, Head, Office of Risk Management S. Zaidansyah, Principal Counsel, OGC

EXECUTIVE SUMMARY

This review of the Finance Sector Operational Plan (FSOP) affirms the plan’s substantial validity and relevance for three key themes: infrastructure finance, financial sector development, and inclusive finance. Drawing on key findings it recommends measures to calibrate a response under these three key themes to increase and strengthen finance sector operations and its cross-cutting impact. The review provides a platform to launch the FSOP beyond 2020 to ensure its relevance on ADB’s road to 2030.

Finance sector development is one of five core operational areas in ADB’s Strategy 2020: The long-term strategic framework for 2008–2020 recognizes its importance to economic growth and poverty reduction in Asia and the Pacific and the sector’s importance was reemphasized in the Midterm Review (MTR) of Strategy 2020 Action Plan of 2014. The organization therefore approved the FSOP in 2011 to articulate and guide implementation of the finance sector development agenda through 2020.

The FSOP mandated a midway review of its own implementation—reiterated in the 2014 Action Plan—to strengthen its strategic and operational relevance by examining strengths, weaknesses, opportunities, and challenges. The review covered the finance sector development landscape in this region; analyzed finance sector operational performance; assessed the alignment of ADB’s sector operations with the FSOP; reviewed the contribution of knowledge management and partnerships; reviewed institutional gaps in skills, capabilities and resources to meet the evolving demands; and examined the success of product and financing modalities.

Finance sector development in Asia and the Pacific: Developing member countries (DMCs) in the region are promoting a range of policy actions, and structural and institutional reforms to expand the relevance of financial markets in otherwise mostly bank-dominated financial systems. Many countries, however, still lag behind developed economies, despite achievements in 2011–2015. Progress in the sector varies from country to country reflecting their different levels of finance sector development (that is, from graduated, to middle-income, low-income, and to fragile countries). Challenges also arise out of cyclical financial and macroeconomic shocks in ADB's DMCs. These require, and this review recommends, calibrated strategic and operational measures that allow consideration of country context.

ADB support for finance sector development: ADB has concentrated lending around three subsectors: (i) infrastructure finance and investment funds, (ii) money and capital markets, and (iii) small and medium-sized enterprise finance and leasing.¹ Of the total amount of finance sector approvals from 2011–2015, 64% is for sovereign operations and 36% nonsovereign. Financial cooperation and integration complement these efforts and support development efforts in local currency bond market development through the Association of Southeast Asian Nations (ASEAN), ASEAN+3, the Asian Bond Markets Initiative, and Credit Guarantee Investment Facility, mainly through technical assistance. Other efforts include anti-money laundering and combating the financing of terrorism, and events related to the Asia-Pacific Economic Cooperation.

¹ ADB. 2014. The Project Classification System Toward 2020. A User Guide. Manila.

Finance sector strengths and weaknesses: ADB finance sector operations contributed to 11% of ADB's total lending portfolio over the 2011–2015 review period, about 15% in 2015 alone. ADB's Finance Sector Group also provided a range of knowledge services and products, increasingly geared to meet demand for those in upper middle-income countries. Through its sovereign and nonsovereign operations, ADB has a toolkit of products and financing modalities for customizing solutions to the varying DMC and client demands. Yet, ADB's performance tracking systems suggest finance sector operational performance trails that of other sectors. Several factors explain this shortfall. Among them are misaligned design, process, approval and volume incentives, as well as weakness in quality-at-entry filters and peer review process. Also insufficient have been the implementation focus; shortfalls in resources, skills, capabilities; reliance on consultants that erode staff skills; and the ability to capture staff knowledge and practical experience across ADB in benefit of new operations. While ADB increased its number and volume of transactions in 2015 without expanding staff in operations, gaps in skills and resources are a concern. Due to shortcomings in defining performance indicators and a project classification system that does not capture the complexity and impact of finance sector operations, the finance sector's contribution to ADBs development results is about 19% of the total volume of finance sector operations.

Finance sector opportunities and challenges: The cross-cutting impact of finance on different sectors, industries, and economic activities amplifies opportunities for expanding financial inclusion and poverty reduction. It also promotes savings, improves resource allocation, facilitates economic diversification and management of risk, enhances financial stability, helps sustain infrastructure efforts, and supports stable and inclusive growth. Among the challenges, sector development is a complex multidimensional and multiyear process of reform and development of markets and institutions, and is often country specific.

Key recommendations to scale up operations and strengthen operational capabilities:

Retain focus on finance sector development, inclusive finance, and infrastructure finance. And build capabilities in emerging and innovative finance areas that have a cross-cutting impact—digital, green, disaster risk, Islamic, and municipal finance—where ADB can best support economic growth and reduce poverty, and replicate success of financial integration from ASEAN+3 to other regions.

Add resources and upgrade staff skills and capabilities. Upgrade and redirect finance sector staff capabilities, skills, and resources (number of staff) to support emerging and innovative areas and to grow finance sector operations customized to specific DMC demand for increasingly multidimensional and complex sector support. There is a need to increase resources for both sovereign and nonsovereign operations to better serve client needs, including in frontier countries.

Improve finance sector operational performance. Increase attention to finance sector project and program design quality and resource requirements for effective implementation. The Finance Sector Group will (i) require a strengthened peer review process of proposed finance sector operations, and (ii) increase collaboration between operational departments and other departments as relevant in quality at entry and evaluation of projects and programs.

Improve finance sector analysis. Invest more effort (time, resources) to identify finance sector development constraints, institutional capacity development challenges, and opportunities for finance sector development. Improve the depth and quality of finance sector development analysis, to provide a holistic medium- to long-term overview of a country's finance sector and promote stakeholder support and government understanding and ownership.

Improve systems and methodologies. Improve the project classification system and indicators and methodologies that track the contribution of finance operations to ADB's corporate goals and sustainable development goals.

The cross-cutting impact of finance on different sectors, industries, and economic activities amplifies opportunities for expanding financial inclusion and poverty reduction.

SECTION 1

INTRODUCTION

1. This review examines the implementation of the Asian Development Bank's Financial Sector Operational Plan (FSOP) of 2011 and related assistance, and its adequacy for the challenges ahead. It looks at the critical role of the finance sector in development in Asia and the Pacific and its past performance in identifying strengths and weaknesses in operational capabilities. It also discusses how to overcome quality shortcomings in operations. While the review concludes that the FSOP remains substantially valid and relevant in its broad strategic directions, the evolving finance sector landscape in the region and its opportunities and challenges call for further strengthening and scaling-up.

2. Section 2 discusses the role of finance sector development in the region and the specific nature of development assistance in this process. It outlines the cross-cutting impact of financial development on real sector industries and economic activities, its complexities, how it helps alleviate poverty and inclusive economic growth, and the conditions required for effective ADB assistance. Section 3 describes the strategic and operational background of ADB's finance sector assistance and the review methodology. Section 4 assesses finance sector operations, highlighting what has worked well (strengths) and less well (weaknesses), and reviews the implementation of the FSOP for 2011–2015. The review assesses (i) the quality of ADB's finance sector operational performance, (ii) alignment of the FSOP's intended assistance by subsector against actual operations, (iii) technical assistance in finance sector operations, (iv) knowledge management and partnerships, and (v) the effectiveness of ADB's institutional arrangements. Based on these assessments, lessons are drawn for improving the performance, responsiveness, and relevance of finance sector operations.

3. Section 5 discusses finance sector development in the region and charts the way forward. This includes differing levels of finance sector development and development needs in countries and how national strategies can anchor ADB's medium-term engagement. The section reviews the Midterm Review (MTR) of ADB's Strategy 2020, the New Partnership with Upper-Middle-Income Countries, and ADB's annual Work Program and Budget Framework (WPBF), which provides the medium-term context for resource mobilization and allocation planning.¹

4. Section 6 concludes with recommendations for finance sector operations for 2016–2020 and how to contribute to the establishment of Strategy 2030. Recommendations include:

- Retain focus on finance sector development, inclusive finance, and infrastructure finance;
- Add resources and upgrade sector skills and capabilities;
- Improve finance sector operational performance ;
- Improve finance sector analysis; and
- Improve systems and methodologies.

¹ ADB. 2015. *Clients–Contributors–Collaborators: A New Partnership with Upper Middle-Income Countries*. February. Manila; ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*.

A photograph of a man in a blue t-shirt in the foreground, looking down and counting a stack of banknotes. In the background, a woman wearing a red vest with Thai text and a green shirt stands near a body of water. The scene is outdoors with trees and a clear sky in the distance.

SECTION 2

THE RELEVANCE OF FINANCE SECTOR DEVELOPMENT IN ASIA AND THE PACIFIC

5. The finance sector contributes to economic functioning. An effective finance sector is essential for promoting stable and inclusive growth and has a cross-cutting impact on all sectors, industries, and economic activities. It helps to generate finance for private and public investments, promote savings, improve resource allocation, and facilitate the diversification and management of risks. Deep, liquid, and well-regulated financial systems enhance financial stability while enabling resource mobilization to mid- and long-term gestation investments that societies depend on. Developed finance sectors are essential to closing the huge infrastructure gap in Asia and the Pacific, while greater access to formal financial services can help raise productivity and incomes and reduce poverty.²

6. Finance sector development is a multidimensional process of reform and sequenced introduction of markets and institutions that is complex, involves risks, and is generally country-specific. Like other types of institutional development, it involves the creation of technical and institutional capacities; legal, regulatory, and institutional reforms; and political economy issues on how institutions and macroeconomic policy frameworks interact with financial markets. Sets of financial institutions and financial markets in each ADB developing member country (DMC) provide interconnected and often competing services, but also complement each other.

7. Despite achievements during the period of review of 2011–2015, the development of the finance sector in many of Asia’s developing countries faces challenging and often volatile macroeconomic environments and lags that of developed economies. Most countries in the region also face declining potential economic growth, aging populations, climate change and natural disasters, and the need to maintain financial stability in a more volatile world. In addition, regional financial integration needs additional focus, although efforts in the Association of Southeast Asian Nations (ASEAN) region are showing progress. The diverse conditions in DMCs call for a responsive and adaptable ADB that offers a wide array of subsector expertise. Differences in per capita income, growth rates, and populations generate widely different levels of finance sector development, that must be carefully considered when customizing solutions in the finance sector—and hence the potential to replicate solutions from other country contexts.

8. The sequencing and pace of sector development reforms must therefore be appropriate to each country. Stronger institutions—better protection of property rights, creditor rights and access to information, and regulatory quality and rule of law—take time to develop. The quality of prudential finance sector supervisory and regulatory frameworks—as well as supporting efforts from supervisors and regulators to enforce compliance with prudential principles in banking, insurance, and securities—is crucial for building sound financial systems. The benefits of sound financial systems are best illustrated during economic and financial crises, in forgone growth, inefficient financial intermediation, and lack of public confidence in financial markets. The adverse impacts can be large. Financial stress represents the single highest risk to gains in poverty alleviation. Sequenced introduction and development of complementary institutional subsectors and financial markets require regulatory and institutional structures that share legal and informational underpinnings, technology, and innovative financial instruments that are often complex and need international technical assistance.

² There are today 2 billion adults globally who do not have access to formal financial services. There are approximately 1.5 billion people globally, most of whom live in Asia and Africa, who cannot prove their official identity. World Bank - Global Financial Inclusion (Global Findex) Database 2014 <http://microdata.worldbank.org/index.php/catalog/2512>

9. Empirical evidence suggests strong links between sound finance sector development, real sector economic growth, employment and poverty alleviation. A more diverse financial system tends to be more stable and better able to absorb shocks. Well-functioning capital markets are an integral part of financial systems, particularly because they support real growth in sectors that require long-term finance, such as corporate investment, infrastructure, and housing. Local capital markets expand the range of investment opportunities available to institutional investors, such as pension funds and life insurance companies that have long-term horizons for their liabilities.³ The rapid rise of Islamic finance in the some DMCs, including equity-based markets in both stock and *Sukuk* markets, also supports economic growth and mobilizes domestic resources. Increased financial development reduces poverty by easing credit constraints on the poor, reducing income inequality, and improving the allocation of capital. Development of financial services through digital channels can provide cost effective ways to expand poor people's access to formal financial services, helping them transition out of poverty and build financial security more quickly. Banks, microfinance institutions, mobile operators, and other providers are increasingly using mobile phones and point-of-sale devices, along with networks of small-scale agents, to offer basic financial services at greater convenience and lower cost than what traditional banking allows. It is also important that appropriate legal frameworks promote financial literacy and consumer protection, and that legal frameworks on anti-money laundering and combating the financing of terrorism maintain the integrity of financial systems.

10. ADB support for finance sector development, by enabling its systemic benefits to transfer into other sectors, industries, and economic activities, can support global development agendas such as the Sustainable Development Goals (SDGs) of 2030.⁴ ADB's support of DMC efforts to develop more complete (in terms of institutional groups and markets), effective, and efficient finance sectors must:

- Be holistic, based on in-depth system-wide analysis of a country's finance sector and institutional capacity;
- Take a medium-to long-term view in its focused policy dialogue;
- Be based on the political economy of finance sector development, including strong government commitments and ownership;
- Consider appropriate sequencing of reforms to strengthen and deepen the finance sector while mitigating ensuing risks; and
- Overcome operational shortcomings and resource constraints on quality, and grow finance sector operations.

³ ADB. 2013. Broadening the Investor Base for Local Currency Bonds in ASEAN+2 Countries. Manila.

⁴ Finance sector development can be supportive of a country's private and public investment (Sustainable Development Goals [SDG] 8 and 9) and of stable public domestic resource mobilization to health care and education systems and urban services provision (SDG 3, 4, 6 and 11). It can help widen access to financial services across a country's population or private sector (SDG 10 and 2 when it enables financial access to small farmers) and innovations in financial instruments that enable investments in clean energy sources (SDG 7). It can encourage economic and employment growth (SDG 8). Through each of these, in turn, finance sector development and reform can contribute indirectly to SDG 1: "End Poverty in All its Forms Everywhere".

Developing member countries (DMCs) in the region are promoting a range of policy actions, and structural and institutional reforms to expand the relevance of financial markets in otherwise mostly bank-dominated financial systems.

SECTION 3

REVIEW OF THE FINANCIAL SECTOR OPERATIONAL PLAN AND REVIEW METHODOLOGY

11. ADB's long-term strategic framework for 2008–2020 (Strategy 2020) recognized the importance of finance sector development to economic growth and poverty reduction and identified the finance sector as one of five core areas of operational focus. Strategy 2020 emphasized the need for (i) greater effort to develop national and regional financial systems; (ii) stronger financial risk management, credit standards, and internal control procedures in many DMCs; and (iii) broadening inclusiveness by an expansion in access to financial services, especially in rural areas and the informal sector. Strategy 2020 called for ADB to increase its support to the finance sector through the development of financial infrastructure, institutions, products, and services. The strategy noted the importance of helping finance systems in DMCs to channel savings into productive investments and bridge the infrastructure gap through development of capital markets.

12. In response to this strategic emphasis, ADB approved the FSOP in 2011 to articulate its finance sector development agenda and guide its implementation. The plan identified the main institutional development challenges of the region's national financial systems,⁵ analyzed the determinants of assistance needs across DMCs, and identified themes and subsectors that ADB would cover in support of countries' diverse needs and regional challenges. The FSOP clustered 15 themes and subsectors across five topics: (i) foundation for financial sector development and banking sector development, (ii) inclusive finance, (iii) infrastructure finance and access to capital markets, (iv) financial stability and integrity, and (v) regional monetary and financial cooperation and integration.⁶ FSOP prioritization also envisaged ADB phasing out areas in which most DMCs had built significant capacity or where multiple development partners were providing support, such as in "foundations for financial sector development" and "financial stability and integrity". It also noted that regional financial integration mostly requires technical assistance (TA). ADB was expected to build a knowledge base in areas of limited experience—while strengthening the quality of operations in established areas—such as building capacity in central banks (including payment systems), housing finance, insurance, and monitoring and managing capital flows.

13. The FSOP laid out important directions for ADB business models, modalities, and product lines. These included the following needs:

- Knowledge products and services would be based on policy dialogue and strong analytical underpinnings, ensuring that DMCs continue to value sovereign operations in finance sector development as dependence on external resources is reduced;
- Greater knowledge content and value in policy-based loans, to keep them useful for DMCs, particularly middle-income countries that access international capital markets. This would require stronger analytical work in advance of program formulation;

⁵ ADB. 2011. Financial Sector Operational Plan. Manila. May. Section 2 and Box 1.

⁶ The classification used in the 2011 FSOP differs from the project classification system approved in 2014. In particular, "Foundation for Financial Sector Development" included public debt markets, central banking, basic financial infrastructure like payment systems, core financial laws, and accounting systems; "Financial Inclusion" included microfinance, SME finance, housing finance, and trade finance; "Infrastructure Finance and Access to Capital Markets" included debt, equity and derivatives markets, subnational debt markets and contractual savings (like insurance industries and pension funds); "Financial Stability and Integrity" included prudential regulatory frameworks and supervisory capacity, deposit insurance systems and anti-money laundering mechanisms; "Regional Monetary and Financial Cooperation and Integration" covered initiatives to liberalize capital accounts and foreign direct investment in the finance sector, adopt common standards and develop infrastructure for cross-border financial transactions and services, and manage risks that emerge from the financial integration process.

- More systematic coordination between regional departments and private sector operations department in finance sector development, better synergy between sovereign and nonsovereign operations, and for sovereign operations to incorporate nonsovereign transactions in a programmatic approach;
- Enhance quality and quantity of technical assistance operations linked with financial intermediation loans to achieve policy reforms and capacity building and to ensure sustainability. For standalone project lending, focus on central bank management information systems and interbank payment systems. The FSOP also provided direction for addressing project performance concerns (for example through peer review) and guiding principles for development effectiveness; and
- Identify core skill areas and leading experts, and build staff capacity by training and hiring.

14. ADB has continued to support finance sector development in its DMCs across several dimensions. Over 2011–2015, provided \$7.5 billion, or 11% of total lending. The FSOP also called for its own review—reiterated in the MTR Action Plan of 2014—and for provisions to increase involvement in the finance sector over the medium term. The review draws on the MTR of Strategy 2020, annual reporting on Strategy 2020 progress through ADB's development effectiveness reviews, Work Program and Budget Framework, project validation reports (PVRs), extended annual review reports (XARRs), the Independent Evaluation Department's special and thematic evaluations studies, ADB sector and thematic group operational plans, and other ADB reports and studies such as the New Partnership with Upper Middle-Income Countries; Reforming the Country Partnership Strategy; and the Project Classification System, Toward 2020. A User Guide.⁷

⁷ The Finance Sector Group Secretariat and the Finance Sector Group committee consisting of staff from various ADB departments coordinated the preparation of the FSOP review. This was based on an annotated structure discussed and agreed in early 2016, which set the scope and expectations for the exercise. The secretariat drew on staff expertise from across ADB. Finance Sector Group committee meetings, brainstorming sessions, interviews and extensive background reports provided analytical support.

Drawing on key findings it recommends measures to calibrate a response under these three key themes to increase and strengthen finance sector operations and its cross-cutting impact.

SECTION 4

REVIEW OF FINANCE SECTOR OPERATIONS

15. This review assessed finance sector operations by four measures: (i) the quality of ADB's finance sector operational performance, (ii) alignment of the FSOP's intended assistance by subsector against actual operations, (iii) knowledge management and partnerships, and (iv) the effectiveness of ADB's institutional arrangements.

A. Finance Sector Operational Performance

16. The assessment of finance sector operational performance analyzed a sample set of completed projects and programs, with most of them designed and approved during 2000–2009—that is, prior to the establishment of the FSOP—and with PVRs for sovereign operations and XARRs for nonsovereign operations prepared during 2010–2015. For sovereign finance sector operations, this assessment covered PVRs and project completion reports (PCRs) in terms of relevance, effectiveness, efficiency, and sustainability; for nonsovereign finance sector operations it covered XARRs. This analysis of finance sector operations, an essential component of the FSOP review, helped identify structural issues and challenges and enabled discussions with operational departments on whether current design and implementation efforts are overcoming those.

17. The PVRs and XARRs provide the basis for the Development Effectiveness Review, which reports on ADB's performance in achieving the priorities of Strategy 2020. The Development Effectiveness Review assesses development progress in Asia and the Pacific, analyzes ADB's effectiveness in supporting it, and indicates the outputs and outcomes achieved in core operational areas.⁸ Review findings are an important input into the annual WPBF. Its success ratings for finance sector operations, sovereign and nonsovereign, are well below the corporate target of 80% success rate. For sovereign operations, the success rate was 48% for the 3-year average for 2010–2012, 2011–2013, and 2012–2014, and 47% for 2013–2015. Meanwhile, for nonsovereign operations, it improved from 41% in 2010–2012 to 55% in 2013–2015. Important to note is that some finance sector projects reviewed were impacted by the global financial crisis of 2008–2009. Success factors for nonsovereign operations were also impacted by the underperformance of some private equity investment funds, which was reflective of a nascent private equity market in Asia and the Pacific at the time of investments, as well as a concentration of investments in South Asia that did not yield the expected returns. As private equity investment funds do not involve a financial institutions intermediary, consideration is being given to reclassify these types of investments as other than finance sector operations. The finance sector group will work with the Strategy and Policy Department on these efforts. Recognizing weaknesses in finance sector operational performance, measures have been taken that will need to be systematically applied and

⁸ Methodological changes introduced in the 2014 Development Effectiveness Review: (i) success rates of programs and projects based on the Independent Evaluation Department's validation ratings and completion reports, are now based on that department's validation results; (ii) reporting year changed from calendar year to a rolling 12-month period (July 1 to 30 June) to ensure a broader base for validation of completion reports; (iii) success rates of sectors based on primary and secondary sector classification based on the project classification system of 2014 (see para. 27 for discussion on the project classification system).

continually reviewed.⁹ The Development Effectiveness Review contributed to the need for in-depth analysis of finance sector operational performance to better understand strengths and weaknesses in finance sector operations and to identify measures to enhance operational performance.

18. An Operations Services and Financial Management Department 2015 assessment analyzed the quality of sovereign finance sector operations in 2011–2014 in three stages of ADB's operations business process cycle:¹⁰ (i) approval (scale of operations and their strategic mapping); (ii) implementation (in particular, the effectiveness of performance indicators that determine project risk ratings); and (iii) completion. This highlighted “strategic-fit” issues, implementation difficulties, and lessons learned from operations departments. In consultations with operational departments and the Independent Evaluations Department further feedback was gathered on the challenges that influence the quality of project design and implementation efforts in finance sector operations. The assessments acknowledge the limits imposed by the small samples and nature of finance sector operations.

i. Sovereign Finance Sector Operational Performance

19. The performance assessment looked at a sample of 29 PCRs and PVRs (para. 16).¹¹ Of the 29 programs and projects, 12 were rated successful, 14 less than successful, and 3 unsuccessful. Overall performance ratings are based on four measures: (i) relevance of project design, (ii) effectiveness in achieving outcome and outputs, (iii) efficiency in achieving outcome and outputs, and (iv) preliminary assessment of sustainability. Although the causes of weak performance differed somewhat between the four measures (Box 1), they included (i) designs not aligned or underpinned by government strategy; (ii) complex design, targeted outcomes, and outputs beyond the control of the program or project, too ambitious to achieve given the implementation period; (iii) inadequate ADB field support during implementation; (iv) delays in implementation and consultant recruitment; (v) lack of government commitment; (vi) weak capacities of executing and implementing agencies; (vii) delays in policy reform; and (viii) unforeseen risks. Common risks in finance sector operations, sovereign and nonsovereign, were unexpected macroeconomic or financial shocks, and market disruption events.

⁹ Sovereign and nonsovereign operations have implemented measures to strengthen performance of finance sector operations. The full effects of these measures are not yet reflected, as many of the projects and programs approved since their introduction are still under implementation. See Appendix 3 for measures taken to improve finance sector operational performance. Based on the same sample of projects included in the performance assessment, sovereign and nonsovereign operations rated successful prior to validation was for the period 2013–2015 60% and 61% respectively. Based on the total sample of PCRs prior to validation—50 projects and programs in total—the success rate was 71%. All nonsovereign operations are validated.

¹⁰ For the period of analysis, 2011–2014, there were approvals of 64 programs and projects and 123 technical assistance projects. At implementation and completion stage, 22 sovereign finance sector operations were evaluated (validated and non-validated project completion reports). The analysis covered projects/programs in the approval, implementation, and completion stage. The approval and the implementation stages constituted largely active projects/programs. Source: ADB. 2015. Financial Sector Operation Performance Review 2011–2014. Operations Services and Financial Management Department.

¹¹ This included PCRs and PVRs for programs and projects in Pakistan (5), Sri Lanka (4), India (3), Viet Nam (3), Lao People's Democratic Republic (2), Mongolia (2), Nepal (2), Philippines (2), and one each for Afghanistan, Bangladesh, Indonesia, Papua New Guinea, Tajikistan, and Uzbekistan.

20. The assessment further analyzed performance by financing modalities. Of the 29 PVRs for 2010–2015, these include 1 multi-tranche financing facility (100% successful); 9 projects, including credit lines (33%); 9 policy-based loans (33%), 5 programmatic approach (40%), and 5 sector development programs (60%).¹² While the limited sample size of PVRs did not allow for conclusive identification of strengths and weaknesses of different modalities, common causes for weak performance included (i) weak capabilities of executing and implementing agencies; (ii) inadequate implementation arrangements; (iii) lack of government commitment; (iv) changes in policy midway through implementation or lack of monitoring; and (v) inadequacy in project design, which was either too complex or underestimated risks.

Table 1: Performance of Finance Sector Sovereign Operations by Financing Modality, 2010–2015

Financing Modality/PCR Rating	Highly Successful	Successful	Less than Successful	Unsuccessful	Total
Multitranchise financing facility/project	0	1	0	0	1
Project	0	3	4	2	9
Policy-based loan: Stand-alone	0	3	6	0	9
Policy-based loan: Programmatic approach	0	2	3	0	5
Sector development program	1	2	1	1	5
Total	1	11	14	3	29

Source: ADB staff calculations.

¹² Of 29 projects and programs assessed 2010–2015, 21, or 72%, had some form of associated or attached technical assistance (TA) support. Of these 21 projects and programs, the percentage rated successful was 43%. The assessment revealed that TA support can be instrumental to (i) formulate and prepare the project and program design; (ii) provide technical guidance and support in the areas of policy, and supervision and regulation; (iii) supplement program management and implementation capacity gap; and (iv) monitoring and post-completion support. See Appendix 4 for a list of PVRs and extended annual review reports.

Box 1: Financial Sector Operational Performance: Sovereign Operations by Ratings Criteria

Figure B1.1: Performance of Finance Sector Sovereign Operations, 2010–2015

Relevance of project design. Relevance ratings are high (76%) suggesting a strong strategic fit between the developing member countries' finance sector development needs and ADB's interventions. Causes for the less relevant ratings include: (i) designs were not aligned or underpinned by a specific government strategy; (ii) designs were complex, targeted outcomes that were beyond the control of the program/project, or both; and (iii) policy reforms were difficult to implement given the limited institutional capacities of executing and implementing agencies.

Effectiveness in achieving outputs and outcomes. Effectiveness was 38%. Causes for the less than effective ratings include: (i) outcome and output performance indicators were too ambitious to achieve given the implementation period; (ii) lack of country ownership or commitment to follow through on policy reforms and legislative changes; (iii) the need for capacity development of implementing and executing agencies was underestimated; and (vi) unforeseen events, such as deterioration in macroeconomic environment, political or security turmoil, and global financial crisis.

Efficiency in achieving outputs and outcomes. Efficiency was 35%. Causes for the less efficient ratings include: (i) weak capacity of executing and implementing agencies coupled with lack of ADB field support during implementation, that is, insufficient review missions, which becomes particularly important when there is lack of political will or resistance to reforms; (ii) lack of government commitment to follow through on policy, legislative and regulatory reforms; and (iii) delays in implementation and in consultant recruitment.

Sustainability. Likely sustainable was 55%. This criterion covers economic, financial, and environmental aspects. Causes for the less than likely sustainable ratings include (i) lack of essential complementary policy reforms; (ii) key outputs and outcomes did not materialize; and (iii) government commitment was lost.

Source: ADB staff calculations based on validated project completion report ratings.

Source: ADB staff.

Box 2: Financial Sector Operational Performance: Nonsovereign Operations

Figure B2.1: Performance of Finance Sector Nonsovereign Operations 2010–2015

Source: ADB staff calculations based on validated extended annual review report ratings.

Overall performance of nonsovereign operations: This was based on the evaluation measures mentioned above and ranked in descending order as follows: highly successful, successful, less than successful, and unsuccessful. Of the 40 nonsovereign operations, 5 were highly successful, 20 successful, 7 less than successful, and 8 unsuccessful. That is, 63% were either highly successful or successful. The following looks at the performance of evaluated operations by the different modalities: private equity, direct equity, and loan guarantees.

- **Performance of private equity fund operations:** Of 14 private equity fund operations: 1 was highly successful, 6 successful, 3 less than successful, and 4 unsuccessful. The combined success rate was 50%. The main causes for less than successful or unsuccessful performance were (i) lack of due diligence of the market potential and the capabilities of the fund manager; (ii) low deal closures; (iii) shortfall in fund size; (iv) inadequacy of fund internal selection process, which undermined the credit quality of investments and resulted in insufficient diversification; and (v) exogenous factors including the global financial crisis. The recently adopted private equity funds business strategy guidelines (of Appendix 1) seek to actively address these issues through a strategic realignment aimed at enhancing both financial returns and development impact.
- **Performance of direct equity operations:** Of the 10 direct equity operations, 3 were highly successful, 5 successful, 1 less than successful, and 1 unsuccessful. The combined success rate was 80%, significantly better than private equity fund operations. The main causes for less than successful or unsuccessful performance in direct equity operations were (i) inappropriate business and financing strategy, and (ii) inadequate due diligence of the existing shareholders.
- **Performance of loan operations:** Of 14 loan operations, 1 was highly successful, 9 successful, 2 less than successful, and 2 unsuccessful, and combined success rate was 72%. Performance was second best among the financing modalities. The global financial crisis had severe impact on the two unsuccessful operations.
- **Performance of guarantee operations:** Of 2 guarantee operations, one was rated less than successful and one unsuccessful. Given the small sample size, the assessment did not draw any general patterns of causes.

Source: ADB staff.

ii. Nonsovereign Finance Sector Operational Performance

21. The analysis and assessment looked at the performance quality of 40 completed nonsovereign finance sector operations through the four main evaluation measures used across each XARR: (i) development outcome and impact, (ii) ADB's investment profitability, (iii) ADB's work quality, and (iv) ADB's additionality. Development outcome and impact depends on four factors: (i) private sector development, (ii) business success, (iii) economic sustainability, and (iv) environment, social, health, and safety safeguards. The performance evaluations were carried out over 2010–2015. The portfolio comprised a sample of 40 completed and validated reports out of a total of 54.¹³ Of the sample set, 63% of the projects were successful.

22. Composition of nonsovereign finance sector operations by instrument: The portfolio comprised 24 equity investments, 14 loans, and 2 guarantee transactions. Among the 24 equity investments, private equity fund investments numbered 14 (35% of total nonsovereign operations) and direct equity investments numbered 10 (25%). While the causes for weak performance varied to some extent among the different products, common causes included (i) exogenous factors, such as the global financial crisis, which specifically impacted three projects in Kazakhstan; and (ii) inappropriate business and financing strategy. Additional contributing factors in the less than successful or unsuccessful performance of private equity fund investments included (i) inadequate due diligence of market potential, the capabilities of the fund manager, and existing shareholders; (ii) low deal closures; (iii) shortfalls in fund size; and (iv) inadequacy of the fund's internal selection process, which undermined the credit quality of investments and resulted in insufficient diversification.

B. Alignment of Sector Operations with the Finance Sector Operational Plan

23. To assess alignment of sector operations with priorities in the FSOP, reviews were made of (i) how well finance sector operations aligned with strategic themes outlined in the FSOP, (ii) how extensively the finance sector was covered in country partnership strategies, (iii) how well the project classification system captured finance sector operations, and (iv) how well the results framework captured the impact of finance sector operations. The review assessed finance sector operations in line with the project classification system, which was revised in 2014 to include 10 subsectors and retrofitted from 2000.

i. Finance Sector Operations

24. Finance sector operations are concentrated in three of the ten finance subsectors in the project classification system: (i) infrastructure finance and investment funds, (ii) money and capital markets, and (iii) small and medium-sized enterprise (SME) finance and leasing. While the FSOP recognized the importance of infrastructure finance and capital market development, it also envisaged phasing out finance sector development, which continues to remain an important area of ADB support. For 2011–2015 subsector lending in infrastructure finance and investment funds was 27% of the total finance sector loan portfolio, while money and capital markets, and SME finance and leasing were 15% each.

¹³ The self-assessment and validation evaluation methods, as well the issues of focus, vary between sovereign and nonsovereign operations. The comparability of ratings between the two is thus limited.

Figure 1: Share of Finance Subsectors of Total Finance Sector Lending, 2011–2015

NBFI = nonbank finance institutions, SME = small and medium-sized enterprise.

Source: Asian Development Bank. 2016. *Operations Dashboard* (accessed December 2016). Manila.

Notes: For central banking systems, 0% accounts for 1 program with approved amount of \$1 million. Trade finance does not include annual ADB-supported trade finance transactions under the Trade Finance Program, but rather only overall increases in the program under Board approvals. Inclusive finance, likewise, does not reflect annual ADB support under the nonsovereign Microfinance Risk Participation and Guarantee Program.

25. During the review period 2011–2015, sovereign operations comprised 64% of the total finance sector portfolio and nonsovereign operations 36%.¹⁴ A total of 89 programs and projects were approved for a total of \$7.5 billion, 46 were sovereign operations (\$4.8 billion) and 43 were nonsovereign operations (\$2.7 billion). Sovereign operations were concentrated in infrastructure finance and investment funds (33% of total sovereign finance sector operations), money and capital markets (24%), and finance sector development (15%). Support to sovereign finance sector operations with a gender equity theme and gender mainstreaming was 42%.¹⁵ Nonsovereign operations were concentrated in inclusive finance

¹⁴ \$7.6 billion includes misclassified private equity funds projects.

¹⁵ ADB. 2016. *Gender Equality and Women's Empowerment Operational Plan (2013–2020): 2015 Performance Summary*. April. Manila. The Gender Operational Plan from 2013 mentions that improved access to financial services alone is insufficient to help women build and sustain livelihoods or enterprises and that opportunities will be explored to comprehensively address constraints on women's enterprise development through policy reform, financial products and services tailored to female client needs and building women's entrepreneurial skills and financial literacy through business development support and other training.

(28%), SME finance and leasing (21%), and infrastructure finance and investment funds (17%). Nonsovereign operations funding has steadily increased in the area of inclusive finance (including in the area of inclusive business) to target the many underbanked and base of the pyramid customers in ADB's DMCs. For the review period, 17% of nonsovereign projects had effective gender mainstreaming, if not gender equity component, and 48% some gender elements. Of the total project volume approvals from 2011–2015, 59% was targeted at projects supporting underserved customer segments. The Private Sector Operations Department (PSOD) addresses base of the pyramid entrepreneurs directly by funding MFIs and banks and through the Microfinance Risk Participation and Guarantee Program, which was approved in 2010 and became operational during the review period (Box 3). Nonsovereign operations' contribution to regional finance integration is primarily through support for trade finance through the Trade Finance Program (TFP). During 2011 through 2015, the Board approved in July 2012 a Major Change in Program for the TFP, which removed the sunset clause, thereby mainstreaming the program. It also approved INR and CNY-denominated transactions (in addition to existing USD, EUR, and JPY-denominated transactions). During the period of 2011–2015, TFP mobilized cofinancing of \$10.5 billion. For ADB's account, \$7.4 billion was financed or guaranteed. Over 90% of the transactions were done in ADF countries. In total, it is estimated that over 7,000 SME transactions were supported. To date, there have been no losses.

Box 3: Microfinance Risk Participation and Guarantee Program

To support younger or smaller microfinance institutions (MFIs), Private Sector Operations Department launched the Microfinance Risk Participation and Guarantee Program in 2010 (the "MFI Program"). The MFI Program has mobilized funding to microfinance institutions (MFIs) for base of the pyramid entrepreneurs. The MFI Program started in the aftermath of the Andhra Pradesh crisis in India where many MFIs faced a shortage of funding. Much of the initial support was therefore focused on India. As it is a regional program, it has expanded to other countries (Bangladesh, Indonesia) and will expand further in the future. ADB's exposure during this period totaled \$126 million and \$142 million was cofinanced by private sector financial institutions. Nearly 2 million microfinance borrowers were supported by the MFI Program during this period—almost all of whom were rural women. The ADB Board approved an increase of the program limit by \$50 million in October 2015, which increased the overall limit of the program to \$240 million. The ADB Board also mainstreamed this program, removing the initial expiration date. To date, there have been no losses in the program.

Source: Staff resources

ii. Country Partnership Strategies

26. Based on an assessment in 2015 of country partnership strategies for ADB's 41 DMCs, it was found that about half during 2011–2015 included a finance sector assessment. While these assessments cover several subsectors, they focus on (i) inclusive finance, (ii) SME finance and leasing, (iii) money and capital markets, (iv) finance sector development, and (v) infrastructure finance and investment funds. A recent study of the country partnership strategies found them insufficiently tailored to the circumstances of an individual country,

undermining the relevance and usefulness in informing their content.¹⁶ Staff consultations also identified the lack of preparation of regular finance sector assessments and analytical work with integrated analyses of finance system development challenges and links to country needs. In this context, finance sector assessments were considered descriptive, with lack of detail or underlying analysis of constraints and challenges, and that this has prevented operational support from programming finance sector interventions to optimize impact.

iii. Project Classification System

27. The project classification system aims to facilitate the tracking, capture, analysis, and reporting of trends and the nature of ADB operations across sectors and subsectors, its strategic agendas, drivers of change, and poverty and location impacts. In 2014, the project classification system was revised in line with recommendations of the MTR of Strategy 2020, and using a subsector classification that differed from that laid out in the 2011 FSOP. The revision included a redefinition of the “multisector” category to enable more accurate reporting, especially because that allows the capture of the primary and secondary sectors; subsectors 1, 2, and 3; and the secondary subsector.¹⁷ Following introduction of the new project classification system, ADB operations were retrofitted as far back as 2000. The system before the 2014 revision implied some underreporting; for example, some projects that cut across finance were not classified as such. While revisions in sector and subsector categories aligned project classification system terminology with ADB’s business needs and operations, inconsistencies still exist for subsectors. One example is insurance and contractual savings, which by definition should be included under the subsector “banking systems and nonbank financial institutions”. The category of infrastructure finance and investment funds are not related. Investment funds are private equity funds that are financed by nonsovereign operations and cover many sectors. They are not considered to be finance sector projects as they do not involve financial intermediaries. The project classification system terminology on subsectors also mixes up themes and institutional groupings and there are gaps in its application, leading to misclassification of projects. Such inconsistencies undermine effective monitoring and reporting of the finance sector’s contribution to development results. Less precision in the attribution of subsector classifications has reduced the effectiveness of the classification system.

iv. Performance Indicators

28. The performance indicators included in level 2 of the results framework are limited in application and do not fully represent finance sector work at ADB.¹⁸ The three level 2 indicators are: (i) trade finance supported (\$ million per year), (ii) the number of microfinance loan accounts opened or end-borrowers reached (female and male), and (iii) the number of SME loan accounts opened or end-borrowers reached. Trade finance (excluding

¹⁶ ADB. 2015. *Reforming the Country Partnership Strategy*. Manila.

¹⁷ ADB. 2014. *The Project Classification System, Toward 2020. A User Guide*. Manila. The project classification system for finance sector includes 10 subsectors: (i) central banking systems; (ii) monetary institutions banking systems and nonbank financial institutions; (iii) housing finance, housing policy and administrative management; (iv) small and medium enterprise finance and leasing; (v) inclusive finance; (vi) insurance and contractual savings; (vii) money and capital markets; (viii) infrastructure finance and investment funds; (ix) trade finance; and (x) finance sector development. Health care finance and health insurance are classified under health sector.

¹⁸ ADB. Results Framework 2013–2016. *Quick Guide*. Manila.

cofinancing), lending to micro, small and medium-sized enterprises, and inclusive finance together contribute to about 19% of the finance sector loan portfolio during 2011–2015. This means that subsectors—including finance sector development, money and capital market development, and infrastructure finance and investment funds (which together accounted for 61.2% of the loan portfolio)—are not captured by the Results Framework. Limited coverage of performance indicators undermines the ability of the development effectiveness review to assess the finance sector’s contribution to development results, through the success and delivery of finance operations, and to development progress in Asia and the Pacific.¹⁹

C. Technical Assistance in Finance Operations

29. The share of TA directly supporting ADB’s core operational areas—infrastructure, environment and climate change, regional cooperation and integration, finance sector development, and education—increased from 45% to 66% after approval in 2008 of ADB’s TA policy.²⁰ As a share of ADB’s TA for 2011–2015, 11% was for finance sector, or about \$145 million.²¹ TA is an important value addition for both sovereign and nonsovereign finance sector operations in that it helps (i) prepare projects; (ii) develop capacity of governments, financial institutions, and other clients introduce new products and digital technologies; (iii) advise on policies and reforms; and (iv) lift overall impact. TA to support financial cooperation and integration, including ASEAN+3 and Asian Bond Markets Initiatives, was about \$9.6 million. The overall TA success rating averaged 80% in 2011–2015. For the finance sector, it reached 82% (in 2013–2015), up from 81% in previous periods. But the success ratings for finance sector TAs were slightly lower than for sectors such as energy and transport (86%) and water (93%).²² A review of finance sector technical assistance completion reports identified certain factors that could be addressed to further improve performance. These included inadequate technical analysis or design, deficient capacity building, lack of government ownership, insufficient ADB supervision, delays in consultant recruitment, and consultants lacking technical expertise and familiarity with country context.

¹⁹ In connection with the review of the FSOP, stocktaking was done of sustainable development goals, targets, and indicators, and performance indicators in use in other multilateral development banks. It identified a list of potential alternative performance indicators, with the objective to more effectively capture the impact of ADB finance sector operations. These indicators will be developed in coordination with the development of Strategy 2030.

²⁰ ADB. 2014. *Corporate Evaluation Study: Role of Technical Assistance in ADB Operations*. September. Manila.

²¹ For 2011–2015 the total TA to support sovereign and nonsovereign operations was \$126.1 million and \$18.9 million respectively. This includes all TA, such as Office of Regional Cooperation and integration, Office of Risk Management, and Sustainable Development and Climate Change Department. Source funds are ADB and other sources.

²² ADB. Technical Assistance Completion Report Database, (accessed May 2016).

D. Knowledge Management and Partnerships

30. ADB's focus on knowledge and advisory work as support for change in its DMCs responds to rapid economic transformation in Asia and the Pacific. It also recognizes that knowledge-intensive operations are crucial to the multidimensional process of reform and development of financial markets and institutions.²³

i. Knowledge Management

31. Staff knowledge and practical experience often go uncaptured and unshared across ADB. To address this issue and to support innovation and the use of information and communication technology, the Finance Sector Group has facilitated collaboration between knowledge and operations departments and resident missions through information and learning activities and operational support.²⁴ Key findings and lessons learned from ADB finance sector operations are articulated in PCRs, PVRs, and XARRs, on a project-by-project basis, but there has been limited in-depth analysis published and disseminated on common experiences. A systematic look at finance sector operations and to identify lessons from ADB assistance and from DMC efforts in reforms can support the design of finance sector reform and development initiatives. It can also support the development of comprehensive financial system analysis on which to base policy dialogue. Publications on general issues in finance sector development have been substantial. They include books, working papers, policy notes, brochures and flyers, case studies, journal presentations, serials, financial inclusion newsletters, conference proceedings, opinion pieces and blogs.²⁵ The convening role ADB can play through the Finance Sector Group can also be more prominent in facilitating sharing of policy experience across finance sector stakeholders in DMCs.

32. Financial cooperation and integration is supported through regional forums, for example on SME finance and development, insurance, inclusive finance, banking supervision, and anti-money laundering and combating the financing of terrorism, as well as events related to the Asia-Pacific Economic Cooperation. It is also supported through regional capital market development. Ongoing efforts include local currency bond market development through the ASEAN, ASEAN+3, Asian Bond Markets Initiative, and Credit Guarantee Investment

²³ Strategy 2020 mandates ADB to develop, mobilize, and apply knowledge solutions for distilling and disseminating lessons and knowledge sharing with immediate impact for the poor. The New Partnership with Upper-Middle-Income Countries notes that knowledge partnerships with upper-middle-income countries will be expanded, technical advisory functions strengthened, and emphasis placed on innovation and value-addition in lending operations, and advisory and knowledge support. The MTR noted (i) the importance of partnerships and that partners seek collaboration with ADB, primarily in core operational areas; (ii) that stronger institutional coordination of knowledge solutions is needed; and (iii) that DMCs consulted during the MTR demanded solutions that leverage ADB resources through partnerships, and provide knowledge to DMCs to maximize and accelerate development effectiveness.

²⁴ Para. 36 discuss the need to strengthen the finance sector capacity of resident missions.

²⁵ During the FSOP review period 2011–2015, 152 working papers, opinion pieces, and books were published and 20 conferences were delivered. See Appendix 6 for a selection of knowledge products and knowledge events.

Facility.²⁶ These efforts play an important role in developing regional financial infrastructure to strengthen financial stability, promote regional financial market integration and mobilize savings to meet long-term financing needs of the region. The thrust of these activities lies in developing regional capital markets, including local currency bond markets. They are increasingly incorporated in country strategies, such as in Cambodia's National Financial Sector Development Strategy.

ii. Knowledge and Financing Partnerships

33. Knowledge partnerships, though reportedly effective, are not used to their full potential. Links with ADB's specialists and research needs have been tenuous and the criteria for selecting the knowledge partnerships and defining their work programs have been ambiguous. Recent efforts, such as the establishment of Guidelines for Applying Solutions through Knowledge Partnerships, attempt to address these issues.²⁷ The Finance Sector Group's ongoing collaboration with standard-setting bodies, such as the International Organization of Securities Commissions, the International Association of Insurance Supervisors, Islamic Finance Services Board, and the Financial Action Task Force on Money Laundering, contributes to the implementation of international financial standards in the region's developing countries and allows ADB to share its knowledge and expertise, share information in sector policy dialogues, and update its technical knowledge. But ADB is not a member of all standard setting bodies and does not regularly attend meetings. In addition, only a limited number of DMCs are represented in these bodies. To ensure coordination and complementarity of support to DMCs, ADB coordinates country programing with other development partners through donor coordination meetings and during project design, as also reflected in processing documents on development coordination. ADB, however, does not regularly participate or have access to findings and recommendations of the Financial Sector Assessment Program of International Monetary Fund (IMF) and the World Bank. Such access is important to designing assistance that has no critical inconsistencies with such findings. The FSOP sought systematic access to results of the Financial Sector Assessment Program, and to the extent possible, to take part in its process in relevant countries. But this has not been achieved, except on an ad hoc basis.

34. Financing partnerships combine the financial resources of partners to support development efforts and create cofinancing opportunities. They include the Financial Sector Development Partnership Special Fund established to provide ADB-administered TA and

²⁶ The Operational Plan for Regional Cooperation and Integration 2015–2020 will: (i) promote financing for cross-border infrastructure, including support for capital and saving intermediation (particularly from higher-income countries) for infrastructure—e.g. sovereign regional infrastructure funds that issue bonds to attract foreign exchange reserves, or other regional infrastructure bond finance promoting institutional efficiency; (ii) promote value chain participation, especially for SMEs; (iii) support capital market development, including through the ASEAN+3 Asian Bond Markets Initiative and the Credit Guarantee Investment Facility; and (iv) regional cooperation platforms and institutions such as ASEAN+3 Macroeconomic Research Office. ADB support to financial cooperation and integration is built on the Asia Economic Community Blueprint. The formal establishment of the community in 2015 is a milestone in the regional economic integration agenda in ASEAN, offering opportunities in its market of \$2.6 trillion and over 622 million people. Payment and settlement systems are a cross-cutting area within the Asia Economic Community Blueprint 2025.

²⁷ ADB. 2016. *Guidelines for Applying Solutions through Knowledge Partnerships*. Manila.

investment grants for finance sector development in Asia's developing countries.²⁸ The fund has allowed ADB to enhance responsiveness to DMC requests for TA. The FSOP mentions that ADB would work with donors to mobilize financing for rapid deployment of consultants, possibly as part of the fund, but funding from additional donors has not materialized.

E. Effectiveness of ADB's Institutional Arrangements

i. Capabilities, Skills, and Resource Requirements

35. The 2015 staff skills audit assessed staff resources against future operational requirements and identified projected gaps in capabilities, skills, and resources. A Finance Sector Group review complemented the audit.²⁹ While some of these gaps could be narrowed or eliminated through resource sharing across departments, ADB-wide redeployments, secondments, and engagement of consultants with the requisite skills, the growing demand for financing and technical assistance from operational departments—both sovereign and nonsovereign—necessitates additional staff. Skills gaps are likely to emerge in areas such as green finance (including climate finance), disaster risk finance, digital finance, infrastructure finance, agri-finance, and housing finance. The analysis showed that gaps varied across operational departments, as did the processing and implementation workload. In regional departments, gaps also exist in Islamic and trade finance, and fund management. The review also identified a need to strengthen preparedness and build up skills to respond to urgent DMC demands for budget support during financial and macroeconomic volatility. To build a strong equity portfolio, which has historically generated healthy returns for ADB, more staff with this skill set will be needed. There may also be forthcoming skills gaps in areas such as nonbank financing. With current staffing constraints in nonsovereign operations and to meet volume targets, larger debt deals in more developed DMCs are the norm with smaller transactions in frontier markets and equity transactions executed on an infrequent basis. Additionally, due to the complex and typically higher risk profile of state owned enterprise transformations, coupled with political sensitivities, such transactions are lengthy and the probability of closing a transaction is often lower. Therefore, these transactions are undertaken on a selective basis due to staffing constraints.

36. Many resident missions lack finance-sector skills and resources to address client needs and provide support during design and implementation, including monitoring to ensure that projects are implemented effectively and resources used efficiently.³⁰ Resident mission staff has been increasingly involved as mission members, but their TA administration

²⁸ At establishment in 2006, the Government of Luxembourg contributed €1.5 million, the first of an annual allocation in that amount. With growing DMC demand for support in the finance sector, the fund was changed in 2013 to multidonor to attract and facilitate more funds. ADB management allocated \$2.7 million to the fund to support finance sector development.

²⁹ The Budget, Personnel, and Management Systems Department Statistics provide information on staff with different areas of expertise in ADB. For staff with finance expertise, the information is limited to those with “finance” in their title and should thus be considered an estimate. As of April 2016, there was a total 100 “finance” sector staff, 59 of them in regional departments and 11 in PSOD. Eleven international staff from operational departments are based in resident missions.

³⁰ Weak finance sector capacity in resident missions can also be linked to weak efficiency results in achieving outputs and outcome (Box 1).

has not increased. Workforce and workload analysis found that resident missions were not adequately resourced to administer portfolios delegated to them, with some lacking analysts to allow further delegation. Decentralization of TA administration is also made difficult by centralized ADB procedures for recruiting consultants and managing TA procurement.

37. Institutional coordination between sovereign and nonsovereign operations has improved, but is not systematic. This is in part due to sovereign and nonsovereign operations having different operating principles and policy objectives. Coordination has increased in the preparation of country partnership strategies, and some staff have benefited from development assignments and transaction support. Greater and more systematic coordination between sovereign and nonsovereign operations may be able to generate greater synergies. This is especially so, as the former is important to establishing an enabling environment, through sequenced policy reform, for private sector investment.

ii. Products and Financing Modalities

38. ADB provides a range of products and financing modalities to meet finance sector development challenges in DMCs. For finance sector operations in regional departments, policy-based lending has been more prevalent than the project loan modality. This reflects the nature of finance sector development and the budget support that is coupled with government programs for finance sector reform and development over the medium-term. Such reforms aim to develop a financial system's capacity and the legal and regulatory environment to allow financial institutions to provide the range of financial services economies require. Policy-based lending can be used to benefit programmatic engagement that support structural reforms that encourage finance sector development and improve growth prospects and economic efficiency.

39. Financial intermediation lending has also been a prevalent modality, mostly implemented for credit interventions that target particular borrowers or the promotion of particular financial products (such as for housing and leasing). Sector development programs are gaining traction in ADB finance sector operations. This modality, when used for sector development, combines policy reforms to enhance a country's financial system. It provides financing for investments in physical systems or for credit lines to expand finance to SMEs, urban, or infrastructure sectors, for example. While decisions on the lending modality are often taken during country programming, without previous and thorough finance system analysis, the lending modality can be changed during processing. Although such adjustments are not frequent, ADB policies (as reflected in the Operations Manual, for example) allow flexibility and for project design to respond to an analysis of development needs.³¹

³¹ Operations Manual Section D6/BP, issued on 15 September 2003.

40. Finance sector operations supported through the PSOD fund both private sector financial institutions and state-owned entities. Interventions include (i) credit lines, guarantees or risk participations for targeted end-use—including micro, small and medium-sized enterprises; farmers; agri-businesses and small farmers; infrastructure finance; renewable energy applications; and housing finance; (ii) trade finance and supply chain guarantees and funding; (iii) equity and quasi-equity investments in greenfield financial institutions or existing financial institutions; (iv) privatization of public sector financial institutions; and (v) private equity investment funds.

41. Joint initiatives between PSOD and regional departments—in the nonsovereign operations space—may become more relevant, as was the case in the collaboration between PSOD and the South Asia Department on project bond enhancements, for example.³² Work on enabling environments, particularly for non-banking financial institutions or in areas such as digital finance, will continue to be needed from nonsovereign operations to facilitate private sector growth and funding.

F. Lessons Learned

42. Deeper analysis of the performance of ADB finance sector operations, along with a review of how well such operations have been aligned with the FSOP, helped extract lessons for improving finance sector operational performance. This is crucial to increasing ADB relevance and responsiveness to changing country needs.³³

i. Project Appraisal and Design Phase

1. Link program/project design to a national finance sector or subsector strategy. The existence or formulation and adoption of such national strategies are essential to underpin program reform and ensure government commitment. During program /project design, TA can support the development or updating of such strategies.
2. Reform programs (i.e. sovereign operations), need to be underpinned by sound diagnostics and in-depth analytical work to identify needs and to devise conceptualization efforts that can make a difference. A financial system analysis is required, given the complexity of finance sector development (such as sequencing considerations) and the country-specific nature of finance sector and capital market development. Such deeper analysis is required under ADB guidelines (both under corresponding operations manual and ADB Guidelines for Economic Analysis). Its absence has contributed to underperformance of projects and programs.
3. Strengthen partnership approach and stakeholder consultations. Instances of lack of government commitment, lack of ownership, and resistance to change can partially be traced back to (i) limited stakeholder consultations and time for policy dialogue, (ii) not building wider support for reform initiatives or undertaking public awareness

³² ADB partnered with IIFCL in India to provide credit enhancement to project bonds through a first loss guarantee. This allows (i) project bonds to be of sufficient rating to be investable paper for the insurance and pension market; (ii) development of the project bond market; and (iii) mobilization of a new source of funds from the capital markets for the infrastructure industry.

³³ See Appendix 7 for more detail on lessons learned.

outreach, and (iii) not recognizing political economy issues. Developing partnerships with key stakeholders is important, particularly with the (i) responsible ministry and its implementing agencies, (ii) financial community, (iii) business community, (iii) civil society organizations, where appropriate. Such active and continuous follow-up can best be provided with consistent presence of staff with finance sector capacity in resident missions; support which is currently lacking in many resident missions.

4. Establish measurable targets and performance indicators. Performance targets and indicators, which were beyond the control of the project or the program or were too ambitious to achieve within the given implementation period, impacted effectiveness in achieving outcomes and outputs.
5. Formulate realistic project design, where (i) reforms match diagnosed capacity of executing and implementing agencies; (ii) implementation time reflects challenges in the political economy, complexity of problems, and the limitations of low absorptive capacity; (iii) loan amounts match the scope and magnitude of proposed reforms, and (iv) peer reviews during appraisal and design are effective in quality control.
6. Calibrate support to transitional economies. Enacting legislation and adopting regulation in transitional economies can take longer than anticipated. Particularly among small, transitional countries, gradual finance sector development supported by an agreed roadmap may be more prudent. A roadmap should have flexibility for continual review and for corrective actions and have technical assistance support.
7. Provide TA resources to address project design shortcomings, preempt implementation risks, develop national sector or subsector strategies, maintain the integrity of the financial system such as to comply with international standards on anti-money laundering and combating the financing of terrorism, and support and pilot the development of emerging areas. Such areas include digital, green (including climate finance), disaster risk, Islamic, and municipal finance. To ensure benefits can take root and become sustainable, TA is needed to (i) address institutional capacity constraints, and (ii) support complex legal and regulatory reforms during project and program implementation that require substantial constituency-building.
8. Strengthen technical advisory skills and staff capacity in ADB. Inadequate specialized technical sector skills and staff capacity in finance sector operational areas of focus partly contributed to setbacks in formulating realistic project designs.

ii. Project Implementation Phase

9. Implementation arrangements should reflect executing and implementing agency capacity. Policy and legal reforms should be supported by technical assistance tailored to develop capacity and provide technical support. Where project consultants need to fill gaps, it should be done with the ownership and commitment of executing and implementing agencies.
10. Timely ADB review missions and effective support from resident missions contribute to program success. Review missions are critical, particularly when implementation of reforms encounter resistance or delays. Provided with adequate resources, resident missions can take a bigger role in TA, project, and program implementation.

11. ADB's project administration staff capacity should complement technical and project administration needs for implementation of projects/programs and TA.
12. Strengthen internal capacity for policy advice and reduce reliance on consultants, and provide adequate budget to support monitoring, including staff incentives.
13. Leverage nongovernmental and civil society organizations when implementing programs related to inclusive financing—such as microfinance, rural finance, and housing finance for lower-income groups.
14. Early response and timely corrective action in complex and time-bound programs.

iii. Knowledge Management

15. Conduct continuous knowledge work tailored to each country's needs. Knowledge capture and sharing falls short, undermining effective policy dialogue and analytics.
16. Business processes in project and program design, processing, implementation and evaluation need be improved by leveraging (i) technical experts to peer review the design of proposed finance operations with engagement of the Finance Sector Group; and (ii) partnerships such as interagency coordination partnerships, knowledge partnerships and financing partnerships.

iv. Institutional Changes

17. Systems, methodologies, and indicators that track the contribution of finance sector operations to ADB's corporate goals need to be improved to better capture its impact. It is noted that: (i) Level 2 performance indicators capture only a small portion of finance sector activities; (ii) the project classification system contains inconsistencies at the subsector level and does not fully capture finance sector operations; (iii) finance sector operations' contributions to achieving environmentally sustainable growth through green finance (including climate change adaptation and mitigation) as part of ADB's strategic agenda are not fully captured.
18. The availability of instruments to provide effective, efficient, and timely support can be assessed. With many DMCs approaching middle-income and upper-middle-income status, demand for support is changing, prompting ADB to review policies, operations manuals, and staff instructions for products and financing modalities.
43. This section identified strengths and weaknesses in ADB finance sector operational performance, and the organization's capacity to address the finance sector development agenda of its DMCs. Sections 5 and 6 now propose a way forward for 2016–2020.

Box 4: Tracking Climate Finance in the Finance Sector

Developing countries need enormous financial support to enable them to transition to low-carbon development and as they enhance their resilience to climate change impacts. At the Paris climate change conference in December 2015, 195 countries committed to take action to keep global warming to below 2°C by the end of this century. Each country will prepare and implement nationally determined contributions to reduce greenhouse gas emissions. In this, ADB is committed to climate finance, and in 2015 was among the first multilateral development banks to commit a sizable climate finance target—\$6 billion by 2020, up from the current \$3 billion. Of the \$6 billion ADB target, \$4 billion will be dedicated to mitigation through scaling up support for renewable energy, energy efficiency, sustainable transport, and building smart cities and \$2 billion will be for adaptation and enhanced resilience. Finance sector operations can contribute significantly to this goal.

But for this to happen, ADB is institutionalizing tracking and reporting climate financing, which is to be used consistently by relevant departments. This includes incorporating into its revised project classification system tagging of climate projects and related climate financing and follow the approach to tracking and reporting climate finance of the multilateral development banks—the so-called joint MDB approach implemented since 2012. The approach was developed to support international efforts at transparent, consistent, and robust climate finance tracking and is necessary for building trust and accountability in reporting climate finance commitments. ADB is developing guidance notes based on the joint MDB methodology, to ensure that operations departments identify and track in a robust manner the climate investments, and this will also allow for monitoring and reporting of progress of the climate finance commitment of \$6 billion climate investments of ADB.

Financial institutions participating in climate finance also need assistance in developing internal climate finance reporting capabilities that are integrated into their management information and financial reporting systems. Such capacity building objectives could be part of raising awareness of the international financial resources potentially available to commercial entities that invest in developing credible mitigation and adaptation tracking systems. Finance sector operations that promote climate change mitigation could be projects supporting renewable energy, or energy efficiency through participating financial institutions. Finance sector operations that support climate change adaptation are those aimed at reducing climate vulnerabilities such as with infrastructure and “hubs” that support business continuity during and after extreme weather events and the structuring of index-based insurance products.

The Financing Facility and technical assistance grant for the India Solar Rooftop Financing facility is one example of a finance sector operation that qualifies as climate change mitigation.^a The project is comprised of a \$500 million credit line to a bank to allow the banking sector to mobilize long-term solar rooftop financing resources at reasonable rates. The project will address two important issues. The first is the underutilization in India of solar capacity, rooftop capacity in particular. The former is only 0.4% of potential and the latter just 0.2%. The ADB loan can contribute to the generation of 333 megawatts of solar capacity, or 1.2% of the total investment requirement. The second issue the project will address is the population's poor access to electricity. India accounts for over 300 million of the 1.4 billion people in the world with no access to electricity.

^a ADB. 2016. *IND. Solar Rooftop Financing Facility. Report and Recommendation of the President*. Manila

Source: ADB Staff.

The long-term strategic framework for 2008–2020 recognizes its importance to economic growth and poverty reduction in Asia and the Pacific and the sector's importance was reemphasized in the Midterm Review (MTR) of Strategy 2020 Action Plan of 2014.

A woman wearing a dark blue and white striped hijab and a matching long-sleeved top is using an ATM. She is holding a red banknote. A man with glasses and a dark shirt stands behind her, looking at the machine. The background shows several other ATMs in a row, suggesting a public banking area.

SECTION 5

**FINANCE
SECTOR
DEVELOPMENT
IN ASIA AND
THE PACIFIC**

A. Development Landscape

44. Since the global financial crisis of 2008–2009, global economic expansion has underperformed expectations. Less-than-robust recovery in the industrial economies and slowing growth in emerging markets weigh on growth prospects. Volatility in global financial markets stemming from weakness in emerging markets, monetary tightening in the United States, and the British vote to leave the European Union have heightened uncertainty. While the Brexit vote has affected currency and stock markets in Asia and the Pacific, its impact on the real economy in the short-term is expected to be small.

45. As finance sector development proceeds in developing Asia, policymakers will need to continue to balance financial supervision, regulation, and stability with real sector needs. Regulators will need to balance risk reduction, credit finance availability, and the long-term funding needs of for example MSMEs, housing finance borrowers, and trade and infrastructure funding. The implementation of Basel III in some parts of Asia needs to be placed in its proper context to ensure new standards are calibrated to best-fit domestic circumstances. In other developing Asian countries, prudential regulatory reform challenges are more in line with efforts to implement earlier accords. As finance sectors in the region's countries have evolved and finance systems have become more multidimensional, development levels have diversified, with economies ranging from the low-income with little access to financial services to upper-middle-income with more advanced financial systems.

46. To expand the relevance of financial markets in otherwise mostly bank-dominated financial systems, developing countries in Asia and the Pacific are promoting a range of policy actions and structural and institutional reforms. These cover the design of instruments and operational arrangements for markets; the licensing and restructuring of institutions; and the development of associated legal, information, and liquidity infrastructure. This includes the establishment of money markets, which serve as a channel for the execution and transmission of monetary policy and play a key role in ensuring companies and governments maintain appropriate liquidity on a daily basis. It also includes the establishment of capital markets, which provide critical pooling of domestic savings through contractual savings, and mobilizing foreign capital for productive long-term investment, such as for infrastructure. The development of capital markets also helps governments and businesses reduce currency and maturity mismatches, strengthens financial systems by diversifying financial investment alternatives for borrowers and investors, and enhances stability. ADB support for capital market development is not only important to enhance the sustainability of countries' infrastructure development efforts, but also to enable ADB's issuance of local-currency instruments that can play a fundamental role in ADB's financing of local currency investments.

47. However, in many developing countries in Asia and the Pacific, capital markets remain largely underdeveloped or are non-existent, which concentrates systemic risks and limits mobilization of long-term finance and risk capital. Establishing local capital markets is a long, step-by-step establishment of financial instruments, regulatory and legal frameworks, and market infrastructure, in addition to a critical mass of market participants. Countries such as India and the Philippines face significantly different challenges than do Azerbaijan, Cambodia, the Kyrgyz Republic, the Lao People's Democratic Republic, or Nepal. Developing effective capital markets may be more challenging for small economies, which have a limited local investor and issuer base, especially when compared with the possibilities available

Box 5: Wide Diversity in Finance Sector Development Challenges and Reform Needs

Size and liquidity of markets varies across countries and regions.^{a,b} The region's bank deposits equal 60% of regional gross domestic product (GDP), stock market capitalization 71% of GDP, public bond markets 26%, and private bond markets 20%. However, these levels lag those of advanced economies, such as in the Organisation for Economic Co-operation and Development, which has on average a banking system equaling 110% of GDP, stock market capitalization at 85%, public bonds at 85%, and private bonds at 58%.^c Countries in the upper range of financial market depth in Asia and Pacific include Malaysia and Thailand; countries including India, the PRC, and the Philippines follow these. At the lower range are several countries that have prepared and announced finance sector development strategies that cover the broad objectives of subsectors and infrastructure dimensions. These include Cambodia, Kazakhstan, Sri Lanka and Timor-Leste.^d

Access to finance varies.^e Bank account penetration ranges from 46% in South Asia to 51% in Europe and Central Asia, and 69% in East Asia and the Pacific. In high-income Organisation for Economic Co-operation and Development economies, account ownership is almost universal, with 94% of adults reported to have an account in 2014. Women and people in rural areas, in particular, have lower levels of access to finance. The World Bank's Global Findex Database 2014, reports a gender gap where globally 58% of women own a bank account, compared to 65% of men. Regionally, the gender gap is largest in South Asia, where 37% of women have an account compared to 55% of men (a 18 percentage point gap).^f The international development community is committed to bridging the gap between the financially excluded and the banking sector, and many developing countries in Asia and the Pacific view financial inclusion as a prominent policy objective and critical to support inclusive growth, with financial inclusion strategies developed in countries such as Pakistan, the Philippines, Vanuatu and Myanmar. In many countries remittances play an instrumental role in fostering financial inclusion and underscores the importance of maximizing the economic impact of remittances towards sustainable development. In countries such as Tajikistan, remittances account for 42% of GDP.^g Migrant workers demand facilities for remitting money to their families securely, quickly, and affordably. Remittances are a lifeline for reducing poverty, a safety net reducing vulnerability, and an investment source. These inflows can be used to invest in public funds for infrastructure and contribute to long-term macroeconomic growth. In countries such as Armenia, Georgia, Mongolia, and Uzbekistan, access to financial markets is low even though they have appreciable access to financial institutions. In countries such as Fiji, the Maldives, Tonga, and Vanuatu, financial markets are either incipient or altogether nonexistent. A key aspect is that smaller economies face significant size-related constraints in developing financial markets in general and capital markets in particular. Armenia and Azerbaijan are examples of small economies that have developed capital market strategies.

Finance sector efficiency—the efficiency of institutions to provide low-cost financial services with sustainable revenues, and the sophistication of activity of capital markets—has progressed noticeably in more advanced countries such as the PRC followed by economies such as Bangladesh, India, and Thailand, and noticeably less in countries with less developed financial institutions and markets such as Bhutan, Cambodia, the Kyrgyz Republic, the Lao PDR, Nepal, and Tajikistan.^h The sequencing of reforms becomes crucial to allow countries to achieve efficiency in their financial institutions, which is necessary for their financial markets to have a significant impact on economic development. Thus, even in sizable financial systems with broad reach, economic development impact is limited if they remain wasteful (in transaction costs) and inefficient (in lack

continued on next page

Box 5. continued

of competitive behavior). Banks are typically the largest and most important financial institutions, with investment banks, insurance companies, mutual funds, pension funds, venture capital firms, and other types of nonbank financial institutions developing, in sequence, into eventually coming to play complementary roles within ever-more-sophisticated national financial systems. While India, Indonesia, and the Philippines, which have similar positions in the development of their financial institutions' development, Marshall Islands, Tajikistan, Timor-Leste, Turkmenistan, and others, have nascent financial institutions.

- a. Finance sector development can be described along three dimensions: (i) depth refers to the size and liquidity of markets, (ii) individuals' access to financial services, and (iii) efficiency of institutions to provide low-cost financial services with sustainable revenues, and the sophistication of activity of capital markets. Financial systems consist of financial institutions and markets that interact to mobilize funds for investment and provide facilities for financing commercial activity. Source: IMF. 2015. *Rethinking Financial Deepening: Stability and Growth in Emerging Markets*. IMF Staff Discussion Note. IMF, Washington, DC.
- b. Measures of financial institutional depth: (i) ratio of private sector credit to GDP, (ii) ratio of pension fund assets to GDP, (iii) mutual fund assets to GDP, and (iv) ratio of insurance premiums (life and non-life) to GDP. Measures of financial market depth: (i) ratio of stock-market capitalization to GDP, (ii) ratio of stocks traded to GDP, (iii) ratio of international debt securities of government to GDP, (iv) ratio of total debt securities of financial corporations to GDP, and (v) the ratio of total debt securities of nonfinancial corporations to GDP.
- c. IMF. 2015. *Rethinking Financial Deepening: Stability and Growth in Emerging Markets*. IMF Staff Discussion Note. IMF, Washington DC.
- d. See Appendix 8 for a list of developing member countries that have announced finance sector strategies.
- e. Measures of access to financial institutions: (i) branches (commercial banks) per 100,000 adults, and (ii) ATMs per 100,000 adults. Measures of access to financial markets: (i) percent of market capitalization outside of the 10 largest companies, and (ii) the total number of issuers of debt in the country.
- f. World - Global Financial Inclusion Database 2014 <http://microdata.worldbank.org/index.php/catalog/2512>
- g. International Fund for Agricultural Development and World Bank. 2015. *The Use of Remittances and Financial Inclusion*. Report prepared for the G20 Global Partnership for Financial Inclusion. September 2015.
- h. Measures of efficiency of financial institutions: (i) net interest margin, (ii) lending-deposits spread, (iii) non-interest income to total income (iv) overhead costs to total assets, (v) return on assets, and (vi) return on equity. Measures of efficiency of financial markets: stock market turnover ratios (stocks traded/capitalization).

Source: ADB staff.

in larger and more mature economies.³⁴ Many of the developing countries in Asia and the Pacific are also highly dollarized, complicating the development of local-currency financial markets. Cross listing in international financial centers has become a possibility for firms and governments in more advanced countries such as the People's Republic of China (PRC) and Malaysia.³⁵

48. Financial institutions in the region increasingly require local currency solutions to mitigate foreign exchange risk on their balance sheets and to manage risk for their borrowers.³⁶

³⁴ B. Bossone and J.K. Lee. 2004. "In Finance, Size Matters: The 'Systemic Scale Economies' Hypothesis." IMF Staff Paper 51 No. 1, IMF, Washington, DC.

³⁵ This might reduce the pressure posed by this traditional constituency for capital markets development.

³⁶ Either direct exposure, if their assets and liabilities carry different currency-denominations, or through exchange-rate-risk-induced credit risk when their ultimate borrowers end up currency-mismatched.

Recent volatility in global currency markets has brought exchange rate risk back to the forefront. Both regional departments and PSOD have provided local currency lending, but options remain limited in many countries. As countries establish functioning money markets and adopt modern operational frameworks for monetary policy, local currency liquidity will become available to the banking system in national interbank markets, on demand and in conditions that enable banks' maturity transformation role (i.e. the management of the funding-liquidity risks that are inherent in running medium to longer term loan books while offering deposit liabilities on demand to the public). However, banks in many developing countries in the region remain constrained, as these institutional mechanisms for systemic liquidity management in money-markets by central banks are not yet in place. ADB's finance sector development assistance is important in this context by (i) helping DMCs develop the well-functioning money markets that strengthen the banking sector ability to manage liquidity risk and provide term financing in local currency, through policy reform and institutional development assistance (such as policy-based); and (ii) providing financial intermediation lending in local currency that can provide immediate support to banks. The challenge for ADB is that financial intermediation lending interventions in local currencies require sourcing in required tenors and at prices that can be attractive, for example, to commercial banks. In doing so, it is important not to discourage domestic resource mobilization, cause interbank market distortions, or disrupt ongoing money market development reforms and efforts.

49. ADB has historically relied upon two modes of providing local currency funding: (i) through swap markets and (ii) by issuing local currency bonds in either onshore or offshore markets. Relatively few swap markets, with the exception of India and Thailand, are mature enough to provide ADB and its clients with long-tenor funding at attractive rates and in the necessary quantum. ADB has issued local currency bonds in domestic markets—such as in Georgia; India; and Hong Kong, China—to, with the resulting balances, meet the local currency funding requirements of its development projects, including in finance sector intermediation interventions. In 2016, ADB issued significant volumes of local currency bonds in the offshore Indian Rupee bond market, while adapting interest rate hedging modalities and thereby catalyze lending in the Indian financial sector. According to local market conditions and the existence of appropriate hedging instruments, ADB can offer flexibility in providing either fixed or floating-rate loans. The establishment of the \$10 billion equivalent Asian Currency Note Program dedicated to note issuance in regional currencies has been a significant milestone, but it would be a very good initiative to add new currencies to the program to support local currency lending in more members.³⁷ ADB will need to continue to explore options in this area and help mobilize local currency resources for financial institutions in DMCs, particularly for nonbank financial corporations. Policy advice, credit enhancement mechanisms, and guarantee funds established with multilateral development banks, such as ADB, or international lender support can significantly improve local government access to external financing.

50. Combining grants with loans, equity or other risk sharing mechanisms from public and private financiers is an important vehicle for leveraging additional resources to support investments in particular sectors, where blending concessional funds may catalyze

³⁷ The \$10 billion Asian Currency Note Program, launched by ADB in 2006, served as the first regional multi-currency bond platform dedicated to issuance of bonds in regional currencies. It links domestic capital markets of Singapore; Hong Kong, China; Malaysia; and Thailand. Under the scheme, Asian currency bonds are issued in domestic markets under a single unified framework with a common set of documents governed by English law.

investments that would not otherwise happen.³⁸ This can be relevant for other types of development assistance in ADB, such as for infrastructure finance to subnational entities, or in efforts that combine municipal bond market development objectives with institutional investors' needs.³⁹

51. Growth of Islamic finance—with services ranging from banking, capital market, to *takaful* (insurance)—in some countries in Asia has underscored its potential as an alternative financing source for infrastructure and economic development, and in improving financial inclusion, including those who are currently financially excluded or not inclined to use interest based financial products. During 2009 and 2014, the Islamic financial industry experienced robust expansion, with a compound annual growth rate of 17%.⁴⁰ Growth has been led by Bangladesh, Brunei Darussalam, Indonesia, Malaysia, and Pakistan, with significant growing interest in Islamic finance in Azerbaijan, the PRC, India, Kazakhstan, the Philippines, and Thailand.

B. Sector and Subsector Strategies as Anchors of Medium-Term Policy Engagement

52. The co-evolution of financial institutions and financial markets requires the development of supportive financial infrastructure—including legal, institutional, information, market and transaction rules, and technologies. The development of this infrastructure involves complex institutional change and reform that is country-specific. ADB's experience has highlighted challenges in developing financial institutions and markets as well as how financial reforms need to be supported. Multiyear national finance sector development strategies as anchors of medium-term policy engagement, in-depth analytical work, and technical assistance can provide key support in policy engagement with the authorities.⁴¹ Also, with countries in the region at various levels of the multidimensional process of finance sector development, a broad range of expertise is required to support legal, regulatory, and institutional development.⁴²

53. With an expanded resource mobilization capacity, ADB can do more for developing countries in Asia and the Pacific, but it must continue to do so in coordination with global agendas, such as the Sustainable Development Goals and in coordination with other multilateral development banks. The establishment of the New Development Bank (of Brazil, the Russian Federation, India, the PRC) in 2014 and of the Asian Infrastructure Investment Bank in 2015 is a factor of change in the architecture of development finance, which can

³⁸ ADB. 2015. *Making Money Work. Financing a Sustainable Future in Asia and the Pacific*. Manila; Joint Ministerial Committee. 2015. *From Billions to Trillions: Transforming Development Finance Post 2015*. Development Committee Discussion Note. Financing for Development: Multilateral Development Finance. April.

³⁹ This allows a national or provincial entity to borrow under a long-term sovereign modality, but also absorb commercial finance from a bank or with bonds on the strength of their balance sheets. Blending a portion of commercial finance with low-cost sovereign resources is a step toward preparing national or provincial entities to expand the scope of commercial borrowings. Such a blending modality is under processing for an urban sector intervention in India and can be replicated in other sectors in India and in other developing countries in the region.

⁴⁰ Malaysia Islamic Finance Center. 2015. *Asia: Future Prospect for Islamic Finance*. Kuala Lumpur.

⁴¹ ADB. 2011. *Special Evaluation Study on ADBs Microfinance Development Strategy 2000*. July. Manila.

⁴² Support can include leveraging internal expertise; knowledge partnerships in especially new and emerging areas or in areas where ADB support is not frequently requested and where consultants with specific technical expertise can enhance operational support.

Box 6: Islamic Finance in Asia

The global Islamic financial industry reached \$1.9 trillion dollars as of 2015. Among ADB member countries, Islamic finance has reached systemic significance in Bangladesh, Brunei Darussalam, and Malaysia, where it accounts for more than 15% of total domestic banking sector assets. In Pakistan, Islamic finance assets' share in the domestic banking sector increased from 9.8% in 2014 to 11% in 2015, with the government aiming to further increase this share to 15% by 2018. Meanwhile, Indonesia's Islamic banking assets, while only representing 5% of the domestic sector, have been progressing rapidly with a compound annual growth rate of 29% between 2010 and 2014. The People's Republic of China, India, Kazakhstan, Sri Lanka, and other Asian countries are also showing considerable interest in developing Islamic finance for infrastructure financing and for expanding financial inclusion.

Developing member countries (DMCs) are also beginning to tap into Islamic funds as an alternative source for funding infrastructure projects given Asia's massive infrastructure investment gap and the growing acceptance for Islamic finance. Pakistan is showing strong interest to utilize Islamic funds to build the country's infrastructure with a number of projects already in the pipeline. Market trends also show that Shari'ah-compliant instruments are becoming popular vehicles for sustainable, responsible and ethical investments, consistent with ADB's thrust for promoting sustainable development.

The relevance of Islamic finance is growing among ADB DMCs. Since 2004, ADB has, mainly through technical assistance, been assisting DMCs in building and strengthening their Islamic financial sector and addressing challenges and needs unique to the industry. ADB's support has included: (i) assisting in the development of regulatory and supervisory frameworks and the use of best international standards; (ii) advising and assisting on Islamic capital market developments; (iii) improving access to Islamic microfinance services; and (iv) working with DMCs and cofinanciers toward financial innovation.

Recent ADB projects include program loans supporting Islamic capital market development in Bangladesh and Indonesia. ADB is preparing a regional TA to develop the legal and regulatory framework and to support capacity of regulatory bodies to facilitate implementation of Islamic finance in five DMCs in Central and West Asia. ADB is also exploring funding infrastructure projects through Islamic finance instruments either by using its own funds or acting as "financier of record" for domestic Islamic banks. As the industry continues to expand and with Asia expected to drive further this growth, ADB is in a position to play a catalytic role in ensuring financial stability while supporting innovations in the Islamic finance industry in the region.

Source: ADB Staff.

complement ADB and other existing international financial institutions. With the 1 January 2017 merger of the Asian Development Fund equity and lending operations with the ordinary capital resources balance sheet, ADB's total annual financing capacity can increase by up to \$20 billion (or by 50% over the current level of about \$10 billion) by 2020. ADB's annual financing commitments to poor countries (formerly called Asian Development Fund-only countries) could increase to \$7.5 billion–\$11 billion, from the current \$6.5 billion. This combination will also enhance ADB risk-bearing capacity and strengthen preparedness for natural disasters and future economic and financial shocks countries in the region will increasingly face as global integration continues.

54. The 2014 MTR of Strategy 2020 reconfirmed the areas of focus of the strategic document, including finance as one of five core sectors. Strategy 2020 recognizes that DMCs are at different stages of progress in economic and development management performance. It sees that this requires ADB to “tailor assistance and cooperation to individual countries along” four different perspectives: graduated DMCs; middle-income countries; low-income countries; and fragile countries and situations.⁴³ This is a basic challenge for ADB, not so much in instrument availability, but in the number of expert specializations it must retain and the necessary critical mass of experts in each specialization that is necessary to credibly engage in policy dialogue. For example, some countries in the region are still trying to establish the legal, regulatory, and informational underpinnings of modern financial activities of bank and nonbank institutions (and public debt management and issuance), but other challenges are already centered on capital market development.

55. The New Partnership with Upper Middle-Income Countries of 2015 recognizes these countries as clients, active contributors to regional development, and collaborators and partners of ADB in its vision of a region free of poverty. Three characteristics of upper-middle-income countries stand out: (i) while distinctive individually, they have made similar progress in areas such as reduction in poverty, human development achievements, international competitiveness, and credit standing; (ii) their progress as a group puts them ahead of lower-middle-income countries and low-income countries (low-income countries); and (iii) they still lag high-income economies on a range of development indicators. Upper-middle-income countries also face increasingly complex development challenges and a host of issues requiring international partnerships. Because of their generally higher-level of integration with global capital markets and international trade, upper-middle-income countries are typically more vulnerable than low-income countries to cyclical economic downturns. This vulnerability was demonstrated during the 2007–2008 economic and financial crisis and more recently in Central and West Asian oil-producing economies vulnerability to the sharp drop in oil prices and to volatility in the Russian Federation. The new partnership also recognizes that for this subset of clients, unfinished reform agendas in finance sector development require ADB assistance. These include improving the efficiency of state-owned enterprises and running them on market principles, improving legal and regulatory frameworks, including those for public–private partnerships; and develop sound financial systems. Another area is to broaden long-term sources of financing. This includes public private partnership policies and frameworks, deepening capital markets, and strengthening bond markets to facilitate private investment in infrastructure, including the development of institutional investors. It also includes developing contractual savings, including pension funds and insurance, to help provide additional long-term finance for infrastructure while supporting social protection systems.

56. While ongoing ADB operations are guided by the strategic directions illustrated above, the WPBF 2017–2019 describes the strategic priorities and operational program of ADB within the context of the MTR of Strategy 2020 and provides a medium-term framework for ADB’s 2017 budget. It shows the size, sector, and thematic composition of the pipeline of operations, as jointly determined by ADB and its DMCs. The projections submitted by the regional departments for the 2017–2019 pipeline are an indication of what each department perceives to be attainable, but on the basis of a resource envelope that might not fully reflect the possibilities of the merger of the Asian Development Fund with its ordinary capital

⁴³ ADB. 2008. *Strategy 2020. The Long-Term Strategic Framework of the Asian Development Bank. 2008–2020*. Manila. pp. 16–17.

resources balance sheet.⁴⁴ The WPBF 2017–2019 included about \$8.3 billion in project initiatives classified under finance sector, with \$7.5 billion firm and \$930 million stand-by. In the WPBF, 56% of the volume of projects is concentrated in three subsectors: insurance and contractual savings, infrastructure finance and investment funds, and banking systems and NBFIs.⁴⁵ In terms of number of projects, 54% are focused on three subsectors: insurance and contractual savings (with a noted increase in disaster risk finance), finance sector development, and inclusive finance. Differences exist in subsector focus across departments, which reflect the different levels of finance sector development across the DMC groupings of each regional department as well as government priorities. The projected loan portfolio for finance is largest in Southeast Asia, at 13% of the department's projected total loan portfolio, with focus on subsectors such as infrastructure finance and investment funds, followed by money and capital markets, and inclusive finance. East Asia has a projected finance sector pipeline of about 11% of the department's total projected portfolio, with focus on finance sector development, banking systems and NBFIs, and insurance and contractual savings. The projected pipeline for Central and West Asia accounts for 7% of the department's total pipeline. Subsectors are focused on insurance and contractual savings, banking systems and NBFIs, and SME finance and leasing. South Asia projected finance portfolio represents 3% of the total projected portfolio. The projected pipeline is focused on banking systems and NBFIs, infrastructure finance and investment funds, and housing finance. Projected portfolio for the Pacific is less than 1% of the total projected portfolio and is focused on banking systems and nonbank financial institutions. The different areas of subsector focus are of importance and relevance for planning the availability of finance subsector expertise in ADB.

57. Not included in the WPBF's classification for finance sector as it is reflected in one overall PSOD target number, is the indicative nonsovereign finance sector pipeline of about \$2 billion for 2017–2019. There is increasing demand from financial institutions for ADB funding through nonsovereign operations. Increases in overall volumes and number of projects, particularly in frontier countries, will be directly dependent upon increased resources for nonsovereign operations. During the forthcoming period, nonsovereign finance sector operations will continue to provide targeted credit lines for such end usage as inclusive finance—including inclusive business, agri-finance, and housing finance—as well for infrastructure finance. Transactions using quasi-equity and equity products are increasing. Equity is needed to help financial institutions meet higher regulatory capital requirements for Basel III and to support overall growth, providing strong development impact and potentially sound investment returns for ADB (Box 9). In order for ADB to have a shareholding level sufficient to obtain a board seat—an important component of ADB's value addition as well as a risk mitigant—an investment greater than the current single obligor limit for direct equity of \$75 million is needed (while maintaining a minority stake of not more than 25%), particularly in markets where financial institutions are larger. Support for non-bank financial institutions, such as insurance companies, is also expected to expand. Processing of smaller projects has been facilitated through the Faster Approach to Small Nonsovereign Transactions (FAST). Based on its initial success, nonsovereign finance sector operations aim to expand the scale and terms of FAST to support small transactions. If ADB is able to obtain third-party funds for nonsovereign finance sector operations, higher risk projects may be facilitated through blended financing or first loss positions. The MFI Program will expand into new markets and with new partner institutions. For 2017–2018, it is anticipated that the TFP will support

⁴⁴ The WPBF 2017–2019 indicates that projects were identified for a baseline case, while a stronger pipeline is envisaged. Although WPBF projections account for sector prioritization in the different DMCs, the assistance needs of those countries in finance sector development may not be fully reflected in ADB's operational pipeline projections. Yet, it provides useful information on what ADB's operational departments are preparing for.

⁴⁵ Does not include nonsovereign projects.

Box 7: Digital Finance Boosts Financial Inclusion

Digital finance, globally one of the fastest-moving (and most disruptive) industries, is reinventing traditional business models in the financial sector. At the same time, financial inclusion is accelerating much more rapidly than at any other time in history. Between 2011 and 2014, 700 million adults became bank account holders and people without one—the financially excluded—dropped by 20% to 2 billion globally and to about 1 billion in Asia and the Pacific. Yet barriers to financial inclusion remain and to broaden such services in emerging markets, financial service providers must engage, train, and learn from vast networks of customers and prospective customers must develop the skills to effectively use financial products.

The most prominent barriers vary by market, but tend to follow common themes and include: (i) overly restrictive regulatory regimes; (ii) unclear demand; (iii) lack of interoperability between service providers; (iv) poor product design, insufficient investment in agent networks, and liquidity; (v) costly transaction fees (especially when compared to the hidden costs of cash); (vi) a lack of identification required for consumers to open bank accounts; and (vii) a lack of compliance from providers with “know-your-customer” rules. Policies promoting financial inclusion therefore need to (i) remove barriers to financial access and inclusion; (ii) design incentives to enhance inclusion (such as tax incentives); and (iii) reduce the abuses in financial services, such as fraud and the selling of inappropriate products, poor data security, and the technical vulnerabilities that arise out of data sharing.

That said, the costs of financial transactions are being reduced. And the more they can be, the greater the possibility of sustainably reaching the financially excluded. This is happening through a combination of emerging digital channels—basic mobile phone service first and foremost, as well as low-cost smartphones connected to the internet—and innovations in business models to allow consumers to conduct financial transactions from handsets or with nearby agents embedded in the local economy. The cost-savings from digital transactions give providers an opportunity to create flexible, affordable products designed for the needs of people struggling to escape poverty.

Digital financial services typically begin with basic mobile payments, such as what M-Pesa offers in Kenya, and evolve to offer more sophisticated savings accounts and small, on-demand loans. In Bangladesh the fastest-growing provider is bKash, a company specialized in mass-market mobile financial services begun in July 2011. The total registered customers in 2016 exceeded 24 million with an active ratio (one financial transaction in a month) of 35%. This fast start resulted from (i) specialized organizational structure built to deliver mobile financial services; (ii) a shared vision for scale among a diverse investor group; and (iii) a flexible regulatory environment that enabled the expansion.

ADB can support the expansion of the digital financial services industry by profiling champions in the private sector and identifying funding opportunities to promote financial inclusion. In the public sector, ADB can help conceptualize pilots for government-to-private sector projects, and crucially help governments craft fair and effective regulations that enable growth in the private sector. This effort focused on both the public and private sectors will bring macro benefits such as lower system inefficiencies and greater security. Specifically, it can help groups including micro, small and medium-sized enterprises as well as people at “the base of the pyramid”—that is, those living under a minimum threshold income and women.

In the Kyrgyz Republic, for example, nearly everyone has a mobile phone—market penetration is more than 130%—but only about 20% of people use banking services. In 2011, Kyrgyz Investment and Credit Bank received a \$10 million loan from ADB’s private sector department to extend medium- and long-term financing to small and medium enterprises in the country.³ In addition,

continued on next page

Box 7. continued

the bank introduced innovative practices and developed services to cater to those businesses' specific needs. This included the mobile wallet ELSOM, which is an e-wallet or the system that can be used to pay for various services and to send money transfers through a mobile phone or a smartphone. ADB is through technical assistance also supporting financial institutions in India strengthen their outreach to the underserved through enhanced digital finance platforms. Through combined efforts of the Private Sector Operations Department and the Sustainable Development and Climate Change Department ADB is through a \$700,000 TA (i) analyzing the impact of digital financial inclusion for three market segments—base-of-pyramid, MSMEs, and women—in Cambodia, Indonesia, Myanmar, and the Philippines; (ii) assessing regulatory frameworks for digital finance in each country to identify barriers to financial inclusion; and (iii) identifying private sector pilot projects involving digital finance to expand financial inclusion.

^a Senior Unsecured Loan to Kyrgyz Investment and Credit Bank for Small and Medium-Sized Enterprise Finance approved 2011.

Source: ADB Staff.

Box 8: Disaster Risk Finance as a Tool for Financial Sector Development

The effective financial management of disaster risks is a critical public policy challenge for governments in Asia and the Pacific. Many developing countries in the region are highly exposed to disaster risks and yet have limited capacity to manage the financial impacts of natural disasters, such as floods, earthquakes, cyclones, and pandemics. At the same time, climate change is expected to increase the frequency and intensity of extreme events.

Disaster risk financing (DRF) solutions allow governments to anticipate and plan for the financial consequences of natural hazards and to provide funding for timely disaster relief, early recovery, and reconstruction. Adequate ex ante (pre disaster financing secured before disaster) DRF arrangements—including insurance, disaster budgeting and reserving, credit products, and capital market instruments to transfer disaster risk—allow governments to smooth related costs over time. A DRF strategy must account for financial capacity, desired risk retention and transfer levels, as well as the cost, timing, and availability of financing options and the benefits of risk retention or risk transfer compared to investments in risk prevention. The importance of DRF actions to strengthening disaster resilience is reflected in ADB's strategic climate change priorities and, more recently, in the Midterm Review of Strategy 2020 and the Operational Plan for Integrated Disaster Risk Management, 2014–2020. These call for stronger ADB engagement in DRF. This includes support to enhance the fiscal management of disaster risk by supporting the development of DRF instruments and wider DRF strategies for households, businesses, and governments, enhancing the public and private financial management of residual disaster risk.

Disaster risk insurance is a new area for many of ADB's developing member countries. Work has been selective in carrying out risk profiling and risk modeling for management of disaster risks at the sovereign level in Bangladesh and management of disaster risks at the sub-sovereign level in the Indonesia, the Philippines, and Viet Nam. A pilot is under way to develop and implement weather index-based crop insurance in Bangladesh as an adaptation tool to reduce the climate variability and extreme weather vulnerability of the agriculture sector, especially impacting small farm households. It has helped improve understanding of the potential benefits of ex-ante DRF

continued on next page

Box 8. *continued*

instruments in enhancing the management of disaster risk. ADB has also approved a new regional technical assistance to develop tools to assess and strengthen the environment for establishing DRF in countries in the region, including legislation and regulations in Fiji, Nepal, Pakistan, and Sri Lanka. This is expected to assist ADB's developing member countries to improve their fiscal resilience to disaster risk using appropriate DRF instruments.

ADB is providing a \$10 million loan to fund the Cook Islands Disaster Resilience Program,^a which will make available financing in the event of a disaster. The program supports implementation of the government's National Sustainable Development Plan, through the achievement of critical actions in the areas of policy strengthening and institutional arrangements for disaster risk management, building resilient infrastructure, and expanding disaster risk financing. ADB is also providing a \$200 million loan to strengthen Pakistan's disaster risk management, including support to the National Disaster Risk Management Fund (NDRMF) to reduce the country's vulnerability to disasters from natural hazards, and climate variability and change. The government will pass on ADB loan funds to the NDRMF as a grant, for on-granting by NDRMF to eligible implementing partners. The NDRMF will finance up to 70% of the cost of eligible subprojects that will enhance Pakistan's resilience to extreme weather events and other natural hazards. It will also enter into insurance arrangements to develop markets for the transfer of residual risks that cannot be mitigated.

^a ADB. 2016. Cook Islands. Disaster Resilience Program. *Report and Recommendation of the President*. Manila

^b ADB. 2016. PAK. National Disaster Risk Management Fund. *Report and Recommendation of the President*. Manila

Source: ADB Staff.

Box 9: RBL Bank of India–Equity Investment and Loan

Established in 1943, RBL Bank undertook a transformation in 2010 to support a shift in its regionally focused strategy to one with a national focus, specifically catering to the underserved through various business verticals, such as agriculture and inclusive finance (directly to farmers and micro entrepreneurs and through wholesale lending to microfinance institutions where the bulk of funding is provided to women). Although one of the smallest banks in India, it is one of the most rapidly growing, expanding its branch network across India and providing services through digital finance. To support RBL's future growth, additional capital was needed. An initial public offering (IPO) was planned, however, it was held due to delays in regulatory approvals and volatile emerging market conditions. To bridge the funding gap, a pre-IPO was undertaken in 2015 with ADB as anchor investor, obtaining a 4.6% shareholding. In August 2016, RBL opened its IPO, which was the first private sector bank listing in India since 2005. The IPO was oversubscribed. Based on its entry price and RBL's market price, ADB's initial returns are expected to be strong. In 2016, ADB also disbursed a long-term 5-year loan of \$100 million to support inclusive finance. A capacity building TA will help strengthen the bank's digital finance platform, as well as risk assessment and monitoring capabilities for agrifinance. The project is classified as gender equity with a projected target of supporting 600,000 women customers.

Source: ADB Staff.

\$2.5 billion in trade each year with approximately \$1.2 billion of the amount each year being co-financed by the private sector. The program is moving into new, underserved markets, such as the Pacific, and will add new products. The new Supply Chain Finance program is increasing its activity and will also expand into new countries. Nonsovereign finance sector operations expect to approve 4-5 investment funds per year equivalent to about \$150 million-\$200 million in total.

58. For a forward-looking framework of finance sector development assistance to be feasible, strengths need to be maintained and expanded where appropriate with required resources, capabilities and skills; weaknesses need to be addressed; and challenges (internal and external) need to be overcome. Adequate staff resources, capabilities and skills; planning and programming; improved operational performance; and flexibility in products and financing modalities can expand finance sector operations, realize the opportunities of financial innovations, and improve developmental sustainability. TA will continue to be an important component of finance sector operations, providing value addition for finance sector clients.

Figure 2: Finance Sector Work Program and Budget Framework: Finance Subsectors as Share of Total Finance Sector Lending (2017–2019)

Notes: Work Program and Budget Framework does not include nonsovereign operations. Trade finance does not include annual ADB-supported trade finance transactions under the Trade Finance Program, but rather only overall increases in the program under Board approvals. Inclusive finance, likewise, does not reflect annual ADB support under the nonsovereign Microfinance Risk Participation and Guarantee Program.

Source: ADB Staff Consultant calculations and estimates based on the WPBF of regional departments.

ADB has concentrated lending around three subsectors: (i) infrastructure finance and investment funds, (ii) money and capital markets, and (iii) small and medium-sized enterprise finance and leasing.

SECTION 6

RECOMMENDATIONS AND CONCLUSIONS

59. ADB can sharpen its finance sector support through greater responsiveness to help DMCs meet the challenges outlined in this review and to grow finance sector operations. It can do this using the lessons from the assessment of finance sector operational performance, the review of alignment of finance sector operations with the FSOP, TA in finance operations, knowledge management and partnerships, effectiveness of institutional arrangements. Also important is the recognition of the multidimensional nature of financial systems development, DMC priorities as articulated in national strategies, and ADB's strategic directions. Figure 3 looks at strengths, weaknesses, opportunities, and challenges in ADB finance sector operations.

Figure 3: ADB's Finance Sector Development Operations

Source: ADB staff.

- a. **Retain focus on finance sector development, inclusive finance, and infrastructure finance.** And build capabilities in emerging and innovative finance areas that have a cross-cutting impact—digital, green, disaster risk, Islamic, and municipal finance—where ADB can best support economic growth and reducing poverty, and replicate the success of financial integration from ASEAN+3 to other regions.
 - i. **Finance sector development**, the mainstay of finance sector operations, includes developing diverse, efficient, and stable financial institutions and markets and regional financial cooperation and integration.
 - ii. **Inclusive finance**, which has the greatest impact on poverty alleviation, will deliver affordable financial services to low-income households and to small businesses.
 - iii. **Infrastructure finance**, which is complementary to ADB's major business line and includes facilitating the efficient allocation of long-term finance to meet financing needs for infrastructure.

Table 2: Finance Sector Operational Areas of Focus

	Finance Sector Development	Inclusive Finance	Infrastructure Finance
Financial architecture	International best practices and standards in supervision and regulation of financial markets, institutions and systems	Digital platforms and other alternative delivery channels/ distribution mechanisms to expand access to financial services	Policies and frameworks to support infrastructure finance
	Consumer protection	Financial literacy	Policies and frameworks to support green finance (incl. climate finance)
	Crisis management and resolution		
	Anti-Money Laundering and Counter Terrorist Financing		
	Regional financial cooperation and integration		
Subsector and types of finance	Money and capital markets	Microfinance, microsavings, microinsurance	Public-private partnerships
	Banks	Micro, small, and medium-sized enterprises and leasing	Disaster risk finance
	Nonbank financial institutions, including insurance and contractual savings	Trade finance	Green Finance (including climate finance)
	Islamic finance	Housing finance	
	Municipal finance		

Source: ADB staff.

- b. **Add resources and upgrade sector skills and capabilities.** With the expansion of operations resulting from the merger of the Asian Development fund with ordinary capital resources, both the number of new projects and projects being administered are expected to increase. This will include assess gaps in skills, capabilities and resources and develop training modules around these identified areas.
- Strengthen staff capabilities and skills, and add resources for sovereign and nonsovereign operations in a) operational areas of focus, including emerging and innovative areas such as digital, green, disaster risk, Islamic, and municipal finance, recognizing DMC demand for increasingly multidimensional and complex sector support; b) project design, processing and management; and c) due diligence.
 - Strengthen technical advisory skills to effectively engage in consultations and dialogue to formulate and create realistic project design.
 - Promote resource sharing across operational departments and from non-operational departments, including sector and thematic groups to help fill projected gaps, including through development assignments.
 - Contribute to quality and appropriate skills in external recruitment of staff and engagement of secondees with expertise in areas where gaps exist.

- v. Strengthen role and capacities of resident missions in design and implementation of TA/programs/projects, and in procurement and consultant management to allow timely response as issues arise, contribute to boost client responsiveness, and have a beneficial impact on implementation.
 - vi. Develop partnerships on which staff can leverage knowledge.
 - vii. Allocate sufficient time in work plans to design, implement and monitor projects, programs and TA, and provide incentives for staff to balance the focus on disbursement and implementation, for undertaking knowledge and innovative work, and revise the staff performance evaluation system.
- c. **Improve finance sector operational performance.** Increase attention to finance sector project and program design quality and for resource requirements for effective implementation.
- i. Strengthen peer review of proposed finance sector operations, including guidelines for peer review.
 - ii. Increase collaboration between operational departments and other departments as relevant in quality at entry and evaluation for projects/programs.
- d. **Improve finance sector analysis.** Invest more effort (time, resources) to identify finance sector development constraints, institutional capacity development challenges and opportunities for finance sector development, ahead of (and as a basis for) project/program design and dialogue. Improve the comprehensiveness and quality of finance sector development analysis to provide a holistic medium- to long-term overview of a country's finance sector, and promote stakeholder support and government understanding and ownership.
- i. Link to national sector or subsector strategy—where this is not developed, TA can help.
 - ii. Address country conditions—including political economy and government absorptive capacity, sustainability issues through risk identification and mitigation, and information and communications technology and data capture services for the finance sector.
 - iii. Address reform needs and the sequencing concerns that are essential for a country's finance sector development, and identify the strategic fit of ADB financing instruments.
 - iv. Include stakeholder consultations, including executing and implementing agencies, and resident mission involvement throughout the project cycle from planning and preparation to implementation and evaluation.
 - v. Link to country partnership strategy/country operations business plan preparation, as there is opportunity to mainstream dialogue with development partners about priorities, including cofinancing.
 - vi. Collaborate across sector and thematic groups and operational departments for sequencing and delivery of coordinated and structured support to DMCs.
 - vii. Allocate staff resources for analytical work or TA to engage consultants. Involvement in Financial Sector Assessment Program and assessments undertaken by standard-setting bodies, and access to reports, including Reports of Observance of Standards and Codes, would contribute to comprehensive finance system analysis.
 - viii. Finance Sector Group draft guidance notes on issues where clarification is needed about methodologies and requirements under operations manuals, formulating financial systems analysis, outcome and output indicators to standardize what constitutes success, and peer reviews.

- e. **Improve systems and methodologies.** Improve the project classification system and indicators and methodologies that track the contribution of finance operations to ADB's corporate goals and to the sustainable development goals.
 - i. Improve level 2 performance indicators to more accurately represent finance sector operations.
 - ii. Improve project classification system to better capture finance sector operations.
 - iii. Develop a tracking system to capture the contribution of finance sector operations to climate change adaptation and mitigation and incorporate it into the ADB project classification system.
 - iv. Review and strengthen as required existing products and financing modalities to meet DMC demand for ADB support as well as relevant operations manuals and staff instructions.

ADB finance sector
operations contributed to
11% of ADB's total lending
portfolio over the 2011–2015
review period, about 15%
in 2015 alone.

APPENDIXES

APPENDIX 1: FINANCE SECTOR OPERATIONAL PLAN RESULTS FRAMEWORK¹

	Indicators	Results (based on period covered)	Period Covered
Level 1: Development Progress in Asia and the Pacific			
1	Depositors with commercial banks (per 1,000 adults) ^a	621	2014
2	Proportion of adults (15 years and older) with an account at a bank or other financial institution or with mobile money service provider (%) ^b	59%	2014
Level 2: ADBs Contribution to Development Results			
	Quality at Completion ^c		
3	Completed sovereign operations rated successful	47%	2013-2015 (3-year average)
4	Projects	50%	
5	Policy-based loans	56%	
6	Rated likely sustainable	80%	
7	Completed nonsovereign operations rated successful	55%	
8	Completed technical assistance projects rated successful	82%	
Core Operational Results			
9	Trade finance supported (\$) ^d	22.51 billion	2009-2015
10	Microfinance loan accounts opened or end borrowers reached (number) ^e	5,582,709	2010-2015
	- Female ^e	2,240,676	2010-2015
	- Male ^e	542,033	2010-2015
11	Small and medium-sized enterprise loan accounts opened or end borrowers reached (number) ^e	130,172	2010-2015
Level 3: ADB's Operational Management			
12	Finance sector operations in percent of total ADB operations (%) ^f	15%	2015
13	Sovereign finance sector operations in percent of total ADB operations (%) ^f	10%	2015
14	Nonsovereign Finance sector operations in percent of total ADB operations (%) ^f	5%	2015
15	Direct value-added cofinancing (% of ADB financing approved) ^g for the finance sector	15%	2015
16	Official and other concessional cofinancing for the finance sector	835 million	2011-2015
17	Commercial cofinancing for the finance sector, nonsovereign operations ^h	11,369 million	2011-2015

continued on next page

¹ FSOP review will be based on current results framework, and to include any revisions on new indicators that result from the FSOP review of Financial Sector Indicators.

Appendix 1. *continued*

Level 4: ADB's Organizational Management	
	Human resources <ul style="list-style-type: none"> • 36 hoursⁱ allocated annually to Chair for the management of the Finance Sector Group Committee • 6 staff in SDCC Finance Sector Group to assist and deliver its mandate. • Additional resources are required for (i) assessing the financial sector capabilities required to deliver the 2017-2020 work program, (ii) to analyze the skill and resources gap, (iii) develop training modules for staff, and (iv) prepare relevant guidelines to support finance sector operations.
	Budget resources (including Special Funds and Donor Funds) <ul style="list-style-type: none"> • Financial Sector Development Partnership Special Fund allocates at least €1.5 million annually to support finance sector development • At least \$13.725 million TA funds allocated to supporting finance sector development annually^j • At least \$77,500k provided annually to support finance sector training, including at least 4 training and development programs for staff on topics relevant to finance sector development implemented • At least \$140,700l provided annually to support the operation of the Finance Sector Group
	Process Efficiency and Client Orientation <ul style="list-style-type: none"> • Deliver at least 2 knowledge sharing events per year as part of knowledge transfer and dissemination to DMCs and staff • Review of external partners and new partners identified and retained by 2020 as relevant • Peer review • Guidance notes

^a Number of deposit account holders at commercial banks and other resident banks functioning as commercial banks that are resident nonfinancial corporations (public and private) and households. Results based on average of data from Afghanistan, Azerbaijan, Bangladesh, People's Republic of China, Georgia, Kiribati (2013), Kyrgyz Republic, Lao PDR (2013), Maldives, Myanmar, Pakistan, Palau, Philippines, Samoa, Solomon Islands, Tajikistan (2013), Thailand, Timor-Leste, Uzbekistan, and Vanuatu. Source: World Bank, World Development Indicators (accessed December 2016).

^b Approximate number of adults who report having an account (by themselves or together with someone else) at a bank or another type of financial institution or report personally using a mobile money service in the past 12 months. Source: World Bank, 2015 Little Data Book on Financial Inclusion.

^c Source: ADB Strategy and Policy Department.

^d Source: Trade Finance Program 2016 brochure.

^e Source: Asian Development Bank's Contributions to Development Results database (accessed on September 2016). <https://www.adb.org/site/development-effectiveness/results-adb-supported-operations>

^f Covers ADF and OCR only, based on Strategy 2020 classification. Source: Operations Dashboard and PSFI database

^g Ratio of total net direct value-added (DVA) cofinancing to total approved OCR and ADF financing for 2015. Source: 2015 ADB Annual Report.

^h Commercial cofinancing for ADB private finance sector operations.

ⁱ 3 hours per month to include 1 hour for FSG Committee meeting and 2 hours for other meetings and business matters.

^j Based on TA funds approved in 2015. Includes TASF only. Source: Loan and TA Approvals database (accessed September 2016)

^k Based on average projected costs for 2016 and 2017 as indicated in the Sector and Thematic Skills Development Plan.

^l Based on 2015 FSG budget allocation. Covers business travel, staff consultancy, representation and membership fees to international bodies.

APPENDIX 2: FINANCE SECTOR GROUP ACTION PLAN

Actions/Strategies	Responsible Unit(s)	Indicative Timeframe
1. Areas of focus		For completion
1.1. Retain focus on finance sector development, inclusive finance, and infrastructure finance	Operational Departments	Ongoing
1.2. Increase operational involvement in cross-sector/thematic, and innovative areas—digital, green, disaster risk, Islamic, and municipal finance	FSG Secretariat, Operational Departments	Ongoing
2. Upgrade Sector Skills		
<u>2.1. Staffing</u>		
2.1.1. Assess gaps in skills, capabilities and resources—including for staff sharing opportunities across operational departments and non-operational departments—and develop training modules around these identified areas	FSG Secretariat, Operational Departments	Q1 2018
2.1.2. Conduct training and capacity development programs for ADB staff (HQ and RM) on operational areas of focus; project design, processing and management; and due diligence	FSG Secretariat	Ongoing
2.1.3. Contribute to quality and appropriate skills in external recruitment of staff and engagement of secondees to address findings of skills gap audit	FSG Secretariat, Operational Departments, BPMSD	Ongoing
2.1.4. Develop partnerships that can be tapped on short notice to support operations	FSG Secretariat	Q1 2018
<u>2.2. Financing</u>		
2.2.1. Attract additional donor funds, including into the Financial Sector Development Partnership Special Fund to finance TA	FSG Secretariat, OCO	Q4 2020
<u>2.3. Knowledge</u>		
2.3.1. Organize and deliver knowledge products and knowledge sharing and learning events	FSG Secretariat, Operational Departments	Ongoing
2.3.2. Review and establish as relevant partnerships with centers of excellence, academia, and regional and international networks to remain updated on financial sector developments and issues	FSG Secretariat	Q4 2020
2.3.3. Incorporate internal dissemination processes into ADBs engagement with international standard setting bodies (BIS, IAIS, IOPS, FATF, IOSCO, IADI, and IFSB), continue to provide technical inputs and advice	FSG Secretariat, Operational departments, nonoperational departments	Ongoing

continued on next page

Appendix 2. *continued*

Actions/Strategies	Responsible Unit(s)	Indicative Timeframe
3. Improve Finance sector operational performance		
3.1. Establish guidelines for a structured peer review process of proposed finance sector operations	FSG Secretariat, SPD	Q1 2018
3.2. Increase collaboration between operational departments and other departments in quality at entry and evaluation for projects/programs	FSG Secretariat, Operational Departments	Ongoing
4. Improve finance sector analysis		
4.1. Establish guidance notes for conducting comprehensive finance sector assessment to identify opportunities and challenges	FSG Secretariat, Operational Departments	Q4 2018
4.2. Establish guidance notes on finance sector outcome and output performance indicators and targets across finance sector operations	FSG Secretariat, Operational Departments	Q4 2018
5. Improve systems and processes		
5.1. Improve level 2 performance indicators to more accurately represent finance sector operations.	FSG Secretariat, Operational Departments, SPD	Q1 2018
5.2. Improve project classification system to better capture finance sector operations.	FSG Secretariat, Operational Departments, SPD	Q1 2018
5.3. Develop tracking system to capture finance sector operations contribution to climate change adaptation and mitigation and incorporate into the ADB project classification system.	FSG Secretariat, SDCC	Q4 2017
5.4. Review and strengthen as required existing products and financing modalities to meet DMC demand for ADB support as well as relevant operations manuals and staff instructions.	FSG Secretariat, Operational Departments, SPD	Ongoing

BIS = Bank for International Settlements, BPMSD = Budget, Personnel, and Management Systems Department, DMC = developing member country, FATF = Financial Action Task Force, FSG = Finance Sector Group, HQ = headquarters, IADI = International Association of Deposit Insurers, IAIS = International Association of Insurance Supervisors, IFSB = Islamic Financial Services Board, IOPS = International Organisation of Pension Supervisors, IOSCO = International Organization of Securities Commissions, OCO = Office of Cofinancing Operations, RM = resident mission, SDCC = Sustainable Development and Climate Change Department, SPD = Strategy and Policy Department, TA = technical assistance.

APPENDIX 3: MEASURES TO IMPROVE FINANCE SECTOR OPERATIONAL PERFORMANCE 2011–2015

- I. Sovereign and nonsovereign operations have implemented measures to strengthen performance of finance sector operations. The full effects of these measures are not yet reflected in the Development Effectiveness Review, as many of the projects and programs approved since their introduction are still under implementation.
- II. Sovereign operations
 - A. Program/project design
 - 1. Streamlined business processes
 - 2. Design and monitoring framework training and updated guidelines
 - 3. More rigorous scrutiny of financial intermediation loans through enhanced due diligence²
 - a. Integrity due diligence for financial intermediation loans introduced 2011
 - b. Technical Guidance Note on Project Financial Reporting and Auditing revised in 2015
 - c. Technical Guidance Note for conducting financial due diligence for financial institutions. This includes (i) an illustrative terms of reference for the technical assistance consultant conducting due diligence and outline of a due diligence report; and (ii) updated questionnaires for financial management assessment.
 - 4. Organized peer review process including
 - a. Peer reviewers:
 - (i) development and updating a list of peer reviewers
 - (ii) peer reviewers assigned on a no-objection basis by Finance Sector Group committee members
 - b. Roundtable discussions:
 - (i) organization of roundtable discussions on project and program proposals prior to management review meeting and staff review meeting with the objective to help strengthen the proposal and to share knowledge and experience on similar proposals
 - B. Program/project implementation
 - 1. Greater emphasis on program/project monitoring through increased consultation with key stakeholders and review missions.
 - 2. eOperations updating and monitoring.
- III. Nonsovereign operations
 - A. Independent review by the Office of Risk Management and involvement at concept approval stage as a measure to strengthen the performance of nonsovereign finance sector operations.
 - B. Implemented a more rigorous investment committee approval process
 - C. Enhanced credit assessment

² Due diligence includes assessment of financial management systems, financial analysis, and integrity due diligence.

1. Introduction of rating and pricing models for lending projects to ensure that transactions are priced on a cost-recovery basis and that the credit spread reflects the probability of default and loss given default. The introduction of cost-recovery pricing will ensure the Asian Development Bank (ADB) is adequately compensated for the credit risk associated with the projects
- D. For private equity funds, new strategy guidelines adopted in October 2015 will enhance financial returns and development impact by:
 1. Partnering with experienced fund managers with demonstrated track record and operating experience in targeted sectors;
 2. Minimizing excess exposure to multiple risk layers in the same investment, including through limiting exposure to single country/sector funds;
 3. Increased focus on sectors that have strong alignments with ADB's expertise and mandate to enhance ADB's value addition;
 4. Targeting growth platforms to provide capital at scale, with a minimum target fund size of \$150 million;
 5. Prioritizing funds that provide co-investment opportunities at attractive economics to augment ADB's equity deal sourcing capabilities;

APPENDIX 4: FINANCE SECTOR OPERATIONS UNDER REVIEW

Table A4.1: Sovereign Operations

Loan/Grant Number	Country	Dept	Project Name	Date of Approval	Overall	Relevance	Effectiveness	Efficiency	Sustainability
0067/0068-G	AFG	CWRD	Private Sector and Financial Market Development Program	14-Dec-06	LS	R	LE	LE	LLS
1987/1988	PAK	CWRD	Rural Finance Sector Development Program	20-Dec-02	U	PR	I	I	U
2270	PAK	CWRD	Private Participation in Infrastructure Program	31-Oct-06	LS	R	LE	LE	LLS
2291/2292	PAK	CWRD	Improving Access to Financial Services (Phase 1) Program	14-Dec-06	PS	R	LE	LE	LS
2335	PAK	CWRD	Earthquake-Displaced People Livelihood Restoration Program	27-Jun-07	S	R	LE	E	LS
2340	PAK	CWRD	Second Generation of Capital Market Reform Program	31-Jul-07	LS	R	LE	LE	LLS
2000/2001	TAJ	CWRD	Microfinance Sector Development Program	26-Jun-03	HS	HR	HE	E	MLS
1963	UZB	CWRD	Small and Microfinance Development Project	09-Dec-02	LS	LR	LE	E	LLS
1848	MON	EARD	Rural Finance Project	25-Oct-01	U	PR	IE	IE	U
2218	MON	EARD	Financial Regulation and Governance Program	15-Dec-05	LS	R	LE	LE	LLS
1768	PNG	PARD	Microfinance and Employment Project	19-Oct-00	S	R	E	LE	LS
2232	BAN	SARD	Improvement of Capital Market and Insurance Governance Project	09-Mar-06	S	R	E	LE	LS
1871	IND	SARD	Private Sector Infrastructure Facility at the State Level (PSIF II)	11-Dec-01	LS	R	LE	LE	LS
2281	IND	SARD	Rural Cooperative Credit Restructuring and Development Program	08-Dec-06	LS	LR	LE	LE	LLS

continued on next page

Appendix Table A4.1. *continued*

Loan/Grant Number	Country	Dept	Project Name	Date of Approval	Overall	Relevance	Effectiveness	Efficiency	Sustainability
2404/2509	IND	SARD	India Infrastructure Project Financing Facility	20-Dec-07	S	R	E	E	LS
1811	NEP	SARD	Corporate and Financial Government Project	14-Dec-00	U	LR	LE	I	LLS
2268/0059	NEP	SARD	Rural Finance Sector Development Cluster Program	26-Oct-06	S	R	E	LE	LS
1849	SRI	SARD	Southern Province Rural Economic Advancement Project	26-Oct-01	LS	R	LE	E	LLS
1913/1914	SRI	SARD	Plantation Development Project	13-Sep-02	S	R	E	E	LS
2040/2041/ 2042	SRI	SARD	Rural Finance Sector Development Program and Project	11-Dec-03	LS	LR	LE	LE	LLS
2138/2139	SRI	SARD	Financial Markets Program for Private Sector Development	15-Dec-04	S	R	E	LE	LS
2379/2577	INO	SERD	Capital Market Development Program Cluster	10-Dec-07/ 16-Nov-09	S	R	E	E	LS
2252/2253	LAO	SERD	Rural Finance Sector Development Program	17-Aug-06	S	R	E	E	LS
1946	LAO	SERD	Banking Sector Reform Program	28-Nov-02	PS	PR	LE	LE	LLS
2278/2715	PHI	SERD	Financial Market Regulation and Intermediation Program	06-Dec-06/ 07-Dec-10	LS	R	LE	LE	LS
2199	PHI	SERD	Microfinance Development Program	22-Nov-05	S	R	E	HE	MLS
1932/2118	VIE	SERD	Second Financial Sector Program Loan Cluster (Subprograms 1 and 2)	20-Nov-02/ 03-Dec-04	S	R	E	E	LS
1990	VIE	SERD	Housing Finance Project	20-Dec-02	LS	R	LE	LE	LLS
2377/2707	VIE	SERD	Third Financial Sector Program	6-Dec-07/ 29-Nov-10	LS	R	LE	LE	LS

For overall rating, HS = highly successful, S = successful, LS = less than successful, PS = partly successful, U = unsuccessful. For relevance, HR = highly relevant, R = relevant, LR = less than relevant, PR = partly relevant. For effectiveness, HE = highly effective, E = effective, LE = less than effective, I = ineffective. For efficiency, HE = highly efficient, E = efficient, LE = less than efficient, I = inefficient. For sustainability, MLS = most likely sustainable, LS = likely sustainable, LLS = less than likely sustainable, U = unlikely sustainable. For department, CWRD = Central and West Asia Department, EARD = East Asia Department, PARD = Pacific Department, SARD = South Asia Department, SERD = Southeast Asia Department.

Table A4.2: Nonsovereign Operations

Investment No.	Project Type	Country	Project Name	Date of Approval	Validated Overall
7101/7102	Equity	REG	The Asian Infrastructure Fund and the Asian Infrastructure Fund Management Company	12-Apr-94	Successful
7136	Equity	REG	Kula Fund Limited	29-Apr-97	Less than successful
7127	Equity	PRC	China Everbright Bank	05-Nov-96	Less than successful
7177	Equity	BAN	Central Depository Project	15-Aug-02	Highly successful
7197	Equity	MON	The Trade and Development Bank of Mongolia	20-Apr-04	Successful
2081	Loan	MON	The Trade and Development Bank of Mongolia	20-Apr-04	Successful
7189/2057	Loan	IND	Private Sector Housing Finance Project - Dewan House Finance Corporation Ltd.	18-Dec-03	Successful
7218	Guarantee	PHI	Small and Medium Enterprise Development Support Project	29-Sep-05	Unsuccessful
7139	Equity	BHU	Financial Sector Intermediation Facility - Equity Investment	22-Oct-97	Successful
7105	Equity	IND	SARA Fund	20-Sep-94	Partly satisfactory
7134/7135	Equity	REG	Asian Infrastructure Mezzanine Capital Fund and Asian Infrastructure Mezzanine Capital Management Fund Limited	17-Dec-96	Unsuccessful
7138	Equity	IND	Infrastructure Development Finance Company	14-Oct-97	Highly successful
7211/2169	Loan	IND	Infrastructure Development Finance Company	19-Apr-05	Highly successful
7156/7157	Equity	THA	Thailand SME Investment and Restructuring Fund and Thailand SME Fund Management Company	09-Mar-00	Unsuccessful
7170	Equity	REG	Mekong Enterprise Fund	07-Sep-01	Less than successful
7171	Equity	THA	Lombard Thailand Intermediate Fund	07-Sep-01	Successful
7181	Equity	IND	The Infrastructure Fund of India (Henderson)	16-Dec-02	Unsuccessful
7179/7220	Equity	PRC	China Environment Fund 2002 and 2004	29-Oct-02	Successful
7184	Equity	REG	ASEAN China Investment Fund	15-Apr-03	Successful
7195	Equity	REG	ADM Maculus Fund	19-Mar-04	Successful
7199	Equity	AFG	Afghanistan International Bank	13-May-04	Highly successful

continued on next page

Appendix Table A4.2. *continued*

Investment No.	Project Type	Country	Project Name	Date of Approval	Validated Overall
7196	Equity	PRC	Yangtze Special Situations Fund	19-Mar-04	Unsuccessful
7193	Equity	PHI	LGU Guarantee Corporation	19-Jan-04	Successful
7200	Equity	PRC	Credit Orienwise Group Limited	09-Feb-07	Unsuccessful
7219	Equity	PRC	Bank of China Ltd.	04-Oct-05	Successful
7204	Equity	PRC	Actis China Fund 2, L.P	26-Nov-04	Highly successful
7209	Equity	REG	Aureos South-East Asia Fund	15-Mar-05	Successful
2233	Loan	AZE	Private Banks and Leasing Companies in Azerbaijan	30-Mar-06	Less than successful
7236/2236	Loan	KAZ	Term Loan Facility JSC BTA Bank	15-Jun-06	Unsuccessful
7235/2235	Loan	KAZ	Term Loan Facility JSC Alliance Bank	15-Jun-06	Unsuccessful
7240	Equity	PRC	Bank of Hangzhou	27-Jul-06	Successful
7264	Loan	ARM	Senior Unsecured Loan Inecobank Closed JSC Micro and Small Enterprise Financing Facility	22-Oct-07	Successful
2322	Loan	MLD	Secured Loan South Asian SME Leasing Facility, Maldives	27-Mar-07	Less than successful
7246/2235	Guarantee	KAZ	Guarantee Facility for Fixed Rate Notes Issued by Alliance Bank JSC and Secured by Diversified Payment Rights	10-Oct-06	Less than successful
2321	Loan	SRI	Secured Loan South Asian SME Leasing Facility - Lanka ORIX Leasing Company Limited	27-Mar-07	Successful
2343	Loan	MON	Senior Unsecured Loan Khan Bank	02-Aug-07	Successful
2341	Loan	AZE	Debt Financing to Bank of Baku	01-Aug-07	Successful
2369	Loan	SRI	People's Leasing Company Limited	23-Nov-07	Successful
2370	Loan	SRI	Commercial Leasing Company Limited	23-Nov-07	Successful
2432	Loan	INO	Senior Secured Syndicated Loan to Bank Mandiri (A-Loan)	29-Jul-08	Successful

Source: Strategy and Policy Department, Asian Development Bank.

APPENDIX 5: PARTNERSHIPS

	No.	Partner	Topics covered	Operational relevance
Inter-agency coordination partnership		Formal		
	1.	Asia-Pacific Economic Cooperation (APEC) - APEC Finance Ministers Meeting, Senior Finance Official's Meeting	ASEAN Economic Community, financial stability, banking, capital markets, insurance and pensions, disaster risk financing, infrastructure finance, SME/MSME, financial inclusion, trade finance	Financial cooperation and integration Opportunities for policy dialogues Demonstrating Asian Development Bank (ADB) knowledge and expertise in sector policy dialogues
	2.	Association of Southeast Asian Nations (ASEAN)		
	3.	Association of Southeast Asian Nations (ASEAN) +3/ Asian Bond Markets Initiative		
	4.	Organisation for Economic Co-operation and Development	Insurance and private pensions, disaster risk financing, long term investment and infrastructure financing, trade and SMEs	Finance Sector Group's priority areas of work
	5.	World Bank		
	6.	International Monetary Fund		
	7.	Inter-American Development Bank		
		Standard Setting Bodies		
	8.	International Organization of Securities Commissions*	Capital markets, regulation and supervision, financial stability	Promote compliance with international prudential standards and facilitate Financial Sector Assessment Programs
	9.	International Association of Insurance Supervisors*	Insurance, regulation and supervision, financial stability	Opportunities for ADB to regularly meet national regulatory authorities and carry policy dialogues
	10.	Islamic Financial Services Board*	Islamic banking Islamic insurance, Sukuk, markets, financial stability, financial inclusion	Platform for ADB to convey concerns of Asian developing member countries Demonstrating ADB's knowledge and expertise in sector policy dialogues
	11.	Financial Action Task Force	Anti- Money Laundering (AML) and Combating Financing of Terrorism (CFT)	Promote compliance with international standards for AML-CFT. Due diligence of participating financial institutions in ADB's financial intermediation operations
	12.	International Actuarial Association (IAA)*	Pensions, insurance, disaster risk financing	Finance Sector Group's priority areas of work

continued on next page

Appendix 5, continued

	No.	Partner	Topics covered	Operational relevance
Informal	13.	Financial Stability Board (FSB) – Regional Consultative Group (Asia)	Financial Stability, Implementation of international financial standards	Promote the compliance with international prudential standards.
	14.	Bank for International Settlements (BIS)	International banking standards and Basel III	Opportunities for ADB to regularly meet with national regulatory authorities and carry policy dialogues
	15.	G20 Local Currency Bond Market Initiative	Capital markets	Platform to convey concerned of Asian DMCs Demonstrating ADB's knowledge and expertise in their sector policy dialogue
	16.	Asian Forum for Insurance Regulators	Insurance	
	17.	ASEAN Insurance Regulators Meeting	Insurance	
	18.	Pacific Islands Regional Initiative	Financial Inclusion, SMEs and Insurance	
	19.	South Asian Association of Regional Cooperation Insurance Regulators Forum	Insurance, Insurance,	
	20.	Asia Pacific Finance and Development Center	Capital markets	Capacity building in the APEC and ASEAN +3 through training workshops, forum and academic research
	21.	APEC Financial Regulators Training Initiative	Banking, Insurance, Capital Markets and Financial Inclusion	Capacity building
	22.	International Public Asset Management Companies (AMCs) Forum (IPAF)	Resolution of nonperforming loans and distressed banks	Developing operations to support the establishment of a public AMC
Knowledge partnership	23.	Korea Capital Market Institute	Capital markets	Finance Sector Group's priority area of work
	24.	Consultative Group for Assisting the Poor	Financial Inclusion	Innovative solutions through practical research and active engagement with financial service providers, policy makers, and funders to enable approaches at scale
	25.	Deutsche Gesellschaft für Internationale Zusammenarbeit	Insurance, Financial Inclusion	Capacity building and shared learning
	26.	Japan International Cooperation Agency	Infrastructure finance	Establishment of a trust fund for supporting public-private and other private sector infrastructure projects
				Co-financing framework for supporting the governments of developing countries to promote public infrastructure

continued on next page

Appendix 5. continued

	No.	Partner	Topics covered	Operational relevance
	27.	Asian Development Bank Institute	All financial sector topics	Capacity building and research on Finance Sector Group priority areas
Financing partnership	28.	SME Finance Forum	SME/ MSME	Expand access to finance for small and medium businesses
	29.	Alliance for Financial Inclusion	Financial Inclusion -Microfinance, Microinsurance, Digital Finance	Shared learning and dialogue with financial policymakers from developing and emerging countries working together to increase access to appropriate financial services for the poor
	30.	Access to Insurance Initiative	Microinsurance	Capacity building, research and policy dialogue for inclusive insurance markets by supporting the activities of the global insurance regulatory community through the International Association of Insurance Supervisors
	31.	Pacific Pension Institute	Pensions	Dialogue and knowledge sharing on issues facing long-term institutional investors in Asia and the Pacific
	32.	Financial Sector Development Partnership Special Fund supported by Government of Luxembourg.	Strengthening regional, subregional, and national financial systems in Asia and the Pacific	Finances a program of projects, including technical assistance operations, components of investment projects, and stand-alone grant-financed activities, focusing on the financial sector
	33.	#Credit Guarantee and Investment Facility supported by ASEAN, People's Republic of China, Japan, Republic of Korea	A key component of the Asian Bond Markets Initiative of the ASEAN+3 cooperation.	Promote economic development, stability and resilience of financial markets in the region. Provide credit guarantees for local currency denominated bonds issued by investment grade companies in ASEAN+3 countries

continued on next page

Appendix 5, continued

		No.	Partner	Topics covered	Operational relevance
		34.	# Cooperation Fund For regional Trade and Financial Security Initiative supported by Australian Agency for International Development; Ministry of Finance Japan, United States Department of State	Anti- money laundering and combating terrorist financing (AMLCFT) efforts.	Strengthen developing member country capacity to address AMLCFT, in particular through assistance in the establishment of financial intelligence units and effective legal and supervisory regimes for AML
		35.	# Technical Assistance Grant Fund supported by Ministry of Foreign Affairs and Trade, New Zealand	Finance, education, environment, water and waste management, poverty reduction, governance	Funding, project activity and design, project or activity implementation

SME = small and medium-sized enterprise, MSME = micro, small and medium-size enterprise.

Note: # managed by other departments, * fee paying.

Source: Finance Sector Group, Asian Development Bank

APPENDIX 6: SELECTION OF FINANCE SECTOR FLAGSHIP EVENTS AND PUBLICATIONS 2011–2015

Events

Event	Date
Forum on Promoting Remittances for Development Finance	18–19 Mar 2015
Global Seminar on Disaster Risk Financing	17–18 Sept 2015
Innovative Financial Inclusion Solutions for the Real Economy	25–26 Sept 2014
Conference on Islamic Finance for Asia: Development, Prospects and Inclusive Growth	4–5 Nov 2013
International Insurance Seminar: In Pursuit of a More Resilient and Inclusive Insurance Sector	21–22 Oct 2013
Second OECD–ADB Workshop on Enhancing Financial Accessibility for Small and Medium Enterprise: Lessons from Asian and OECD Areas' Crises	21 Oct 2013
First ADB–OECD Workshop on Enhancing Financial Accessibility for SMEs: Lessons from Asian and OECD Areas' Crises	6–7 Mar 2013
Seminar on Enhancing Financial Accessibility for Small and Medium-sized Enterprises (SMEs): Lessons from National Practices on Improving Access to Finance in Asia and the Pacific	2–3 Sept 2015

Publications

	Title
1	The Road to ASEAN Financial Integration
2	Asia Small and Medium-Sized Enterprise (SME) Finance Monitor
3	Asia Bond Monitor
4	ASEAN+3 Bond Market Guide
5	ASEAN Corporate Governance Scorecard: Country Reports and Assessments 2013–2014
6	Asian Development Review: Volume 32, Number 1
7	Financial Inclusion, Poverty, and Income Inequality in Developing Asia
8	Capital Market Financing for SMEs: A Growing Need in Emerging Asia
9	Financial Inclusion in Asia: An Overview
10	Global Shock, Risks, and Asian Financial Reform
11	ASEAN Corporate Governance Scorecard: Country Reports and Assessments 2012–2013
12	Asian Development Outlook 2012: Confronting Rising Inequality in Asia
13	Bond Market Development in Developing Asia
14	Financing Asia's Growth
15	Poverty, Income Inequality, and Microfinance in Thailand
16	ADB Trade Finance Gap, Growth, and Jobs Survey

Source: Finance Sector Group, Asian Development Bank

APPENDIX 7: FINANCE SECTOR OPERATIONAL PERFORMANCE REVIEW: SUMMARY OF KEY LESSONS

1. Project Design and Appraisal	
Link program design to a national finance sector or subsector strategy	The existence, or the formulation and adoption of such a national plan is essential to underpin program reform and to ensure government commitment and ownership. A significant number of developing member countries (DMCs) have in recent years implemented/prepared and announced sector and subsector strategies including strategies for financial inclusion, capital market development, and finance sector development more broadly. During program/project preparation, technical assistance (TA) can support in developing or updating such strategies.
Build sound diagnostics.	Conceptualization practices have often been unsatisfactory, including design and monitoring framework. Recent improvements in design and monitoring framework design practices are visible. However, the analytical basis of project design and processing needs to be stronger. Given the complexity (e.g. sequencing considerations), and the country-specific nature of finance sector and capital market development processes, preparatory diagnostic and in-depth analytical work—a thorough financial systems analysis—should be regimented as essential milestones.
Establish measurable targets and performance indicators.	One factor impacting effectiveness in achieving outcomes and targets was performance indicators, which were beyond the control of the project or program, or were too ambitious to achieve given the implementation period. Performance indicators are important to ensure accountability for results and provide an important basis for establishing the success rate of a project, program or technical assistance.
Formulate realistic project designs.	In addition to sector needs and technical parameters: <ul style="list-style-type: none"> • Reforms need to match the capacities of executing and implementing agencies. • Implementation time needs to consider the challenges posed by political economy, complexity and absorptive capacity. • Loan amount needs to match the scope and magnitude of the proposed reforms. • Peer reviews during appraisal and design should be used for reality check and avoid later revisions.
Calibrate transitional economies.	Enacting legislation and adopting regulation in transitional economies takes more time than anticipated. Particularly among small transition economies, it may be more prudent to take a gradual approach to financial market development, within a development continuum supported by an agreed upon road map. Such a road map should have flexibility for continuing review and for taking corrective actions, and be supported by technical assistance until such a time the country exhibits maturity of institutions, strong internal capacity, and political and economic stability.
Strengthen partnership approach and stakeholder consultations.	Lack of government commitment, lack of ownership, and resistant to change can be traced back to (i) limited stakeholder consultations and policy dialogue; (ii) not building wider constituencies for reform support and public awareness of the targeted benefits; and (iii) not recognizing the importance of political economy. These require developing partnerships with the key stakeholders, particularly the responsible ministry and its implementing agencies, the financial community (e.g., banking community), business community (e.g., chamber of commerce), and where appropriate civil society organizations. Regional departments should develop country specific strategies and allow sufficient time for building these relationships.

continued on next page

Appendix 7. continued

Provide TA resources to address project design shortcomings, preempt implementation risks, and support development of emerging areas.	TA resources are needed to help address project design shortcomings and preempt implementation risks, and support staff in developing clearer national policy roadmaps on which to base projects and programs. To ensure the benefits can take root and become sustainable, TA is needed to address institutional capacity constraints that take time to overcome, and to support complex legal and regulatory reforms during project and program implementation that require substantial constituency-building. Capacity development requires strategic approaches that are mindful of the minimum absorptive capacity that human-resource efforts by implementing agencies need to produce. TA can also support the development of emerging and innovative areas such as digital finance, climate finance, disaster risk finance, Islamic finance and municipal finance.
Strengthen technical advisory skills and staff capacity in ADB.	Inadequate specialized technical sector skills and staff capacity in the operational areas of focus partly contributed to setbacks in formulating realistic project designs. The actions to address these include (i) direct skills development in operational areas of focus (including on-the-job training and development assignments); (ii) resource sharing across operational departments and from non-operational departments to help fill projected skills gaps; (iii) external recruitment of staff and consultants with expertise in areas where gaps exist (and for which a central pool of TA resources is a crucial enabler); as well as (iv) knowledge management practices that can effectively turn institutional experience into key inputs in new project design efforts. Staff resources also need to be allocated to allow for sufficient time in work plans to design, implement and monitor projects, programs and TA.
Others	<ul style="list-style-type: none"> • Reform programs should consider building in incentives for institutional strengthening and government ownership. • Long-term programmatic assistance is more effective when formulating complex policy and legal reforms. It provides more flexibility and helps better sequence the policy actions. • Effectiveness and efficiency of interventions in infrastructure financing needs a good pipeline of bankable subprojects. In particular for public-private partnerships, provisions should be made or built in to develop capacity in parallel and after completion of the program. • Interventions relating to access and deepening of financial markets requires strong and viable financial intermediary or intermediaries at the outset. Dependence on financially troubled institutions as intermediaries should be avoided.
2. Project Implementation	
Implementation arrangements should reflect executing and implementing agency capacity	Policy and legal reforms should be supported by technical assistance tailored to develop capacity and provide technical support. Where gaps are to be filled in by project consultants it must be done with ownership and commitment of the executing and implementing agencies.
Ensure timely review missions and effective support from resident missions	Timely Asian Development Bank (ADB) review missions and effective support from resident missions contribute to program success. ADB review missions are critical particularly when implementing reforms that are likely to encounter resistance or time delays. Resident missions have contributed to successful implementation of supportive technical assistance and to program/project implementation.
Strengthen technical and project administration capacity of administration staff	ADB's project administration staff capacity should complement the technical and project administration needs of implementation.
Strengthen internal capacity for rendering policy advice	ADB should strengthen its internal capacity for rendering policy advice to avoid reliance on consultants, and provide adequate budget to support monitoring, including provision of staff incentives.

continued on next page

Appendix 7. continued

Leverage nongovernment organizations and civil society organizations	Leverage nongovernment organizations and civil society organizations when implementing programs related to inclusive financing—e.g., microfinance, rural finance, and housing finance for the lower income groups.
Ensure early response and timely corrective action	In complex, time-bound programs, early response and timely corrective actions are critical.
3. Knowledge Management	
Conduct knowledge work on an ongoing basis that is tailored to the circumstances of individual DMCs.	<p>Knowledge capture and sharing was found to fall short, impacting effective policy dialogue and analytics. To improve knowledge development and sharing of best practices there is a need to</p> <ul style="list-style-type: none"> a. Better capture and share knowledge produced by operational departments; b. Improve quality and coordination of knowledge products and services among ADB departments and offices, including resident missions (who coordinate knowledge partnership opportunities with DMCs); c. Increase the involvement of Finance Sector Group at an early stage for project design, processing, and implementation; d. Better capture of frontier issues that need special attention, such as infrastructure, access to finance, regional financial cooperation and integration, and the investment climate; e. Increase resources for knowledge activities, including knowledge partnerships with centers of excellence and standard setting bodies; f. Assign clear indicators to monitor knowledge management effectiveness;^a g. Work across sector and thematic groups, in view of ‘finance’ sector development crosscutting impact on industries and other sectors. <p>The establishment of closer links with external partners and centers of excellence can play an important role in both supporting core TA objectives of capacity development, mobilizing expert advice to better meet DMC demand for more knowledge support, and in strengthening the review process of program/project design. Two specific arguments can be made:</p> <ul style="list-style-type: none"> A. External sources of knowledge, including centers of excellence, financing partnerships, standard setting bodies and other multilateral development banks need to be better leveraged.^b This will include (i) evolving areas such as climate finance, disaster risk finance, digital finance, Islamic finance and municipal finance; and (ii) expanding financing partnerships to support project and program design, implementation and capacity building. In collaboration with the Office of Cofinancing, efforts need to be made to (i) scale up available financial resources to support development efforts, (ii) increase collaboration with public and private sector partners to develop and structure innovative financial products, and (iii) create cofinancing opportunities. B. Collaboration with standard-setting bodies needs to be strengthened so that ADB can more effectively facilitate DMCs’ implementation of international financial standards. Continuing to participate in meetings with international standard setters allows ADB to demonstrate knowledge and expertise, share information in sector policy dialogues and update technical knowledge.
Improve business processes by leveraging knowledge.	Business processes related to project and program design, processing, implementation, and evaluation need be improved by (i) leveraging technical experts to peer review the design of proposed finance operations with engagement of the Finance Sector Group, and (iii) leveraging external knowledge and knowledge partnerships, including expanding and deepening such knowledge partnerships; (ii) partnerships such as interagency coordination partnerships, knowledge partnerships and financing partnerships.

continued on next page

Appendix 7. continued

4. Institutional changes	
Improve systems, methodologies, and indicators that track the contribution of finance sector operations to ADB's corporate goals to better capture the impact of finance sector operations	Current performance indicators in ADB's results framework capture only a small portion of finance sector activities. New indicators thus need to be established. This requires close collaboration with the Strategy and Policy Department to (i) identify level 2 performance indicators, which more accurately represent finance sector work at ADB, (ii) strengthen the project classification system to better capture finance sector operations, ^c and to (iii) capture the contribution of finance sector operations to climate change adaptation and mitigation by raising awareness of tracking methodologies and incorporating these in project design. A stock-take conducted by the Finance Sector Group of sustainable development goals, targets and indicators as well as performance indicators in use in other multilateral development banks identified a list of alternative performance indicators with the objective to more effectively capture the impact of ADB finance sector operations. These will be further discussed within the Finance Sector Group and in collaboration with SPD as part of the development of a new strategy 2030, and other relevant departments.
Assess availability of instruments to provide effective, efficient, and timely support	With an increasing number of DMCs approaching middle-income and upper middle-income status, including countries such as Bangladesh and Indonesia, demand for ADB support is changing, both in nature and quantity, prompting ADB to review policies, operations manuals, and staff instructions for existing products and financing modalities. This includes assessing (i) instruments for their relevance and flexibility and an exploration of possible new instruments; and (ii) financing terms, including tenor and more differentiated pricing. The adoption of changes to existing financing modalities and of new ones is critical. This includes modalities to expand investments in infrastructure, support SMEs, and target underserved segments to boost employment, growth, and productivity, as well as modalities that can provide budget support to facilitate fiscal stimulus during external shocks to the economy or to support climate-smart investments. In all of this, the use of financing modalities needs to be based on close dialogue with country authorities about policies and underlying investment and be used in appropriate combination with project lending and technical assistance projects.

- ^a Under "One ADB" all ADB departments work together to provide knowledge solutions. Resident missions will seek knowledge partnerships and dialogue opportunities with DMCs and coordinate ADB support. To ensure that knowledge work is operationally relevant, ADB's communities of practice will become more actively involved with project processing and preparing related knowledge products. Knowledge solutions, along with the other strategic priorities, will help promote innovative development solutions and services in DMCs. Source: Midterm Review of Strategy 2020. 2014. ADB.
- ^b Center of Excellence: "A research or training institution, a think tank, a university or one of its departments, or a private research institution having a high reputation in scholarly research in development, public policy, science, and entrepreneurship. The institution's mission comprises institution building and capacity development in a developing country or a country in transition" (Source: ADB. 2014. *Knowledge for Solutions Technical Assistance Report*. Manila.
- ^c Project classification systems refer to (i) the project classifications system 2011–2013 and (ii) the current project classification system implemented in 2014.

APPENDIX 8: NATIONAL FINANCE SECTOR STRATEGIES

Table A8.1: Examples of Broad Finance Sector Development Strategies

DMC	Title (leading agency, approval date)
Cambodia	Financial Sector Development Strategy 2011–2020 (Ministry of Finance and National Bank of Cambodia, 2014)
Kazakhstan	Financial Sector Development of the Republic of Kazakhstan until 2030 (President, 2014)
Sri Lanka	Road Map: Monetary and Financial Sector Policies for 2012 and Beyond (Central Bank of Sri Lanka, 2012)
Timor-Leste	Timor-Leste Financial Sector Development Master Plan 2025 (Banco Central de Timor-Leste, 2015)

Source: Finance Sector Group, Asian Development Bank.

Table A8.2: Examples of National Financial Inclusion Strategies

DMC	Title (leading agency, approval date)
India	Pradhan Mantri Jan-Dhan Yojana: A National Mission on Financial Inclusion, August 2014–August 2018 (Department of Financial Services, Ministry of Finance, 2014)
Indonesia	National Strategy for Financial Inclusion (Ministry of Finance and Central bank, 2012)
Mongolia	National Financial Inclusion Strategy 2016–2025 ^a (FRC, Ministry of Finance, the Bank of Mongolia; 2016)
Myanmar	Financial Inclusion Roadmap 2014–2020 (President of the Union of Myanmar, 2013)
Pakistan	National Financial Inclusion Strategy - 2015–2020 (State Bank of Pakistan and Ministry of Finance, 2015)
Papua New Guinea	National Financial Inclusion and Financial Literacy Strategy 2014–2015 (Bank of Papua New Guinea, 2013)
Philippines	National Financial Inclusion Strategy (Bangko Sentral ng Pilipinas, 2015)
Vanuatu	Medium Term Strategy for Financial Inclusion (Reserve Bank of Vanuatu, 2013)

^a Included in the Mongolia National Strategy of Financial Market Development–2025

Source: Finance Sector Group, Asian Development Bank.

Table A8.3: Capital Market Development Strategies of ADB Developing Member Countries

Country	Title (leading agency, approval date)
Armenia	Capital Market Development Strategy (Central Bank of Armenia, 2012)
Azerbaijan	State Program on the Development of the Securities Market of the Republic of Azerbaijan (State Committee for Securities, 2011)
Mongolia	Capital Market Development Strategy, 2009–2012 (Financial Regulatory Commission, 2008)
Viet Nam	Capital Market Development Plan (State Bank of Vietnam, 2007)

Source: Finance Sector Group, Asian Development Bank.

APPENDIX 9: ANTI-MONEY LAUNDERING AND COMBATING TERRORIST FINANCING

Money laundering and terrorist financing pose a substantial threat to global economic and financial stability. Money laundering has an estimated value of approximately 2–5 per cent of the world's gross domestic product. It diminishes tax revenue, weakens government control over the economy, and can undermine the integrity of national financial systems and industry sectors.

In order to address the threat of money laundering to the integrity of the financial system, Financial Action Task Force (FATF), an intergovernmental body, was established in 1989 to (i) issue international standards on anti-money laundering and combating financing of terrorism (AML/CFT); as well as (ii) promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and the financing of proliferation, and other related threats to the integrity of the international financial system. The standards are called FATF Recommendations.

Jurisdictions are required to comply with the FATF Recommendations and will be assessed on their compliance. The assessors will either be from FATF, FATF-style regional bodies,³ International Monetary Fund and World Bank. Jurisdictions that are deemed to have strategic deficiencies in their AML/CFT frameworks in complying with these standards are identified through public statements.

The original FATF Recommendations were drawn up in 1990 and there have been a number of revisions since then. The latest recommendations were issued in February 2012. The main change to the recommendations include requirement for jurisdictions to apply a risk-based approach on the risks associated with money laundering and the financing of terrorism that affect them. The other changes include (i) requirement to pay attention to countries with high ML/FT risks, notably those that are under close scrutiny by the FATF, and require enhanced due diligence to be carried out for transactions involving these countries; as well as (ii) an increased focus on the connection between anticorruption and AML/CFT, which includes the requirement for financial institutions to pay attention to an expanded scope of politically-exposed persons. This includes individuals who are or have been entrusted with those functions by an international organization.

ADB has provided technical assistances to a number of developing member countries (DMCs) to meet some of the requirements set out in the FATF Recommendations. At present, the main focus of our assistance has been to assist countries in conducting national risk assessment in order to assess, identify and understand their money laundering and terrorist financing risks. These include assistance to Cambodia, Fiji, Mongolia, Papua New Guinea, Solomon Islands, and Tajikistan. It is expected that by understanding the AML/CFT in the country, authorities as well as reporting entities⁴ will be to allocate resources efficiently.

³ There are eight FATF-style regional bodies. ADB is an observer member to two of these bodies, namely the Asia Pacific Group on Anti Money Laundering and the Eurasian Group on Combating Money Laundering and Financing of Terrorism.

⁴ These are financial institutions as well as designated non-financial bodies and professions that are required by local legislations to submit suspicious transaction reports to the relevant authorities.

APPENDIX 10: ADB OPERATIONS IN THE FINANCE SECTOR

Figure A10.1: Finance Sector Operations

Source: ADB estimates.

Figure A10.2: Shares of Finance Subsectors (2011–2015)

NBFI = nonbank financial institution.

Notes: Asian Development Funds and Ordinary Capital Resources only. Trade finance does not include annual ADB-supported trade finance transactions under the Trade Finance Program, but rather only overall increases in the program under Board approvals. Inclusive finance, likewise, does not reflect annual ADB support under the nonsovereign Microfinance Risk Participation and Guarantee Program.

Source: ADB estimates.

Table A10.1: Performance of Finance Sector Operations by Subsector**Sovereign Loans and Grants (2010–2015)**

Subsector	Total	HS/S	%
Banking systems and nonbank financial institutions	2	0	0
Finance sector development	10	4	40
Housing finance	3	2	67
Inclusive finance	9	5	56
Infrastructure finance and investment funds	5	2	40
Insurance and contractual savings	2	2	100
Money and capital markets	2	0	0
SME Finance and leasing	1	0	0
Total	34	15	44

Nonsovereign Loans and Equity (2010 – 2015)

Subsector	Total	HS/S	%
Banking systems and nonbank finance institutions	13	9	69
Finance sector development	1	1	100
Housing finance	1	1	100
Infrastructure finance and investment funds	16	9	56
Inclusive finance	1	1	100
Money and capital markets	2	1	50
SME finance and leasing	6	3	50
Total	40	25	63

Technical Assistance (2010–2015)

Subsector	Total	HS/S	%
Banking Systems and nonbank financial institutions	6	6	100
Money and capital markets	32	28	88
Finance sector development	50	38	76
Housing finance	4	2	50
Inclusive finance	8	6	75
Insurance and contractual savings	9	7	78
Infrastructure finance and investment funds	3	3	100
SME finance and leasing	3	3	100
Total	115	93	81

Notes: HS/S = highly satisfactory/satisfactory rating. Ratings based on validated Project Completion Reports and Extended Annual Review Reports. Data covers reporting year for Project Completion Reports, Extended Annual Review Reports and Technical Assistance Completion Reports. For sovereign loans and grants, sectors were reclassified for 2010–2015 following ADB's 2014 Project Classification System. Data covers only those programs and projects with finance as primary sector.

Source: Strategy and Policy Department database, Asian Development Bank

Table A10.2: Performance by Sector**Sovereign Loans and Grants (2010–2015)**

By 3-Year Average	RY ^a 2010–2012			RY 2011–2013			RY 2012–2014			RY 2013–2015		
	July 2009– June 2012			July 2010– June 2013			July 2011– June 2014			July 2012– June 2015		
Sector	HS/S	Total	%S	HS/S	Total	%S	HS/S	Total	%S	HS/S	Total	%S
Agriculture, natural resources, and rural development	28	44	64	31	41	76	24	30	80	21	28	75
Education	10	20	50	10	20	50	15	21	71	16	18	89
Energy	11	19	58	12	19	63	12	15	80	12	14	86
Finance	12	25	48	11	23	48	10	21	48	7	15	47
Health	7	10	70	9	10	90	10	11	91	11	14	79
Information and communication technology	2	2	100	3	3	100	3	3	100	2	2	100
Industry and trade	6	12	50	5	7	71	7	8	88	5	5	100
Public sector management	12	24	50	16	22	73	15	19	79	17	22	77
Transport	29	41	71	33	44	75	30	42	71	22	38	58
Water and other urban infrastructure and services	12	22	55	15	26	58	12	17	71	11	14	79
Total Asian Development Bank	111	190	58	124	183	68	113	156	72	102	142	72

Nonsovereign Loans and Equity (2010–2015)

By 3-Year Average	RY 2010–2012			RY 2011–2013			RY 2012–2014			RY 2013–2015		
	July 2009– June 2012			July 2010– June 2013			July 2011– June 2014			July 2012– June 2015		
Sector	HS/S	Total	%S	HS/S	Total	%S	HS/S	Total	%S	HS/S	Total	%S
Education	0	0	0	0	0	0	0	0	0	1	1	100
Energy	4	5	80	9	10	90	10	11	91	11	11	100
Finance	7	17	41	10	23	43	17	31	55	18	33	55
Transportation and ICT	1	1	100	1	1	100	3	3	100	2	2	100
Water Supply and Municipal Services	0	0	0	0	0	0	1	1	100	1	2	50
Total Asian Development Bank	12	23	52	20	34	59	31	46	67	33	49	67

HS = highly successful, ICT = information and communication technology, RY = reporting year, S = successful, %S = percent successful.

Source: Strategy and Policy Department, Asian Development Bank.

APPENDIX 11: FIGURES ON ECONOMIC AND FINANCE SECTOR LANDSCAPE IN DEVELOPING MEMBER COUNTRIES

Income categories are based on the World Bank's country classification, as of July 2015.

Low-income countries (gross national income [GNI] per capita of \$1,045 or less): Afghanistan, Cambodia, Nepal.

Lower-middle-income countries (GNI per capita between \$1,046 and \$4,125): Armenia, Bangladesh, Bhutan, Georgia, India, Indonesia, Kiribati, Kyrgyz Republic, Lao People's Democratic Republic, Federated States of Micronesia, Myanmar, Pakistan, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Tajikistan, Timor-Leste, Ukraine, Uzbekistan, Vanuatu, Viet Nam.

Upper-middle-income countries (GNI per capita between \$4,126 and \$12,735): Azerbaijan, People's Republic of China, Fiji, Kazakhstan, Malaysia, Maldives, Marshall Islands, Mongolia, Palau, Thailand, Tonga, Turkmenistan, Tuvalu.

High-income countries (GNI per capita of \$12,736 or more): Cook Islands,* Nauru.*

*Not listed among World Bank countries. Category determined by SDCC consultant based on GNI per capita (as indicated in un.data.org).

Source: World Bank. New Country Classification. <http://blogs.worldbank.org/opendata/new-country-classifications>

Figure A11.1: Comparison of Gross Domestic Product Growth Rate by Income Level (%)

A. Low-Income Countries

B. Lower-Middle-Income Countries **C. High-Income and Upper-Middle-Income Countries**

Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China.

Source: Economic Research and Regional Cooperation Department, Asian Development Bank.

Figure A11.2: Comparison of Per Capita Gross Domestic Product Growth Rate by Income Level (%)

A. Low-Income Countries

B. Lower-Middle-Income Countries

C. High- and Upper-Middle Income Countries

PRC = People's Republic of China.

Source: Economic Research and Regional Cooperation Department, Asian Development Bank.

Figure A11.3: Financial Market Development Indicators

A. Financial Depth

B. Financial Access

C. Financial Efficiency

ARM = Armenia, AZE = Azerbaijan, BAN = Bangladesh, BHU = Bhutan, CAM = Cambodia, PRC = People's Republic of China, FIJ = Fiji, GEO = Georgia, IND = India, INO = Indonesia, KAZ = Kazakhstan, KIR = Kiribati, KGZ = Kyrgyz Republic, LAO = Lao People's Democratic Republic, MAL = Malaysia, MLD = Maldives, RMI = Marshall Islands, FSM = Federated States of Micronesia, MON = Mongolia, MYA = Myanmar, NEP = Nepal, PAK = Pakistan, PNG = Papua New Guinea, PHI = Philippines, SAM = Samoa, SOL = Solomon Islands, SRI = Sri Lanka, TAJ = Tajikistan, THA = Thailand, TIM = Timor-Leste, TON = Tonga, TKM = Turkmenistan, UZB = Uzbekistan, VAN = Vanuatu, VIE = Viet Nam.

Note: Data covers all developing member countries except Afghanistan, the Cook Islands, and Nauru.

Source: Katsiaryna Sviryzdenka. 2016. Introducing a Broad-based Index of Financial Development. Working Paper Series No. 5. International Monetary Fund.

Figure A11.4: Comparison of Finance Sector Development for Selected Developing Member Countries by Income Level (% of GDP)

A. Low-Income Countries

B. Lower-Middle-Income Countries

C. Upper-Middle-Income Countries

PRC = People's Republic of China.

Notes: For deposit taking financial institutions, latest data available for Lao PDR is as of quarter 3 (Q3), 2015, Papua New Guinea is as of 2014. For nonbank financial institutions, latest data available for Bangladesh, People's Republic of China, Nepal, Papua New Guinea, Philippines, and Thailand is as of 2014; Indonesia is as of Q3 2015; and Kazakhstan is as of November 2015. For market capitalization, latest data available for Armenia, Indonesia, Kazakhstan, and Sri Lanka is as of 2012. For total bonds outstanding, India, Indonesia, Pakistan, and Philippine data are based on domestic securities only.

Source: ADB estimates using data available from national sources (accessed through CEIC data, Haver Analytics, websites), World Bank, World Economic Outlook database, and Bank for International Settlements.

Figure A11.5: Finance Soundness Indicators**A. Nonperforming Loans to Total Gross Loans (%)**

Note: 2006 data used for Tajikistan and Uzbekistan; 2011 for Bangladesh and Sri Lanka; and 2014 for Bangladesh, People's Republic of China, Kyrgyz Republic, Tajikistan, Samoa.

B. Regulatory Capital to Risk-Weighted Assets (%)

Note: 2006 data used for Kyrgyz Republic, Tajikistan and Uzbekistan; 2011 for Bangladesh and Sri Lanka; 2012 for Viet Nam and Turkmenistan.

C. Domestic Credit Provided by the Finance Sector (% GDP)

Note: 2006 data used for Afghanistan.

D. Bank Deposits to Gross Domestic Product (%)

PRC = People's Republic of China.

Note: 2012 data used for Timor-Leste.

Source: World Bank, Global Financial Development and World Development Indicators Database (accessed June 2016).

Review of 2011 Financial Sector Operational Plan

The cross-cutting impact of finance on different sectors and economic activities amplifies opportunities for expanding financial inclusion and poverty reduction, which is why the Asian Development Bank's (ADB) 2011 Financial Sector Operational Plan (FSOP) was designed to address challenges ahead. ADB's finance sector operations contributed 11% of total lending portfolio over 2011–2015, about 15% of that in 2015 alone. This review examines the implementation of the 2011 FSOP and looks at the critical role of the finance sector in development in Asia and the Pacific. While this publication affirms that the FSOP remains valid and relevant, it also makes recommendations up to 2020 and provides a platform to launch the FSOP beyond 2020 to ensure its relevance with ADB's road to 2030.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to a large share of the world's poor. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

Finance Sector Group

ASIAN DEVELOPMENT BANK

6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
www.adb.org