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MEMORANDUM

TO : **THE BOARDS OF DIRECTORS**

FROM : **Cecilia AKINTOMIDE**
Secretary General

SUBJECT : **DRAFT FINANCIAL SECTOR DEVELOPMENT POLICY AND STRATEGY 2014-2019 – REVISED** *

Please find attached a **Revised version** of the above-mentioned document. It was discussed by CODE on June 17 and September 30, 2014, in accordance with the guidance and comments received.

Attach:

Cc: **The President**

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AFRICAN DEVELOPMENT BANK GROUP

FINANCE TO ACCELERATE AFRICA'S TRANSFORMATION:

DRAFT FINANCIAL SECTOR DEVELOPMENT POLICY AND STRATEGY 2014-2019

REVISED

OFSD and COSP DEPARTMENTS

October 2014

Acknowledgments

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Acronyms and Abbreviations

AADFI	Association of African Development Finance Institutions
ADB	African Development Bank
ADBF	African Domestic Bond Fund
ADF	African Development Fund
AFMD	African Financial Markets Database
AFMI	African Financial Markets Initiative (AfDB)
ALSF	African Legal Support Facility
AML-CFT	Anti-money laundering and combating the financing of terrorism
ANRC	African Natural Resources Center (AfDB)
BIS	Bank for International Settlements
BOAD	Banque Ouest Africaine de Développement
CSP	Country Strategy Paper
COSP	Strategy & Operational Policies Department (AfDB)
DFI	Development Finance Institution
DFCs	Development Finance Corporations
DFID	Department for International Development (UK)
EIB	European Investment Bank
ECON	Office of the Chief Economist, Vice Presidency (AfDB)
EDRE	Development Research Department (AfDB)
ESTA	The Statistics Department (AfDB)
ESW	Economic and Sector Work
FDI	Foreign Direct Investment
FFMA	Financial Management Department (AfDB)
FRMB	Resource Mobilisation & External Finance Department (AfDB)
FSAP	Financial Sector Assessment Program
FSD	Financial Sector Development
FSDPS	Financial Sector Development Policy and Strategy
FSF	Fragile State Facility (ORFS, AfDB)
FTRY	The Treasury Department (AfDB)
GDP	Gross Domestic Product
GECL	General Counsel & Legal Services (AfDB)
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISP	Institutional Support Program
LIC	Low Income Country

MFI	Microfinance Institution
MFW4A	Making Finance Work for Africa Partnership
MIC	Middle Income Country
MSMEs	Micro, Small and Medium Enterprises
NEPAD	New Partnership for Africa’s Development
NSO	Non Sovereign Operations of the AfDB
ODA	Official Development Assistance
OFSD	Financial Sector Development Department (AfDB)
OITC	Transport & ICT Department (AfDB)
OIVP	Infrastructure, Private Sector, Water & Sanitation and NEPAD, Regional Integration and Trade Operations Vice Presidency (AfDB)
ONEC	Energy, Environment & Climate Change Department (AfDB)
ONRI	Regional Integration Department (AfDB)
OPEV	Operations Evaluation Department; changed to Independent Development Evaluation Department (IDEV)
OPSM	Private Sector and Microfinance Department (AfDB)
ORFS	Fragile States Department (AfDB)
ORQR	Results & Quality Assurance Department (AfDB)
ORVP	Country and Regional Programs and Policy Vice Presidency (AfDB)
OSAN	Agriculture & Agro-Industry Department (AfDB)
OSGE	Governance, Economic/Financial Sector Reform Department (AfDB)
OSHD	Human Development Department (AfDB)
OWAS	Water & Sanitation Department (AfDB)
PBO	Policy-Based Operation
PFI	Private Financial Institution
PPP	Public Private Partnership
PSD	Private Sector Development
RECs	Regional Economic Communities
RISP	Regional Integration Strategy Paper
RMC	Regional Member Country
RRCs	Regional Resource Centres
SASSA	South African Social Security Administration
SEOG	Office of the Special Envoy on Gender, Vice Presidency (AfDB)
SMEs	Small and Medium-Sized Enterprises
TYS	Ten-Year Strategy (AfDB)
USAID	US Agency for International Development

FINANCIAL SECTOR DEVELOPMENT POLICY AND STRATEGY

Executive summary

The financial sector—the lifeblood of the continent's real economy—has had an important role in Africa's recent progress. And it is vital to achieving inclusive growth and the transition to green growth, the two strategic objectives of the Strategy for 2013–2022 of the African Development Bank Group (the Bank Group). But the absence of deep, efficient financial markets constrains economic growth: limited access to finance lowers welfare and hinders the alleviation of poverty and the emergence of a middle class, while implementing monetary policy in a context of shallow markets is costly and inefficient. The aim has to be well-functioning financial systems that mobilize and allocate savings, supply the credit needs of economic agents, and allocate resources more efficiently while reducing intermediation costs.

Despite recent improvements, much more needs to be done to ensure that financial resources reach all sectors of the economy—notably traditionally disadvantaged sectors, such as agricultural businesses, micro, small, and medium enterprises, and women-owned businesses. Achieving this vision will require the Bank Group's Regional Member Countries (RMCs) to pursue an ambitious agenda of financial sector development and reforms ranging across financial sector policies, financial infrastructure, regulatory and supervisory institutions, and a variety of financial institutions in the private and public sectors.

Driving the Bank Group's Financial Sector Development Policy and Strategy 2014–2019 (FSDPS) is a vision of vibrant, innovative, robust and competitive financial systems, both domestic and regional. Under this vision, Africa's financial systems will seek to provide near universal access by 2025 of essential financial services for all—critical for inclusive growth. Those systems should also offer the full range of financial products and services to the economic sectors including agriculture, infrastructure, manufacturing, mining; micro, small, and medium enterprises; and trade. Africa's investment needs are estimated to be over US$200 billion annually. And a huge financing gap should be filled by improvements in the financial sector's ability to mobilize and intermediate finance.

Drawing lessons from the evaluation of the Bank's financial sector interventions[1] and building upon the TYS as well as new dynamics within the business environment of the African financial sector, the Bank Group has formulated a FSDPS, which defines and articulates the approach and specific means for implementing the Policy, on two pillars: one is increasing access to the underserved to the full range of financial services, and the second broadening and deepening Africa's financial systems. Cutting across the two pillars is the need for sound governance of Africa's financial systems. The Strategy foresees a differentiated approach across RMCs based on the stage of development of their financial systems to promote private sector development and regional integration. It also gives special attention to fragile states, gender, food security, and agriculture. Through this Strategy, the Bank Group will foster innovation and promote the scaling up of breakthrough technologies, some pioneered in Africa.
To implement the Strategy, the Bank Group will deploy the full range of its instruments, across sovereign and non-sovereign windows under the One Bank approach. It will be selective in its interventions and will leverage partnerships. The Strategy also foresees a gradual build-up of skills and expertise within the Bank Group, necessary for effective implementation and lasting development impact.

[1] See annex 1

In order to ensure that the strategy is properly reflected in a clear plan of action and that the concomitant budget and staff needs are mobilised, a detailed business plan will be developed alongside the FSDPS in order to articulate the different activities and operations to be undertaken.Introduction

The Ten-Year Strategy for 2013–2022 of the African Development Bank Group (the Bank Group), approved in April 2013, aims to assist the Bank Group's regional member countries (RMCs) to achieve more inclusive growth and a gradual transition to green growth. It identifies five operational priorities: infrastructure development, regional integration, private sector development, governance and accountability, and skills and technology. It also defines three areas of special emphasis: fragile states, agriculture and food security, and gender. The Bank Group's support will contribute to Africa's vision to become a prosperous continent with high-quality growth that creates employment opportunities for all, especially women and youth.

This Financial Sector Development Policy and Strategy (FSDPS) establishes an updated policy framework and a new strategic approach to the Bank Group's work in financial sector development (box 1). It has Bank Group–wide applicability, covers both private and public sector activities, and has been developed through wide internal and external consultations. It is consistent with other high-level corporate documents of the Bank Group, including the 2013 Private Sector Development Strategy, the 2014 Governance Strategic Framework and Action Plan, and the draft Policy on Non-Sovereign Operations (still under development). It will guide all Bank Group interventions in the financial sector at national and regional levels.

Box 1: The Financial Sector

The financial sector encompasses a nation's network of financial institutions and markets as well as the instruments, norms and procedures employed in carrying out financial transactions. It serves three key functions: it mobilizes and allocates savings, supplies the credit needs of investors, and provides efficient payment mechanisms within national economies. A well-functioning financial system that meets the needs of individuals (rural or urban, rich or poor) and enterprises (public or private, micro, small, medium, or large) increases a country's competitiveness. It helps raise domestic savings and allocates resources more efficiently while reducing intermediation costs, thus raising overall economic growth. And it is instrumental in attracting a diversified, sustainable and expanding pattern of external capital flows.

This FSDPS aims to help RMCs improve access to financial services by the underserved and to broaden and deepen the continent's financial systems. It calls on the Bank Group not only to commit to facilitating access to investment and working capital by financial institutions, but also to contribute to developing local capital markets. In parallel, the Bank Group will promote better corporate governance and better risk management of financial institutions, in compliance with international best practices, standards and regulations.

1. Financial systems in Africa: recent developments and key challenges

Africa's 54 financial systems are as diverse in depth, breadth, robustness and complexity as its economies. This section highlights important developments in the financial context and markets and distils several issues for Africa's financial systems. These challenges form the basis of the continent's financial sector development agenda.

a. Global trends and developments

Four fundamental trends shape global financial markets, all with consequences for the RMCs, and in turn, the Bank Group's interventions.

Financial market globalization: The internationalization of financial and capital markets, the emergence of global corporations, the deregulation and opening of domestic markets, the recent advances in technology—all have combined to unleash globalization (and regionalization). As in other regions, these phenomena affect African economies, requiring that they build resilience domestically; similar to what Asian economies did after the Asian financial crisis of 2007–08.

Technology and the rising pace of innovation: The introduction and widespread adoption of technologies such as electronic trading platforms have cut the cost of financial transactions and accelerated the development of new products and services, while boosting economies of scale. Technology has increased access to credit in emerging markets, including mobile-payment systems (box 2) and bond-trading platforms set up by technology firms. However, greater regulatory oversight is required to manage the risk of lending by institutions other than banks.

Box 2: Increasing access to financial services through technology

Kenya—M-Shwari Mobile Banking
Africa has seen a massive growth in cell phone use—to 650 million subscribers in 2012. Low rates of retail bank access and large sums of money transferred as remittances underlie the demand for innovation in financial services. Mobile banking emerged in the early 2000s in Zambia, South Africa, and the Philippines, but found its champion in 2007 with the creation of M-PESA, an SMS-based Kenyan money transfer service managed by Safaricom, the nation's dominant mobile network operator.

M-Shwari, launched in November 2012, is a paperless banking service for M-PESA subscribers, provided by the Commercial Bank of Africa in conjunction with Safaricom. Its two main features are savings with interest rates between 2% to 5%, and access through M-PESA accounts to instantly available microloans in amounts as little as US$1. As at the end of March 2014, M-Shwari had reached an estimated 3.6 million active customers, at least US$542 million in cumulative deposits, and more than US$160 million in loans disbursed since its launch. The 2.7 percent default rate on the total disbursed loans is less than the traditional banking average of 5 percent.

South Africa—Biometric Payment System
In 2012, the South African Social Security Agency (SASSA) introduced a biometric fingerprint identification system to minimize fraud, reduce costs, and extend financial inclusion. Designed by UEPS Technologies, the system provides social grant recipients a SASSA Debit MasterCard that can be used to conduct offline, point-of-sale transactions. Merchants then settle transactions by sending data to a central system, creating a complete audit trail.

The biometric payment system has increased South Africa's banked population and reduced costs for SASSA. Prior to the program's introduction, SASSA spent, on average, US$3.33 per grant recipient to pay beneficiaries; the SASSA Debit MasterCard has cut such costs in half. As part of grant recipients' registration, they open a no-monthly-fee bank account with Grindrod Bank.

The changing role of governments: Whereas the provision of financial services around the world has steadily shifted from government and public institutions to the private sector over the past two decades, that change has been more gradual in Africa. As African countries continue the transition, public financial institutions remain relevant, especially those deploying long-term finance. And the need is even greater for better regulatory and supervisory institutions.

Market demand for greater transparency: Globalized financial markets require greater transparency in national policies and in the corporate governance and operations of individual financial institutions. Allowing for better assessment of risk and borrower creditworthiness, such transparency reduces market collusion. Similarly, globalized financial markets also require concerted action against illicit financial flows and tax avoidance and evasion. Given the continuing convergence of macroeconomic and trade policies and the openness to foreign investment, countries—including those in Africa—compete for global capital resources on the basis of the quality and agility of their domestic institutions.

b. Financial systems in Africa: recent developments

African financial systems improved significantly following the first generation of reforms—liberalizing interest rates and privatizing state-owned financial intermediaries. Coupled with the removal of many barriers to entry and exit in the sector, as well as better regulatory frameworks, and greater transparency and accountability, financial systems across the continent have improved significantly from the crisis situation generally faced by the sector in the 1980's. Much of the malaise was then due to years of highly distortionary interest rate policies and arbitrary state intervention in credit allocation. For some countries over indebtedness had jeopardized the solvency of banks, limiting their ability to source fresh external capital and increasing the cost of trade finance.

More recently, many African countries have begun to establish an enabling environment for long-term finance. The new context is characterized by better governance, greater transparency in public spending, stronger macroeconomic management, better fiscal policy, improved national infrastructure, and fewer barriers to trade and capital flows. Beyond the new technologies in many RMCs (see box 2 above), microfinance institutions are addressing the needs of microenterprises, households and individuals with very limited resources. Indigenous and pan-African banks and investment funds are becoming more efficient and increasingly offering products and services targeted at large and medium-size local firms and investors. The insurance industry is also growing, albeit mainly from a base with few product categories. Stock markets are still small, illiquid, and poorly capitalized (10 percent of GDP in Sub-Saharan Africa), but now have greater potential due to unprecedented private equity activity in Africa as domestic and international corporate institutional investors are investing more cash in African markets.

Many regional economic communities (RECs) are coordinating and harmonizing their financial regulatory and supervisory frameworks to ease capital flows and lower transaction costs. The peer-review mechanism of the New Partnership for Africa's Development (NEPAD) now evaluates progress toward compliance with international banking and financial standards.

The commercial banking sector has also become stronger, with lending (US$600 billion) and customer deposits (US$800 billion) up more than 20 percent in the last 10 years. In the public markets, debt issuance in 2013 hit a record high of US$21 billion, up 66 percent from 2012, with new borrowers entering the market to take advantage of historically low yields and strong investor interest. FDI flows in 2013 also rose (for the third year) to an estimated US$60 billion, making Africa one of the few regions registering year-on-year growth.

c. Key challenges and development agenda

With few exceptions Africa's financial systems are small (measured by the size of the banking system and financial markets relative to GDP) and among the world's least developed. They also tend to be highly fragmented. The range of institutions is narrow, and assets in most low-income African countries are smaller than those held by a single medium-size bank in an advanced economy. Few Africans have access to even basic payment services or savings accounts, and the largest part of the productive sector cannot obtain credit. That being as it may, some of the continent's middle-income countries perform better.

Most national financial systems are constrained by:

- High exposure to economic and socio-political shocks, including crop failures, volatile prices of traded commodities, civil unrest, policy and regulatory uncertainty, all shorten the time horizons of savers and investors and make investment risky and costly;

- The high incidence of informality, by which as much as 55 per cent of Sub-Saharan Africa's GDP and 80 per cent of the labour force is accounted for by the informal sector;

- The lack of documentation and formal contracts in personal, professional, and business transactions restricts access to the formal credit markets by the poor, rural households and micro-entrepreneurs;

- Limited market infrastructure, including that for efficient trading, clearing, and settlement systems; safeguard arrangements and depositories; asset servicing and data provision;

- Gaps in key elements of financial infrastructure and related ecosystem, such as common accounting standards, credit bureaus, functioning systems for payment, securities settlement, and remittances;

- Governance and regulatory deficiencies, including weaknesses in the contractual framework such as such as collateral enforcement, high degree of corruption, risks of expropriation, lack of capacity of the regulatory institutions, and inefficient bureaucracies.

Access to financial services is limited. Only 23 percent of adults in Africa have an account with a formal financial institution, ranging from 7 percent in Central Africa to 42 percent in Southern Africa. In addition, recent estimates show that 4 out 5 women lack access to an account at a formal financial institution compared to about 1 out of 4 men. Many adults use informal methods to save and borrow from friends, family, and informal private lenders. In the majority of RMCs, few micro- and household enterprises rely on financial institutions to support their regular activities. Micro-credit schemes, valuable as they are, cover a small set of the population. One of the biggest challenges in supporting the needs of the traditionally underserved segments of society and in fostering more inclusive financial systems is providing the full range of financial services (box 3).

Box 3: Financial services required by the poor

In most countries the poor require four financial services:

Depository services: A safe, readily accessible, and reliable depository for savings, as a substitute for cash stowed under the mattress, is arguably the most important service all poor people need especially in fragile economies.

Payment and transfer services: Efficient, low-cost, and reliable national, sub regional and international payment and transfer services facilitate the sustained growth of trade and RMC integration in global value chains.

Credit services: The growth of micro, small, and medium enterprises (MSMEs) is stifled by lack of affordably priced financial services—particularly (but not only) long- and medium-term credit, working capital, trade finance letters of credit, and guarantees.

The problem usually cited is the mismatch between the predominantly very short-term financial deposits and the longer term tenor of credit that these enterprises require.

The poor face difficulties getting even short-term credit without documented collateral such as land and housing. Commercial banks do not find it profitable to make and collect small loans. This explains the appeal of innovations, such as micro-credit institutions and borrowers' clubs as well as the promise and potential of more widespread use of mobile banking.

Insurance services: Even small but unpleasant financial surprises can create severe problems for the poor, as few of them have access to formal insurance and must self-insure. Some African countries (such as Ethiopia) are piloting programs that offer insurance against, for example, crop failures, floods, or other natural disasters.

Financial sector performance is a major constraint in the development of the private sector. Of investments by small and medium-size enterprises (SMEs), 84 percent are internally financed or supported by friends and family (compared with 70 percent in other developing regions). Almost half of small businesses report that gaining access to financial services is a major constraint. Only 22 percent of companies hold a loan or line of credit from a financial institution, which is less than developing Asia (31 percent), Latin America (47 percent), and Europe (48 percent).

African traders also face severe difficulties in securing trade finance, and where available, the costs are often prohibitive and the repayment tenors short. There are major challenges in addressing the vast needs of the manufacturing and mining sector, infrastructure (last estimated at about US$100 billion annually), agriculture (estimated at US$100 billion annually), and the growing needs for trade finance and for housing finance to keep pace with urbanization.

Most African bond and equity markets are underdeveloped. They are constrained by the small size of most economies and the lack of a critical mass of local companies that are candidates for public listing or the issuance of rated bonds. In bond markets, documentation, filing, and consultations can lead to delays. Tax regimes also act as a barrier to issuance in some markets, and structure and issuing is a challenge. Governments are the principal issuers in African bond markets, at a 9:1 ratio over corporate bonds. The scale and tenor of government bond issues are vital to the growth of corporate markets, which require a benchmark issuer and a well-developed yield curve.

The high growth rates of a large number of African economies in the past few years have improved investor perceptions and attracted foreign investor interest in African stock markets. At times, the inflows have been quite significant, relative to the size of these markets. This carries its own risks, however, particularly where foreign investors with short-term horizons play a prominent role in the market, and points to the need of striking a healthy balance between local and foreign investor bases.

Developing a local (and regional) institutional investor base is a key priority in developing well-functioning securities markets in Africa and their further deepening should include more appropriate regulation related to local institutional investors.

There is also a growing trend across African countries to have "SME" segments on their local stock markets, as a way of recognizing 'high-growth potential' SMEs, that need to raise finance through capital markets.

The contractual savings industry has not provided enough institutional investors to provide long-term financing. Added to the legal and regulatory barriers, there is limited local fund management expertise in alternative investments not listed on a stock exchange such as private equity, infrastructure funds, SME funds, and agricultural funds. This constrains the growth of pension funds, sovereign wealth funds, and insurance companies.

In light of these challenges, the longer-term policy agenda in Africa should be driven by a shared vision of a regional financial system capable of mobilizing and channelling a much larger share of domestic savings to meet the needs of the productive sector. The region needs to focus on two complementary areas:

- Expanding access to financial services to the underserved, including micro and household enterprises now operating in the informal sector.

- Developing deeper and more robust domestic financial markets and financial institutions, with more diversified products among commercial banks and other financial institutions, larger equity and bond markets, deeper money, commodity and foreign exchange markets, and high-growth SME market segments of stock exchanges, as real-sector markets develop and expand.

A "one-size-fits-all" financial sector agenda will not be appropriate for all RMCs, whose country contexts and financial systems differ. Table 1 offers one typology, with priority agendas by financial system category. Issues of access and improving financial sector governance are relevant in all countries. Capital market development, often part of a standard financial sector development policy and strategy, is relevant to different degrees.

Table 1: Financial system classification and priority agenda

Financial system category	Financial sector characteristics	Priority agenda
Category I	Underdeveloped	Building basic financial institutions, creating sound banking and microfinance, and increasing access of the poor to basic financial services.
Category 2	Basic	Further developing the financial system and financial soundness and adopting international prudential norms, including those for nonbanking segments.
Category 3	Advanced	Further deepening the financial system with a focus on capital markets thereby increasing financing sources and incentivise banks to lend at competitive rates to SMEs; improving financial market infrastructure, and integrating with regional markets.

2. Lessons from the Bank Group Experience

Since issuing its Financial Sector Policy in 2003, the Bank Group has intensified efforts to foster financial sector development in RMCs to ensure sustainable economic growth and poverty reduction. Four departments – ONRI, OSGE, OSHD and OPSM were mandated to extend Bank Group support to RMCs in selected segments of the financial sector, using multiple instruments (annex 1). In assisting RMCs, the Bank Group has learned four main lessons (discussed below), and responded in part with the establishment of OFSD (box 4).

Box 4: Creation of Financial Sector Development Department

The persistence of systemic financing gaps affecting critical sectors and groups across Africa, the number of new financial actors, and the shifting regulatory concerns warrant reconsideration of how the Bank Group is organized to assist RMCs. In light of these changes and the lessons outlined here, Management created the Financial Sector Development Department (OFSD) in October 2013 and tasked it with leading the development of the Bank Group's FSDSP. In line with the new strategy, the newly created department also brings together all relevant FSD initiatives across the Bank under one roof, in order to create a solid platform that provides leadership, coherence and critical mass in this vital area, going forward.

a. Concentrate efforts

Scattered efforts cannot produce concerted and impactful change. For example, the Bank Group's financial sector operations with the highest outstanding loans are regional, mostly lines of credit to regional banks and equity investments in private equity funds with operations in more than one country. In keeping with the TYS strategic objectives, the Bank Group should have an explicit strategy of piloting solutions in different regions and then rolling them out and scaling them up to others to reach the poor. Selectivity will be applied, taking into account the Bank's experiences with its major partners and other donors in areas of comparative advantage such as regional financial integration, regional payment systems, and policy dialogue, (see Annex 3)

b. Develop efficient financial markets

The Bank Group, much like other multi-lateral development banks, recognizes that efficient financial markets and institutions capable of mobilizing domestic savings and allocating scarce capital where returns are highest are a prerequisite for private sector development. And because investment finance provided by the development community supplies only a minute fraction of the capital used by private agents across Africa, it is important for the Bank Group's resources to be channelled in ways that develop national financial systems.

This implies working through and strengthening existing approaches, such as channelling interventions through financial intermediaries where possible and setting interest rates at levels consistent with mobilizing savings and encouraging the return of flight capital—and trying out new approaches, such as strengthening financial infrastructure across the continent.

c. Diversify financial institutions and services

The 2013 review of the Bank Group's NSOs called for support of initiatives to deepen and expand financial and capital markets, especially those encouraging diverse financial institutions and services.

It also encouraged the development of financial instruments to mobilize term finance and leverage technical assistance, cash grants, and other efforts increasing local currency availability to fund private sector projects. To achieve diversification on financial inclusion, a benchmarking exercise undertaken by the Bank against selected key partners called upon the Bank to ratchet up its internal operational processes in order to improve on speed or responsiveness, reliability, predictability, and client engagement.

d. Sharpen Bank Group focus

Finally, the OPEV[2]evaluation of the Bank Group's Microfinance Policy and Strategy 2006, generated additional lessons for the financial sector operations. In the 2003 Financial Sector Policy, multiple departments (OPSM, OSHD, OSAN, and OSGE) were all mandated to implement the microfinance strategy, reducing clarity and ownership. In addition, Bank Group processes—including project approval, procurement, and staff incentives— were not adapted to cater for small microfinance projects (the average size is US$2.4 million). As a consequence, the Bank Group did not play a significant role in macro policy issues, and there were few program innovations, limiting opportunities for replicating and scaling up successes.

The evaluation accordingly underlined learning from past lessons about defining areas of focus, finding an adequate business model, and having in place the necessary staff in addition to leveraging on the MFW4A partnership.

In light of the lessons outlined above, coupled with the diverse needs of RMCs, whose country contexts and financial systems have dramatically evolved, the following section not only builds up on the Financial Sector Policy (2003), but will supersede and replace its provisions by clearly articulating a new trajectory for the future.

3. The Bank Group's Financial Sector Development Policy

This section outlines the Bank Group's updated policy on financial sector development in Africa, including rationale for a new policy, the vision, goals, and objectives in promoting financial sector development.

a. Rationale for a new policy

The TYS provides a new vision of how the Bank will build on its solid achievements to better support Africa's transformation at a time of great change and promise. It calls on the Bank Group to strengthen the financial sector by stimulating the lending to MSMEs, help develop local capital markets, promote better governance and risk management of financial institutions, promote the adoption and implementation of financial standards and regulations and support initiatives that enhance financial inclusion. In light of the importance of the financial sector, the PSD Strategy (2013) recommended to undertake a comprehensive review of the Bank Group approach to the financial sector, through the preparation of a new FSDPS that would replace the 2003 Financial Sector Policy.

[2] The name OPEV (Operations Evaluation Department) was changed is now Independent Development Evaluation Department (IDEV)

Business environment- The environment in which African financial systems operate has deeply changed over the past years. The recent financial crisis has led to a major transformation of the global financial system and to regulatory reform discussions among developed and emerging countries, with repercussions on financial sector regulation in Africa. The environment for financial firms remains difficult and progress has not been as fast as had been hoped. The combination of improvements and unfulfilled potential warrant a new look at the role the Bank Group should play.

Current state of knowledge- The set of information and experiences is larger. The Bank, other IFIs and bilateral donors have recently carried out a number of analytical works on the financial sector in Africa. Through the analysis of richer and more detailed set of data available, Africa can learn from the rest of the World and broadly capture successfully efforts by some African countries to increase reach of its financial systems.

Emergence of new actors and paradigm shift- The advent of modern technology and other innovations have successfully enabled a handful of pioneers to provide banking services to a far wider income customer base than ever before and represents a paradigm shift where the barriers of financial services are continuously being disturbed. Technology has changed how commercial banks operate and also who is involved, such as telecom companies and internet-based providers. Equipping regulators to work in a setting of rapid and continual business model change is a major challenge.

b. Vision

The Bank envisions a financial sector that is vibrant, innovative, robust, and competitive both nationally and regionally. Modern financial systems will steadily expand their coverage, approaching near universal access by 2025, providing essential financial services and products (deposit, payments, credit, and insurance), and offering a full range of financial products and services for the continent's productive sector. Likewise, Africa's financial systems will aim to mobilize enough domestic and foreign savings to meet the investment needs of Africa's structural transformation and growth. And it will efficiently allocate those resources at stable and competitive interest rates and rates of return, while meeting national and international prudential norms and standards.

The commitment, under the FSDPS, to promote robust financial systems in a competitive market, both domestically and regionally, is also consistent with the goals and objectives of the Bank's TYS to put finance at the service of the productive sectors, engineer financial inclusion, and strengthen the capacity to finance Africa's transition to green growth (figure 1).

c. Objectives

In support of its vision for Africa's financial sector, the Bank Group, working with other key development partners, will support its RMCs and RECs in meeting three mutually reinforcing objectives:

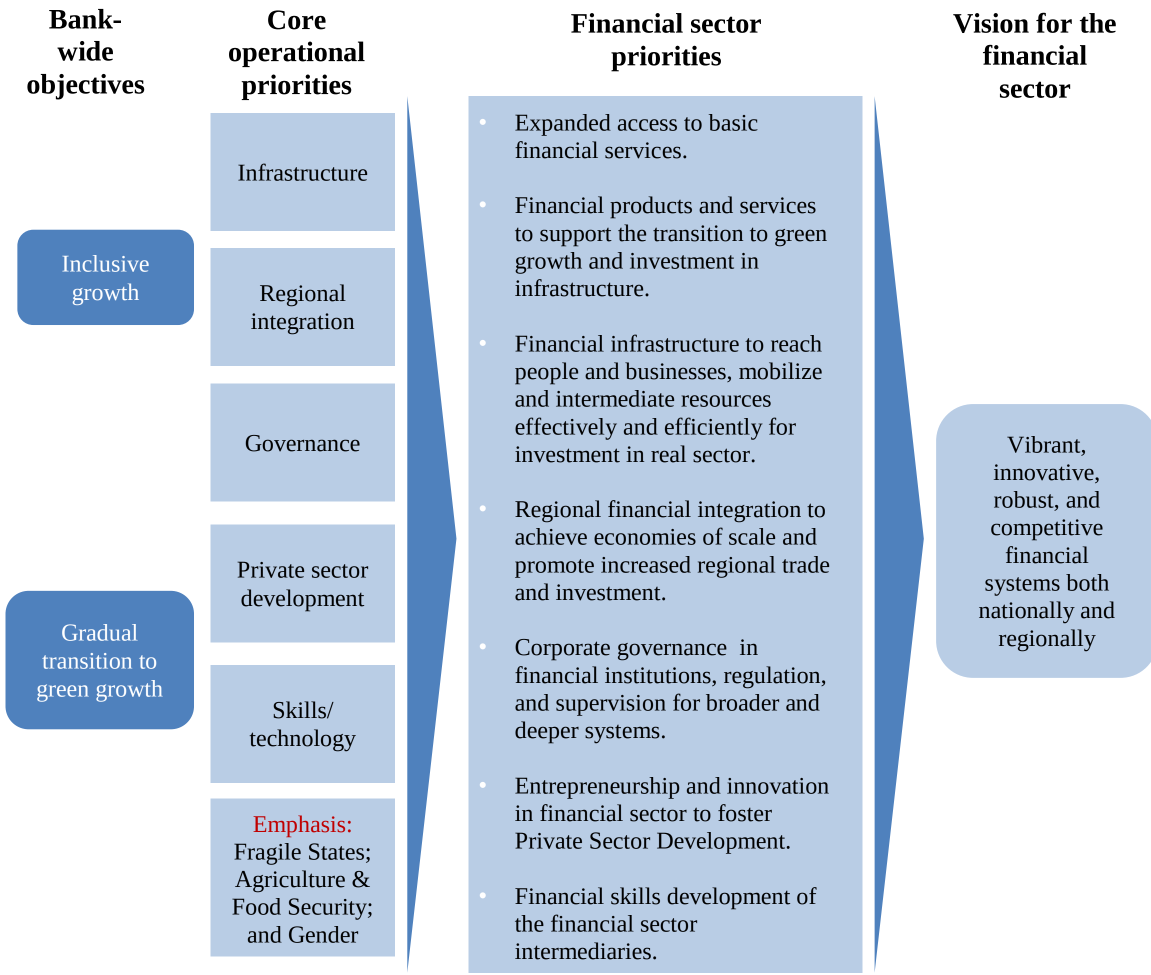
- Increasing access to a range of quality, reliable, and affordable financial services geared to the needs of all segments of society, paying particular attention to reaching the traditionally underserved (including women and youth) through the most effective approaches, including innovations consistent with the requirements of financial stability.

- Deepening financial markets through sound financial sector policies, laws, and regulatory frameworks that provide a conducive environment for a diverse range of financial institutions that can provide a wide range of products and services (leasing, factoring, insurance) and the development of diverse financial instruments (credit lines, bonds, equities, warrants) that can mobilize term finance.

- Safeguarding the stability of Africa's financial system through strengthening the monitoring and supervision of financial institutions and capacities to ensure compliance with national and regional regulations and international financial standards, e.g. AML-CFT frameworks.

Dedicated implementation of sound financial sector policies, laws, and regulatory systems by RMCs individually or jointly is crucial in anchoring the stability of the financial sector and building mutual trust among financial institutions in their business and systemic interactions. Also crucial is building public confidence and trust in the viability and fiduciary integrity of individual financial institutions—encouraging the general public and institutions to rely more on the domestic financial institutions to manage their short, medium, and long-term savings and investments.

Figure 1: From the Long-Term Strategy to Financial Sector Vision



d. Guiding principles

To assist RMCs and RECs in achieving these objectives, the Bank Group will be guided by five principles:

Principle 1 – Ownership. In its interventions for supporting financial sector development, the Bank Group will promote ownership of the financial sector development agenda by RMCs, RECs, and other relevant stakeholders. Assistance will be aligned to country and REC strategic priorities. Since individual countries have specific needs, linked to their level of development and institutional history, the Bank Group will tailor its approaches to the specific requirements of country financial systems. All FSD programmes will be developed on a demand driven basis to ensure full ownership by the respective RMCs.

Principle 2 – Selectivity. Taking into account that other institutions, such as the IMF, the World Bank, and the Bank for International Settlements have been widely intervening in financial sector development, the Bank Group will be selective in its support, focusing on its comparative advantages as reflected by its track record and internal capacity, and on areas where it expects to contribute to development outcomes most cost-effectively.

Guided by the Bank's Delegation of Authority Matrix (DAM), and working closely with field offices and regional resource centres (RRCs), strict criteria will be used in selecting FSD projects that the Bank will support.

Principle 3 - Additionality. In its operations in support of financial sector development in RMCs, the Bank Group will ensure additionality. It will evaluate the specific impact of its operations, as well as their long-term sustainability, and ensure 'best value for money'. An important source of additionality will be induced by the holistic approach of promoting financial sector development through both sovereign and non-sovereign operations. The Bank Group will leverage the potential benefits of joint engagements with developing partners, particularly the Bretton Woods institutions.

Principle 4 – Reinforcement of markets. Competition is critical to achieving the financial innovation that Africa requires to deepen and broaden its financial systems. The Bank Group will foster the development of domestic and regional financial systems to help them assume a central role in the intermediation of finance for private-sector-led development. In line with this principle, it will promote competition by improving the enabling environment, building wholesale delivery capacity in local intermediaries, channelling FSD support and credit through existing local financial systems, developing appropriate products, such as local currency financing, and supporting regional financial integration.
The Bank will ensure compliance with the requirements of transparency and will conduct the selection process of partner corporations in a way that doesn't distort the competitive nature of the market. In addition, the Bank will ensure that its interventions are conducted within a robust operational framework which effectively channels the funds to their intended beneficiaries.

Principle 5 – Financial integrity. The Bank Group will maintain high standards of operational performance and financial prudence consistent with its mandate as a development finance institution—in line with its Risk Management Framework approved by the Boards of Directors of the Bank Group, and as stipulated in Article 17 (e) of the *Agreement Establishing the African Development Bank.*

e. Activities, clients, and partners that the Bank Group will support

In line with the guiding principles, under this FSDPS, the Bank Group will provide assistance to RMCs using suitable combinations of resources drawn as appropriate from its different financing windows. The Bank's support will also target areas of existing comparative advantage and those in which there is huge potential to build credibility and improve brand positioning. Proven focus areas such as regional financial integration, financial sector reform, and convening power for policy dialogue will be prioritised (see Annex 3).

Assistance will be provided to RMC governments, RECs, or pertinent public-sector institutions when the purpose is to support financial sector policies, legal or regulatory reforms, or institution building and strengthening to achieve one or more of the objectives outlined above. The processing and implementation of such operations will be in line with the Bank Group's *Policy on Programme-Based Operations* (March 2012) [3].

[3] ADB/BD/WP/2011/68/Rev.3/Approved - ADB/BD/WP/2011/38/Rev.3/Approved.

When the objective is to directly strengthen capacity of financial institutions to deliver better and more reliable financial services and products to an expanding clientele, the Bank Group will focus on both private financial institutions (PFIs) and public-sector financial institutions. This will include development finance corporations (DFCs, also called DFIs) that are majority-owned by the state, RECs, or local governments, provided that they have a viable balance sheet, sound corporate governance practices, are under the financial supervision of the national/regional Central Bank and have been granted statutory autonomy to manage their operations and finances. State-owned institutions must also have a legal personality and not be protected by exemptions and immunities that are not provided to comparable private financial institutions.

Bank Group support will normally be provided to institutions that meet these criteria with or without a cover by sovereign guarantees, subject to fulfilment of Bank's risk management framework requirements, and in line with Principle 4 – Reinforcement of markets. The processing and implementation of those Bank Group operations in support of, or in partnership with, PFIs, DFCs/DFIs, and other eligible public-sector owned financial institutions will be guided by the Bank Group's draft *Policy on Non-sovereign Operations* of 2014[4].

f. Activities, clients, and partners that the Bank Group will not support

Also arising from the guiding principles, and in line with specific limits set by the respective operations policies for the Bank Group's public-sector and private-sector operations as indicated above, there are particular activities or clients that the Bank Group will not support, or partnerships in which the Bank Group may not engage. Among operations the Bank Group will not support are:

- Operations to which RMC governments have expressed objections, or those that the Bank Group assesses to be in potential violation of its integrity and fiduciary safeguards.

- Financial institutions under investigation or subject to penalties for failing to meet international standards on Anti-Money Laundering or Combating the Financing of Terrorism in line with the Bank Group's policies and strategies5 and its Integrity Due Diligence Policy and Guidelines[6].

- Financial institutions that may channel Bank Group financial resources to production or trade in any product or activity deemed illegal under host country laws or regulations or international conventions and agreements including discrimination based on race, gender, nationality, political grounds, and the like.

- Other financial sector–related activities included in the negative list of the Bank Group's Integrated Safeguards System Policy statement and operational guidelines and Private Sector Development Policy.

4 ADB/BD/WP/2014/76/ - ADB/BD/WP/2014/48/. [Under review by CODE.]

5 "Strategy for the Prevention of Money Laundering and Terrorism Financing in Africa" (ADB/BD/ WP/2007/70 and ADF/BD/WP/2007/46); July 2007; and "Guidelines for Preventing and Combating Corruption and Fraud in Bank Group Operations" (ADB/ BD/WP/2003/148/Rev.2/Approved-ADF/BD/WP/2003/185/Rev.2/Approved); March 2004. These guidelines have largely been superseded by other agreements, policies and guidelines, and work is under way to replace them with updated policy instruments.

6 "Integrity Due-Diligence Policy for Non-Sovereign Guaranteed Operations" (ADB/BD/WP/2014/96 - ADB/BD/WP/2014/94), and Guidelines for its implementation are in the process of being finalized.

g. Policy Implementation

Upon approval by the Board, these provisions will supersede and replace those provided in the Bank Group's *Financial Sector Policy* (ADB/BD/WP/2002/49/Rev.2-ADB/BD/WP/2002/55/Rev.2) approved by the Boards of Directors on September 10, 2003.

The new Policy will be implemented through a financial sector development strategy and business plan. The Strategy will define and articulate the approach and specific means for providing effective support to RMC authorities, RECs, and financial institutions in Africa. In implementation of the FSDPS, the Bank Group will employ the full range of sovereign and non-sovereign financing instruments at its disposal, in conformity with appropriate operational policies, guidelines, processes, and procedures of the Bank Group.

4. Bank Group's Financial Sector Development Strategy 2014-2019

This section summarizes the Financial Sector Development Strategy for 2014–2019, which defines and articulates the approach and specific means for implementing the Financial Sector Development Policy.

a. Bank Group positioning

The Strategy involves clear choices about what the Bank Group will and will not do, areas of comparative advantage, and is built around two pillars for selective Bank Group support. One is increasing access to financial services for Africa's traditionally underserved segments. Second is broadening and deepening Africa's financial systems. Both these pillars are underpinned by a cross-cutting theme of financial stability and governance (figure 2).

The pillars reflect a critical step in defining the Bank Group's strategic positioning—how it will compete and effectively serve its RMCs in the financial sector while meeting the various expectations of its key stakeholders, notably its shareholders. At the core of the Strategy is to be the 'partner of choice' among all development partners of the RMCs. In essence, the selection of its areas of interventions aims at attracting and retaining the various clients of the Bank Group in its RMCs. As outlined in the TYS, this Strategy aims to place the Bank Group as the foremost catalyst and convener in the operational areas of the two pillars. The Bank Group also seeks to be a credible knowledge broker, trusted advisor, and key voice.

Figure 2: Schematic summary of the Bank Group's Financial Development Policy and Strategy

VISION

Vibrant, innovative, robust, and competitive financial systems at both domestic and regional levels

OBJECTIVE

To contribute to increasing access to finance, deepening Africa's financial institutions and markets at RMC and regional level while supporting financial stability

	PILLAR I Increasing access to financial services for the underserved	PILLAR II Broadening and deepening Africa's financial systems
EXPECTED OUTCOMES	• Near universal access to basic financial services • Greater coverage of the informal sector • Increased access to financial resources by women • Branchless banking and digital platforms • Innovative products and services for previously underserved sectors of the economy, such as Islamic Finance • Payment systems to support Branchless banking & digital platforms • Enhanced skills development (including women entrepreneurs and the youth)	• Higher savings and investment levels (including for infrastructure) • Increased supply of long-term finance • Innovation in financial services and products • Lower intermediation costs • Efficient mobilization and flow of remittances, including related products • Strengthened credit unions, savings banks, post offices, etc. • More competitive and resilient national and regional financial systems • Deeper national and regional capital markets • Better financial infrastructure at national and regional levels

FINANCIAL STABILITY AND GOVERNANCE

- Improved financial sector policies
- Stronger financial sector regulatory and supervisory frameworks which ensure compliance with national and regional regulations and international best practice
- Enhanced capacity of financial institutions and regulatory and supervisory authorities
- Africa-wide forum of financial sector policymakers, regulators, and supervisors

ACTIVITIES	• Provide liquidity through liquidity facilities to financial service providers, mobile banking providers or to smaller, less formal organizations such as microfinance banks • Support MFIs in deploying innovative and commercially viable business models; • Enhance consolidation in microfinance industry • Finance payments system for mobile banking, including payments by government • Invest in incubators or funds that focus on inclusive finance • Provide challenge (innovation) grants to commercial entities to expand agent networks • Assist in scaling up financial innovations • Partner with local providers for financial skills development	• Strengthening DFIs through knowledge, finance, capacity building, and coordination • Enhanced dialogue with apex bodies and initiatives • Facilitate trade finance and related infrastructure (set up trade finance default register and traders' database) • Incubate innovations in financial sector including in addressing the needs and expectations of remitters • Provide advisory services in capital markets and identify investment opportunities with FIs • Develop financial products (including equity funds) to support investment in infrastructure • Invest in capital market services companies and commodity exchanges • Lead structured finance and transactions to deepen sub components of capital markets • Lead investment in local currency denominated, sovereign and sovereign guaranteed sub-national bonds including infrastructure bonds • Lead projects in development of local currency bonds yield curves
INSTRUMENTS	• Economic and sector work (ESW) • Policy dialogue/advice • Policy-based operations (PBOs) • Technical assistance • Fee-based advisory services • Institutional support programs (ISPs)	• Loans/lines of credit • Trade finance • Grants • Guarantees: political, credit, and first loss • Equity and related instruments • Agency lines

b. Pillar I: Increasing access to financial services for the underserved

The Bank Group will support RMCs in their aim for near-universal access of essential financial services. This will require an ambitious ramping up of its activities in the financial sector, distinguishing it from other development partners. This will also be an integral part of the Bank Group's overall efforts to accelerate inclusive growth and thus tackle a fundamental weakness in the region—disparities and inequalities. The main beneficiaries will be the poor economic actors from the informal sector (including household enterprises and others) not yet served by the formal financial system. Almost 70 percent of Africans including MSMEs would be potential target beneficiaries.

The Bank Group's programs and projects will facilitate the unbanked populations' access to basic financial services at a lower cost, while achieving acceptable financial security and safeguarding financial stability. This includes providing all basic financial services required by the poor: depository services, payment services, credit facilities, and insurance (box 3).

Innovative solutions adopting the latest technological developments and tailored to country conditions will be critical for RMCs. The Bank Group will work with RMCs to implement branchless banking (mobile banking and agent networks), encourage client identification systems using biometric data (fingerprinting, iris scans), and foster cash-to-electronic transactions in government-to-person payments. It will also support commercial banks in implementing innovative business models to service the mass retail markets. It will seek out partner banks and other institutions that have demonstrated a commitment to financial inclusion and have a significant track record.

Other Bank Group activities will include:

- Working with retail banks and MFIs in deploying innovative and commercially viable business models such as credit scoring and cash-flow lending to boost lending to the landless and to MSMEs.

- Supporting incubators or funds that focus on increased financial access (including women and the youth).

- Developing financial infrastructure by investing in or lending to information systems, and systems to address access.

- Supporting public-private initiatives to bring down transaction costs for consumers by ensuring that e-money platforms are interoperable (as for card systems and mobile money).

- Facilitating regional platforms —including banks, retail chains, and mobile network operators—to undertake needed analytical work, legal research, and market studies and to exchange views, disseminate good practices, and improve coordination.

c. Pillar II: Broadening and deepening Africa's financial systems

The goal under this second pillar is to deepen and broaden the financial system so that it meets the evolving needs of the real economy in RMCs.

Financial systems should provide a full range of financial products and services—all to promote more robust economic growth by facilitating higher savings rates and a more efficient allocation of resources.

The basic elements for successful deepening of capital markets are issuers with long term financing needs, investors with a need for interest-bearing, long-dated securities, intermediaries, financial infrastructure, and a regulatory regime to support market operations. An efficient market benefits from interactions among these elements, allowing it to progress to a sophisticated financial system.

The Bank Group will adopt a broad approach to help RMCs and financial institutions increase the availability and affordability of financial services. Special attention will be given to long-term finance necessary to support investments in capital goods in the formal sector and in infrastructure, as well as working capital and trade finance needs of the business sector.

Developing high-quality African banks, with international systems and practices, is vital for the continent's economies to build sources of domestic growth. Assisting financial institutions successful in their domestic market to become regional or pan-African players will speed up and deepen the economic integration and trading relationships between countries. It will also help other businesses to grow beyond their borders. Special attention will be given to remittances as a means to promote cross-border banking. The Bank will engage in partnerships that will seek to provide innovative products to capture and reduce the cost of remittances through MFIs, cooperatives and other institutions.

The Bank Group's objectives when working through financial intermediaries are four-fold: to support financial inclusion and to increase financing of SMEs; to build regional and national financial intermediaries' capabilities to mobilize needed resources to finance long-term investments in the infrastructure sectors for economic transformation; and to support intra- and inter-regional trade and investment. In order to address the IDEV 2013 recommendations on NSOs regarding the need for better client reporting data and monitoring of financing through intermediaries to SMEs, the Bank Group is rolling out guidance materials for originating and supervising financial intermediary transactions focusing on defining and measuring intermediary performance indicators based on comparators' best practices.

The Bank Group will develop its relationship from a financier to a partnership-oriented relationship. As confidence in financial partners builds, it will evolve its product offering to include agency lines, equity and equity-like instruments, and technical assistance to address persistent financing gaps, relying on partner institutions to carry out due diligence and to manage investments. It will extend lines of credit to creditworthy financial intermediaries that explicitly target SMEs that have the potential for significantly strong impact on job creation and women economic empowerment.

Beneficiaries of Bank Group support will be required to develop and implement policies that encourage prudent lending to companies that provide stable employment for women and youth, as well as to smaller women-owned enterprises. Where feasible, the Bank Group will support the entry of commercial banks and other financial institutions to provide such products and services.

As appropriate, its lines of credit operations will include capacity building and business development services for targeted SMEs, embedding rigorous evaluations to compare the cost-effectiveness of its alternative approaches.

For the transition to green growth, the Bank Group will support clients in implementing policies consistent with its environmental guidelines, with a focus on climate change, sustainable use of natural resources, and their optimization through efficient technologies. It will also facilitate investments that support renewable energy and technology adaptation, including the mobilization of concessional funding to enhance project bankability, while mitigating potential distortionary effects.

The Bank Group will also assist in developing financial products and services such as financial leasing, factoring and forfaiting to expand the range of financial products offered by financial institutions in Africa toward filling the SME credit gap – an important priority. These financing techniques, with the supporting regulatory framework, could better serve SMEs that lack adequate collateral and established credit history – and would mitigate the risk of loan default.

Through its non-sovereign operations, the Bank has provided support to real estate markets in Africa. A major shareholder of Shelter-Afrique, it has extended credit lines to ease mortgage finance. It will assist RMCs to develop mortgage liquidity facilities accessible to all financial institutions, including through securitization, and support for real estate investment trusts. The strategies to expand capital sources at domestic and regional levels will target pension and insurance funds and other institutional investors to supply the needed long-term funds to the productive sectors, thus addressing maturity, foreign exchange, and structural mismatches of the banking system.

In addition to scaling up trade finance operations through liquidity support, the Bank will support technical assistance programmes to enable SMEs access trade finance products; as well as implement capacity-building initiatives to address the needs of African financial institutions (especially DFIs) to better serve the trade finance needs of SMEs in their respective markets.

The Bank Group will focus on transactions that will serve to deepen the various components of the capital markets through working with regulators, large commercial banks, and pension and insurance funds around a specific financing or investment. This deepening will create opportunities for banks to invest alongside funds/institutions in infrastructure projects or agriculture, as has been successful in South Africa and Latin America. Vehicles are needed that enable pension and insurance companies to diversify their holdings beyond listed companies' equity and government bonds in their own countries. By pooling pension and insurance funds in regional or pan-African vehicles, sufficient diversification could be obtained to prudently invest in such transformational investments as private equity, venture funds, and asset-backed securities.

As domestic capital markets develop and there are more instruments to rate, it will be more attractive and cost-effective for rating agencies to operate in Africa. The Bank Group will work with RMCs in establishing local rating agencies that help broaden coverage of the local markets and build a rating culture among institutional investors. The Bank Group will also support the establishment of regional capital markets.

RMCs will be encouraged to adopt a regional approach to ease access to the regional capital markets, which will allow for greater cross-border access to investors and issuers, and help broaden the investor base and product range. Greater liquidity, scale, and capacity will put Africa in a position to integrate with global market.

The Bank Group's presence as a local currency issuer is important. The African Domestic Bond Index of the African Financial Markets Initiative (box 5) will provide a knowledge dissemination platform to promote bond markets development, and market internal Bank expertise in debt markets across the continent. This initiative will be bolstered by the Bank Group's research on capital markets, enhancing its reputation as a trusted advisor. The Bank Group will also invest in equity or subordinated debt**,** leading investments in capital market service companies or exchanges, especially those with regional or pan-African reach and private participation.

Other significant national and regional activities will include:

- Investing in equity or lending for securities market infrastructure for clearing and settlement systems.

- Nurturing and scaling up existing initiatives, such as a dedicated SME program, the African Guarantee Fund, African Trade Insurance, and the Afreximbank Factoring Initiative, through investment and complementary interventions in the business-enabling environment.

- Investing (equity/debt/grants) in clearinghouses for warehouse receipt systems, including supporting efforts to develop commodity exchanges in recognition of special emphasis on agriculture and food security through FSD.

- Strengthening the capacity and resources of financial institutions in the region, such as clearing houses or commercial banks that are members of the clearing house, regional securities exchanges, and central depository and settlement systems and their members.

- Supporting the development of new financial products and services, such as Islamic Financial Products, particularly Sukuk, which seek to promote inclusive growth, risk-sharing and social justice, as a potential method of additional resource mobilization for Africa. Other new products include forfaiting, leasing and factoring. The Bank Group will as far as possible leverage institutions such as the International Islamic Liquidity Management Corporation, African Leasing Facility managed by the IFC and the African Guarantee Fund.

d. Cross-cutting theme: financial stability and governance

Supporting financial stability and promoting financial governance cut across the Bank Group's proposed interventions (see figure 2). Stability and resilience of financial systems are critical to ensuring a continuous flow of resources to support economic growth and to preventing crises and capital-flow volatility. Increasing access to financial services and improving outreach, by offering new products and services as well as deepening the financial markets, carry additional risks that need to be mitigated through improved governance of the financial system. Despite progress under current reforms, new risks have emerged linked to new products and the increasing globalization of international markets. The policy, legal, and regulatory framework—as well as the supervisory capacity—should match the pace of change and financial growth.

The Bank Group's non-sovereign operations portfolio and pipeline in particular are heavily exposed to the financial sector.

The Bank Group will lend its support to regulatory and supervisory reforms associated with the operational priorities identified under both pillars. Interventions will include the support of the adoption of the International Financial Reporting Standards in RMCs. The Bank Group will also support RMCs' alignment of policy, legal, and regulatory frameworks with the principles for securities regulation and supervision of the International Organization of Securities Commissions, including complying with AML-CFT principles.

It will give priority to improving the capacities of regulatory and supervisory bodies (including central banks, tax authorities, pension regulators, capital market authorities, insurance regulators) to monitor, develop, and implement regulatory guidance.

Other Bank Group activities will include:

- Creating an advisory practice in capital markets to provide advice and/or technical assistance on policy, regulatory, and supervisory issues using an appropriate and sustainable business model (on a cost-recovery or fee-basis where feasible).

- Strengthening DFIs through knowledge, finance, capacity building, and coordination; as well as supporting the restructuring of public banks and other public financial institutions to help them become more viable and efficient.

- Developing financial ecosystems by investing in or lending to support systems (such as the judicial system, land registries, collateral registers & managers, credit registers and bureaus, and land titling).

- Creating a trade finance default register and an African traders' database to reduce the information asymmetry between importers, exporters, and financial institutions at national, regional and international levels.

- Supporting financial infrastructure such as retail payment systems (at national and regional levels), automated clearing houses, and allowing non-bank financial institutions to transact.

- Promoting corporate governance international best practises, compliance with international accounting standards, and credible systems of enforcement (for equity-market development).

- Mobilizing resources from the African diaspora to support financial stability and promote economic development.

e. Bank Group instruments

The Bank Group will deploy its full array of instruments[7] to respond to the diversity of the region's financial systems.

[7] Including loans, lines of credit, agency lines, equity and quasi-equity participation, trade finance, and partial risk guarantees (political, credit, and first loss) - See figure 2 for comprehensive list of instruments.

The exact blend will vary by country and over time depending on the objectives of the Bank Group's strategy for the country, the size and depth of the country's financial system, the quality and needs of local institutions (beneficiaries), and the objectives and design of Bank Group operations. In support of its financial sector development interventions, the Bank Group will emphasize knowledge generation and dissemination, as well as policy dialogue advice and technical assistance to RMC governments.

Box 5: Bank Group role in assisting countries to improve financial sector data

AFMI is part of the capacity building program initiated by the Bank Group for African domestic financial markets. As part of the AFMI project to provide reliable, up-to-date and comprehensive data on financial markets, the Statistics Department set up the African Financial Markets Database. The aim is to improve the availability and transparency of data on African bond markets, reconcile and standardize data produced by various institutions using different concepts and methods, and ensure the sustainability of the development of statistics on the bond markets in Africa.

The database was designed on the basis of data provided by African central banks. More than 30 liaison officers have been designated in RMCs to regularly submit data to the Bank Group. The data are processed, analysed, and then disseminated through the AFMI Web Portal. The database currently includes data on the primary bond market for 2000–13. The portal also provides access to macroeconomic and treasury data. The Bank Group is currently working with central banks on facilitating data exchange and sharing over open data platforms. Staff in central banks will require training on collecting the relevant data using standard concepts and definitions and submitting the data over open data platforms. These data will be supplemented with data from household surveys to better understand household and corporate behaviour and needs.

5. Implementation

a. Operational Approach

In light of the vast FSD agenda, OFSD will work with other departments and organizational units to deliver on the ambitious work program within the framework of the One Bank Approach. The agenda will need to be prioritized and sequenced to be commensurate with the Bank Group's financial and human resources. To ensure that the financial sector receives due attention in all RMCs, constraints specific to the country and region will be identified under the Country Strategy Papers and Regional Integration Strategy Papers. The economic and sector work conducted as part of the preparation process will include an in-depth analysis of the financial system. The strategic role played by field offices and RRCs will be leveraged in the identification and appraisal of all FSD operations in RMCs[8].

As a next step, OFSD is preparing a detailed business plan. This will link the work plan and lending and investing levels to the strategy pillars grounded in an analysis of demand in the identified priority areas at both country and regional levels. It will cover a rolling three-year work program for financial sector activities to be carried out by OFSD and other units. The plan will also cover the required mix and location of skills, the organization of these skills, and the results measurement framework (discussed below). It will also address the budgetary resources to deliver the agreed work program.

[8] see annex 2 for the overall implementation arrangements of the FSDPS

b. Mix and location of skills

The financial strategy lays out a bold and ambitious agenda for the Bank Group. Delivering on this agenda will require a wide range of financial skills, some redeployed from other units, supplemented by retraining. Specific attention will be paid to fill the identified skill gaps in line with the build-up of the OFSD work program.

Decentralization: As indicated above, the financial sector is increasingly a global business, and there is a high premium on global and, in Africa, regional knowledge. Implementing the FSDPS will consider the need for specialization, proactive deal origination, regional networking, and identification of target sponsors. Portfolio management will require more active monitoring of investments, identifying problem projects at an earlier stage, undertaking scheduled supervision, and monitoring work and general business development. The location of OFSD staff will gradually build up in each of the RRCs to ensure effective support to financial sector development on the continent.

c. Organization

The FSDPS articulated in this paper is the strategy for the Bank Group. Previously, four departments were mandated to extend financial sector support: ONRI for regional financial integration, OSHD for Micro-finance Capacity Building and Remittances, OSGE for governance and regulation of the sector, and OPSM for supporting a broad range of financial institutions, including MFIs and intermediaries. The bulk of these activities will now be led by OFSD, which will lead the strategy implementation process.

The FSDPS will be implemented through a One Bank Approach—to promote financial sector development through both sovereign and non-sovereign operations. This has proven to be a challenge at other multilateral development banks. The location of OFSD within OIVP is intended to foster interdepartmental collaboration, and Key Performance Indicators will be considered to facilitate this approach.

d. Partnerships

In order to maximize the development impact in RMCs, the Bank will prioritise value adding strategic partnerships and avoid duplication of effort in its FSD operations. To that end, the Bank Group's expansion of activities in the financial sector will take account of the existing activities of other development partners. In financial systems governance, large advisory and lending activities, financial sector assessments, Article IV monitoring and the related technical assistance, the Bank will partner with organisations such as the World Bank, IFC and the IMF, who already play an active role in these areas (see annex 3).

Without restricting itself on future collaboration with other partners in the area of financial inclusion, the Bank will also develop strategic relationships with organisations such as the Bill & Melinda Gates Foundation, MasterCard Foundation, UN Secretary General's Special Advocate for Inclusive Finance for Development, GIZ, Better than Cash Alliance, CGAP and the Alliance for Financial Inclusion. In the area of remittances, the Bank will leverage the Agence Française de Développement (AFD) and the inter-American development bank, whilst partnerships with other organisations such as the UNDP & ILO will be pursued in the area of gender and financial literacy.

The Bank Group will also strengthen its partnership with bilateral agencies including those that work with the private sector and focus on activities where it can best add value. It will seek to develop more effective partnerships with other regional multilateral development banks (such as the Asian Development Bank) to help promote best practices and facilitate the transfer of knowledge from developed to developing countries as well as among developing countries in different regions. To strengthen the supervisory capacity of central banks in RMCs, the Bank will leverage the MFW4A partnership as a platform to mobilize available competencies and resources. It will also seek synergies by strengthening partnerships with sub-regional development financial institutions[9] such as PTA Bank, ATI, BOAD, Afreximbank and EADB as they will be key partners in implementing the strategy.

e. Fostering of innovation

In its work in the financial sector, the Bank Group will look for innovative solutions and help to scale them up. Several innovative approaches are already being applied, and recent technological breakthroughs now allow basic financial services to be provided economically even to the smallest customers in remote locations. Investments in innovation will be paired with rigorous evaluations that provide evidence of relative cost-effectiveness and the ability to scale.

As Africa's premier development institution, the Bank Group is well placed to promote such innovations. In particular, it will attempt to identify solutions that can help provide near-universal access of basic financial services at low cost, help reduce the costs of transferring remittances, help small businesses operating in the informal sector (including those run by women or businesses in agriculture), and find technological solutions to providing essential financial services to residents and refugees living in fragile situations. The Bank Group will look for innovative approaches to strengthen its support across agricultural value chains, including innovative products such as crop insurance schemes to mitigate risk and create conditions for better access of farmers to financial resources. Public–private partnerships or co-investing with other development partners may be especially pertinent in such endeavours.

f. Financing of the Financial Sector Development Strategy

Projects and programs identified for financing will be funded from the ADB window or ADF Performance-Based Allocation for eligible countries as well as the regional and fragile state envelopes of the ADF. The Bank Group will endeavour to make optimal use of existing trust funds to support, for example, technical assistance and capacity building. In addition, the Bank Group aims to explore mobilizing resources from new sources of financing, including leveraging resources from other financiers, both domestic & international. Most important, increased lending will possibly will be an additional source of revenues to the Bank Group and more than cover the budgetary allocations to OFSD.

g. Results Measurement Framework

Annex 4 shows a proposed list of indicators for a proposed four-level strategic results measurement framework for monitoring and evaluating the Bank Group's financial sector development program. The uniqueness of FSD as a new territory for the Bank, has presented a number of challenges in getting readily available data for some of the identified indicators.

[9] A new partnership framework with African DFIs will be implemented in collaboration with AADFI

This is due to the fact that either there aren't any specific projects that the Bank has done before (e.g. on mobile banking, remittances, etc.), or some FSD projects were never identified as such in the past (but rather by the originating sector department e.g. agriculture, human capital, or governance).

h. Risks and mitigation measures

The Bank Group will take measures to safeguard against the risks that may adversely impact the effective implementation of the Strategy. The key risk is the people risk—relating to a gap in the skills and expertise required to deliver effectively on commitments to RMCs. To mitigate such risk, the business plan will prioritize and sequence activities to be commensurate with the build-up of the required skills and resources. There is the related risk of inadequate resources to support the full implementation of the strategy. This risk will be mitigated by developing and systematically implementing a comprehensive business plan.

An additional risk is the quality of the Bank Group's operations in the sector, which could limit development effectiveness and pose a reputational risk. OFSD will ensure that the design of operations and subsequent support to their implementation is entrusted to teams with experienced team leaders and the requisite expertise. Another important risk is inadequate commitment in some RMCs to the needed financial sector reforms, which the Bank Group will seek to address by engaging in policy dialogue and awareness building, as well as selectivity in its operations.

The Bank Group will seek opportunities and expects to build up its work program in all parts of the continent, including countries that have recently become eligible for ADB financing. This will safeguard against excessive concentration of its financial sector portfolio in a few countries as well as ensure an appropriate balance in its portfolio. An evolving, more competitive and more segmented development finance environment make it essential that the Bank Group improves the efficiency of its operating procedures. The speed of change in the development finance industry makes it urgent for the Bank Group to change and adapt to the evolving needs of Africa.

6. Conclusion and recommendation

6.1 The FSDSP lays out the strategic direction of the Bank Group's financial sector work in RMCs during 2014-2019, with a strong focus on financing to accelerate Africa's transformation. Its commitment to promote vibrant, efficient, innovative, and robust financial systems in a competitive market, both domestically and regionally, is consistent with the goals and objectives of the Bank's TYS for 2013–2022—to put finance at the service of the productive sectors, and strengthen the capacity to finance Africa's inclusive growth. The new Policy also complements the Bank Group's PSD strategy (June 2013) and takes into account the special needs of MICs, LICs, and Fragile States, as well as gender and food security considerations.

6.2 Responsiveness and selectivity is critical and the Bank will focus its engagement on the areas where it can have the biggest impact. The Strategy is cognizant that the demand is high and the Bank can neither respond alone, nor try to do everything. Forging strategic alliances will therefore be essential. To be successful, this Strategy needs to be owned by RMCs and supported across the Bank, as it implies changes in approach and processes that are cross-departmental. Thinking "out of the box" and piloting innovative approaches will therefore be at the core of the Bank's actions.

6.3 Senior Management recommends the approval of this Bank Group's Financial Sector Development Policy and Strategy 2014-2019, by the Boards of Directors. On approval, the provisions stated in Sections 4 and 5 of this document will supersede and replace those provided in the previous Bank Group's Financial Sector Policy (ADB/BD/WP/2002/49/Rev.2 - ADB/BD/WP/2002/55/Rev.2) approved by the Boards of Directors on September 10, 2003.

Annex 1: The Bank's Past Support to the Financial Sector: Experience Acquired

During the last decade, the African Development Bank has extended its support to the development of Africa's financial systems using financial and non-financial instruments. The Bank has provided up to UA 8 billion in the form of loans, lines of credit, equity participation, guarantees and grants to regional, public and private financial entities to promote financial sector development and support economic growth in benefiting regions and countries. The Bank also used policy-based loans to support sector reforms. In parallel, the Bank has conducted policy dialogue with RMCs and RECs to enhance understanding of financial sector issues and their implications on development. It has also played a founding role for several sub-regional and specialized institutions e.g. Afreximbank, Africa Guarantee Fund; and played a role in improving the dedicated African institutions capacities, in various related areas, including on project structuring and financial packaging, privatization of enterprises; microfinance and private sector development, foreign investment, capital market development and other related topics.

The established paradigm for making financial services accessible to the poor was to build institutions to demonstrate the sustainability of providing such services to the bottom of the pyramid. The Bank has been supportive of inclusive finance because in addition to its potential to expand opportunities for the poor and reduce their vulnerability, it is also a profitable investment opportunity. In this regard, the Bank has taken equity stakes in a number of Greenfield microfinance institutions, extended lines of credit to MFIs, and funded technical assistance and capacity building programs alongside its investments. The Bank has also supported banks to serve the mass-market, in particular SMEs. While the Bank did not conduct a comprehensive evaluation of the Bank's financial sector interventions, it has undertaken evaluations of its operations in critical areas. They include an evaluation of its activities in Microfinance and for non-sovereign operations with special focus on their impact on SMEs development. Both evaluations concluded on the mixed results of the Bank's engagement.

The Evaluation of Bank Assistance to Small and Medium Enterprises compared cumulative volumes of approvals for the Bank and others for the six-year period 2006-2012. In this period, the Bank had a volume of USD 1.4 billion and 72 projects, compared to the World Bank at USD 35 billion and 1,100 projects. The description that is provided in this review of other Donors/DFIs underlines that too narrow a range of products are brought to bear. Guarantees, technical assistance and cash grants are notably absent. It also makes clear that the Bank's concerns about the effectiveness of its SME programs are shared by other donors/DFIs. Both evaluations underlined the need for the Bank to be more specific on defining areas of focus, developing adequate business model and having in place the necessary staff.

In another area, the Bank has laid important groundwork for supporting local capital markets. Several of the products the Bank has explored for its own transactions and balance sheet prepare the Bank for financing or investing in risk mitigation products. The experience gained in sponsoring off-balance sheet vehicles such as Africa Re is also relevant to an improved understanding of the requirements of different groups of institutional investors prepared to take Africa risk. In addition to lessons learned about comparatively new intermediaries (the Bank has substantial experience with traditional private equity funds and commercial banks), the Bank is investing in exploring a broader range of products to mobilize private sector investment as well as to manage the risk of its own balance sheet. However, the Bank has been a follower, even a reluctant follower, on some types of innovative finance structures, particularly those involving blended capital that involve grants or concessionary capital in public-private partnership. In addition, the Bank has sometimes been unwilling to outsource the technical and legal work associated with these new products to the experienced African or international companies who could support implementation, frequently preferring to hire individuals who have had prior experience with the Bank and rely on internal Bank processes. Nevertheless, on balance, the Bank is comparatively well-positioned to make a difference in deepening capital markets. Its direct experience in Africa's domestic capital markets and its reputation in regional projects are meaningful differentiators in the market. Structured finance operating through the capital markets channels liquidity to sectors where its effect on economies is most amplified, namely through domestic banking institutions that in turn finance SMEs, agriculture, and infrastructure.

Through the MFW4A Partnership, the Bank has positioned itself as the primary hub for financial sector reforms in Africa. Crucial is the combination of policy momentum, advocacy, stakeholder engagement and action. Success factors include core working groups on specific topics and the establishment of a solid network to initiate complex reform processes, including multiple stakeholders, such as central banks, donors and financial institutions, all over Africa. The partnership has become a real brand name and exhibits a significant power to convene donors and African stakeholders. As the Secretariat is hosted at the Bank, the partnership is widely seen as an African initiative, which helps to bring African stakeholders on board. Other initiatives the Bank supports are described in the box that follows.

Given its small size and expected role, the Bank has to be selective and as well as look to make a catalytic development impact in selecting its operations.

Box 6: Bank Involvement in Financial Sector Innovation

The African Financial Markets Initiative (AFMI) is a Bank initiative hosted by OFSD to promote the development of African local currency bond markets. The aims of AFMI include reducing the dependence of African countries on external debt; expanding the investor base in African debt markets; improving the availability and quality of fixed income data; and providing alternative sources of long term funding for African borrowers. The AFMI is implemented through two pillars: the African Financial Markets Database (AFMD) and the African Domestic Bond Fund (ADBF). To maintain the AFMD, the Bank maintains a network of liaison officers in central banks, debt management offices, and stock exchanges in 18 countries to collect data on African domestic debt markets on a monthly basis. These updates are posted on a public website and supplemented with original research and current market news. The ADBF is AFMI's instrument for investing in local currency-denominated sovereign guaranteed sub-national bonds. Ultimately, the ADBF will serve as a passively managed index tracker fund, once the African Domestic Bond Index is constructed.

The Making Finance Work for Africa Partnership (MFW4A) is a G8 initiative to support the development of African financial sectors. It is a unique platform for African governments, the private sector, and development partners to coordinate financial sector development interventions across the continent, avoiding duplication and maximizing developmental impact. Its Secretariat, housed at the Bank, undertakes activities related to knowledge management and sharing, donor coordination, stakeholder engagement, and advocacy.

The Secretariat's accomplishments include: building a bilingual website that hosts more than 1,700 publications about the FSD; producing 16 publications on various thematic areas, including one book; creating a Donor FSD Project Database that maps more than 1,600 projects; coordinating six working groups on topics such as remittances and mobile banking; establishing three stakeholder networks related to agribusiness, SME finance, and banking regulation and supervision; and organizing the MFW4A Partnership Forum for financial stakeholders and development partners.

The Migration and Development Fund is a multi-donor Fund that provides financing for: (i) improving knowledge on migrant remittances in Africa; (ii) providing support to reforms of the regulatory frameworks required to improve transfer conditions;(iii) developing financial products;(iv) providing support for productive investment in the migrants' countries of origin; and (v) providing support for local development in the migrants' countries of origin. Since its inception in 2009, the Fund has received over EUR 6 million in donors' commitments and has played a noticeable role in raising overall awareness on issues related to remittances, notably the high costs of transfer and the effort to increase its overall development impact in the receiving countries.

Africa50 Fund was recently established by the Bank with the objective to finance infrastructure development in Africa. The vision of Africa50 Fund is to significantly narrow Africa's infrastructure financing gap by delivering commercially viable transformative infrastructure projects and building competitiveness across Africa. Africa50 aims to unlock public and private financing sources and to accelerate the speed of infrastructure delivery in Africa, thereby creating a new platform for Africa's growth and prosperity. It will focus on high-impact national and regional projects in the energy, transport, ICT and water sectors. In addition, the Company will aim at reducing the time it takes from project idea to financial close from a current average of 7 years to an intended 3 years, thus accelerating the pace of infrastructure delivery in the continent. It will do this by building on the Bank's recent successes in overcoming early-stage bottlenecks to infrastructure projects, mobilizing political support for necessary reforms, and deploying skilled experts to work along-side Government. Africa50 Fund is targeting to raise USD 3bn in equity capital and will also augment its financial capacity by raising debt in the international capital markets to reach a targeted total balance sheet of USD 10 bn. Africa50 will have three broad groups of equity investors, including African countries, international and regional development institutions, and private institutional investors such as sovereign wealth and pension funds.

The African Guarantee Fund (AGF) is a joint initiative in which the Bank together with the Danish Government (through Danida) and the Spanish Government (through AECID) are the founding shareholders. As an innovative public-private partnership (PPP) set up as a specialized, legally independent entity, AGF provides loan portfolio guarantees to partner lending institutions (PLIs), including microfinance institutions (MFIs). It also provides institutional guarantees to PLIs, including non-bank financial institutions such as leasing companies. Financial support is normally combined with capacity development (CD) support for PLIs. The AGF will develop its own capacity to manage and market the guarantee activity while it will subcontract CD activities to seasoned players and partners in the field.

African Trade Insurance Agency (ATI) is a Multilateral Political Risk and Credit Insurer established by International Treaty by African Member States at the initiative of Common Market for Eastern and Southern Africa (COMESA). Due to the systemic significance of the Agency, its Charter underscores the importance of retaining the organization as an African entity. Since January 2014, the Bank is a shareholder in ATI, following the approval of its USD15 million equity investment. ATI provides medium-long term credit and political risk insurance as well as other risk mitigation products to the Bank's RMCs and related public and private sector actors (foreign and local investors, exporters, and commercial operators). These products directly encourage and facilitate foreign direct investment (FDI) and trade both regionally and internationally. Furthermore, ATI also facilitates trade in Africa through underwriting trade credit, which is in line with the Bank's recently approved Trade Finance Programme as well as catalyzing private sector investment in infrastructure projects.

Shelter Afrique (SHAF) is Pan-African housing finance and development institution with the mandate to mobilize and deploy resources for housing development in Africa and to assist private and public sector institutions in identifying, financing and implementing housing and related infrastructure. The Bank in its capacity as a major shareholder, also actively promotes SHAF's mandate in assisting African governments to formulate and implement policies related to housing. SHAF came into existence against the background of the acute housing shortages prevalent in most African countries hence necessitating the urgent need for African governments to pool resources to tackle the problem. Specifically, the company's objectives are to: Promote investment in the housing sector and viable housing institutions; Provide Technical Assistance (TA) to member states, especially for establishing housing development and financial institutions; and provide TA to Governments in housing policy formulation and implementation.

Afreximbank - Factoring Development Programme is a joint initiative in which the Bank, in addition to availing liquidity support to Afreximbank (through lines of credit, guarantees and equity) looks to provide technical assistance and capacity building to private sector projects through grants to support small and micro-scale enterprises in scaling up factoring activities on the continent. The Bank is a founding shareholder in Afreximbank which was established in 1993 together with African governments, Central Banks, and other institutional investors as a vehicle for promoting trade and regional integration.

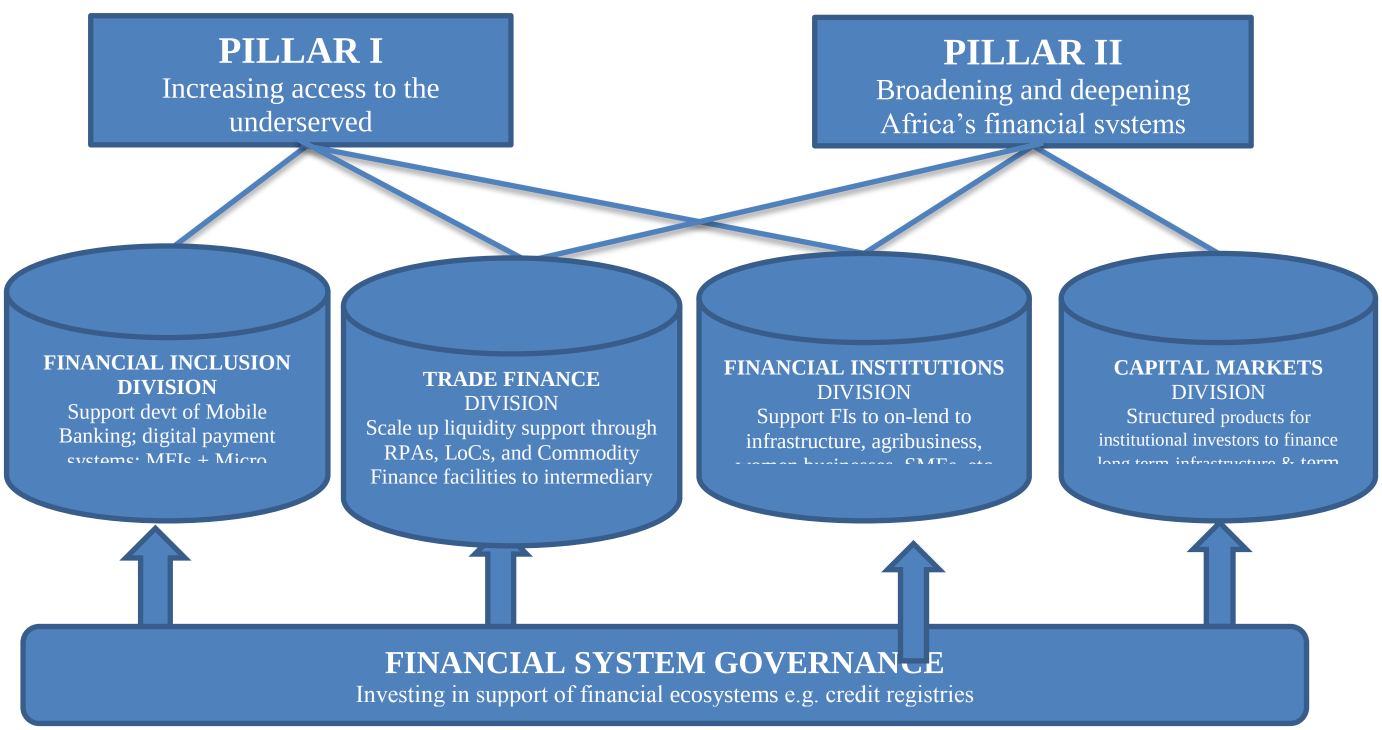
Annex 2: Implementation of the Financial Sector Development Policy and Strategy

To achieve the Ten-Year Strategy's twin objectives of inclusive growth and gradual transition to green growth, FSD requires special attention in all RMCs. Countries and regional constraints that impact FSD need to be identified and addressed in a holistic manner. A dedicated organizational unit to develop, lead and coordinate the Bank FSD program is required. OFSD is set up to fulfil this mandate. Its organizational structure and its staffing are aligned accordingly. To ensure that OFSD is able to deliver, the transfer of core financial sector activities and related staff from other organizational units will be conducted in 2014. Therefore, for 2014, OFSD operates in a budget neutral structure.

OFSD's 2014 work program is built upon the transfer of core financial sector activities and staff from other organizational units. During the current year, while continuing with already approved work program for financial sector development support under the other organizational units, OFSD is developing its business plan and has been undertaking a preliminary assessment and identification of the priority areas and related operations to be supported by the Bank, at both country and regional levels. The business plan will include a detailed rolling three-year work program for financial sector activities to be carried out by OFSD in conjunction with other Bank's Units.

Organizational Structure

Anchored on the two strategic pillars which are outlined in this FSDPS, as well as the cross-cutting theme of financial system governance, the organizational structure of OFSD will include four divisions: Financial Inclusion; Trade Finance; Financial Institutions; and Capital Markets, as indicated below:



To ensure that OFSD successfully carries out its mandate of bringing together all relevant FSD initiatives across the Bank under one roof, and create a solid platform that provides leadership, coherence and critical mass in this vital area, the above clusters will broadly carry out the following operational priorities:

Financial Inclusion Division

- ✓ Provide liquidity e.g., through liquidity facilities to financial service providers, mobile banking providers or to add smaller, less formal organizations such as microfinance banks to formal payment system;
- ✓ Support MFIs in deploying innovative and commercially viable business models; encourage consolidation in microfinance industry;
- ✓ Finance payments system for mobile banking, including payments by government;
- ✓ Finance development of national identification systems and census bureaus;
- ✓ Invest in incubators or funds that focus on mobile solutions;
- ✓ Provide challenge (innovation) grants to commercial entities to expand agent networks

Trade Finance Division

- ✓ Scale up liquidity support through RPAs, LoCs, and Commodity Finance facilities to intermediary FIs;
- ✓ Develop new financial products and services, such as forfaiting, leasing and factoring;
- ✓ Set up trade finance related infrastructure, i.e. trade finance default register and traders' database
- ✓ Technical Assistance programmes to enable SMEs access trade finance and capacity-building initiatives to address the needs of African financial institutions;

Financial Institutions Division

- ✓ Scale up intermediation through FIs (primarily commercial Banks as well as credit unions, savings banks, post offices, etc.)
- ✓ Integrate rigorous evaluations into SME lending support;
- ✓ Enhanced dialogue with apex bodies and initiatives;
- ✓ Support equity investments in the FSD ecosystem, and incubate work on remittances, collateral registries, etc.

Capital Markets Division

- ✓ Invest in capital market services companies and commodity exchanges;
- ✓ Lead structured finance and transactions to deepen sub components of capital markets and infrastructure financing;
- ✓ Lead investment in local currency denominated, sovereign and sovereign guaranteed sub-national bonds;
- ✓ Lead projects in development of local currency bonds yield curves;
- ✓ Provide advisory services in capital markets and identify investment opportunities with FIs;

Cross-cutting Initiatives

- ✓ Cross cutting initiatives which primarily support the financial stability objective through financial systems governance programs will be nurtured to ensure seamless collaboration across clusters.

Skills and Staffing

In 2014, which corresponds to the build-up phase, OFSD will operate on the basis of the transfer of staff from other units, supplemented by retraining programs. This exercise will allow OFSD to fill a certain proportion of the skills needs and will enable management identify the skills and staffing gaps that subsist. Management will then take the necessary steps to ensure that adequate staffing and skills are provided for the implementation of the work program.

Organizational arrangements

We note the establishment of PSD Steering Committee to oversee, monitor and report on Bank's PSD agenda. We recommend that once approved by the Board, implementation of the FSDPS is also overseen by the PSD Steering Committee especially as the FSDPS agenda has a strong applicability in the private sector. In order to engage immediately with implementation of the FSDPS, microfinance operations and related funding instruments (trust funds) are now under OFSD responsibility and authority. Financial intermediation operations, including trade finance transactions previously under OPSM were also integrated in OFSD. Regional financial integration operations and the non-transactional trade finance component were moved from ONRI, whilst PBO/ISP work on financial infrastructure and financial sector governance has been transferred from OSGE. FTRY's advisory functions have also migrated to OFSD, to be part of OFSD's Capital Markets Development activities.

With the redeployment having been completed, OFSD is now finalising a detailed business plan which will link the work plan and lending and investing levels to the strategy pillars grounded in an analysis of demand in the identified priority areas at both country and regional levels. The plan will also cover the required mix and location of skills, the organization of these skills, and address the budgetary resources to deliver the agreed work program.

The financial sector is increasingly a global business, and there is a high premium on global and, in the context of Africa, regional knowledge. Implementation of the FSDPS with regards to OFSD staff location will consider the following: need for specialization; proactive deal origination; regional networking and the identification of target sponsors; for Portfolio Management to develop a more active monitoring of investments, facilitating identification of problem projects at an earlier stage; the undertaking of scheduled supervision and monitoring work and general business development. The location of OFSD staff will gradually build up in each of the RRCs to ensure effective support to financial sector development in Africa.

Financing the FSD Strategy

Projects and programs identified for financing under this strategy would be funded through the ADB window and the ADF Performance-Based Allocation for eligible countries. The Bank will endeavour to make optimal use of existing trust funds to support technical assistance, and capacity building activities, among others, in the financial sector. In addition, the Bank aims to explore mobilizing resources from new sources of financing. Most importantly, the increased level of lending will generate additional revenues for the Bank and is expected to more than cover the budgetary allocations to OFSD. The Business Plan will provide details.

Most of the FSD work program will be led and/or undertaken by OFSD, jointly with other organizational units of the Bank (see table below).

Operational Areas & Activities	Organization Units (OUs) Involved	Role
Applicable to All Operations		
Economic and Sector Work	OFSD ECON/EDRE ONRI Other OUs	Initiate/Participate Lead Participate Participate
Financial Education to industry/market & regulatory professionals	OSHD OFSD EADI SEOG	Lead Co-Lead Participate Participate
Mainstream FSD initiatives in country & regional programming (RISPs and CSPs)	ORVP: all Regional Departments and Field Offices OFSD	Lead Support
Partnerships	OFSD FRMB GECL	Initiate & Lead Co-Lead Contribute
Technical Assistance	OFSD FRMB OPSM (FAPA) ORVP Fragile States Facility (FSF)	Initiate Contribute Contribute Contribute Contribute
Financial Inclusion Enhancing		
Technical support to MFIs	OFSD OSHD SEOG OPSM	Initiate/Lead Participate Participate Participate
Support in the extension of the use of mobile	OFSD	Initiate/Lead

Operational Areas & Activities	**Organization Units (OUs) Involved**	**Role**
banking and digital payments technology	OITC OSGE	Participate Participate
Financial Institutions Deepening Financial Support to banks to implement policies consistent with AfDB's environmental guidelines, focussing on climate change, the sustainable use of natural resources, and their optimization through efficient technologies. Facilitate investments that support renewable energy, women-owned enterprises, agribusiness, and trade Technical assistance to enhance capacity of DFIs	 OFSD ONEC/ ANRC GECL FFMA SEOG OFSD OSHD EADI	 Initiate & Lead Participate Participate Participate Participate Participate Initiate & Lead Participate Participate
Capital Markets Development Support to Infrastructure Financing Lead AfDB's (Bank) own local currency bond issuance Support the development of regional financial infrastructure, regional capital markets & regional Capital Markets Institutions	 OFSD FTRY OPSM OITC ONEC OWAS GECL FFMA OSGE FTRY OFSD FFMA OFSD OPSM ONRI OSGE OITC OSAN	 Lead Participate Participate Contribute Contribute Contribute Contribute Contribute Contribute Lead Advise Participate Lead Participate Participate Participate Participate Participate
Financial System Governance Improvement Enhance capacities of regulatory and supervisory bodies (central banks, tax authorities, pension regulators, capital market authorities, insurance regulators) to monitor, develop, and implement regulatory guidance	 OFSD OSGE OSHD FRMB OPSM	 Lead Participate Co-Lead Participate Participate

Operational Areas & Activities	**Organization Units (OUs) Involved**	**Role**
Development of financial ecosystems by investing in or lending to support systems such as judicial system, land registries, collateral registers, credit registers and bureaus, land titling	OFSD OSGE OPSM GECL	Lead Participate Participate Participate
Support for the creation of financial infrastructure such as retail payment systems, at both national and regional levels, Automated Clearing Houses and the deployment of solutions to allow non-bank financial institutions (e.g. MFIs) to transact.	OFSD OPSM GECL ORFS OITC	Lead Participate Participate Participate Participate
Anti-money laundering and combating the financing of terrorism (AML-CFT) - frameworks	OSGE OFSD OPSM GECL	Lead Participate Participate Participate

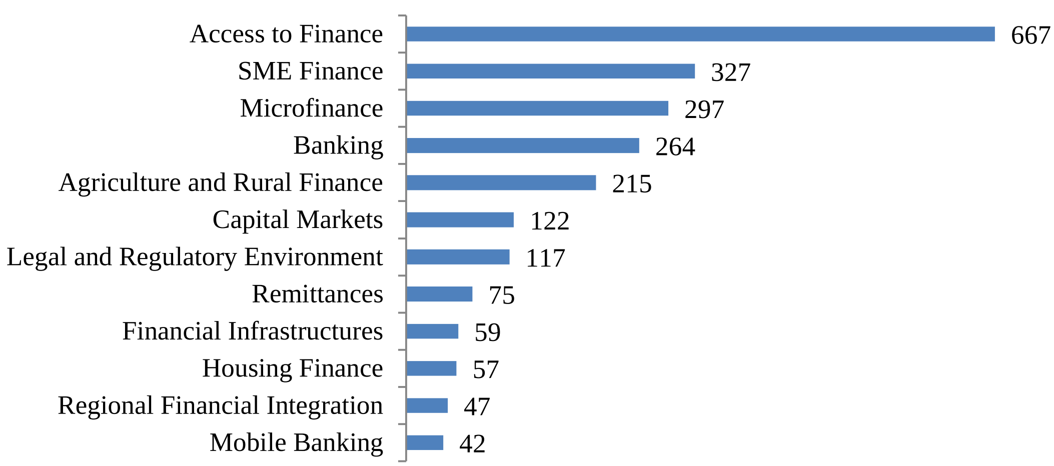
Annex 3: Contribution of Development Partners to Financial Sector Development in Africa

Financial Inclusion

African countries have experienced positive developments in access to financial services in recent decades as a result of the significant support to the sector. Recent evidence from the Global Findex database shows that the sector covers more than 44 million deposit accounts and 20 million loans.

The Bank's development partners are playing an important role in broadening the access to financial services in poor and rural areas. According to the MFW4A Donor Projects Database, more than 660 active financial sector development projects in Africa include at least a component related to access to finance. Figure 1 below shows the interventions broken down by financial sector theme. Most of these interventions are funded by multilateral development banks and bilateral financial institutions, such as the World Bank, IFAD, EIB, AFD, and GIZ.

Figure 1: Interventions by Financial Themes (number of projects)

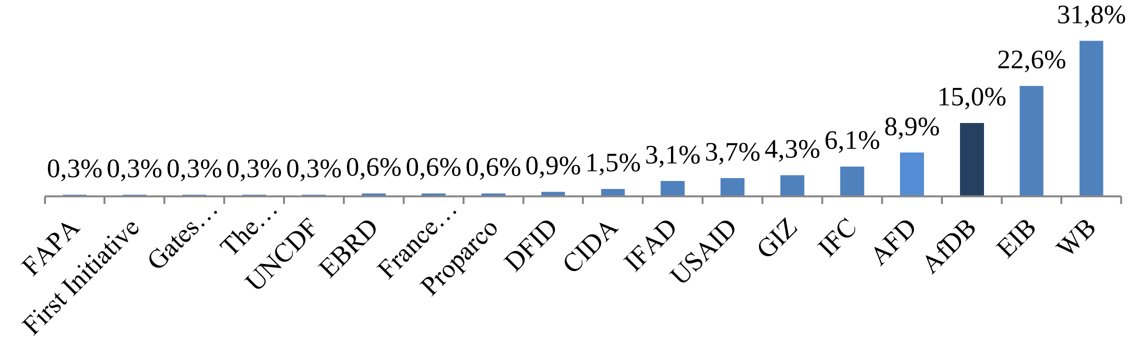


Moreover, new technologies such as mobile money help broaden access to financial services, including savings and payments products. In this context, the Bill and Melinda Gates Foundation funds initiatives to broaden the reach of digital payment systems, particularly in poor and rural areas, and expand the range of services available on these platforms. In addition, the MasterCard Foundation, in partnership with IFC, Opportunity International, and other DFIs, is working toward expanding access to financial services through innovative and cost-effective solutions.

Lending to Small and Medium Enterprises

When compared to other economies, many firms in Africa lack proper access to a bank line of credit. Other financing sources, such as equity markets, are also underdeveloped. Currently there are over 320 active projects related to SME finance, mostly funded by World Bank, EIB, the Bank, AFD, IFC, GIZ and USAID (see Figure 2).

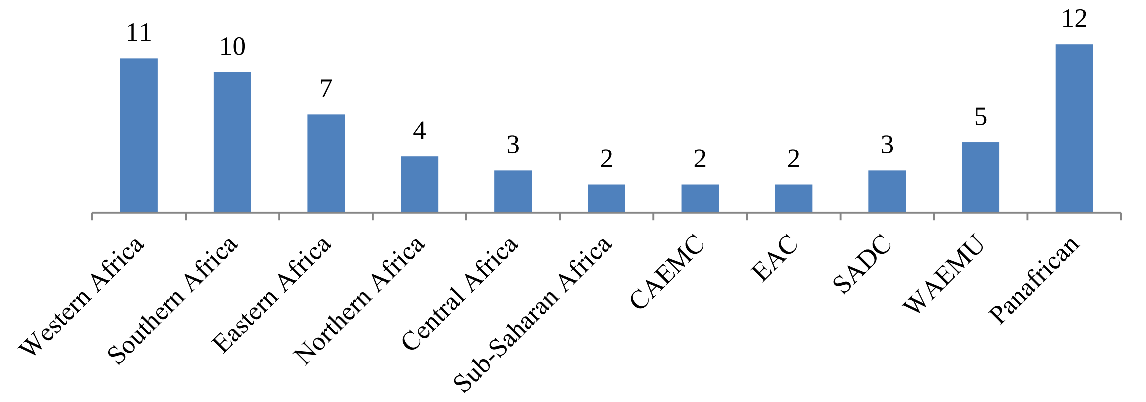
Figure 2: Development Partners' Contributions to SME Finance (percent of total)



Capital Market Development

Capital markets, which remain underdeveloped, narrow, and illiquid, are one of the main obstacles to access to finance. More than 135 active capital markets projects are currently being implemented in Africa, as shown in Figure 3.

Figure 3: Capital Market Interventions by Geographic Region and REC

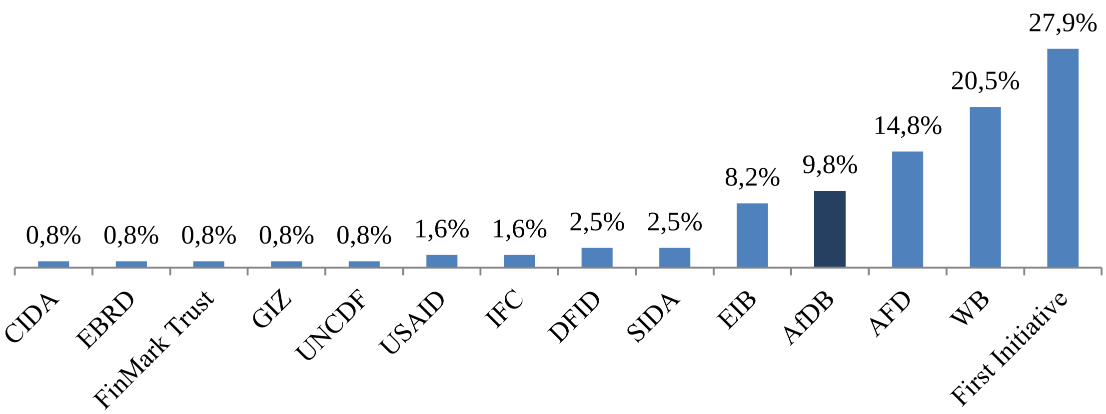


The projects focus on providing the following, as shown in the figures below:

- Guarantees
- Capacity enhancement of stock exchanges to support SMEs
- Development of local currency
- Support to improve the debt management framework or to deepen the domestic debt market

The most active donors in this sector are the FIRST Initiative (27.9 percent) (regulation and capacity building), World Bank Group (enabling environment and enhance the private investment climate), AFD Group (providing different types of guarantees), the Bank, and EIB (Bank restructuring and development of local currency markets), as shown in Figure 4.

Figure 4: Capital Market - Donor's Interventions (%)

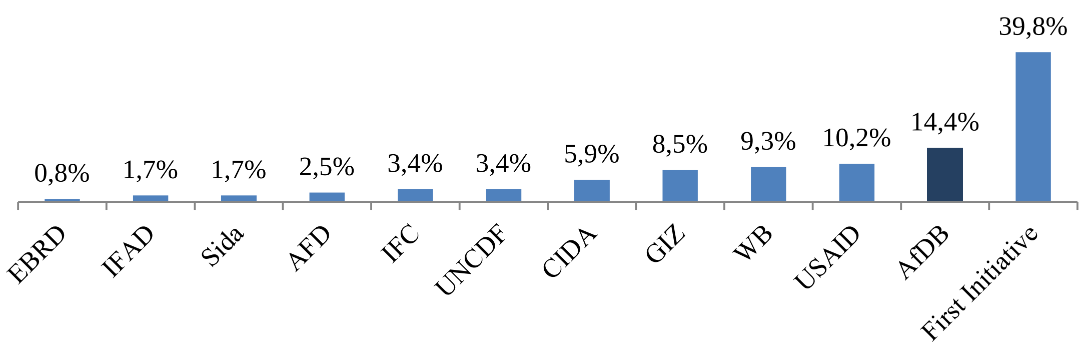


Financial Sector Reform

In light of the pivotal role of the legal and regulatory environment in the smooth operation of the financial sector and in the efficient management and integration of capital flows and domestic savings, several African countries have been undergoing a necessary reform process. More than 100 FSD projects include at least one component related to financial sector reform. As Figure 5 shows, among these development partners the FIRST Initiative (39.8 percent) is most active in Financial Sector Assessment Programs (FSAP), followed by the Bank (14.4 percent).

The Bank has, however, become an active partner in the process in a complementary context. In order to strengthen its future participation in policy-based operations (PBOs), the Bank is playing a more active role in background studies and policy dialogue to ensure it adds value to the content and design of policy framework papers. Other partners in supporting financial sector reforms include USAID (10.2 percent), the World Bank (9.2 percent), and GIZ (8.5 percent).

Figure 5: Legal and Regulatory Environment: Interventions (percent of total)



Annex 4: Strategic Results Measurement Framework

LEVEL 1 – What development progress are African countries making in Financial Sector Development?

This table summarises the development progress between 2010 and 2013.

	ALL AFRICAN COUNTRIES		ADF COUNTRIES	
	BASELINE 2010	LATEST 2013[2]	BASELINE 2010	LATEST 2013[2]
INCREASING ACCESS TO FINANCE				
ATMs per 100,000 adults	9.74	11.17	4.80	15.10
Adults with a bank account in a formal financial institution (% adult population)	…..	22	…..	17
Access to mobile financial services (per 1000)	42	42	59	59
Access to finance (% population)[3]	...	22	…	14
Access to credit (% population)	46	46	29	25
Loans from a financial institution in the past year, female (% age 15+)	…..	4.4	…..	3.7
Cost of trading across borders (USD)	2 090	2 290	2 864	3 178
Cost of remittance transfers (%)	10	10	15	15
DEEPENING AFRICA'S FINANCIAL SYSTEM				
Private sector credit relative to GDP (%)	35	…..	27	…..
Financial institutions' assets relative to GDP (%)	18.9	19.2	13.8	14.0
Outstanding loans from commercial banks (% of GDP)	15.49	17.11	13.67	15.61
Net interest margin	…..	…..	…..	…..
Borrowers from commercial banks per 1,000 adults	36.66	37.78	22.84	24.05
Intra-African trade (billion USD)	130	130	77	…..
SUPPORTING FINANCIAL STABILITY				
Stock market capitalization relative to GDP (%)	…..	…..	…..	…..
Turnover ratio (stock market annual turnover / market capitalization)	…..	…..	…..	…..
Non-performing loans ratio (%)	…..	…..	…..	…..

…. = data not available; ADF = African Development Fund; GDP=gross domestic product; USD=United States Dollars.

2 Where data are not available for 2013, the latest available values are used.
3 As the Global Financial Inclusion Database does not have historic data available, proxies from the IMF are used to assess progress in expanding access to credit.

LEVEL 2: How well is AfDB contributing to Financial Sector Development in Africa?

This table presents the contribution the Bank is making to development through its operations. The Bank's performance is measured by comparing expected and actual achievements for all operations that have been completed. In light of FSD operations being a new focus operational area, there hasn't been any results to report on some indicators the Bank did not have any projects to support them:

	2011-2013			2014-2016
	EXPECTED	DELIVERED		EXPECTED
INCREASING ACCESS TO THE UNDERSERVED (INCL. SMEs & HOUSEHOLDS)				
SME effect (turnover from investments) (US$ million)	….	704	….	1044
Cost of Remittances transfer reduced to (%)	…	…	…	5%
Jobs created (number)	856,907	856,907	100%	13,023
of which jobs for women[2]		287,377		6,677
People benefiting from investee projects and microfinance (number)	4 547 000	4 560 000	100%	5 070 000
of which are women[2]	…	2 394 000	…	1 825 000
Microcredits granted (number)	192, 838	156, 477	81%	84 629
Microfinance clients trained in financial literacy (number)	10 266	10 054	98%	34 131
P2P transactions (value US$m)	…	…	…	2 800
Mobile banking transactions as a percentage of GDP (%)	…	…	…	…
BROADENING AND DEEPENING AFRICA'S FINANCIAL SYSTEMS				
Government revenue from investee projects and sub-projects (US$ million)	…	…	…	34
Countries with Bond Yield curve beyond 5 years (number of market places)	…	…	…	3
Countries with local currency denominated sovereign/sovereign guaranteed bonds	…	…	…	6
Countries with restructured Public Sector Finance institutions (number)	…	…	…	5
Investments in regional capital markets (including commodity exchanges) - US$m	…	…	…	50

…=data not available; P2P=person to person payments; SME=small or medium-sized enterprise; US$=United States dollars;
[2]Gender-disaggregated figures are extrapolated from a subset of projects that have available data with baseline and actual data built in. As more projects have started to include gender-informed design, these data are expected to become increasingly robust and complete.
Note: UA figures from material converted at 1 UA= $1.53.
Source: African Development Bank.

LEVEL 3: How is AfDB's Effectiveness in Supporting Financial Sector Development?

	LATEST 2013	BASELINE 2013	TARGET 2019
STRENGTHENING COUNTRY DIALOGUE AND ENGAGEMENT			
New RISPs (incl mid-term reviews) with FSD-informed design (%)	….	….	100
New CSPs (incl mid-term reviews) with FSD-informed design (%)	….	….	100
Knowledge Products: FSD Analysis, ESW, briefs	….	….	11
Building capacity for results (number of institutions/people trained)	….	….	10
Volume of FSD financing approved by the Bank (UA'm)[1]	1, 504	1, 504	2, 071
DELIVERING EFFECTIVE AND TIMELY OPERATIONS			
Learning from our operations			
Completed operations rated satisfactory (%)	80	100	>90
Completed operations with sustainable outcomes (%)	88	100	>90
Ensuring strong portfolio performance			
Disbursement ratio of ongoing portfolio (%)	….	….	>22
Time for procurement of goods and works (months)	….	….	<7
Preparing high-quality operations			
Time to first disbursement (months)	11	8.4	<8
New operations rated satisfactory (%)	98	100	>95
New FSD projects with fragility-informed design (%)[2]	….	50	60
New FSD projects with gender-informed design (%)[2]	….	….	100

CSP = Country Strategy Paper; ESW = economic and sector work; RISP = Regional Integration Strategy Paper; …. = Data not available
Source: African Development Bank.

1 This will capture all lending and non-lending operations, both sovereign and non-sovereign.
2 As programming documents will increasingly consider cross cutting issues of fragility, gender and food security, all FSD operations will address drivers of these themes and will help build institutional resilience.

LEVEL 4: How is AfDB's Efficiency in Supporting Financial Sector Development?

	LATEST 2013	BASELINE 2013	TARGET 2019
DECENTRALISATION: MOVING CLOSER TO OUR CLIENTS			
Operational staff based in field and regional offices (%)	…	tbd	tbd
Projects managed from field and regional offices (%)	…	tbd	50
Time spent on Client engagmeent	…	[tbd]	[tbd]
HUMAN RESOURCES: ENGAGING AND MOBILISING STAFF			
Number of staff in HQ trained in FSD operations	…	17	50
Number of staff in Field and Regional Offices	…	2	tbd
Number of professional staff	23	23	tbd
of which are women	6	6	tbd
VALUE FOR MONEY: IMPROVING COST EFFICIENCY			
Cost of preparing an FSD lending project (UA '000)[1]	[71]	…	[80]
Cost of supporting project implementation (UA '000)[1]	[28]	[27]	[25]
Work environment cost per seat (UA '000)[2]	3.7	6.8	6.0

UA=Units of Account; …=data not available; […] = estimates
1 both the cost for project preparation and the cost for project implementation are based on estimates.
2 This includes all Field presences. Cote d'Ivoire is not included as it is the Bank's Headquarters and costs cannot be singled out