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IDA/R2017-0189/1

May 26, 2017

**Closing Date: Thursday, June 15, 2017  
at 6:00 p.m.**

FROM: Vice President and Corporate Secretary

**Pakistan - Financial Inclusion and Infrastructure Project**

**Project Appraisal Document**

Attached is the Project Appraisal document regarding a proposed credit to Pakistan for a Financial Inclusion and Infrastructure Project (IDA/R2017-0189), which is being processed on an absence-of-objection basis.

Distribution:

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Report No: PAD2012

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 100.3 MILLION

(US\$137 MILLION EQUIVALENT)

TO THE

ISLAMIC REPUBLIC OF PAKISTAN

FOR A

PAKISTAN FINANCIAL INCLUSION AND INFRASTRUCTURE PROJECT

May 15, 2017

Finance and Markets Global Practice  
South Asia Region

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## CURRENCY EQUIVALENTS

(Exchange Rate Effective April 28, 2017)

Currency Unit = Pakistani Rupees (PKR)

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US\$ 1 = PKR 104.8

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US\$ 1 = 0.73 SDR

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## FISCAL YEAR

July 1 – June 30

Regional Vice President: Annette Dixon

Country Director: Patchamuthu Illangovan

Senior Global Practice Director: Ceyla Pazarbasioglu-Dutz

Practice Manager: Niraj Verma

Task Team Leader(s): Gabi George Afram, Mihasonirina Andrianaivo

## ABBREVIATIONS AND ACRONYMS

ACH	Automated Clearing House
ADC	Alternative Delivery Channel
ATM	Automated Teller Machine
BB	Branchless Banking
BISP	Benazir Income Support Program
BSC	Banking Services Corporation
CBS	Core Banking System
CDNS	Central Directorate of National Savings
CE	Citizen Engagement
CGAP	Consultative Group to Assist the Poor
CGF	Credit Guarantee Fund
CGS	Credit Guarantee Scheme
CPEC	China Pakistan Economic Corridor
CPFL	Consumer Protection and Financial Literacy
CPS	Country Partnership Strategy
DA	Designated Account
DG	Director General
DFID	U.K. Department for International Development
DFS	Digital Financial Services
DTA	Digital Transaction Account
E&S	Environmental and Social
ERP	Enterprise Resource Planning
ERR	Economic Rate of Return
ESMS	Environmental and Social Management System
ESMU	Environment and Social Management Unit
FAO	Food and Agriculture Organization
FIIP	Financial Inclusion and Infrastructure Project
FINDEX	Global Financial Inclusion Database
FIP	Financial Inclusion Program
FISF	Financial Inclusion Support Framework
FM	Financial Management
FSAP	Financial Sector Assessment Program
G2P	Government-to-Person Payment
GDP	Gross Domestic Product
GOP	Government of Pakistan
GPSS	Global Payment Systems Survey
GRS	Grievance Redress Service
GSD	General Services Department
HR	Human Resources
IBRD	International Bank for Reconstruction and Development
ICT	Information and Communication Technology
IDA	International Development Association
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IT	Information Technology
IUFR	Interim Unaudited Financial Report
KfW	<i>Kreditanstalt für Wiederaufbau</i> (Reconstruction Credit Institute)
KIBOR	Karachi Interbank Offered Rate
LOC	Line of Credit
M&E	Monitoring and Evaluation

MFB	Microfinance Bank
MFI	Microfinance Institution
MOF	Ministry of Finance
MNO	Mobile Network Operator
MSME	Micro, Small, and Medium Enterprise
NADRA	National Database and Registration Authority
NFIS	National Financial Inclusion Strategy
NPG	National Payment Gateway
NPL	Nonperforming Loan
NPS	National Payments System
NPV	Net Present Value
NSS	National Savings Scheme
OM	Operations Manual
OTC	Over the Counter
PACRA	Pakistan Credit Rating Agency
PCG	Partial Credit Guarantee
PCU	Project Coordination Unit
PD	Project Director
PFI	Participating Financial Institution
PIU	Project Implementation Unit
PMIC	Pakistan Microfinance Investment Company
PMN	Pakistan Microfinance Network
PP	Procurement Plan
PPAF	Pakistan Poverty Alleviation Fund
PPRA	Pakistan Procurement Regulatory Authority
PPSD	Project Procurement Strategy for Development
PSP	Payment Service Provider
QBS	Quality-Based Selection
QCBS	Quality- and Cost-Based Selection
RFB	Request for Bids
ROA	Return on Assets
ROE	Return on Equity
RSF	Risk Sharing Facility
RTGS	Real Time Gross Settlement
SBP	State Bank of Pakistan
SECP	Securities and Exchange Commission of Pakistan
SME	Small and Medium Enterprise
TA	Technical Assistance
TOR	Terms of Reference
UFA	Universal Financial Access
WBG	World Bank Group



**BASIC INFORMATION**

Is this a regionally tagged project? No	Country(ies)	Financing Instrument Investment Project Financing
<input type="checkbox"/> Situations of Urgent Need of Assistance or Capacity Constraints <input checked="" type="checkbox"/> Financial Intermediaries <input type="checkbox"/> Series of Projects		
Approval Date 22-Jun-2017	Closing Date	Environmental Assessment Category F - Financial Intermediary Assessment
Bank/IFC Collaboration No		

**Proposed Development Objective(s)**

The proposed development objective is to contribute to increasing access and usage of digital payments and other financial services for households and businesses in Pakistan.

This will be done by: (a) improving market infrastructure and institutional capacity, (b) supporting the uptake and usage of Digital Payments and Financial Services and by (c) improving access to financial services for micro, small and medium enterprises (MSMEs).The project will seek to substantially increase access and usage of financial services by women and support women-owned MSMEs.

**Components**

Component Name	Cost (US\$, millions)
Direct Support to the NFIS Implementation	17.50
Supporting Expansion of Access Points for Financial Services	9.40
Improving Access to Microfinance and to Financial Services for Micro, Small, and Medium Enterprises	110.10



**Organizations**

Borrower : Islamic Republic of Pakistan

Implementing Agency : Development Finance Group, State Bank of Pakistan  
Central Directorate of National Savings (CDNS)- Ministry of Finance

**PROJECT FINANCING DATA (IN USD MILLION)**

<input type="checkbox"/> Counterpart Funding	<input type="checkbox"/> IBRD	<input checked="" type="checkbox"/> IDA Credit <input type="checkbox"/> Crisis Response Window <input type="checkbox"/> Regional Projects Window	<input type="checkbox"/> IDA Grant <input type="checkbox"/> Crisis Response Window <input type="checkbox"/> Regional Projects Window	<input type="checkbox"/> Trust Funds	<input type="checkbox"/> Parallel Financing
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Total Project Cost: 137.00	Total Financing: 137.00 Of Which Bank Financing (IBRD/IDA): 137.00	Financing Gap: 0.00
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**Financing (in US\$, millions)**

Financing Source	Amount
International Development Association (IDA)	137.00
<b>Total</b>	<b>137.00</b>

**Expected Disbursements (in US\$, millions)**

Fiscal Year	2018	2019	2020	2021	2022
Annual	40.00	40.00	30.00	17.00	10.00
Cumulative	40.00	80.00	110.00	127.00	137.00



## INSTITUTIONAL DATA

### Practice Area (Lead)

Finance & Markets

### Contributing Practice Areas

### Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

### Gender Tag

Does the project plan to undertake any of the following?

a. Analysis to identify Project-relevant gaps between males and females, especially in light of country gaps identified through SCD and CPF

Yes

b. Specific action(s) to address the gender gaps identified in (a) and/or to improve women or men's empowerment

Yes

c. Include Indicators in results framework to monitor outcomes from actions identified in (b)

Yes

## SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

### Risk Category

### Rating

1. Political and Governance	● Moderate
2. Macroeconomic	● Moderate
3. Sector Strategies and Policies	● Low
4. Technical Design of Project or Program	● Moderate
5. Institutional Capacity for Implementation and Sustainability	● Moderate
6. Fiduciary	● Moderate
7. Environment and Social	● Moderate



8. Stakeholders	● Low
9. Other	
10. Overall	● Moderate

**COMPLIANCE**

**Policy**

Does the project depart from the CPF in content or in other significant respects?

Yes  No

Does the project require any waivers of Bank policies?

Yes  No

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01		✓
Natural Habitats OP/BP 4.04		✓
Forests OP/BP 4.36		✓
Pest Management OP 4.09		✓
Physical Cultural Resources OP/BP 4.11		✓
Indigenous Peoples OP/BP 4.10		✓
Involuntary Resettlement OP/BP 4.12		✓
Safety of Dams OP/BP 4.37		✓
Projects on International Waterways OP/BP 7.50		✓
Projects in Disputed Areas OP/BP 7.60		✓

**Legal Covenants**

Sections and Description

Loan Agreement and Financing Agreement

Project Operations Manual: The Borrower shall carry out the Project in accordance with the Project Operations Manual. (Recurrent; throughout implementation)



Subsidiary Agreements: The Borrower shall enter into subsidiary agreements with SBP under terms and conditions acceptable to the Bank. (Recurrent; throughout implementation)

CDNS PIU for Part 2 of the Project: The Borrower shall maintain throughout the period of implementation of the Project, a project implementation unit within CDNS, with functions and resources satisfactory to the Bank, and with staff in adequate numbers and with qualifications, experience and terms of reference satisfactory to the Bank.(Recurrent; throughout implementation)

Environmental and Social Risk Management for Parts 3(a) (Sub-loans) and 3(b)(i) (Risk sharing facility) of the Project (These covenants are also applicable SBP as per Project Agreement): For purposes of managing the environmental and social risks and impact associated with the implementation of Parts 3(a) and Part 3(b)(i) of the Project, the Borrower shall ensure, and cause the Project Implementing Entities to ensure, that:

- (a) Loan proceeds are provided only for those PFIs and those proposed Eligible Microfinance Investments and Eligible SME Investments that meet the criteria detailed in the Project Operations Manual; and
- (b) all Eligible Microfinance Investments supported under Part 3(a) of the Project and all Eligible SME Investments Project under Part 3(b)(i) of the Project are prepared and operated in accordance with the Applicable Environmental and Social Requirements through adequate implementation of the ESMS.

(Recurrent; throughout implementation)

#### Sections and Description

##### Project Agreement with SBP for Part 3(a) of the Project

SBP PIU for Part 3(a) of the Project: SBP shall maintain throughout the period of implementation of the Project, a project implementation team, with functions and resources satisfactory to the Bank, and with staff in adequate numbers and with qualifications, experience and terms of reference satisfactory to the Bank. (Recurrent; throughout implementation)

Project Operations Manual: Prior to extending any Sub-loans under Part 3(a) of the project, SBP shall adopt the Project Operations Manual. Thereafter, SBP shall: (a) carry out Part 3(a) of the Project in accordance with the Project Operations Manual. (Recurrent; throughout implementation)

Sub-Loans to PFIs: For purposes of carrying out of Part 3(a) of the Project, SBP shall:

- (a) select Participating Financing Institutions (“PFI”s) in accordance with the selection procedures and eligibility criteria set out in the Project Operations Manual; and
- (b) make Sub-Loans to PFIs for the financing of Eligible Microfinance Investments under sub-loan agreements which shall include terms and conditions acceptable to the Borrower and the Bank (“Sub-loan Agreements”).

(Recurrent; throughout implementation)

#### Sections and Description



Sections and Description

Project Agreement with SBP for Parts 1 and 3(b) of the Project

SBP PIU: SBP shall maintain throughout the period of implementation of the Project, a project implementation unit with functions and resources satisfactory to the Bank, and with staff in adequate numbers and with qualifications, experience and terms of reference satisfactory to the Bank, responsible for implementation of Parts 1 and 3(b) of the Project, with staff, functions and responsibilities as set out in the Project Operations Manual. (Recurrent; throughout implementation)

Project Operations Manual: SBP shall carry out the Project in accordance with the Project Operations Manual.(Recurrent; throughout implementation)

Risk Sharing Facility: For purposes of carrying out Part 3(b)(i) of the Project and in case the Bank concurs with the Borrower and SBP to have SBP as the entity implementing the risk sharing facility, SBP shall operate such facility under terms and conditions and with operating principles set out in the Project Operations Manual, including, inter alia: (a) criteria for selecting PFIs and Eligible SME Investments, and (b) legal arrangements for engaging with PFIs and SMEs. If not, SBP shall submit to the Bank in writing for its review and concurrence its Selected Entity prior to carrying out any activities under Part 3(b)(i) of the Project. (Recurrent; throughout implementation)

**Conditions**

Type  
Effectiveness

Description  
Description  
The SBP Subsidiary Agreement has been executed in substance and form satisfactory to the Bank; and

Type  
Disbursement

Description  
Description  
Category (1)(b) until: (a) the Recipient and/or SBP has/have prepared rules of business for Part 3(a) of the Project under terms and conditions acceptable to the Association, and with operating principles set forth in the Project Operations Manual in a manner acceptable to the Association; and (b) SBP has prepared and disclosed an ESMS for Part 3(a) of the Project in a manner acceptable the Association; and  
  
Category (1)(c) until: (a) the risk sharing facility has been established on terms and conditions, and with operating principles set out in the Project Operations Manual, and acceptable to the Bank; and (b) if SBP is not operating the risk sharing facility,



the Selected Entity is acceptable to the Bank and has entered into an agreement with the Bank and/or SBP as determined by the Bank on terms and conditions acceptable to the Bank.

**PROJECT TEAM****Bank Staff**

Name	Role	Specialization	Unit
Gabi George Afram	Team Leader(ADM Responsible)	Financial Inclusion and MSME finance	SACPK
Mihasonirina Andrianaivo	Team Leader		GFM06
Haider Raza	Procurement Specialist(ADM Responsible)		GGO06
Khalid Bin Anjum	Procurement Specialist		GGO06
Qurat ul Ain Hadi	Financial Management Specialist	Financial Management	GGO24
Ahmad Imran Aslam	Environmental Specialist		GEN06
Amena Raja	Team Member		SACPK
Amir Munir	Team Member		ITSCR
Ann Christine Rennie	Team Member		GFMDR
Anwar Ali Bhatti	Team Member		SACPK
Aza A. Rashid	Team Member		GFM06
Danielle Malek Roosa	Team Member		LEGES
Dorothee Delort	Team Member		GFM2B
Ehtesham-ul Haq	Team Member		SACPK
Ekaterina Grigoryeva	Team Member		GEN03
Faly Diallo	Team Member		WFALA
Harish Natarajan	Team Member		GFM2B
Helen Luskin Gradstein	Team Member		GFM2B
Inder Singh Takhar	Team Member		GFM06



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Jorge Luis Alva-Luperdi	Team Member		LEGES
Pratibha Chhabra	Team Member		GFM2A
Salma Omar	Safeguards Specialist		GSU06
Sarmad Ahmed Shaikh	Team Member	Financial Inclusion	GFM06
Sarwat Aftab	Team Member		GTC06
Subika Farazi	Team Member		GFM06
<b>Extended Team</b>			
<b>Name</b>	<b>Title</b>	<b>Organization</b>	<b>Location</b>

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PAKISTAN  
PAKISTAN FINANCIAL INCLUSION AND INFRASTRUCTURE PROJECT

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## I. STRATEGIC CONTEXT

### A. Country Context

1. **A mild growth recovery is under way in Pakistan and external account pressures have subsided.** Pakistan's economy posted a gross domestic product (GDP) growth of 4.7 percent in FY2015/2016, up marginally from 4 percent the previous year. Government consumption posted strong growth, and private consumption was supported by record high remittances of some US\$18.7 billion in FY2014/2015. Moderately higher economic growth driven by investment and productivity gains in services and manufacturing is forecasted in the near term (5 percent in FY2017, 5.5 percent in FY2018). In the near term, investments under the China Pakistan Economic Corridor (CPEC) and low international oil prices will also support growth. Increasing reserves have contributed to stability in foreign exchange markets and low inflation. Modest growth, however, will not be sufficient to create jobs for the large number of youth joining the workforce every year. The population is forecasted to grow fairly rapidly, to reach 310 million by 2050, up from an estimated 189 million in 2015, while unemployment and underemployment are expected to be among the major challenges. Sustainable and inclusive growth, job creation, and poverty reduction will require greater private sector investment and the development of infrastructure, as well as a continued focus on fiscal consolidation and structural reforms. It is critical that the Government addresses structural challenges such as low electricity availability, narrow fiscal space, and limited access to credit.

### B. Sectoral and Institutional Context

2. **In the last 25 years, Pakistan's financial sector has moved from one dominated by underperforming state-owned banks to a modern and sound financial sector dominated by private banks.** The banking sector accounts for 74.7 percent of financial sector assets, with the balance of 16.5 percent in the National Savings Scheme (NSS)<sup>1</sup>, 4.8 percent with insurance companies, 4 percent with nonbank financial institutions, and 0.1 percent with microfinance institutions (MFIs).<sup>2</sup> The microfinance sector is small in assets but is significant in terms of financial access. Financial soundness indicators indicate that the banking sector is generally sound, liquid, and profitable (see annex 5). Islamic finance is also growing rapidly and currently accounts for 11 percent of sector assets.

3. **Financial markets in Pakistan are stable but remain shallow and narrow, thus playing a limited role in sustainable and inclusive growth.** In 2015, financial sector assets stood at 68.5 percent of GDP, below the level of other relevant emerging markets (see annex 5). Private sector credit to GDP declined significantly from 2008 to 2015 and was just 15.4 percent, significantly below the regional average of 47.6 percent. Stable, deep, diversified, efficient, and inclusive financial systems are essential for poverty reduction, job creation, and economic growth.

4. **For over a decade, Pakistan has taken measures to improve financial inclusion and has led the way in South Asia in digital payments and branchless banking (BB).**<sup>3</sup> A proactive regulator (State Bank of

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<sup>1</sup> NSS deposits are equal to 30 percent of total banking deposits and account for 24 percent of the domestic debt of the Government of Pakistan (GOP). The NSS deposit base is used as a proxy for assets.

<sup>2</sup> And microfinance banks (MFIs) accounts for 0.5 percent of banking sector assets.

<sup>3</sup> In Pakistan, this term refers to using agent-based models linked to a specific type of bank account.

Pakistan [SBP]) and widespread computerized national identity cards issued by the National Database and Registration Authority (NADRA) have contributed to significant growth in digital transaction accounts (DTAs).<sup>4</sup> The Government has digitized some of its own payments, including its main social safety net program, namely the Benazir Income Support Program (BISP). Banks and MFBs are actively involved in BB, in partnership with mobile network operators (MNOs).<sup>5</sup> As a result, Pakistan has the highest penetration of mobile money<sup>6</sup> accounts in South Asia, with 5.8 percent of the adult population, compared to the South Asian average of 1.9 percent. The gender gap on mobile accounts is much narrower than the overall gap for accounts.

5. **In May 2015, Pakistan launched its National Financial Inclusion Strategy (NFIS)** to achieve its vision, that is, ‘individuals and firms can access and use a range of quality payments, savings, credit, and insurance services which meet their needs with dignity and fairness’.<sup>7</sup> Pakistan’s goal is to expand financial access to at least 50 percent of adults, and to increase the percentage of small and medium enterprise (SME) loans in bank lending to 15 percent by 2020.

6. **Despite these achievements, financial access remains low.** As discussed above in paragraph 3, the credit to GDP ratio is very low, only above that of Afghanistan in the region. This implies that intermediation in the financial markets is well below the levels that are required to foster the growth of firms and households’ financial intermediation that Pakistan needs to sustain and enhance economic growth. According to the World Bank Global Financial Inclusion Database (FINDEX), only 13 percent of adults in Pakistan had access to a formal account in 2014, far behind Sri Lanka, which is at 83 percent, India at 53 percent and Bangladesh at 31 percent.<sup>8</sup> Use of formal financial services is also limited. Individuals often make payments or borrow informally (about 43 percent of unbanked adults made or received payments informally and half of the Pakistani population reported borrowing through informal methods).<sup>9</sup> Some market segments are significantly excluded from the formal financial sector.

- a. There is a significant untapped market for microfinance, which is suffering from funding constraints. The microfinance sector serves only 4.3 million borrowers (as of March 2016), which is just 16 percent of the estimated potential market.<sup>10</sup> To fund future growth and reach 10 million active borrowers by 2020, the industry needs additional funding (debt for onlending) of PKR 300 billion (US\$2.9 billion).<sup>11</sup>
- b. Despite women constituting about 25 percent of the labor force, only 4.8 percent of them are included in the formal financial sector, compared to the South Asian average of 37.4

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<sup>4</sup> In Pakistan, this refers to accounts that are designed to be accessed through digital channels and for making digital payments.

<sup>5</sup> There are eight to nine significant Digital Financial Services (DFS) businesses (two of which have been providing DFS for the past six to seven years and many are start-up innovators) led by all four major MNOs and some of the biggest banks. The three largest MNOs each own an MFB.

<sup>6</sup> In the context of Pakistan, these are also BB accounts that are designed for access through mobile phones.

<sup>7</sup> In addition, other headline targets of the NFIS include an increase in the percentage of adults living within 5 kilometers of an access point by 2020, 25 percent of women with a transaction account, and 10 percent of adults saving at a formal financial institution in the past year.

<sup>8</sup> About 26 percent of unbanked adults cited that financial services were too far to access.

<sup>9</sup> 23 percent of adults cited that financial services are too expensive to use.

<sup>10</sup> Pakistan Microfinance Network (PMN), Microfinance Growth Strategy 2020.

<sup>11</sup> and equity of PKR 45 billion (US\$429 million).

percent. Loans to women account for less than 3 percent of total bank loan volume (see annex 6).

- c. Similarly, even though SMEs constitute 90 percent of enterprises in Pakistan, as of June 2015, banks were lending to just 4.7 percent of the estimated total SMEs of 3.2 million in the country. Banks have limited appetite to serve the SME sector due to perceived risks and have favored alternative investment options, notably government securities.<sup>12</sup> The limited appetite stems largely from business and credit risks associated with SMEs and lack of appraisal capacity rather than a lack of liquidity on banks' balance sheets. As a result, SMEs use their own sources for 89 percent of working capital and 75 percent of investment needs. A risk sharing facility (RSF) could help mitigate the perceived financial risk of taking on new SME loans while leveraging the existing liquidity in the sector.

**7. The development of BB has the potential to significantly enhance financial inclusion, but several issues need to be addressed to expand access to DTAs.**

- a. Gaps in the National Payments System (NPS) that hamper financial inclusion and broader financial sector development need to be addressed. These include inadequacies in the legal framework, the payments infrastructure, fair and transparent access to settlement systems, and the overall oversight framework for the NPS. Significant investment is needed to upgrade payments, settlements, and information technology (IT) systems.
- b. While digital payments have been growing, most transactions (80 percent) are done over the counter (OTC) instead of through customer accounts. This implies high transaction costs and limited scope for product development. At the same time, merchant acceptance of electronic payments is not widespread. A recent global study by the World Bank Group estimated that, in Pakistan, out of approximately US\$13 billion retail sales by micro, small, and medium retailers in 2015, cash pays for more than US\$10.8 billion.<sup>13</sup> Cash is also the preferred payment method by micro, small, and medium retailers in Pakistan for supplier and wage payments.<sup>14</sup>
- c. Expanding access to DTAs and reaching scale and viability can be achieved through digitization of bulk payments such as government payments.<sup>15</sup> For example, according to the

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<sup>12</sup> As of June 2016, commercial banks hold about PKR 6.5 trillion (US\$62 billion) of government, domestic debt (about 42 percent of total assets) and investments in government securities constitute approximately 92 percent of total banking system investments (which has largely explained the robustness of the banking sector, Pakistan Economic Update, 2016). The situation is starting to reverse with the easing of interest rates and efforts in fiscal consolidation (see annex 5).

<sup>13</sup> World Bank Group. 2016. *Cash vs. Electronic Payments in Small Retailing: Estimating the Global Size*. Washington, DC: World Bank.

<sup>14</sup> Recent data by the Global Payment Systems Survey (GPSS) of the World Bank also confirms this: the number of cashless transactions per capita in Pakistan in 2015 was 0.4 compared to the low- and middle -income countries' average of 22.4 cashless transactions per capita in 2015. According to the GPSS, cashless transactions per capita per year were around 274 in high-income countries. For further information, see: World Bank Group. 2016. "Global Payment Systems Survey: Universal Financial Access — Accounts & Access Module."

<sup>15</sup> Digitization of government payments can also be linked to fiscal savings for the government, including from reduced administration costs of paying benefits and public sector wages in cash, and lower levels of 'leakage' as a result of recipients being paid directly into accounts.

FINDEX, roughly 3.4 million adults receive government payments in cash (and are unbanked).

8. **More diverse, sustainable, and efficient access points are also critical for financial inclusion.** Various networks can be leveraged for access, such as the Central Directorate of National Savings (CDNS) or the Pakistan Post, which has 12,000 branches. However, this would require end-to-end automation, modernization of the existing manual systems, and enabling integration and connectivity of existing access points. Modernization will allow more avenues for the delivery of financial transactions and services.

9. **The Government of Pakistan (GOP) has requested for a project that will support the NFIS's holistic approach.** The project will focus on the development of market infrastructure and the ecosystem that will facilitate access and usage of digital payments and financial services. Access to credit for micro, small, and medium enterprises (MSMEs) will be supported by a line of credit (LOC) and an RSF that will catalyze private sector financing and focused interventions, including technical assistance (TA). The proposed project will support the authorities' efforts to move toward universal financial access (UFA) as envisaged in the NFIS.

10. **The project will factor in lessons learned from financial sector work in Pakistan and in peer countries.** Underlying analytical and operational work include the NFIS,<sup>16</sup> the Financial Inclusion Support Framework (FISF) TA supporting NFIS implementation, the United Kingdom (U.K.) Department for International Development (DFID) program funded Private Sector Development Trust Fund, and the recently completed Financial Sector Assessment Program (FSAP). The project will be action and outcome-oriented and complemented by World Bank-financed policy credits that unlock constraints in the financial sector.<sup>17</sup> Coordination will also be sought with activities of International Finance Corporation (IFC)<sup>18</sup> and other development partners engaged in financial inclusion efforts, such as the Gates Foundation, Consultative Group to Assist the Poor (CGAP), and DFID (through Karandaaz, a local company promoting financial inclusion for SMEs and individuals ).

11. The project fits well with the World Bank strategy in the financial sector that focuses on UFA and responsible finance as a key pillar.<sup>19</sup> The World Bank will support key market infrastructure and capacity enhancement and will catalyze private sector financing in areas where the private sector has been reluctant to enter.<sup>20</sup> It will leverage its international experience, its sustained engagement with Pakistan, and its influence and credibility with standard-setting bodies and the G20.

### C. Higher Level Objectives to which the Project Contributes

12. **The World Bank Group's (WBG's) engagement on financial inclusion is driven by the global commitment toward achieving UFA.** Pakistan accounts for 5.2 percent of the world's unbanked adults and is a priority country for the World Bank Group's UFA 2020 commitment. The WBG's Country

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<sup>16</sup> Such as MSME finance, DTAs, payment systems' technical notes, NFIS action plan, and so forth.

<sup>17</sup> Including the upcoming Development Policy Credit on Finance for Growth, which includes for example, the launch of a new DTA scheme concept in its prior action among others.

<sup>18</sup> More particularly, in the SME finance sector and gender finance.

<sup>19</sup> The World Bank has assisted Pakistan in developing its NFIS. It has supported the development and outreach of microfinance sector through its engagement with PPAF, and has helped in enhancing financial infrastructure, which are key to promote financial inclusion.

<sup>20</sup> For instance in microfinance and SME lending, the project will support market-based principles, related TA and demonstration effects.

Partnership Strategy (CPS) for 2015–2019 targets improved financial inclusion of MSMEs, women, and youth. Addressing inclusion reduces poverty and contributes to equitable growth. The project’s focus on women is well aligned with the CPS objective of expanding opportunities for women.

13. **The strategic approach of the WBG’s engagement in the financial sector is a combination of financial, advisory, knowledge, and convening services, complemented by investments and private sector engagement by IFC.** The WBG supported the development of the NFIS, and is now providing a comprehensive package of support to enable Pakistan to achieve its targets. This includes: (a) Development Policy Credits to support institutional and legislative reforms; (b) data and policy analysis to underpin more effective reforms (the NFIS, the Consumer Protection and Financial Literacy [CPFL] diagnostics, and the FSAP); (c) TA to build implementation and supervisory capacity (FISF); and (d) support for critical improvements to the enabling environment (FISF, and the Financial Inclusion and Infrastructure Project [FIIP]).

## II. PROJECT DEVELOPMENT OBJECTIVES

### A. PDO

14. The proposed development objective (PDO) is to contribute to increasing access and usage of digital payments and other financial services for households and businesses in Pakistan.

15. This will be done by: (a) improving market infrastructure and institutional capacity; (b) supporting the uptake and usage of Digital Payments and Financial Services; and (c) improving access to financial services for MSMEs. The project will seek to substantially increase access and usage of financial services by women and support women-owned MSMEs.

### B. Project Beneficiaries

16. **The final project beneficiaries are adults in Pakistan, including women and those holding an NSS instrument or account, and MSMEs in the country including those that are women-owned or managed.** This project aims to improve access to credit for MSMEs<sup>21</sup> and to enable individual uptake of digital payments and financial services through an upgraded financial infrastructure and capacity building. Moreover, the project will benefit financial service providers (that is, participating financial institutions [PFIs], MFIs, MFBs, and banks) and government agencies (SBP), and departments of the Ministry of Finance (MOF), including the CDNS.

### C. PDO-Level Results Indicators

17. **The success of the project in reaching the PDO<sup>22</sup> will be measured by the following indicators:** (a) Electronic payments per capita; (b) Number of DTAs; and (c) Number of unique beneficiaries

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<sup>21</sup> The definition of MSMEs adopted by the project will be aligned to the SBP’s definition which defines micro/small enterprises as having 0–20 employees with a maximum of PKR 400 million (US\$3.8 million) in annual turnover and medium enterprises as having 21–250 employees with PKR 400–800 million (US\$3.8–7.6 million) in annual turnover.

<sup>22</sup> Indicators are consistent with IFC Development Goal Access to Finance Revised Methodology for Corporate Score Card Reporting.

(borrowers) reached.<sup>23</sup> Additional intermediate indicators that will help achieve the PDO targets are described in section VII.

### III. PROJECT DESCRIPTION

#### A. Project Components

18. This project aims to contribute to financial inclusion at the individual and firm levels through its three components:

- a. Components 1 and 2 will improve access and usage of digital payments and other financial services at the individual level. This will be done through investments, pilots, capacity building, and analyses aimed at improving the financial infrastructure and the ecosystem for DTAs and the NSS; and
- b. Component 3 will improve access to financial services at the firm level for MSMEs.

#### **Component 1: Direct Support to the NFIS Implementation (US\$17.5 million)**

19. **This component will provide direct support to implementation of the NFIS in line with the priorities laid out in the NFIS action plan.**

#### ***Subcomponent 1a. Improving Financial and Market Infrastructure to Facilitate the Uptake of DTAs (US\$15 million)***

20. **This subcomponent will support the significant investment needed to upgrade payments and settlements systems and the associated IT systems.** These systems are critical to: (a) support the safety, efficiency, and reliability of the NPS; (b) provide settlement services to the various retail payment systems and foster competition and interoperability; and (c) enable the shift of government payments to electronic means.

- a. **Improvement of the payments and market infrastructure.** This will include: (i) upgrade/replacement of the existing SBP-operated payment system by a payment system with dual Real Time Gross Settlement (RTGS) and Automated Clearing House (ACH) capabilities; (ii) implementation of a National Payment Gateway (NPG), which will be operated by the SBP<sup>24</sup>, for interoperability among alternative delivery channels (ADCs), including the BB network, conventional payment service providers (PSPs), and other payments platforms; and (iii) improvements to market infrastructure, which will entail supporting investments in corresponding technical systems/platforms centralized in the SBP such as information technology (IT) systems.<sup>25</sup> The NFIS identified financial, payment, and

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<sup>23</sup> Beneficiaries include microentrepreneurs who receive loans under the LOC detailed in Subcomponent 3a.

<sup>24</sup> The Gates foundation plans to support the creation of a micropayment platform. As indicated above, the NPG will allow the plug-in of various platforms including the future micropayment platform.

<sup>25</sup> Including interfaces allowing small retail investors to participate directly in government securities auctions providing an integrated and secure management of processes connected to the core payment system, in particular for the management of government securities.

information and communication technology (ICT) infrastructure as key enablers of financial inclusion. This critical market infrastructure supports both financial stability and inclusion.

- b. **Capacity building for oversight and improvement of the legal framework in line with the NPS Strategy.** For sustainable financial development, it is key that financial stability is preserved as financial systems are deepened, access is expanded, and new risks emerge. To this end, this sub-component will also support legal and regulatory reforms and capacity building for oversight of the NPS; and the SBP general oversight capabilities.

***Subcomponent 1b. Improving Access and Usage of Digital Payments and Digital Financial Services (DFS) (US\$1.5 million)***

21. **This subcomponent will support the GOP in expanding access and reaching scale and viability with the promotion and use of digital payments and DFS.** DTAs represent an initial entry point for low-income and financially excluded households, which can, over time, provide access to a broad set of financial services that go beyond payments to include savings, credit, and insurance. The GOP launched a scheme in January 2016 to facilitate a shift in financial behavior from cash to digital payments (to support conversion of OTC retail payments to DFS transactions), through the definition of business rules, the establishment of a shared acceptance network, and enabled connection to the national payment infrastructure. The scheme will offer a national platform to standardize digital payment transactions, to achieve scale and increase the use of digital payments, particularly for the disbursement of government payments and the collection of government receivables. In line with the key driver of the Pakistan's financial inclusion strategy, this sub-component will particularly support the digitization of bulk and retail payments including major G2Ps, and corporate payments. This could include, as an initial step, the formulation of a road map for digitizing all government payments with a plan that connects the dots with what already exists, and conducting a detailed mapping of government payments at the federal and provincial levels.<sup>26</sup>

***Subcomponent 1c. Enhancing NFIS Secretariat Capacity and Project Management and Monitoring (US\$1 million)***

22. **The NFIS Secretariat provides an effective national coordination structure for the NFIS, which is key for the implementation and monitoring of the NFIS action plan.** This subcomponent will support the Secretariat's capacity to undertake its roles and responsibilities in implementing the NFIS, including policy and advocacy work. Support is envisaged for, monitoring and evaluation (M&E) and through dedicated technical experts including support to technical committees under the NFIS.

23. **A small team will assume management of project implementation** and a Project Implementation Unit (PIU) will be created at SBP to coordinate implementation of SBP components (see annex 2 on implementation arrangements). The subcomponent will include costs for project management, M&E, and capacity building.

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<sup>26</sup> This activity will be well coordinated with other World Bank projects (past and upcoming) looking into digitization of government payments including the World Bank Public Financial Management PforR project 'Improving Accountability for Service Delivery', which is under preparation, and the past and upcoming World Bank projects supporting the BISP (supporting the payments of social transfers to poor women in Pakistan through bank accounts).

## **Component 2. Supporting Expansion of Access Points for Financial Services (US\$9.4 million)**

24. **This component will support investments, capacity building and analyses that will drive financial access points.** Focus will be on integrating more diverse, sustainable and efficient access points across Pakistan, notably through the CDNS, which runs the NSS through 375 branches.

25. **The most important reforms needed to bring CDNS potential access points into the formal financial sector's outreach and facilitate the expansion of DTAs are the end-to-end automation and modernization of existing CDNS systems.** Through the NSS, the CDNS is a key contributor to financial inclusion, with an investor base of around 7 million and a portfolio of over PKR 3.3 trillion (US\$31.5 billion), equivalent to 33 percent of bank deposits. Most of its products are designed for low-income segments of the society. However, due to the lack of automation and operational constraints, the NSS has not been able to extend its financial services across the country, especially to the rural areas. The current NSS systems are based on manual records, processing, and reconciliation with single entry cash-based accounting principles. This component will support the automation and modernization of the CDNS, which is in line with the recommendations of the 2016 Pakistan FSAP. Annex 1 provides information on what will be financed.

## **Component 3: Improving Access to Microfinance and to Financial Services for Micro, Small, and Medium Enterprises (US\$110.1 million)**

### ***Subcomponent 3a. Improving Access to Microfinance and to Financial Services for Micro Enterprises (US\$75 million)***

26. **This subcomponent will provide an LOC to PFIs to refinance eligible loans to microfinance sector.** The LOC will be channeled through the SBP for PFI (which could include wholesale lenders) on-lending.<sup>27</sup> End beneficiaries are microfinance borrowers, including microentrepreneurs. The project will use debt instruments, including subordinated debt, and financing will be at market determined rates. The LOC is expected to ease the current liquidity constraint of the microfinance sector by crowding in private investment in the microfinance sector and facilitating access to market funding.

27. **PFIs will be selected based on transparent and clearly defined eligibility criteria around their financial health, institutional capacity to on-lend, governance, and operational processes.** To ensure the sustainable development and growth of the microfinance sector, covenants and performance measures to promote good practices, including on consumer protection, corporate governance, environmental and social risk management, internal controls, and transparency, will also form part of the eligibility criteria. The component will also focus on: (a) developing products tailored to client needs;<sup>28</sup> (b) encouraging loans to first time borrowers; and (c) promoting availability of financial services for microentrepreneurs and in particular women microentrepreneurs.<sup>29</sup> The component has a gender dimension with a target of

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<sup>27</sup> On the choice of the central bank to channel the LOC, the project has looked at other Bank projects that used a similar channel (for instance in Jordan and Tunisia) and ensured that adequate checks and balances are maintained and captured in the OM that has been developed.

<sup>28</sup> The LOC will take into account product development and loans using innovative financing mechanisms and delivery channels.

<sup>29</sup> The LOC will seek to support the transition of MFB from lending to individuals to lending to microenterprises and small businesses and promote microloans to women.

allocating 60 percent of loans to women and women-owned microenterprises. The project will also seek to focus on underserved areas.<sup>30</sup>

**Subcomponent 3b. Improving Access to Financial Services for Small and Medium Enterprises (US\$35.1 million)**

28. In line with the NFIS action plan, this subcomponent will support access to finance for SMEs with selected activities.

- a. **Risk Sharing Facility (US\$33.1 million).** The governing body of the Credit Guarantee Scheme (CGS) for small and rural enterprises, operated by the SBP and funded by the GOP and DFID, has decided to undertake an analysis of alternatives to the current CGS, including options for an independent public-private Credit Guarantee Fund (CGF) for SMEs. DFID will fund this study under its Financial Inclusion Program (FIP). To endow the modified scheme or fund through capitalization from the GOP, US\$33.1 million will be allocated. To be eligible for this funding, the proposed fund would need to meet the World Bank’s requirements with regard to additionality, leverage, and sustainability, and broadly meet the principles for public guarantee scheme for SMEs 2015.<sup>31 32</sup>
- b. **Technical Assistance and Innovation Challenge Funds for SME Lending (US\$2 million).** This activity will provide a range of analytical work, awareness campaigns, and challenge funds to support development of innovative financial products for SMEs and women entrepreneurs, and capacity building for regulators to support increased access to finance to SMEs, with focused interventions on women entrepreneurs (see annex 1 for details).

**B. Project Cost and Financing**

29. **The lending instrument will be Investment Project Financing (IPF), with an implementation period of five years.** The total project cost is US\$137 million and will be financed through an International Development Association (IDA) credit in the amount of US\$37 million (SDR 27.5 million) and IDA Scale Up Facility (SUF) in the amount of US\$99.7 million (SDR 72.8 million).

**Table 1- Project Costs and Financing**

Project Components	Project Cost	IBRD or IDA Financing	Trust Funds	Counterpart Funding
Component 1. Direct Support to the NFIS Implementation	17.5	17.5	—	—
Component 2. Supporting Expansion of Access Points for Financial Services	9.4	9.4	—	—
Component 3. Improving Access to Microfinance and to Financial Services for Micro, Small, and Medium Enterprises	110.1	110.1	—	—
			—	—
<b>Total Costs</b>	<b>137</b>	<b>137</b>	<b>—</b>	<b>—</b>
Total Project Costs	137	137	—	—

<sup>30</sup> One additional appraisal criteria for PFI may include additionality related to entering new markets.

<sup>31</sup> If a decision to create an independent entity is taken, an assessment will need to be done of the financial capacity of the new entity and appropriate legal arrangements will need to be established between the Bank and the new entity. This could require a project restructuring at the time.

<sup>32</sup> 2015, First Initiative and World Bank Group.

Front End Fees		-	—	—
<b>Total Financing Required</b>		137	—	—

### C. Lessons Learned and Reflected in the Project Design

30. **The project reflects lessons learned from recent analytical work in Pakistan, including during the preparation of Pakistan’s NFIS.** Consultations highlighted key enablers that will lay the foundation for achieving widespread financial inclusion: (a) public and private sector commitment; (b) enabling legal and regulatory environment; (c) adequate supervisory and judicial capacity; and (d) adequate access to financial, payments, and ICT infrastructure. The above-listed key enablers support targeted actions (drivers) aimed at increasing access and developing financial services that meet the needs of the nation’s population and enterprises. These drivers are: (a) promoting DTAs and reaching scale through bulk payments; (b) expanding and diversifying access points; (c) improving the capacity of financial service providers; and (d) increasing the levels of financial capability. Components 1 and 2 aim to support both the enabling environment and critical actions for DTAs, which include the upgrade of payments systems, digitization of government payments and expansion of access points. The mapping on digitization of government payments will incorporate lessons learned from past World Bank projects, including one that digitized social transfers under the BISP.

31. **The project design also reflects other lessons learned from recent, ongoing, and completed World Bank Group and donor projects** in Egypt, Sri Lanka, Jordan, Morocco, and other countries; international best practices on financial inclusion policies; and the World Bank’s operational policy guidelines on Financial Intermediary Financing. Subcomponent 3a provides an LOC to the microfinance sector, which will operate on market-based principles, catalyzing private sector financing. The design of this component builds on the conclusions of the 2006 Independent Evaluation Group (IEG) evaluation of LOCs.<sup>33</sup> The project is well positioned and addresses all areas of weaknesses found in the IEG study, with an experienced counterpart in the SBP. SBP is staffed by experienced officers who successfully implemented the Pakistan Banking sector technical assistance project (TABS) focusing on modernization of the SBP but also implemented several targeted schemes for financial inclusion including the microfinance credit guarantee facility (MCGF) with DFID funding. In addition there are strong potential candidate PFIs, clear eligibility criteria, strong monitoring capacity, and well-defined products (see annex 5).<sup>34</sup>

<sup>33</sup> The IEG report outlines that while experience with financing of credit lines has been mixed, issues mainly stemmed from the following: (a) inadequate accountability and management capacity of the borrower and implementing entities; (b) lack of clearly defined and transparent eligibility criteria for commercially oriented private sector financial intermediaries, PFIs, to ensure their financial and operational quality, (c) poor monitoring of the overall project impact due to inadequate selection of monitoring indicators and inadequate supervision during implementation, and (d) lack of identification of suitable products for end beneficiaries and delivery mechanisms and inflexibilities in project design making it difficult to reflect the changing circumstances. In addition, the IEG report emphasizes that any foreign exchange risk of sub-loan repayment should be borne by either the end user or the Government but not by the PFI.

<sup>34</sup> SBP and DFID launched the MCGF in December 2008 to help address the funding problem of MFBs/MFIs. The MCGF has reached the end of its lifecycle and it was decided in April 2017 that SBP would cease to issue new guarantees under MCGF. However, the guarantees issued earlier will remain valid until their expiry (see summary of MCGF performance in annex 5).

32. **The design of Subcomponent 3b also incorporates best practices and lessons learned from past operations.** The World Bank conducted a study in 2012<sup>35</sup>, which analyzed the World Bank’s experience with Partial Credit Guarantees (PCGs), and the principles for public guarantee scheme for SMEs 2015.<sup>36</sup>

## IV. IMPLEMENTATION

### A. Institutional and Implementation Arrangements

33. **The Islamic Republic of Pakistan is the borrower and the SBP and the CDNS (MOF) will execute the project’s activities.**<sup>37</sup> Bank funds will flow through separate Designated Accounts (DAs) established for the SBP and CDNS one for each loan type (see details in FM section).

34. **An overall project coordination team or unit (“PCU”)** will be established and maintained at the MOF Finance Division. The coordination team will ensure overall coordination of the project’s activities including consolidation of financial reporting.

35. **Small project teams at each agency will be responsible** for the execution of project activities under that agency’s purview, notably with respect to financial management (FM) including financial reporting, procurement, and safeguards.

36. **The SBP, which hosts the NFIS Secretariat, will be responsible for Component 1 and Component 3.** For Subcomponent 3a, the MOF will channel funds through the SBP for on-lending to other PFI (see details on fund flows in annex 2 and see annex 5 on financial sector review). The SBP will have a PIU with the requisite capacity on project management, FM, procurement, and environmental and social (E&S) safeguards. Dedicated project managers will be responsible for some aspects, with the support of technical teams. A Project Director (PD) at the executive director rank will head the PIU. The PIU will be in charge of project coordination at the SBP, as well as overseeing FM, procurement, reporting, M&E, audit, public information, and related functions.

37. **The CDNS (MOF) will be responsible for Component 2.** The CDNS will establish and maintain a small team with adequate capacity on project management, FM, and procurement.

38. **The responsible agencies will hire part-time technical specialists as required and capacity building will also be provided.** To facilitate project implementation, a detailed OM has been prepared by the SBP, and the CDNS (MOF).

### B. Results Monitoring and Evaluation

39. **The M&E system will be based on the Results Framework and will be used to track and monitor progress and impact.** The framework will assess project activities using the indicators described in section VII. Additional indicators will also be collected for monitoring purposes during the project’s implementation to measure in more detail the uptake, demand, and disbursement of the project. These indicators will segment relevant demographic information (most notably gender) to track and monitor

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<sup>35</sup> Partial Credit Guarantee Forum Report, July 2012.

<sup>36</sup> 2015, First Initiative and World Bank Group.

<sup>37</sup> Adequate resources for project implementation will be provided by all agencies, including in-kind contributions, operational staff, government civil servants, and so forth.

participation in the project by demographics. This full M&E framework for tracking short-, medium-, and long-term results will be finalized with the responsible agencies and included in the OM. Project progress will be monitored over time based on the framework. In addition, the project will incorporate a citizen engagement (CE) feedback loop, as described in section VI-F.

40. **National-level indicators of the NFIS that reflect contributions of this project will also be monitored to assess Pakistan’s progress toward financial inclusion targets.**<sup>38</sup> However, national headline indicators will not directly measure the success of this project and will be monitored only for reference. Further details are included in the OM. The overall project coordination team or unit will be responsible for the M&E of the different components and will need to liaise with all relevant agencies involved in the project implementation for comprehensive tracking and monitoring. Each responsible agency will be required to designate the M&E collection to a core staff member or coordinator and the M&E function will be funded out of project’s funds or agency’s contribution to the project.<sup>39</sup> The midterm review of the project, which will assess implementation progress, is expected to be undertaken in month 30.

### C. Sustainability

41. **The project maintains and fosters sustainability by using preexisting structures and institutions to deliver financial services to support financing of MSMEs and individuals.** The project has coordinated and collaborated with implementing agencies and government institutions extensively to ensure the highest commitment of implementing partners. Additionally, the components of the project are designed to maintain sustainability. Key design features that enable project sustainability include: (a) the creation of payments and financial infrastructure to continuously improve the enabling environment to facilitate lending and uptake of DTAs and DFS; (b) the support and capacity building to help financial institutions reengineer their business models to serve the MSME sector more profitably and encourage a shift in attitudes toward MSMEs; and (c) the endowment of an RSF which will be designed to be financially sustainable while taking into account additionality and leverage. In particular, the sustainability of payments and financial infrastructure is expected to be maintained through medium term strategies by SBP and CDNS to proactively maintain and invest in systems beyond the life of the project.<sup>40</sup> Additionally, the sustainability of the MSME beneficiaries is strengthened through the coordinated provision of both financial services and sectoral capacity building. Furthermore, financing under the project will be undertaken on market principles to ensure sustainability in the long run. In addition, TA and implementation arrangements (on safeguards and fiduciary) will allow support to the MSME sector in undertaking commercial activities in a sustainable and efficient manner. The project activities also strongly support GOP priorities in financial inclusion as discussed in section I above. This again contributes to ensuring sustainability of project outcomes.

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<sup>38</sup> Relevant national-level indicators that reflect the project’s contribution to NFIS goals include, for instance, that by 2020 (a) 50 percent of adults are expected to own a transaction account and (b) loans to SMEs will account for 15 percent of total bank loans to the private sector.

<sup>39</sup> The incremental cost of the project’s M&E arrangements include designated work-plans or designated M&E coordinators for each unit or team. Pakistan has a rich data infrastructure and the project will leverage off of the indicators already collected. M&E coordinators will develop templates for data collection, but no significant time or cost (aside from data requests) will be borne by the institutions already collecting the data.

<sup>40</sup> SBP’s strategic framework and annual plans already include investments and maintenance of payments systems infrastructure, while the CDNS business plan expected to be designed under this project will ensure that systems are maintained and sustained.

## D. Role of Partners

42. **Parallel funding of activities will be explored with development partners.** In particular, there exist many synergies with respect to the support to SME lending and to the microfinance sector for parallel financing, in particular with the IFC. Additionally, complementary donor interventions are ongoing with other project activities such as on the digitization of government payments, the payment systems (Gates Foundation; Karandaaz), the potential RSF for SME lending (DFID), and gender/SME finance (FISF Trust Fund by the Netherlands and Gates Foundation).

## V. KEY RISKS

### A. Overall Risk Rating and Explanation of Key Risks

43. The overall risks are Moderate and risks are summarized in the table below

**Table 2- Project risks and mitigation**

Risk Category	Risk Rating	Description of the Risks and Mitigation
1. Political and Governance	● Moderate	The main risks are associated with the broader political and security situations in Pakistan, which can have a bearing on the commitment and/or ability to proceed with the NFIS action plans, including those supported under the project. Despite these ongoing risks, the authorities have been able to implement and sustain significant reforms in the microfinance sector over the past decade.
2. Macroeconomic	● Moderate	Macroeconomic risks are mitigated by the presence of a strong regulatory framework and well-established financial sector.
3. Sector Strategies and Policies	● Low	The GOP has remained committed to financial sector development over many years as demonstrated in previous engagements and through demand for the project and for medium-term financial inclusion reform.
4. Technical Design of Project or Program	● Moderate	The development objectives are based on analytical work and consultations with multiple stakeholders, including during the process of developing the NFIS. As a result, they align with the development focus of the implementing agencies, complement efforts of the donor community, and represent an inherent demand from private sector players in the banking and microfinance sectors, regardless of the NFIS targets. A potential risk is that there will be insufficient demand for the RSF under Subcomponent 3b of the project. The existing CGS implemented by the SBP with DFID's support has not been fully used. Nonetheless, all project components reflect demand expressed by the SBP and discussions with potential PFIs, including the Pakistan Bankers' Association. DFID is conducting an independent assessment of the CGS performance, Based on which (or another feasibility study), recommendations on the future of the CGS or a successor entity will be provided and the project will only fund the endowment/capitalization of the (modified) scheme or new entity if it meets the World Bank's requirements, notably on additionality, sustainability, and leverage.
5. Institutional Capacity for Implementation and Sustainability	● Moderate	Another risk is the negative impact that a possible slow implementation of the NFIS actions would have, particularly those related to the development, testing, and scaling up of innovative approaches (e.g. DTAs). This may have an impact on the achievement of the NFIS targets and on the authorities' commitment to the strategy. This risk is mitigated by the experience and strong collaboration with the SBP and the World Bank over the last two decades, and the SBP's demonstrated capacity to implement innovative projects with various development partners while respecting implementation arrangements (including fiduciary and safeguards).
6. Fiduciary	● Moderate	The risk can stem from major changes in the top management of the SBP and the capacity to implement the new IT systems and infrastructure, which can lead to delays in implementation due to potential procurement delays associated with the installation of a complex IT architecture envisioned under the project. These risks are mitigated by strong commitment at various levels of the GOP and the SBP's capacity in implementing projects with development partners, including the World Bank. The overall financial management risk of the project is assessed as Moderate.

7. Environment and Social	● Moderate	Components 1, 2, and Subcomponent 3b-Activity 2 involve analytical studies, capacity building, upgrading digital payment systems/software etc. and are not expected to have E&S risks and impacts, thus no safeguard policies are triggered. Components involving commercial lending instruments – LOC for financing microfinance enterprises (subcomponent 3a) and RSF for financing SMEs (subcomponent 3b-Activity 1) – are expected to have E&S risks and impacts associated with lending for private sector activities implemented by private sector entities (MSMEs) across manufacturing and service sectors as described in the E&S sections
8. Stakeholders	● Low	The proposed engagement builds on previous stakeholder relationships with the SBP in delivering development outcomes such as strengthening the financial sector and increasing outreach.
10. Overall	● Moderate	The overall risk is moderate.

## VI. APPRAISAL SUMMARY

### A. Economic and Financial (if applicable) Analysis

44. **The economic analysis for each of the three components is done separately.** For project components where benefits are not easily quantifiable, evidence from literature is presented to highlight the potential benefits that can be expected from different activities under each component.

45. **For Components 1 and 2, a review of evidence from literature is undertaken because benefits are indirect and/or not easily quantifiable.** Improving financial infrastructure, increasing access to and usage of digital accounts, piloting new approaches with DTA and digitization of government payments for increased inclusiveness of the financial sector, and enhancing the NFIS Secretariat’s capacity can improve the supply and quality of financial services, enhance the efficiency with which such services are provided, and smoothen the implementation of the NFIS. Making payment systems safer and more efficient and promoting use of DFS will not only enhance access but will also provide a friendlier environment for piloting and scaling up of new products that can cater to the needs of the population.<sup>41</sup>

46. **For Subcomponent 3a, an attempt was made to quantify the expected net present value (NPV) for microenterprises and the economic rate of return (ERR).** The NPV for microenterprises is estimated at US\$49 million at a 15 percent discount rate. The ERR is expected to be 41 percent. The analysis attempts to calculate the benefits based on difference in cash flows between scenarios with the project and without the project. The assumptions used for estimation are broadly based on the team’s knowledge of Pakistan’s financial sector, particularly the microfinance sector. In addition, data from the World Bank Enterprise Surveys and the Food and Agriculture Organization (FAO) were also used to formulate the model’s assumptions.

47. **Under activity 1 of Subcomponent 3b, the project aims to support an RSF offering a guarantee scheme for loans to SMEs with modalities designed in-line with international best practices.** An attempt was made to quantify what would be the NPV and ERR with a well-designed RSF leveraged and well used; the economic analysis estimates the impact of having guaranteed loans on SMEs separately. The ERR of this activity is expected to be 42 percent, and the NPV is expected to be about US\$2 million with a discount rate of 15 percent. For TA and capacity building activities under Subcomponent 3b, evidence from

<sup>41</sup> See, for example, Payment Aspects of Financial Inclusion 2016, a consultative report prepared by BIS and the World Bank that provides an analysis of the payment aspects of financial inclusion. Also, Digital Financial Inclusion: Implications for Customers, Regulators, Supervisors, and Standard-Setting Bodies, CGAP 2015.

literature is provided given that these activities would offer indirect benefits. The literature supports capacity-building programs to increase the number and improve the customization of products offered to MSMEs.<sup>42</sup> The potential poverty impact for first time users of finance is particularly large, and is primarily obtained through increased savings mobilization and credit provision.<sup>43</sup>

### **Rationale for Public Sector Provision/Financing**

48. **There is a strong rationale for public sector financing of this project due to the lack of sufficient private sector participation in financial sector intermediation and the positive externalities linked to different activities.** Upgrading the payment system infrastructure and experimenting with new approaches and products to enhance the use of digital accounts are public goods and can generate positive externalities in both the short and long run. This justifies public sector involvement and spending to support these activities. Promoting the microfinance sector, which is currently facing liquidity constraints partly due to inadequate investments from the private sector, also justifies contribution from public funding, which in fact intends to leverage and catalyze enhanced private sector funding. Funding structured as debt or quasi-equity will support PFI operations and growth, enhance their financial strength and enable PFI to better leverage and crowd in private commercial funds to onlend larger amounts to the underserved. SMEs face exclusion from the formal banking sector due to the existence of market failures that should be addressed to facilitate SMEs' access to a wide range of financial services in a sustainable manner. The public sector can as well play an important role in the SME sector as well by investing in RSFs that provide guaranteed loans to reduce banks' SME lending risks and by providing capacity building to the SME sector.

### **Value Added of World Bank's Support**

49. **The World Bank is a key player in the development of the financial sector in Pakistan and has played an important role in promoting the financial inclusion agenda.** In particular, the World Bank has assisted Pakistan in developing its first NFIS, supported the development and outreach of the microfinance sector through its engagement with the PPAF, and helped enhance the financial infrastructure, which is key to promote financial inclusion. This project will enable the World Bank to build on the work that has been done in the recent past and go a step further by assisting the authorities with the implementation of a coordinated NFIS, further enhancing financial infrastructure and addressing different constraints faced by the MSME sector. The World Bank's support will catalyze private sector financing in areas where the private sector has been reluctant to enter (for example, microfinance, SME lending) by supporting market-based principles, related TA, and through its demonstration effects. In this process, the World Bank will leverage its international experience on financial infrastructure development, credit guarantee facilities, and access to finance programs in order to support a wider range of financial institutions to provide financial services to a broader range of enterprises, with a particular focus on women.

## **B. Technical**

50. **The project's technical design draws on knowledge that the team obtained through ground research, analyses published by different stakeholders in Pakistan, and the World Bank's knowledge**

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<sup>42</sup> See, for example, The SME Banking Knowledge Guide, IFC 2010.

<sup>43</sup> See, for example, Burgess and Pande 2005. "Do Rural Banks Matter? Evidence from the Indian Social Banking Experiment." *American Economic Review*, 95(3): 780-795.

**and lending projects.** Key principles underlying project design include: (a) enhancing coordination structure for the NFIS to support implementation and monitoring of the NFIS action plan; (b) upgrading retail payment systems in accordance with international best practices; (c) developing transparent eligibility criteria for PFIs based on available data to benchmark sector performance; (d) adhering to market principles for interest rates to final borrowers; (e) designing TA/ capacity building around best practices PFIs to improve SME lending capacity/expertise; and (f) establishing clear indicators and monitoring to track project performance.

### **C. Financial Management**

51. **The assessment reviews the FM arrangements relevant to the project in the executing agencies (SBP and CDNS,) to determine whether they provide reasonable assurance that project funds, guarantee, and credit lines will be used for their intended purpose.** The SBP has established governance practices. Separate books of accounts will be maintained and audited for the project activities and Line of Credit. CDNS is an attached department of MOF and follows government policies and procedures for budgeting, accounting and financial reporting.

52. **Separate segregated DAs, in U.S. dollars (US\$), will be established, one for each loan type for the SBP.** Disbursements will follow the 'report-based' principle whereby funds will be front-loaded to the DAs based on cash forecasts for the following semester provided in Interim Unaudited Financial Reports (IUFs). Each implementing entity will submit separate audited financial statements. The audit reports must be submitted to the World Bank no later than nine months after the year-end. The funds for LoC will be maintained in a separate account.

53. **There is no outstanding audit report from the implementing entities/agencies.**

54. **Based on the assessment and subject to the implementation of mitigating measures for the identified risks (refer to annex 2 for details),** the project's overall FM environment provides reasonable assurance that the financing proceeds will be used for the intended purposes, with due attention to the principles of economy, efficiency, effectiveness, transparency, and accountability, and will be able to support implementation and achieve the desired results.

### **D. Procurement**

55. **The Procurement Regulations for IPF Borrowers (July 2016), which is issued under the World Bank's new Procurement Framework, will be used for carrying out the project procurements.** Under the Procurement Framework, a Project Procurement Strategy for Development (PPSD) and a Procurement Plan (PP) are being prepared by the Implementing Agencies for the project. The procurement plans will be updated during the project implementation period subject to an agreement with the Bank.

56. **The World Bank's on-line procurement management system "STEP" (systematic tracking and exchange in procurement) shall be used for managing the project procurements.** The procurement profile of the project indicates that there will be procurement of IT equipment (medium to high end), business application software, and consulting services assignment. No works procurements are envisaged under the project. The procurement plans corresponding to various activities under SBP and CDNS components are under preparation.

57. **Commercial Practices shall be prepared by the SBP, which will be mutually agreed with the World Bank prior to implementation.** Support will be provided to participating financial institutions (PFI) and other financial service providers for developing and piloting new financial products and services. Each financial service provider (which won a challenge fund) will select providers of services and TA using the Commercial Practices as agreed with the Bank.

58. The following two implementing entities will carry out procurement under the project for their respective components.

#### **SBP**

59. **The organization follows the Federal Public Procurement Rules for procurement activities funded by the Government.** The SBP has extensive experience in handling large IT infrastructure projects. In the past, the SBP has worked on the two World Bank-funded projects. There is a dedicated unit—General Services Department (GSD)—that is responsible for procurement function for the SBP and SBP-Banking Services Corporation (BSC). The department handles procurement activities such as IT equipment and services, professional consultancy services, vehicles, office equipment, furniture and fixtures, medicines, and so on. The GSD is headed by a Group Head (HR and Support Services) who reports to the Managing Director who is the Chief Executive Officer of the SBP-BSC and controls the affairs of the SBP on behalf of the Board of Directors. The Management Committee for IT oversees the whole process, from inception to execution. A detailed assessment for the SBP has been done and relevant mitigation measures are proposed for addressing the risks.

#### **CDNS**

60. **Federal Public Procurement Rules are being followed for procurement activities funded by the Government.** The entity is engaged in doing some small to medium IT equipment procurement, but it has limited experience of procurement of large, complex IT equipment and systems. The entity has no experience of working on World Bank projects or procurements. Mitigation measures are proposed in the PPSD to address the risks identified in the assessment. The organization has a unit to handle procurement activities and for years has had staff to handle procurement activities.

#### **E. Social and Environment (including Safeguards)**

61. Components 1, 2, and Subcomponent 3b-Activity 2 involve analytical studies, capacity building, upgrading digital payment systems/software etc. and are not expected to have E&S risks and impacts, thus no safeguard policies are triggered.<sup>44</sup> Components involving commercial lending instruments – LOC for financing microfinance enterprises (subcomponent 3a) and RSF for financing SMEs (subcomponent 3b-Activity 1) – are expected to have E&S risks and impacts associated with lending for private sector activities implemented by private sector entities (MSMEs) across manufacturing and service sectors<sup>45</sup> in Pakistan. Hence, the World Bank's OP/BP 4.03 (World Bank Performance Standards for Private Sector Activities) has

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<sup>44</sup> Direct environmental and social impacts of these components are very limited. No civil works such as renovation of rooms or building will be undertaken.

<sup>45</sup> Some sectors with perceived higher potential E&S risks and impacts in the country context (namely property/real estate development, commercial construction, tanneries, timber and logging, mining, hunting, and informal cross-border trade) will be excluded from financing under microfinance component as a matter of project design.

been applied. In particular, the approach will be consistent with OP/BP4.03 provisions for projects involving financial intermediaries.<sup>46</sup> It is expected that most of MSMEs will be in industrial estates/zones and areas designated for commercial activities. The project has been classified as Category FI-2 in accordance with OP/BP4.03 based on the expectation that potential adverse environmental and social risks or impacts of these MSMEs will be few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures.

62. The project will also have a positive impact on women and women entrepreneurs who will be targeted for DTAs, are expected to receive 60 percent of total microfinance lending, and will receive specific technical advice support under Subcomponent 3b (see annex 6).

63. The E&S approach for the project is designed in accordance with relevant requirements of the GOP and the World Bank. Given that the project intends to channel finance to PFIs who, in turn, will support a variety of MSME private sector business activities across sectors and the nature of risks and impacts, as well as specific locations are not known at present, core elements of the E&S risk management approach for the project are: (a) clearly defined Applicable Environmental and Social Requirements to be incorporated in all project legal documents (i.e. applicable E&S national and local laws and regulations of Pakistan; List of Excluded Activities included in the Operations Manual); for business activities that present moderate to high risks, the WB Performance Standards 1 through 8<sup>47,48</sup>; (b) ensuring the development and implementation of an Environmental and Social Management System (ESMS) by PFIs to support their effective implementation of E&S screening procedures against these Applicable E&S Requirements, which will be embedded in the overall credit process for end borrowers; and (c) a capacity building plan that will support adequate implementation of the ESMS.<sup>49</sup>

64. In particular for the LOC and RSF respectively, financial intermediaries will be required to put in place an ESMS. At the level of SBP that will serve as a vehicle for channeling funding to PFIs (both wholesale and retail), an overarching E&S policy and corresponding procedures will be developed to guide PFIs in fulfilling their responsibilities for E&S risk management in their lending under the project. These will be formally approved by the World Bank and disclosed by SBP. As part of these procedures, SBP will be responsible for ensuring adequacy of the ESMS for the financial intermediaries involved in LOC.<sup>50</sup>

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<sup>46</sup> In line with the project's structure, SBP (or another institution that may be engaged in implementing SME finance component) will be a vehicle for on-lending to PFIs that can be both wholesale (on-lending to other FIs) and retail (MFIs lending to MSMEs for eligible business activities). Consequently, OP/BP4.03 requirements are applicable to all FIs within the project structure, and it will be done in a practical manner based on gradual capacity improvement and commensurate with the level of risk and actual project's needs.

<sup>47</sup> WB Performance Standard would be applied as commensurate with the outcomes of the environmental and social screening procedures and based on the nature and magnitude of risks and impacts of private sector activities. Application of WB Performance Standards will not be required for microfinance borrowers and is expected to be limited for SME borrowers.

<sup>48</sup> "World Bank Performance Standards" are, in effect, IFC Performance Standards on Environmental and Social Sustainability adopted as the "World Bank Performance Standards" in 2013 pursuant WB Operational Policy 4.03. IFC Performance Standards were first introduced in 2006 and updated in 2012. IFC Performance Standards can be found here: [http://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/ifc+sustainability/our+approach/risk+management/performance+standards/environmental+and+social+performance+standards+and+guidance+notes](http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/our+approach/risk+management/performance+standards/environmental+and+social+performance+standards+and+guidance+notes)

<sup>49</sup> ESMS for a financial institution is defined as is a systematic process, integrated into the overall risk assessment in their lending operations, to assess the environmental and social risks and impacts arising from their investees' business activities, manage the financial institutions' exposure to them, and improve operating efficiency and effectiveness.

<sup>50</sup> As flexibility and continuous improvement is an integral part of the ESMS concept for financial institutions, any modifications of

65. Capacity building for the financial institutions will be the single most important factor for successful practical implementation of ESMS with tangible outcomes. This approach aims to increase ownership of the E&S risk management within key institutions and build long-term capacity to incorporate sound E&S practices within their credit/investment assessment, with a specific focus on MSME finance. Further details related to the implementation of E&S approach are given in annex 2.

## **F. Citizen Engagement**

66. **The project will incorporate a CE feedback loop for MSMEs by surveying a sample of beneficiaries.** Two CE questionnaires<sup>51</sup> will be custom designed for (a) the microenterprise beneficiaries of the LOC and (b) SME beneficiaries of the RSF (subject to Subcomponent 3b activities). A selected subset of beneficiaries will receive the CE questionnaire, which will be designed to assess overall satisfaction of services (including the ease of access, quality, process, disclosure, responsiveness of needs, and so on) of the loan or LOC. The CE questionnaires would be developed after the start of implementation and closer to the midterm review. The CE questionnaire results will be analyzed and drafted into a project report that will contain key recommendations to improve the project (for consideration) during the review period. The report will be shared with government partners, financial institutions, and other relevant stakeholders and will inform if the overall project implementation is feasible.

## **G. Other Safeguard Policies (if applicable)**

67. As part of screening for E&S risks and impacts, issues covered by OP /BP 7.50 and OP/BP 7.60 policies will be considered. If such issues are identified in activities to be financed under LOC or RSF, which is unlikely, such activities will be excluded. Components 1, 2, and subcomponent 3(b)-Activity 2 are not expected to have such impacts.

## **H. World Bank Grievance Redress**

68. Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel, which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate GRS, please visit <http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service>. For information on how to submit complaints to the World Bank Inspection Panel, please visit [www.inspectionpanel.org](http://www.inspectionpanel.org).

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the ESMS for financial institutions will not be subject for formal approval by the Bank.

<sup>51</sup> The CE questionnaire for SMEs is subject to the endowment of an RSF, as detailed in Subcomponent 3b.



## VII. RESULTS FRAMEWORK AND MONITORING

### Results Framework

COUNTRY : Pakistan

Pakistan Financial Inclusion and Infrastructure Project

#### Project Development Objectives

The proposed development objective is to contribute to increasing access and usage of digital payments and other financial services for households and businesses in Pakistan.

This will be done by: (a) improving market infrastructure and institutional capacity, (b) supporting the uptake and usage of Digital Payments and Financial Services and by (c) improving access to financial services for micro, small and medium enterprises (MSMEs).The project will seek to substantially increase access and usage of financial services by women and support women-owned MSMEs.

#### Project Development Objective Indicators

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
<b>Name:</b> Number of digital transaction accounts (in millions)		Number	45.00	60.00	Annual	GPSS, SBP	SBP

**Description:** This indicator measures the number of digital transaction accounts, as detailed in the Global Payment System Survey (GPSS) on an annual basis. The indicator targets take into account projected annual growth and the NFIS account targets.



Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
<b>Name:</b> Electronic payments per capita		Number	0.40	2.00	Annual	GPSS, SBP	SBP

**Description:** This indicator measures the growth in electronic payments and transactions per capita, including the shift of government payments to digital. The number of electronic payments will be divided according to the total population to receive a per capita measurement.

<b>Name:</b> Number of unique beneficiaries (borrowers) reached*		Number	0.00	123900.00	Annual	SBP, PFIs	SBP
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**Description:** This indicator currently captures the number of unique beneficiaries (including microfinance borrowers, microenterprises, and SMEs) reached under the line of microfinance outlined in Component 3. The project is designed to support the assumption that one-third of microentrepreneurs may apply for a second loan. The number of actual beneficiaries reached may be higher if the project endows the RSF.

### Intermediate Results Indicators

Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
<b>Name:</b> Number of digital transaction accounts (female) in millions		Number	7.00	10.50	Annual	GPSS, SBP	SBP

**Description:** This indicator measures the number of digital transaction accounts owned by females as detailed in the GPSS and the SBP on an annual basis. The indicator targets take into account projected annual growth and the NFIS account targets.



Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
<b>Name:</b> Number of unique female beneficiaries reached (rounded to nearest 50)**		Number	0.00	74340.00	Annual	SBP, PFIs	SBP
<p><b>Description:</b> This indicator currently captures the number of unique female beneficiaries (including microfinance borrowers, microenterprises, and SMEs) reached under the line of microfinance outlined in Component 3. The project is designed to support the assumption that one-third of all microentrepreneurs (including females) may apply for a second loan. The number of actual female beneficiaries reached may be higher if the project endows the RSF.</p>							
<b>Name:</b> Number of loans disbursed***		Number	0.00	150000.00	Annual	SBP, PFIs	SBP
<p><b>Description:</b> This indicator includes the number of loans disbursed under the lending window in Component 3. If the project endows the RSF as detailed in Component 4, this indicator will aggregate additional loans facilitated through the RSF and revise the intermediate indicators to include the number of loans disbursed, segmented by Subcomponent 3a or 3b.</p>							
<b>Name:</b> New/Upgraded SBP-Operated Payment system and National Payments Gateway installed and operational (Yes/No)		Text	No	Yes	Annual	SBP	SBP
<p><b>Description:</b> This indicator will receive a 'Yes' once (i) a roadmap and framework for the NPG and SBP operated payment system specifications are drafted; and (ii) Upgrades and replacements based on the detailed system components specified within the roadmap and framework are implemented. This includes upgrades / replacements to the SBP-operated payment system and the platform for interoperable instant retail payments (either the National Payments Gateway or to the existing private sector infrastructure) as specified in the framework.</p>							
<b>Name:</b> DTA Scheme		Text	No	Yes	Annual	SBP	SBP



Indicator Name	Core	Unit of Measure	Baseline	End Target	Frequency	Data Source/Methodology	Responsibility for Data Collection
designed and operational (Yes / No)							
Description: This indicator will receive a “Yes” once the DTA is designed, launched and operational by the SBP.							
<b>Name:</b> End-to-end automation and modernization of the NSS implemented and operational (Yes/No)		Text	No	Yes	Annual	CDNS	CDNS
Description: This indicator will receive a ‘Yes’ once recommendations for improvements to the NSS (as detailed under annex 1) to modernize and automate the system have been implemented, established, and operationalized. The NSS improvements are identified under the detailed Component 2 (annex 1). The delivery of such recommendations for each activity (as designated by the phased approach) will constitute a ‘Yes’ each year for this indicator. The overall implementation and operationalizing of the end-to-end automation and modernized NSS will constitute a ‘Yes’ for this indicator by Year 5.							

**Target Values****Project Development Objective Indicators**

Indicator Name	Baseline	YR1	YR2	YR3	YR4	End Target
Number of digital transaction accounts (in millions)	45.00	48.00	51.00	54.00	57.00	60.00
Electronic payments per capita	0.40	0.70	1.00	1.40	1.70	2.00
Number of unique beneficiaries (borrowers) reached*	0.00	6000.00	36000.00	75900.00	100500.00	123900.00

**Intermediate Results Indicators**

Indicator Name	Baseline	YR1	YR2	YR3	YR4	End Target
Number of digital transaction accounts (female) in millions	7.00	7.50	8.00	9.00	9.50	10.50
Number of unique female beneficiaries reached (rounded to nearest 50)**	0.00	3600.00	21600.00	45500.00	60300.00	74340.00
Number of loans disbursed***	0.00	6000.00	36000.00	78000.00	120000.00	150000.00
New/Upgraded SBP-Operated Payment system and National Payments Gateway installed and operational (Yes/No)	No	No	No	No	No	Yes
DTA Scheme designed and operational (Yes /	No	No	No	Yes	Yes	Yes



Indicator Name	Baseline	YR1	YR2	YR3	YR4	End Target
No)						
End-to-end automation and modernization of the NSS implemented and operational (Yes/No)	No	No	No	Yes	Yes	Yes

**Notes:**

\* Current targets listed in the PDO are reflective of the LOC for microfinance, and project support and beneficiaries reached under the RSF are not yet included. Therefore, actual reach may be higher once the RSF is endowed (pending project assessment), which will increase the number of beneficiaries reached and number of loans disbursed.

\*\* Based on project design the project targets that at least 60 percent of microfinance borrowers should be women. The results indicator is based on current female borrower estimate of 54 percent of portfolio (PMN industry data as of June 2016).

\*\*\* Current targets are estimated using a US\$500 average loan size and are subject to revision with revised loan size depending on the SBP.

\*\*\* Based on project design, the project assumes that one-third of microenterprises may apply for a second loan within two years.



**ANNEX 1: DETAILED PROJECT DESCRIPTION**

**COUNTRY: Pakistan**

**Pakistan Financial Inclusion and Infrastructure Project**

1. The proposed development objective is to contribute to increasing access and usage of digital payments and other financial services for households and businesses in Pakistan. The project has a five-year duration and uses a financial intermediary loan that will contribute to financial inclusion by improving: (a) access and usage of digital payments and DFS for individuals through investments, pilots, capacity building, and complementary analyses aimed at improving financial infrastructure and the ecosystem for DTAs and the NSS and achieve scale through supporting the strategic digitization of government payments (Components 1 and 2); and (b) access to financial services for MSMEs (Component 3). The project provides support to implementation of the NFIS, including the investments needed for financial infrastructure to support the availability and usage of digital payments and DFS (Component 1). It will seek to expand and diversify access points by leveraging the existing network of CDNS (Component 2). The project will support the microfinance sector through a liquidity facility (Subcomponent 3a) and will promote access to financial services for SMEs (Subcomponent 3b) with a potential RSF for SMEs, capacity building and innovations through challenge funds. There will be a particular focus on financial inclusion for women and on women entrepreneurs' access to finance. Table 1.1 summarizes the project's financing by component.

**Table 1.1 Project's Financing by Components**

Project Components	US\$, millions	Responsible Agencies	IDA/IDA SUF
Component 1: Direct Support to the NFIS Implementation	17.5	SBP	
Subcomponent 1a. Improving Financial and Market Infrastructure to Facilitate the Uptake of DTAs	15		IDA
Subcomponent 1b. Improving Access and Usage of Digital Payments and Financial Services (DFS)	1.5		IDA
Subcomponent 1c. Enhancing Secretariat Capacity and Project Management and Monitoring	1		IDA
Component 2. Supporting Expansion of Access Points for Financial Services	9.4	CDNS/MOF	
<i>Automation of the Central Directorate of National Savings (CDNS)</i>	9.4		IDA
Component 3. Improving Access to Microfinance and to Financial Services for Micro, Small, and Medium Enterprises	110.1	SBP	
Subcomponent 3a. Improving Access to Microfinance and to Financial Services for Micro Enterprises	75		IDA SUF
Subcomponent 3b. Improving Access to Financial Services for Small and Medium Enterprises	35.1		
<i>Activity 1. Risk Sharing Facility</i>	33.1		IDA SUF / IDA
<i>Activity 2. Technical Assistance and Innovation Challenge Funds for SME Lending</i>	2		IDA
<b>Total</b>	<b>137</b>		

2. The following sections describe in detail the components and subcomponents of the project.



**Component 1: Direct Support to the NFIS Implementation (US\$17.5 million)**

3. This component will provide direct support to implementation of the NFIS by supporting improvements in the financial market infrastructure and activities to promote the uptake and usage of digital financial services. It will also support the capacity of the NFIS Secretariat and project management and monitoring.

***Subcomponent 1a. Improving Financial and Market Infrastructure to Facilitate the Uptake of DTAs (US\$15 million)***

4. This subcomponent will support the significant investment in financial infrastructure required to upgrade payments and settlements systems, which are key to leverage the payment systems for financial inclusion. It will also support the IT infrastructure needed for the development and uptake of DTAs. Activities supported under this subcomponent are in line with the findings of the World Bank TA provided as part of the FISF project and reflect the NPS Strategy developed under the FISF TA in collaboration with the SBP. Related capacity-building support (for example, on developing the operational rules) will also be provided.

5. **Activity 1. Improvement of the payment infrastructure and the IT and market infrastructure (US\$14 million).** This activity will support the following:

*(a) Replacement of the SBP-operated payment system by a system with dual RTGS and ACH capabilities*

6. The RTGS system is the critical foundation for the NPS as it enables safe and efficient settlement of many other interbank payment infrastructures. The current RTGS system in Pakistan (called PRISM) was procured in 2005 and is now obsolete. Its maintenance contract expired in June 2014. Therefore, a new and state-of-the-art RTGS system is required to handle a significant increase in payment volumes comprising of interbank funds transfers, government securities settlement, and systemic payments such as the settlement of retail payment systems. Besides improving the reliability of the system, the replacement of the RTGS is necessary as the ongoing initiatives to digitalize payments are likely to significantly increase the required payment processing capacity of the RTGS system.

7. SBP will also develop an ACH for direct credit transfers and direct debit transfers, for bulk retail payments. The ACH is an important infrastructure that is currently not available in Pakistan, which is hampering the development of electronic payments, especially for business and government payments. This infrastructure will support the daily processing (including clearing and netting) of a large number of low-value payments. It will also be used to leverage large-volume recurrent payment streams such as employer payrolls and government incoming and outgoing payments through credit transfers, to advance financial inclusion. It will be interfaced with payment card and mobile payment systems to allow for payments from and to e-money instruments and payment cards.

*(b) Implementation of a platform for interoperable instant retail payments needed for the development of DTAs and a National Payment Gateway platform*

8. The SBP intends to develop a platform called NPG to facilitate the interoperability among various payment channels such as ADCs, BB networks, and conventional PSPs; foreign remittances landing point; and gateway for ecommerce.



*(c) Investments in technical systems/platforms supporting improvements in market infrastructure*

9. The upgraded financial infrastructure will require investments in corresponding technical systems/platforms such as IT systems, interfaces for linkages with government systems and government securities. The Payment Aspects of Financial Inclusion report has identified that reliable financial infrastructure is critical to the provision of an efficient and cost-effective payment services. In that light, the infrastructure components of the NPS are a fundamental foundation for financial access and inclusion.

**10. Activity 2. Capacity building for oversight and improvement of the legal framework in line with the NPS Strategy (US\$1 million).**

11. Since an enabling legal environment for the NPS will allow effective use of the infrastructure detailed above (Activity 1), this activity will support Regulations on Electronic Money (e-money and electronic checks). The Payment Systems and Electronic Funds Transfer Act authorizes the SBP to issue regulations on electronic money institutions and license them. However, no regulation on e-money has been adopted even though several areas of e-money have been identified as requiring further regulation. Similarly, electronic checks and check truncation are legally recognized and deemed equivalent to paper checks in the Payment Systems and Electronic Funds Transfer Act (Art. 17), however, the required secondary regulations have not been elaborated and implemented yet. This activity will support improvements in the legal framework. This includes those related to the additional conditions a PSP would be required to comply with in order to obtain a license to issue e-money. Other improvements may include the 'redeemibility' of e-money 'at par value', the fact that the issuance of e-money does not constitute a deposit-taking activity, the conditions for granting and maintaining authorization as e-money issuers (including prudential requirements proportionate to the operational and financial risks faced by such entities in the course of the issuance of e-money). The issue of protection of customer funds in nonbank e-money issuers and the required safeguard mechanisms (such as liquidity requirements and placement of funds in a commercial bank)<sup>52</sup> should also be addressed. Regulatory mechanisms are needed to not only successfully isolate e-money holders' funds but also to ensure that they can retrieve funds in the event of bankruptcy of a nonbank e-money issuer.<sup>53</sup> As part of the strengthening of the legal and oversight framework for payments, this activity will also support the adoption of a comprehensive oversight and legal framework for Pakistan payments market including investments in required tools for data collection on payments and capacity building of SBP staff.

***Subcomponent 1b. Improving Access and Usage of Digital payments and Financial Services (DFS) (US\$1.5 million)***

- a. This subcomponent will support the GOP in expanding access to DTAs. The GOP has launched a Digital Transaction Account Scheme, which will comprise of comprehensive rules, procedures, standards, branding, and acceptance marks. To expand access and reach scale and viability, support will be provided for digitization of bulk and retail payments including major G2Ps, and corporate payments. This could

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<sup>52</sup> Consumer contracts (terms and references) should also be simple, accessible, and clear and the process of complaints for e-money transactions can also be made digitally.

<sup>53</sup> It is also international best practice to have a simplified regime for basic transactional accounts that includes identification requirements, information to be saved by each e-money issuer, tiered KYC 'know your customer', and AML anti-money laundering. The basic requirements and an explicit clear route to move from basic transactional account (usually with caps to the amount transacted) to general/uncapped transactional accounts are generally provided.



include, as an initial step, the formulation of a road map for digitizing all government payments with a plan that connects the dots with what already exists (for example NADRA, retail payment systems while also identifying gaps that need to be filled (for example, connecting people's identities to accounts). This will be done using a detailed mapping of government payments, at the federal and provincial levels.<sup>54</sup>

***Subcomponent 1c. Enhancing NFIS Secretariat Capacity and Project Management and Monitoring (US\$1 million)***

12. This subcomponent will support enhancement of the NFIS Secretariat's capacity as it takes on more responsibilities (including policy and advocacy) as the NFIS implementation progresses. The proposed project will support staffing of the NFIS organization chart that has been finalized by the SBP. Currently, there are only four staff working in the Secretariat, and support is being provided through the FISF TA with experts and consultants on a short-term basis. There is also an expected need for staff training. Support is envisaged for investments in systems, for example, for M&E or results measurement. Finally, support is expected to cover assistance to the NFIS existing governance structure, including the NFIS Council, NFIS Steering Committee, and the NFIS technical committees.

13. The subcomponent will also include costs for project management and M&E. It will provide support to build up the implementing agencies' capacity in the areas of project implementation and M&E. This would include two broad areas: (a) **Project management and capacity building**, under which implementation support will be provided to the responsible unit at each agency for the day-to-day management and coordination of project activities. TA will be provided to increase the dedicated teams' expertise in managing the procurement, FM, and safeguards aspects of the project, including recruitment of short-term consultants with dedicated expertise as needed; and (b) **M&E**, under which capacity to collect and analyze data for project M&E and project impact analysis will be strengthened through TA.

**Component 2. Supporting Expansion of Access Points for Financial Services (US\$9.4 million)**

14. This component will support investments, pilots, and analyses that will drive financial inclusion access points.<sup>55</sup> This is one of the key drivers of financial inclusion highlighted in the NFIS.

15. **Automation of the CDNS.** Support will be focused on integrating more diverse, sustainable, and efficient access points for financial inclusion across Pakistan, notably through the CDNS. The CDNS is a key contributor toward financial inclusion with an investor base of around 7 million and a portfolio of over PKR 3.5 trillion (US\$33 billion). However, due to lack of automation and operational constraints, the NSS has not been able to extend its financial services across the country, especially to rural areas. At present, the NSS instruments and accounts are being offered through a network of 375 National Savings Centers across the country, and through agency arrangements with Pakistan Post and networks of commercial banks. The GOP is considering converting the CDNS into an autonomous body to improve efficiency and service delivery. This conversion is expected to improve governance and is also important for sustainability of the CDNS reform process.

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<sup>55</sup> Including incremental operating costs for MOF PCU functions as part of implementation support.



16. The most important reforms needed to link the NSS with the rest of the formal financial sector and facilitate the expansion of DTAs are the end-to-end automation and modernization of existing systems. The CDNS needs to embark on a comprehensive automation initiative to acquire and implement state-of-the-art financial systems like Alternate Delivery Channels (ADCs), Enterprise Resource Planning (ERP), Customer Relationship Management, and so on to provide modern financial services to its 7 million customers. It will not achieve its goal of leading the financial inclusion effort unless it can offer financial services on mobile phones and internet including Automated Teller Machine (ATM) services, which can only be accomplished by implementing robust financial systems. The automation of the CDNS will comprise of multiple components including the following:

- a. Business process reengineering and IT strategy and implementation plan.
- b. Enterprise Resource Planning for complete automation.
- c. Upgraded IT platforms, ADCs and ancillary applications and systems.
- d. Basic IT infrastructure.
- e. IT capacity building/training and sourcing strategy.
- f. Data Center and disaster recovery, Business intelligence and data warehouse.
- g. Improving financial reporting and controls.

**Component 3: Improving Access to Microfinance and to Financial Services for Micro, Small, and Medium Enterprises (US\$110.1 million)**

***Subcomponent 3a. Improving Access to Microfinance and to Financial Services for Micro Enterprises (US\$75 million)***

17. This subcomponent will provide an LOC to alleviate the funding pressures that the industry faces, thereby catalyzing private investment and promoting access to market funding with the aim to facilitate access to microfinance in Pakistan. The LOC will be channeled through the SBP for disbursement to PFIs (that could include wholesale lenders), to help them refinance eligible loans to the microfinance sector.<sup>56</sup> The project will use debt instruments, including subordinated debt (which will support PFI operations and growth, enhance their financial strength and enable PFI to better leverage and crowd in private commercial funds to onlend larger amounts to the underserved). The on-lending rates for the LOC will reflect the cost of intermediating the funds, including an appropriate credit risk margin, without creating market distortion and in compliance with World Bank guidelines and policies for financial intermediary lending.<sup>57 58</sup>

18. The GOP will enter into a financing agreement with the SBP on mutually agreed terms, for SBP to channel the LOC and administer the funds. The SBP will on-lend funds to PFIs (including MFI, MFB or other wholesale lender) on mutually agreed terms. The selection of PFIs will be based on clearly defined and

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<sup>56</sup> PFI could be microfinance wholesale lenders, microfinance institutions or microfinance banks. End beneficiaries are microfinance borrowers including microentrepreneurs.

<sup>57</sup> The LOC would be on-lent on market terms to cover the cost of funds, operating costs, and currency risk and also to be competitive with market rates. Pricing of the credit line will be determined according to market principles and is expected to vary according to risks and tenors

<sup>58</sup> With regard to the pricing of wholesale funds versus direct operations with retail PFI, the markup over cost of funds will reflect: (i) the difference in credit risk on lending to wholesale PFIs versus directly lending to retail PFIs; and (ii) transactions costs of bulk versus retail lending. The pricing of the refinancing to the PFIs will be determined by SBP in accordance with its appraisal of the PFI and its refinancing policies as described in the OM.



transparent eligibility criteria to ensure their adequate performance and profitability. The eligibility criteria are defined in the OM, including on reporting and fiduciary and safeguards dimensions. The SBP will monitor overall progress and oversee compliance with any covenants. Besides helping address the liquidity constraints and the limited access to market-based funding, the subcomponent aims to promote sustainable growth and development of the sector by covenants of good practices. Although the disbursement and allocation of funds will be demand driven, based on market needs, and will depend on the performance of the various financial intermediaries, the eligibility criteria will include covenants on governance, transparency, and consumer protection. With the exponential growth expected for the sector in the next three years, it is widely recognized that increased outreach and competition require corresponding efforts around client protection, awareness, and transparency.<sup>59</sup>

69. **The subcomponent has a gender dimension and aims to allocate 60 percent of loans to women and women-owned microenterprises.**<sup>60</sup> To help address the lack of financial services for microentrepreneurs, particularly women entrepreneurs, the LOC will also seek to support the transition of MFBs from lending to individuals to lending to microenterprises and small businesses. Another focus will be on developing products tailored to client needs and in that light, participation in the LOC will take into account product development (for example, microinsurance, microloans for housing, energy loans, agriculture loans, and so on) and loans using innovative financing mechanisms and delivery channels. This is essential to ensure that as the industry grows, consumers have access to suitable financial products that cater to their needs and delivered through cost-effective methods that help expand outreach. Lastly, to promote outreach and support initial on-ramp to financial services through the LOC, preference will be given to those PFIs that will support loans to first-time borrowers. The project will also seek to focus on underserved areas.<sup>61</sup>

### ***Subcomponent 3b. Improving Access to Financial Services for Small and Medium Enterprises (US\$35.1 million)***

19. The aim of this subcomponent is to increase access to finance for SMEs<sup>62</sup>, which are underserved by financial service providers. Since 2008, SME lending has declined in both absolute and relative terms, declining from 16 percent of bank lending in 2008 to just 7 percent of a smaller envelope in 2015. Against a backdrop of increasing nonperforming loans (NPLs), slow demand from the private sector, and rising government borrowing over the period, banks invested heavily in government securities, which now exceed private sector credit in banks' portfolios. This subcomponent supports the activities below.

20. **Activity 1. Risk Sharing Facility (US\$33.1 million).** Since 2010, the SBP has operated a CGS for small and rural enterprises, which is funded by the GOP and DFID under its FIP. Low utilization in the early years has led to changes in the scheme over time. This resulted in higher utilization, which stood at 73 percent as of December 2015. The CGS does not adhere to the 'Principles for Public Credit Guarantee Schemes for SMEs' in important ways. It is not established as an independent entity, and the guarantees are free—whereas good practice would require a risk-based pricing policy that covers costs and ensures sustainability.

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<sup>59</sup> This is in line with the findings of the Microfinance Growth Strategy 2020. This also factors in lessons learned from other countries' experience where microfinance sectors grew without adequate attention to these dimensions and then suffered various forms of crises (for instance in Afghanistan or India).

<sup>60</sup> The current female borrower estimate is 54 percent of portfolio (PMN industry data as of June 2016).

<sup>61</sup> One additional appraisal criteria for PFI may include additionality related to entering new markets.

<sup>62</sup> This will help contribute to the NFIS headline target aiming to increase bank lending to SMEs by 8 percentage points by 2020.



Furthermore, the SBP is precluded by law from leveraging the fund's endowment, so guarantees can only be issued to the extent that they are fully cash-collateralized. The FIP Program comes to an end in March 2020, and DFID and the SBP are currently assessing alternatives to replace the current CGS and make it sustainable over the long term. They are contracting an independent study to look into alternative structures and market demand for a stand-alone CGS. It is proposed that US\$33.1 million of the project be allocated to endow or capitalize the new scheme or entity, assuming it meets World Bank requirements and is broadly in line with the 'Principles for Public Credit Guarantee Schemes for SMEs'.<sup>63</sup>

**21. Activity 2. Technical Assistance and Innovation Challenge Funds for SME Lending (US\$2 million).**

A number of proposed activities will support the development of SME finance and enhance the effectiveness of the RSF.

- a. **Comprehensive analysis of demand side and supply side constraints on financing to SMEs.** Select analytical work will be undertaken to identify obstacles to SME lending on both the supply and demand sides and assess the reasons for the high level of NPLs in banks' SME loan portfolios.
- b. **Challenge funds for innovation in SME banking.** The SBP will launch challenge funds to spur innovations and pilots in SME banking. Grants will be awarded (competitively) to financial service providers to test innovative solutions to meet the financial needs of the SME market.
- c. **Financial linkages for women entrepreneurs.** This activity will provide funding to raise awareness of available financial products and services among women entrepreneurs and to link businesswomen to financial institutions. It will build on the existing Women X program, expanding beyond these select entrepreneurs overtime.<sup>64</sup>
- d. **Capacity building for regulators and awareness campaigns to promote SME finance.** Regulators and associations who deal with SMEs may apply for funding for relevant capacity building and awareness campaigns.

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<sup>63</sup> If a decision to create an independent entity is taken, an assessment will need to be done of the financial capacity of the new entity, and appropriate legal arrangements will need to be established between the World Bank and the new entity. This could require a project restructuring at the time.

<sup>64</sup> Women X is a WBG program that provides business education and support services to women who run SMEs in Karachi, Lahore and Peshawar. Women X is providing invaluable education and networking opportunities to its selected entrepreneurs, but has not endeavored to link them with lenders who can provide credit, savings and other financial services.



## **ANNEX 2: IMPLEMENTATION ARRANGEMENTS**

**COUNTRY: Pakistan**

### **Pakistan Financial Inclusion and Infrastructure Project**

#### **Project Institutional and Implementation Arrangements**

1. The Islamic Republic of Pakistan is the borrower, and the project's activities will be executed by the SBP and the CDNS at the MOF.
2. A coordination team will be established and maintained at the MOF Finance Division and chaired by an Additional Secretary. The overall project coordination team or unit will ensure overall coordination of the project's activities including financial reporting. To assume its function, the coordination team may be supported by an external resource.
3. Small project teams at each agency will be responsible for the execution of project activities under that agency's purview, notably with respect to financial management (FM), procurement, and safeguards.
4. The SBP, which hosts the NFIS Secretariat, will be responsible for Component 1 and Component 3. The MOF will channel funds to SBP (please see fund flows in the Financial Management section).
5. The SBP will have a PIU with the necessary capacity on project management, FM, procurement, and E&S safeguards. However, dedicated project managers are expected to be responsible for some aspects, with the support of technical teams, given the scope and complexity of the components. These include Subcomponent 1a on payments systems infrastructure, and on IT infrastructure, Subcomponent 1b on DTAs and DFS, and Subcomponent 3b on SME finance. The PIU will be headed by a PD at the executive director rank, in line with the arrangements during past World Bank projects. The PIU will be in charge of project coordination at the SBP and will oversee FM, procurement, reporting, M&E, audit, public information, and related functions.
6. The SBP has prior experience in implementing a World Bank investment project on banking sector reforms (P074797; 2002–07), under which a similar implementation arrangement was followed. In addition, the SBP's newly formed Financial Inclusion Department has been set up as the Secretariat for the NFIS, which has high-level commitment from the Finance Minister, government ministries, regulators, and the private sector. Because the SBP is already leading the coordination efforts for implementation of the NFIS, this offers a number of synergies and opportunities to complement reform efforts on the NFIS implementation.
7. The CDNS at the MOF will be responsible for Component 2. The CDNS will establish a small team with adequate capacity on project management, FM, and procurement to implement the automation of the NSS and other activities under Component 2. The MOF has also had exposure to a number of World Bank projects including leading projects involving several agencies.
8. The key responsibilities at each agency for the components of the project it is implementing will be as follows:
  - (a) Overall monitoring and supervision of the components;



- (b) Overall procurement and contract management;
- (c) Overall coordination among participating departments within the agency;
- (d) Procurement and disbursement with responsibility for adherence to all fiduciary and safeguard requirements of the World Bank;
- (e) Any other functions needed under the project’s components.

9. The responsible agencies will hire part-time technical specialists as required to support the implementation. To facilitate project implementation, a detailed OM has been prepared by the SBP, and the MOF (CDNS). The OM includes details on the implementation arrangements, including the eligibility criteria for the PFIs and the principles of the appraisal processes that will be followed; fiduciary and safeguards arrangements (which are also defined in the Environmental and Social Management System); project audit requirements, including the Terms of Reference (TOR) for the project audit; disbursement arrangements; the IUFR formats; and so on. It will provide guidance for each responsible agency on the procedural aspects of the project. It will also include the organizational chart of project implementation.

**Financial Management**

10. The FM Assessment was carried out at all the implementing agencies.

**Risk Assessment at the Entity Level**

11. *Risk Assessment at SBP:* The risk at the SBP is assessed as Moderate. SBP has established policies and procedures for budgeting, financial reporting and auditing, defined internal control framework, prior experience of working with donor agencies, and adequate staffing. A strong governance structure exists at the SBP that adheres to corporate governance standards. The effectiveness of the SBP’s governance, risk management, and control processes is assessed through the effective internal and external audit function. The Accounting and Internal Audit Department in the SBP is headed by qualified and well-experienced chartered accountants with rich industry experience. The SBP will establish rules of business for LoC, to the satisfaction of the Bank.

12. *Risk Assessment at CDNS:* The assessed risk at the CDNS is Substantial. The CDNS is the attached department of the MOF headed by a professional and well-reputed Director General (DG) from the private sector. The CDNS is working with other donors; however, it does not have prior experience working with the World Bank.

13. Table 2.1. indicates the actions to be taken for the project to strengthen its FM system.

**Table 2.1 FM Arrangements at the Project Level**

SBP	CDNS
<b>Staffing</b>	
The SBP has assigned professionally qualified chartered accountant acting as Joint Director as a key focal FM staff, which is considered as adequate for project purposes.	DG CDNS will be responsible for FM and will appoint a focal person responsible for accounting and reporting project activities.
Planning and Budgeting	



<p>The GOP budget rules and procedures will apply. The budget for the project to be communicated to the MOF for inclusion at the receipt side of development budget as ‘Estimate of Foreign Assistance’ based on yearly allocation.</p>	<p>The GOP budget rules and procedures will apply. The budget for the project to be communicated to the MOF for inclusion at the receipt side of development budget as ‘Estimate of Foreign Assistance’ based on yearly allocation.</p>
<p>Internal Control</p>	
<p>The internal audit department of the SBP will ensure that agreed operational, accounting, payment, and procurement procedures are followed in implementation of the project. Separate internal audit report of the project will be shared with the World Bank. They will also make recommendations for improving any systemic issues, if identified. The internal control procedures, are discussed in detail in the OM.</p> <p>The repayments by PFIs on LoC will be maintained in separate account (not an assignment account), to channelize the funds for subsequent lending. To maintain operational independence, financing under LoC will be implemented by Banking Service Corporation (BSC), a wholly owned subsidiary of SBP. BSC performs administrative functions and activities on behalf of SBP. The internal control procedures, including controls around the LOC are discussed in detail in the OM.</p>	<p>According to the recent restructuring in the CDNS, the internal audit and finance and accounting functions are completely segregated with different reporting lines. The inspection and audit team performs the internal audit of the CDNS branches and reports to the Director of Internal Audit who reports to the DG. The inspection team will also perform the internal audit of the project; however, it is noted that the department is understaffed. An additional resource will be provided to align current internal audit practices of the CDNS with international best practices.</p>
<p>Financial Reporting and Accounting</p>	
<p>The SBP prepares its accounts in accordance with applicable International Financial Reporting Standards (IFRS) in Pakistan Oracle ERP is implemented in the SBP which has integrated departmental functions related to budgeting, financial accounting, HR, payroll, procurement, and inventory and asset management.</p> <p>Separate books of accounts and financial statements will be prepared for project purposes on IFRS. The SBP will also share the biannual IUFRRs within 45 days at the end of the semester.</p>	<p>The CDNS is manually maintaining its accounts on single entry basis. Separate financial statements will be prepared for the project purposes on cash basis. The CDNS will also share the biannual IUFRRs within 45 days at the end of the semester.</p>
<p>External Audit</p>	
<p>The project will be audited by the SBP auditors appointed by the Board of Directors. The RSF, once functional, will be, however, audited by an independent firm of chartered accountants, acceptable to the World Bank, under agreed TOR. The audited financial statements should be received by the World Bank not later than nine months of the close of each financial year.</p>	<p>The separate financial statement of the CDNS subcomponent will be audited by the Auditor General of Pakistan. The audited financial statements will be submitted to the World Bank within nine months of the close of each financial year.</p>

**Disbursement and fund flow Arrangements**

14. Each implementing agency will maintain a Foreign Currency DA for each loan type (IBRD, SUF and IDA) at the NBP which will follow the Foreign Currency Assignment account procedures issued by the MOF. The World Bank Group will deposit the first advance into the DAs on the basis of a six-month forecast of expenditures. Subsequently, the forecast will be for every six months. The report-based principle will be used for withdrawal of credit proceeds. The withdrawals from the DAs will be only for eligible expenditures. The IUFRRs will be due for submission within 45 days of the end of the semester. On the basis of the IUFRRs, the WBG will document expenditures incurred against advances disbursed into the DAs. For the RSF, the expenditure will be defined as the amount transferred by the SBP or another entity to the Risk Sharing Guarantee Company (RSGC) in respect of creating the guarantee reserve for the RSF. It is being stipulated that the proceeds to the guarantee reserve funds will be subject to satisfactory financial control mechanisms, including independent financial audits, which will be determined and agreed as a part of the proposed FM Assessment (disbursement condition) after the creation of the RSGC.



Subsequently, the funds may be transferred to the company as a guarantee reserve in a single tranche.

**Disbursement Category**

**Table 2.2 Allocation of Loan Proceeds**

Disbursement Category	Total Amount of IDA and IDA SUF (US\$)	% of Expenditure to be financed
Category 1: Goods, Consultants’ Services, Trainings & Workshops, Cost to implement NFIS (excluding NFIS Secretariat staff cost), Financing to operate Risk Sharing Guarantee Facility and Incremental Operating cost at <i>State Bank of Pakistan</i>	52,350,750	100%
Category 2: sub loans by SBP	75,000,000	100%
Category 3: Consultants’ Services, Trainings & Workshops, Hardware and Software, and Incremental Operating at <i>CDNS</i>	9,400,000	100%
Category 4: Front End Fees	249,250	100%
Category 5: Interest Rate Cap or Interest Rate Collar premium		100%
<b>Total</b>	<b>137,000,000</b>	<b>100%</b>

*Note: The financing is inclusive of duties and taxes.*

15. **Retroactive financing** is allowed up to US\$7.5 million from IDA for payments made to meet eligible expenditure incurred from August 1, 2016 to the date of signing the Loan Agreement.<sup>65</sup>

16. **There is no outstanding audit report from the implementing entities/agencies.**

**Procurement**

**SBP - Procurement Capacity**

17. The SBP follows Federal Public Procurement Rules for procurement activities funded by the Government. The SBP has extensive experience in handling large IT infrastructure projects. In the past, the SBP has worked on the two World Bank-funded projects. There is a dedicated unit—the GSD, which is responsible for the procurement function for the SBP and the SBP-BSC. The department handles procurement activities like IT equipment and services, professional consultancy services, vehicles, office equipment, furniture and fixtures, medicines, and so on. The GSD is headed by a Group Head (HR and Support Services) who reports to the Managing Director who is the Chief Executive Officer of the SBP-BSC and controls the affairs of the SBP on behalf of the Board of Directors. The Management Committee for IT oversees the whole process, from inception to execution. There are four procurement sections, namely Proc.1, Proc.2, Proc.3, and Proc.4, each headed by a Divisional Head of OG5/OG4 Group. Proc.1 is responsible for procuring IT-related goods; Proc.2 is responsible for hiring Consultancy Services; Proc.3 for furniture, fixtures, and miscellaneous items; and Proc.4 for vehicles and associated management. Each procurement section is staffed by 3–4 staff. The IT procurement is supported by an IT engineer with combined background in business management. In the last five years, the SBP has handled diversified

<sup>65</sup> As per disbursement guidelines, the maximum period for retroactive financing is up to one year.



projects for servers, networking infrastructure, UPS, and software application upgrades.

18. Contracts are awarded to the lowest evaluated responsive bidders after submission of performance guarantee. For the SBP, it typically takes between 90 and 150 days from bid opening to award. The technical units are managing contracts. In terms of IT activities, Information System Department and the IT Department handle the contracts. These units have adequate capacity to handle contracts for IT activities; however, updates on best practices are to be given to these units. The IT Strategy and Project Management Department is also a new department formed. There is no formal complaint management and dispute resolution mechanism at SBP and no data on the received complaints is available with the implementing agency. The SBP indicated that the incidence of procurement complaints is low. In the absence of any data on procurement related complaint, no firm assessment could be made. It is therefore important that a robust Procurement Complaint Management system is established at SBP.

**Summary of PPSD - SBP**

19. The procurement profile of the SBP is described in Table 2.3. The profile below includes the procurement of Goods, Consulting Services (firms). No works procurements are envisaged under the project.

**Table 2.3 Procurement Profile of the SBP**

Contract Title, Description and Category	Estimated cost (US\$) and Risk Rating	Bank Oversight	Procurement Approach/ Competition	Selection Methods	Evaluation Method
Digitization of G2P and P2G payments, bulk payments for promotion of DTAs	1,500,000		Open-International	QCBS	Lowest Evaluated Cost
Comprehensive analysis of supply and demand-side constraints on financing to SMEs	200,000	Post	Open-National	QBS	Lowest Evaluated Cost
Firm to assist in the design and implementation of women's linkages program	435,000	Post	Open-National	QCBS	Lowest Evaluated Cost
Awareness Campaign for SMEs	165,000	Post	Open-National	QCBS	Lowest Evaluated Cost
Capacity Building for Regulators	200,000	Post	Open-National	QCBS	Lowest Evaluated Cost
Development of a National Payment Gateway platform (A) Replacement of the SBP-operated payment system by a payment system with dual RTGS and ACH capabilities; (B) Implementation of a platform for interoperable instant retail payments needed for the development of DTAs.	12,000,000	Prior	Open-International	RFB	Lowest Evaluated Cost
Investments in technical systems/platforms supporting improvements in market infrastructure	1,000,000	Prior	Open-International	RFB	Lowest Evaluated Cost
Software for data collection oversight	500,000	Prior	Open-National	RFB	Lowest Evaluated Cost
<b>Total</b>	<b>16,000,000</b>				



**CDNS - Procurement System and Capacity**

20. The CDNS is following the Federal Public Procurement Rules (Pakistan Procurement Regulatory Authority [PPRA] 2004). Normally a 15 day window is given for bid submission for national procurement. Technical evaluation is generally completed within 3–4 weeks. Marks obtained are conveyed to all qualified firms and financial bids of qualified bidders are opened and announced publicly. However, the winner is only notified after the approval of the competent authority is conveyed. Bid security is up to 5 percent, whereas performance security is 10–15 percent and covers warranty period as well. Tenders are invited on the basis of single-stage, two-envelope method.

21. The Services Department is responsible for procurements of the CDNS. A Grade 17 officer (In charge) is responsible for procurement by the CDNS. The department handles procurement activities like IT equipment, vehicles, office equipment, furniture and fixtures, and so on. The Services Department is headed by a director-level officer who reports to the DG who controls the affairs of the CDNS on behalf of the Finance Division.

**Summary of PPSD - CDNS**

22. The procurement profile of the CDNS is described in Table 2.4.

**Table 2.4 Procurement Profile of the CDNS**

Contract Title, Description and Category	Estimated cost (US\$) and Risk Rating	Bank Oversight	Procurement Approach/ Competition	Selection Methods	Evaluation
IT procurement and implementation support (Consultancy)	300,000	Post	Open-National	QCBS	Lowest Evaluated Cost
Valuation of assets and liabilities (Consultancy)	200,000	Post	Open-National	QCBS	Lowest Evaluated Cost
ERP implementation (Goods)	1,000,000	Post	Open-National	RFB	Lowest Evaluated Cost
Upgraded IT platforms / Alternate delivery channels (Goods)	3,000,000	Prior	Open-International	RFB	Lowest Evaluated Cost
Basic IT infrastructure (Goods)	2,000,000	Prior	Open-International	RFB	Lowest Evaluated Cost
Business intelligence/data warehouse (Goods)	1,000,000	Prior	Open-International	RFB	Lowest Evaluated Cost
Data center and disaster recovery (Goods)	1,500,000	Prior	Open-International	RFB	Lowest Evaluated Cost
Developing Accounting and Internal Audit Manual (Consultancy)	200,000	Post	Open-National	QCBS	Lowest Evaluated Cost
Training and capacity building (Consultancy)	200,000	Post	Open-National	QCBS	Lowest Evaluated Cost
<b>Total</b>	<b>9,400,000</b>				

23. Table 2.5 describes the risks and respective mitigation measures for the two IAs where project procurements are anticipated.



Table 2.5 Risk and Mitigation Measures

Risk Description	Description of Mitigation	Risk Owner
Significant cost variation or cost overrun	Detailed Market Survey; Focused planning and tracking; Identification of factor effecting the cost	SBP/CDNS
Low bidder participation	Supplier/vendor engagement at early stage of planning; International dissemination; Market-based conditions of bidding document; Unambiguous information	SBP/CDNS
Delays because of any complaint	Complaint management system to be developed	SBP/CDNS
Delay in internal approval for large activities	Standard Operating Procedures for enhanced delegation of monetary powers for World Bank-funded activities. Procurement Manual to be prepared for procurement function.	SBP/CDNS
Unclear technical specifications can create ambiguity and delays	Proper need identification; detailed technical evaluation of all available alternatives	SBP/CDNS
Slippage of timelines	Adequate project management to be in place	SBP/CDNS
Market for business application for the banking sector has technical complexity and limited potential players	Close coordination with market and major players	SBP/CDNS
Lack of awareness of World Bank's Procurement Framework	Training to the SBP staff by the World Bank	World Bank

**Procurement Plan**

24. The procurement plans will be developed by the respective implementing agencies using the Bank's online system "STEP". These PPs shall be subject to the Bank's review and approval prior to implementation. This plan will be updated through STEP only and then approved by the World Bank.

**Environmental and Social (including safeguards)**

**E&S Risks and Impacts Associated with the Project**

25. Components 1, 2, and 3(b)-Activity 2 involve analytical studies, capacity building, upgrading digital payment systems/software etc. and are not expected to have environmental and social (E&S) risks and impacts. Thus no safeguard policies are triggered.

26. The project's core financial intermediation model, which is the same for both Line of Credit (LOC) for microfinance and Risk Sharing Facility (RSF) for SME finance (i.e. components 3(a) and 3(b)-Activity 1), which are expected to have E&S risks and impacts, focuses on lending/providing risk sharing to the PFIs (both wholesale and retail), for on-lending to the MSMEs in various eligible sectors. Business activities of the MSMEs can potentially generate impacts on the environment, human health, and local communities. However, the E&S risks and impacts are deemed to be relatively low in portfolios of the PFIs in the project, and for MSME finance, the sector, the size of the enterprise, and the amount and tenor of loans provided by the PFIs will be taken into account in the assessment of risks and impacts.

**Approach to the Design of E&S Risk Management Structure for FIIP's Lending Components (LOC and RSF)**

27. Core elements of the E&S risk management approach for LOC and RSF components of the project are: (a) clearly defined Applicable E&S Requirements, as listed below, to be incorporated in all project legal documents; (b) ensuring the development and implementation of an Environmental and Social



Management System (ESMS) by PFIs to support their effective implementation E&S of screening procedures against these Applicable E&S Requirements, which will be embedded in the overall credit process for end borrowers<sup>66</sup>; and (c) a capacity building plan that will support adequate implementation of the ESMS across the PFIs.

### ***Applicable E&S Requirements***

28. The E&S risk management approach is designed in accordance with relevant requirements of the GOP and the World Bank. The World Bank's E&S technical and management system requirements applied to this project will be generally governed by the provisions of OP/BP 4.03 (titled "World Bank Performance Standards for Private Sector Activities") for projects involving financial intermediaries. PFIs are required to develop and maintain a functioning ESMS, acceptable to the World Bank,<sup>67</sup> to ensure end borrowers (i.e. MSMEs) comply with the applicable E&S requirements below:

- (a) Applicable E&S national and local laws and regulations of Pakistan;
- (b) List of Excluded Activities (see OM for the list), which will apply to all project MSME activities;
- (c) World Bank Performance Standards 1 through 8.<sup>68</sup> WB Performance Standards would be applied as commensurate with the outcomes of the environmental and social screening procedures and based on the nature and magnitude of risks and impacts of private sector activities. The application of World Bank Performance Standards will not be required for microfinance borrowers and is expected to be limited for SME borrowers.

29. All private sector PFIs will manage the working conditions of their own workforce in accordance with relevant aspects of Performance Standard 2 on Labor and Working Conditions.

30. Additionally, as part of E&S screening, issues of OP /BP 7.50 and OP/BP 7.60 will be considered. If such activities are identified under the LOC or RSF, which is unlikely, they will be excluded. It should also be noted that Components 1, 2, and 3b-Activity 2 are not expected to have such impacts.

### ***Environmental and Social Management System***

31. In particular for the LOC and RSF respectively, financial intermediaries will be required to put in place an ESMS. The ESMS will be tailored to the project structure and E&S risk management profile in line with specific circumstances of the microfinance and SME components (LOC and RSF, respectively) and be

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<sup>66</sup> For wholesale PFIs this means ensuring that retail PFIs they provide finding to have in place and consistently implement adequate E&S screening and risk management measures vis-à-vis final borrowers.

<sup>67</sup> World Bank will ensure such acceptability through approval of the overarching E&S policy and corresponding procedures for the project as prepared by SBP (that will serve as a vehicle for channeling funds to PFIs), as well as through regular supervision activities as part of project implementation support.

<sup>68</sup> 'World Bank Performance Standards' are, in effect, IFC Performance Standards on Environmental and Social Sustainability adopted as the 'World Bank Performance Standards' in 2013 pursuant to the World Bank's OP/BP 4.03. The IFC Performance Standards were first introduced in 2006 and updated in 2012. IFC Performance Standards can be found here: [http://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/ifc+sustainability/our+approach/risk+management/performance+standards/environmental+and+social+performance+standards+and+guidance+notes](http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/our+approach/risk+management/performance+standards/environmental+and+social+performance+standards+and+guidance+notes). This will also include World Bank Group Environment, Health, and Safety (EHS) Guidelines.



commensurate with the level of E&S risks and impacts associated with business/private sector activities financed, as follows.

32. As for these components SBP will serve as a vehicle for channeling funding to PFIs (both wholesale and retail), an overarching E&S policy and corresponding procedures will be developed at the SBP level to support PFIs in fulfilling their responsibilities for E&S risk management in their lending under the project through developing and implementing adequate E&S systems to fulfil their respective responsibilities within the E&S screening and mitigation process for final borrowers. These will be formally approved by the World Bank and disclosed by SBP. As part of these procedures, SBP will oversee the process for ensuring adequacy of the ESMS for the financial intermediaries involved in LOC, throughout the life of the project.

33. To enable PFIs to conduct E&S screening in line with the Applicable E&S Requirements, implementation tools will be provided to them along with training/capacity-building activities. The PFIs will appoint E&S focal persons<sup>69</sup> who will be responsible for incorporating screening against Applicable E&S Requirements in the overall risk assessment process for end borrowers and ensuring agreed E&S mitigation measures have been consistently implemented, conducting periodic E&S monitoring, and submitting the monitoring reports to SBP.

34. It should be noted that for the SME component, the E&S approach that will support its implementation will be developed based on the outcomes of a feasibility study to be conducted (DFID is undertaking one), which will determine the component's design and resulting implementation arrangements.<sup>70</sup> E&S systems and capacity of PFIs that would be involved in lending under this component will be adapted and enhanced accordingly.

### ***Institutional Capacity Assessment and Strengthening***

35. Initial assessment indicates that at present, while SBP will be required to enhance E&S aspects, SBP has prior experience in implementing a World Bank project on banking sector reforms, and developed awareness on E&S issues among SBP staff and some institutional capacity for E&S.

36. As part of the PFIs systems and capacity strengthening process, the project will be able to build on the systems and expertise of SBP already developed through the process of preparation of the Environmental and Social Risk Management (ESRM) Guidelines that are expected to come into effect in June 2017 as part of SBP's activities under the global Sustainable Banking Network supported by IFC. SBP now has several dedicated staff at the institutional level engaged in E&S risk management. ESRM Guidelines will be a regulatory framework for all financial institutions in Pakistan and require them to put in place and maintain adequate institutional ESMS to manage E&S risks and impacts associated with their lending activities.

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<sup>69</sup> These focal persons would have oversight of E&S risk management as part of their responsibilities. Depending on the PFIs' organizational structure, this can be, for example, staff responsible for overall credit or risk management process. Other relevant credit staff that who faces the borrowers during loan appraisal should also be made aware of the screening process.

<sup>70</sup> In the case where SBP would not become the entity implementing Component 3 (b) activity 1 and another FI is selected as the wholesale FI for the Risk Sharing Facility, then the review of ESMS of such wholesale FI will be carried out to ascertain ESMS's appropriateness to identify and manage the risks/impacts of the SMEs activities to be supported by this sub-component.



37. To strengthen institutional arrangements at SBP and any PFIs availing funding, the following is essential: (a) tailoring E&S policy and procedures for these institutions to fit the scope and nature of activities financed through PFIs via LOC and RSF; (b) establishing internal capacity in respective institutions; and (c) appointing E&S focal persons in the PFIs, who will be responsible for incorporating applicable E&S requirements in MSME lending

### ***Capacity Building Plan and Budget***

37. To ensure effective implementation of the E&S risk management measures, formal training will be provided to the SBP and the PFIs' employees,<sup>71</sup> and potentially a selected group of microfinance borrowers. One-on-one assistance will also be provided to the PFIs to better understand the applicable E&S requirements and find ways to incorporate E&S screening tools and procedures in their overall credit process for MSMEs. E&S focal persons at the PFIs and those staff directly facing the borrowers (for example, relationship managers) will be a target audience of capacity building.

38. A well-structured training program will help gradually enhance knowledge among PFIs on the E&S requirements, building an effective ESMS, screening processes, national laws etc. and be conducted with close support of the World Bank. The dedicated E&S staff in SBP PCU will be responsible for managing and implementing the agreed training plans. The 'training of trainers' component will ensure all institutions involved are able to retain this knowledge internally. E&S capacity building budget will be part of the project budget and is estimated at \$25,400 (may increase, if needed).

### **M&E**

39. **The implementation of the M&E system will ensure that timely data is collected to inform project activities and that all data necessary for the reporting of the results indicators is collected.** In addition to the indicators in the Results Framework, the M&E system will include the monitoring of additional indicators as indicated in section VII. These indicators represent further population segmentation of PDOs by relevant sociodemographic information. Because the project complements existing projects in Pakistan, activities of other related projects holistically strengthen the effects of this project's outcomes, and many outcomes may be in line with other related activities outside of the project. Additionally, the project will monitor key NFIS indicators that reflect the project's enabling contribution and facilitation of the NFIS goals.

40. **The responsibility of monitoring and reporting rests with the PCU.** PCU responsibilities with regard to M&E will include data collection, compilation, and reporting from relevant stakeholders and implementing agencies for all components. An M&E Framework will be established and detailed in the OM. The PCU will provide biannual progress reports.

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<sup>71</sup> This will primarily include relationship managers and relevant credit staff.



**ANNEX 3: IMPLEMENTATION SUPPORT PLAN**

**COUNTRY: Pakistan**

**Pakistan Financial Inclusion and Infrastructure Project**

**Strategy and Approach for Implementation Support**

1. The project involves two main entities, the SBP and the CDNS, and throughout the project duration, the World Bank will support the risk mitigation measures and provide the technical advice necessary to help achieve the PDO. The World Bank team will closely monitor the project and will have at least two implementation support visits annually, follow-up visits as deemed necessary, as well as engagement through ongoing dialogue through video and audio conferences and e-mail. During implementation support visits, the World Bank will cover FM and disbursement arrangements, procurement, and safeguards management under the project in addition to overall support. The World Bank Group’s implementation support team is located both in Washington, D.C. and in Pakistan (Islamabad), which will ensure adequate support on a regular basis.

2. In addition to implementation support visits and ongoing engagement, the World Bank project team will carefully monitor the progress of project implementation and achievement of results through formal and informal reporting channels. Formal reporting channels include Implementation Status and Results Reports and results monitoring reports coordinated between the two agencies. Informal channels include interaction with direct beneficiaries of the project, reports from local media, and country economic analyses.

**Implementation Support Plan**

3. The World Bank’s implementation support team will consist of technical specialists from the World Bank Finance and Markets Global Practice, Regional Client Services Unit, and other operations specialists based in Islamabad, including gender, procurement, FM, and safeguards specialists.

4. During project implementation, support will be provided as indicated in Table 3.1.

**Table 3.1 Implementation Support**

<b>Time</b>	<b>Focus</b>	<b>Skills Needed</b>	<b>Resource Estimate</b>	<b>Partner Role</b>
First 12 months	DTA scheme details and improvement, communication and awareness campaigns, initial IT procurement for payment systems and the CDNS, capacity building of the NFIS Secretariat, G2P mapping, LOC to microfinance borrowers, initial TA on SME finance, details on challenge funds	Please refer to Table 3.2.	170,000	
12–60 months	Project management, implementation, and completion	Please refer to Table 3.2.	170,000 per year	
Other				



**Table 3.2 Skills Mix Required**

Skills Needed	Number of Staff Weeks	Number of Trips	Comments
Task team leader/financial sector specialist	50	Minimum of 2 a year	Will need to be adjusted depending upon the skills mix of Pakistan-based World Bank staff
IT specialist	30	Minimum of 2 a year	
Microfinance, SME finance specialist	30	Minimum of 2 a year	
Financial inclusion specialist	30	Based in Islamabad, minimum of 2 a year	
Payments systems specialist	30	Minimum of 2 a year	
Environmental safeguards*	20	Based in Islamabad, minimum of 2 a year	
Gender and social safeguards*	20	Based in Islamabad, minimum of 2 a year	
Procurement specialist*	20	Based in Islamabad, minimum of 2 a year	
FM specialist*	20	Based in Islamabad, minimum of 2 a year	

Note: \* Staff costs expected to be covered out of the specific budget allocated to each function in the program.

The Implementation Support Plan may be reviewed to meet the implementation support needs of the project.



## ANNEX 4: ECONOMIC ANALYSIS

### COUNTRY: Pakistan

#### Pakistan Financial Inclusion and Infrastructure Project

1. The economic analysis for Component 1 (Direct support to the NFIS Implementation), Component 2 (Supporting Expansion of Access Points for Financial Services), and TA and capacity building activities under Subcomponent 3b are based on cost-effectiveness and linked to overall analytical work on the positive effects of access to finance on private sector growth and entrepreneurship. For the mentioned components, a qualitative analysis is included based on the literature discussing the impact of supporting access to finance.
2. The economic analysis of this project is built as a financial analysis with the estimated difference in cash flows to sub-borrowers (microenterprises, SMEs) accounted for as cash flows to the project. The economic analysis of Component 3a (Improving Access to Microfinance and to Financial Services for Microenterprises) and Activity 1 under Subcomponent 3b (Improving Access to Financial Services for Small and Medium Enterprises) quantifies the costs and benefits that are expected to accrue from these investments, and calculates the NPV and the ERR for these components. These valuations are constructed through scenario-based analyses.
3. Component 1, which focuses on upgrading payment systems, expanding access to the DTAs, building capacity to better implement the NFIS, and piloting new approaches with G2P digitization to increase inclusiveness of the financial sector, can potentially improve provision of financial services, add to long-term development of the (micro) finance sector, and promote inclusion.<sup>72</sup> Promoting DFS with G2P digitization has a number of benefits. It helps customers easily access financial services and transact locally in small amounts to better manage their uneven income and expenses. The payment, transfer, and value storage services of the digital transactional platform and the data generated by customer usage can help financial service providers offer additional financial services tailored to customer needs. Digital financial inclusion can also reduce the risk of loss, theft, and other financial crimes posed by cash-based transactions, as well as the costs associated with transacting in cash. Ultimately, it can advance economic growth by enabling asset accumulation and, for women in particular, increasing economic participation.<sup>73</sup> The strengthening capacity of the NFIS Secretariat as well as the demonstration effect from piloting new approaches will have a positive impact on financial inclusion.
4. The relationship between access to finance reform and firm performance is well supported in literature.<sup>74</sup> Greater business opportunities and better access to finance are generally related to a more robust private sector.<sup>75</sup> Capacity building programs to increase the number and customization of products offered to MSMEs have been shown to have a beneficial impact.<sup>76</sup> The potential poverty impact is

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<sup>72</sup> See, for example, 'Payment Aspects of Financial Inclusion', 2016, a consultative report prepared by BIS and World Bank that provides an analysis of the payment aspects of financial inclusion.

<sup>73</sup> See, for example, CGAP. 2015. *Digital Financial Inclusion: Implications for Customers, Regulators, Supervisors, and Standard-Setting Bodies*.

<sup>74</sup> See, for example, Demircuc-Kunt and Klapper 2012.

<sup>75</sup> Demircuc-Kunt, Asli, and Leora Klapper. 2012. "Financial Inclusion in Africa: An Overview." Policy Research Working Paper 6088, World Bank, Washington, DC.

<sup>76</sup> See, for example "The SME Banking Knowledge Guide", IFC 2010.



particularly large for relatively unbanked populations who after gaining access to financial services are able to accumulate more capital and obtain loans for longer-term, productive investments.<sup>77</sup>

**Subcomponent 3a: Improving Access to Microfinance and to Financial Services for Micro Enterprises**

***Credit Facility to the microfinance sector***

5. Subcomponent 3a will provide an LOC administered by SBP, which will be on-lend to the PFIs, including wholesale lenders and that will provide financing to the microfinance sector. End users are microfinance borrowers and microenterprises. Lending to microenterprises is meant to enable them to expand their activities and grow. In this subcomponent, the project is investing a total of US\$75 million disbursed over five years and targets to allocate 60 percent of loans to women and women-owned enterprises.

6. In the economic analysis of this component, the ERR is expected to be 41 percent. The NPV is expected to be about US\$49 million, with a discount rate of 15 percent<sup>78</sup>. The positive valuation indicates that the returns on investment exceed the returns that could otherwise be earned by investing in another project in any similar country.

***Assumptions***

7. The technical data on revenues, costs, and average wage are based on information gathered during the identification and pre-appraisal missions, data from the FAO’s database and World Bank Enterprise Surveys, and benchmarking provided by comparator country estimates. The average loan size of US\$500 is assumed for microloans. The analysis assumes that out of total microloans, 70 percent are for microenterprises that are expected to show an increase in the growth rate of revenue after receiving loan from a PFI.<sup>79</sup> The remaining 30 percent of microloans could be dedicated to nonrevenue-generating activities (for example, consumption). In the base case scenario, the analysis assumes a revenue growth of 4 percent for microenterprises.

**Table 4.1 Economic Analysis of Subcomponent 3a**

NPV (15% Discount Rate)	\$49,128,233
ERR	41%

**Table 4.2 Assumptions - Subcomponent 3a**

Interest rate due to World Bank by the MOF	3.0%
Principle due to World Bank by the MOF	3.3%
Interest rate charged to PFIs by the SBP	9.1%
Year 1 fees by PFIs to the SBP	0.5%
Growth rate of fees	0.0%

<sup>77</sup> See, for example, Burgess and Pande 2005 ("Do Rural Banks Matter? Evidence from the Indian Social Banking Experiment." American Economic Review, 95(3): 780-795) who show in the case of India, that access to finance (measured by rural bank branch expansion) can explain a 14 to 17 percentage point decline in rural poverty headcount—roughly half the overall fall across the period of branch expansion.

<sup>78</sup> Discount rate: The World Bank traditionally has not calculated a discount rate but has used 10–12 percent as a notional figure for evaluating World Bank–financed projects. This notional figure is not necessarily the opportunity cost of capital in borrower countries but is more properly viewed as a rationing device for World Bank funds.

<sup>79</sup> The model assumes that all PFI are directly lending to end-borrowers.



NPL ratio	3.0%
Year 1 average loan size	US\$500
Year 1 number of loans (disbursement/average loan size)	4,000
Interest rate charged to end-borrowers by PFIs	35.0%

**Table 4.3 Microenterprises Beneficiaries Assumptions - Subcomponent 3a**

Average number of employees	3
Average revenue	US\$10,000
Percentage costs	75%
Average value-added revenue*(1-%cost)	US\$2,000
Annual growth (without loan)	1.0%
Annual additional growth increase with loan (Years 1–5)	4.0%
Number of years growth increases due to loan	5
Percentage of microenterprises showing revenue additionality	70%
Percentage tax base	5%
Tax rate	15%

8. The sensitivity analysis indicates that a 5 percent reduction in the number of firms showing additionality will reduce ERR to 36 percent. An increase in the number of firms showing additionality by 3 percent will increase ERR to 44 percent. The results of the sensitivity analysis are provided in Box 4.1.

**Box 4.1 Sensitivity Analysis with Different Scenarios - Subcomponent 3a**

Reduction by 5 percent in number of firms showing additionality: *Reduces ERR to 36 percent*

Increase by 3 percent in number of firms showing additionality: *Increases ERR to 44 percent*

Reduction in costs of microenterprises by 5 percent: *Increases ERR to 61 percent*

Increase in costs of microenterprises by 3 percent: *Reduces ERR to 30 percent*

Reduction in NPLs from 3 percent to 1.5 percent: *Increases ERR to 45 percent*

Increase in NPLs from 3 percent to 5 percent: *Reduces ERR to 36 percent*

**Subcomponent 3b: Improving Access to Financial Services for Small and Medium Enterprises**

9. Under this component, the project aims to support SME financing by providing capital to an RSF that will provide guarantees to the PFIs on SME loans. With the help of this component, SMEs will be able to make investments in capital, labor, and other inputs, resulting in higher sales and profits, thereby increasing their value added (assumed to be observed for three years under this component). Revenue additionality resulting from the project is specified for different types of beneficiaries, including SMEs. The RSF is assumed to leverage its capital by 1.5 times, providing coverage of 70 percent while charging the PFIs an annual fee of 1 percent.

10. The ERR of this subcomponent is expected to be 42 percent, and the NPV is expected to be about US\$2 million with a discount rate of 15 percent. The positive valuation indicates that the returns on investment for this subcomponent exceed the returns that could otherwise be earned on World Bank financing. As such, improvements in SME income and their value added outweigh the cost of investments under this component.



**Assumptions**

11. The technical data on revenues, costs, annual growth rates, and average wage are taken from information gathered during the identification and pre-appraisal missions, data from the FAO’s database and World Bank Enterprise Surveys, and comparisons with countries with similar enterprise demographics. The main impacts of the project are expected in the form of improvements in value added for individual businesses due to the growth in revenues and/or reduction in costs. The economic analysis assumes a job creation rate specified for each business based on the assumption that the RSF will leverage its capital and will have a guarantee rate at par with international best practices. The analysis uses a base case scenario with estimates of the potential impact of the guarantees provided by the RSF with regard to revenue additionality to SME beneficiaries. A 4.25 percent growth in sales and a 2 percent growth in wages for 63 percent of the SMEs supported between years 3 and 5 after project effectiveness.

**Table 4.4 Economic Analysis of Subcomponent 3b**

NPV (15% Discount Rate)	\$2,048,540
ERR	42%

**Table 4.5 Assumptions - Subcomponent 3b**

Interest rate due to World Bank by RSF	3.0%
Principle due to World Bank by RSF	3.3%
Year 1 fees by PFIs to RSF	1.50%
Growth rate of fees	0.0%
NPL ratio	10.0%
Year 1 average loan size	US\$15,000
Year 1 number of loans (disbursement/average loan size)	1,000
Implied leverage of RSF	2.5
Interest rate charged to end-borrowers by PFIs	12.0%
Interest earned on fund capital	6.0%

**Table 4.6 Small and Medium Enterprises Beneficiaries Assumptions - Subcomponent 3b**

	Small Enterprises	Medium Enterprises
Average number of employees	10	40
Average revenue	US\$20,000	US\$60,000
Percentage costs	70%	80%
Average value added (revenue*(1-%cost))	US\$6,000	US\$12,000
Annual growth (without loan)	3.5%	5.0%
Annual additional growth increase with loan (Years 1–5)	6.5%	10.0%
Number of years growth increases due to loan	3	3
Percentage of enterprises showing revenue additionality	60%	65%
Percentage tax base	10%	20%
Tax rate	25%	20%
Average salary (skilled)	US\$1,500	US\$2,000
Average salary (unskilled)	US\$400	US\$400
Annual growth in wages (skilled)	2.0%	2.0%
Annual growth in wages (unskilled)	2.0%	2.0%
Jobs created per US\$ increase in revenue (skilled)	0.000001	0.000001
Jobs created per US\$ increase in revenue (unskilled)	0.000001	0.000001



12. The sensitivity analysis indicates that a 5 percent reduction in the number of firms showing additionality will reduce the ERR to 37.6 percent. In contrast, an increase in the number of firms showing additionality by just 3 percent will increase the ERR to 44 percent. The results of the sensitivity analysis are provided in box 4.2.

**Box 4.2 Sensitivity Analysis with Different Scenarios - Subcomponent 3b**

Reduction by 5 percent in number of firms showing additionality: *Reduces ERR to 37.6 percent*

Increase by 3 percent in number of firms showing additionality: *Increases ERR to 44.1 percent*

Reduction in costs of SMEs by 5 percent: *Increases ERR to 52.5 percent*

Increase in costs of SMEs by 3 percent: *Reduces ERR to 35 percent*

Reduction in NPLs from 10 percent to 7 percent: *Increases ERR to 53.8 percent*

Increase in NPLs from 10 percent to 15 percent: *Reduces ERR to 27.9 percent*

**Rationale for Public Sector Provision/Financing**

13. There is strong rationale for public financing of the present project due to lack of adequate private sector participation and because of the positive externalities attached to such financing. The creation of new and enhancement of existing financial infrastructure justifies public financing as it will not only give a boost to MSME financing in the near term but will have a longer-term impact on sustainable growth of the MSME sector. Considering the presence of positive externalities and the lack of private sector provisions, there is also a strong rationale for the public provision of microfinance and finance for microenterprises and for SMEs, including women-owned/managed enterprises. Despite significant progress in the regulatory environment for financial inclusion and BB, financial access is still significantly low in Pakistan. Several market segments are particularly underserved, including women and SMEs. Given that MSMEs generate economic benefits such as employment, innovation, and entrepreneurship, it is likely that that current level of private sector provisions of debt to MSMEs is below optimal societal levels. The rationale for public provision/financing is strengthened on this ground.

14. The proposed project aims to directly address the supply-side constraints existing in the MSME market through a combination of innovative financing instruments (for example, guarantee financing) and capacity building. Through a demonstration effect highlighting the prospects of financing women and SMEs that have low access to finance, capacity building to better manage SME lending risks, and supporting an RSF for providing guaranteed financing to lower SME lending risks, the project will contribute to the growth of the microfinance and SME sectors, promote employment, spur economic growth, and contribute to poverty reduction.

**Value Added of World Bank's Support**

15. The World Bank is a key player in the development of the financial sector in Pakistan and has been a long-term partner to the authorities on financial sector policy dialogue and to all the relevant stakeholders (including bankers, bank associations' leaders, microfinance players, industry associations and other development partners). It is now engaged on several fronts to improve financial sector stability, supporting, for example, the development of risk-based supervision and the central bank's enterprise risk management, and to improve financial sector efficiency and inclusiveness.



16. The World Bank has played a leading role in supporting financial inclusion in Pakistan, recently assisting the authorities in the development of the NFIS and previously partnering with the PPAF to develop and increase the efficiency and outreach of the microfinance sector. The World Bank is now supporting the authorities on its medium-term financial inclusion reform agenda through initiatives including (a) implementation of the NFIS through budget support (linked to institutional and policy reforms on credit infrastructure enhancement); (b) policy dialogue and assessments (such as the FSAP); (c) financing services and TA for the implementation of the NFIS action plan; and (d) enhancement of insurance, pensions, housing finance, and capital market development.

17. The World Bank Group's comparative advantage in advancing financial inclusion in Pakistan stems from a combination of (a) broad financial sector expertise, including areas relevant to financial inclusion; (b) sustained country engagement and dialogue; (c) a wide range of financing and risk-sharing instruments; (d) unique datasets and strong research capacity; and (e) influence and credibility with standard-setting bodies and the G-20. The World Bank's long-standing and deep experience on credit lines and RSFs throughout the world, including in enhancing financial sector providers' capacity and developing innovative financial products in addition to its experience in several countries on payment aspects of financial inclusion, will be leveraged. The World Bank will also draw internally on relevant Global Practices such as the Social Protection and Labor Global Practice that is supporting the Pakistan BISP, as well as playing a convening role in sourcing global knowledge from external industry and think tanks as needed. It will work closely with the Country Management Unit in design and implementation and also maintain technical collaboration and coordination with IFC.



## ANNEX 5: FINANCIAL ANALYSIS AND INTERMEDIARY ASSESSMENT

COUNTRY: Pakistan

## Pakistan Financial Inclusion and Infrastructure Project

## Financial Sector Review

1. **The size of Pakistan's financial sector is about 68.5 percent of GDP, which compares well within South Asia but is behind relevant emerging markets.** Banking sector assets are approximately 48.7 percent of GDP, lower than India (79.8 percent) and much lower than Malaysia (202 percent). Excluding the NSS, the nonbank financial sector constitutes about 5.8 percent of GDP. There is limited diversification within the nonbank financial sector. Insurance companies represent the highest share but insurance outreach is among the lowest across comparable markets. Mutual funds represent an increasing share and are at about 1.6 percent of GDP, which is low compared to India (5.6 percent) or Malaysia (34 percent). Another weak sector is pensions, representing only 0.1 percent of GDP. Similarly, mortgage, leasing, *modarabas*, and other development finance institutions are still very small in outreach and asset base. Banks dominate the financial sector, representing about 74.7 percent of financial sector assets. The remaining assets of the financial system are in the NSS (16.5 percent), insurance companies (4.8 percent), nonbank financial institutions (4.0 percent), and MFIs (0.5 percent). Table 5.1 provides a detailed asset composition breakdown of the financial sector.

Table 5.1 Financial Sector Asset Composition

	Number of Institutions	Assets (PKR, billions)	% of Assets	% of GDP <sup>d</sup>
<b>Banking Sector</b>				
Public sector commercial banks	5	2,352	13.2	8.6
Local private banks	16	9,542	53.5	34.8
Foreign banks	5	224	1.3	0.8
Specialized banks	4	196	1.1	0.7
Islamic banks	6 <sup>a</sup>	929	5.2	3.4
MFBS	11	82 <sup>f</sup>	0.5	0.3
	<b>45</b>	<b>13,325</b>	<b>74.7</b>	<b>48.7</b>
<b>Nonbank Financial Sector</b>				
Insurance companies	51 <sup>e</sup>	855	4.8	3.1
<i>Modarabas</i>	25	30	0.2	0.1
Mutual funds	180	449	2.5	1.6
Investment banks	3	7	0.0	0.0
Leasing companies	10	36	0.2	0.1
MFIs	28	20 <sup>f</sup>	0.1	0.1
NSS	1	2,939 <sup>c</sup>	16.5	10.7
Development finance institutions <sup>b</sup>	8	184	1.0	0.7
	<b>306</b>	<b>4,520</b>	<b>25.3</b>	<b>16.5</b>
<b>Total Financial Sector</b>		<b>17,846</b>	<b>100.0</b>	<b>68.5</b>

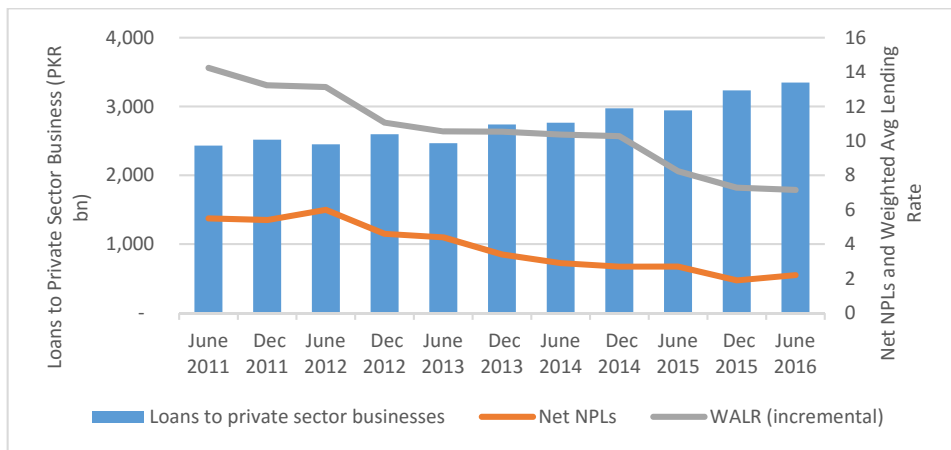
Source(s): SBP, SECP, Insurance Association of Pakistan, nonbank financial institution and Modaraba Association of Pakistan, and PMN. All figures are as of June 2015 unless otherwise stated.

Note: a. MCB Islamic Bank was granted an Islamic banking license in September 2015. b. Development finance institutions include House Building Finance Corporation and Bilateral Investment Firms. c. Includes prize bonds. d. According to the SBP's Monetary Policy Information Compendium, Nominal GDP in FY2015 was PKR 27.4 trillion (US\$261.5 billion). e. Includes non-life, life, and public insurance companies. f. Estimates.



2. **The easing interest rate environment and lower yields on government borrowing have allowed for some growth in private sector credit.** Stronger macroeconomic fundamentals and structural reforms have allowed for considerable easing of the interest rate environment. The weighted average rate on incremental borrowing was at 6.9 percent in July 2016 compared to 7.9 percent a year ago. However, the deposit rate on new deposits is lower, at 3.7 percent in July 2016 compared to 4.1 percent a year ago. The trend in deposit rates has been declining because of the change in methodology for minimum rate of deposits from a fixed rate of 5 percent to a floating minimum rate of 50 basis points below the SBP repo rate in FY2014. In addition, the Government’s incremental borrowing requirements have reduced and offer lower yields, allowing more liquidity to potentially be available for the private sector. There are also early signs of constraints easing from the Government’s efforts to address structural weaknesses in the economy such as power shortages and law and order. As a result, private sector credit has grown by 11.5 percent (year-on-year) in FY2016 following growth of 5.9 percent in FY2015 and 12.6 percent in FY2014.

Figure 5.1 Loans to Private Sector in Relation to Lending Rates and NPLs (FY2011–FY2016)



Source(s): SBP

3. **The banking system remains robust based on standard solvency indicators, largely because of large holdings of government securities.** In recent years, there has been a significant shift in risk behavior of banks from private sector loans to risk-free government securities. As of June 2016, commercial banks hold about PKR 6.5 trillion (US\$62 billion) of government domestic debt, about 42 percent of total assets. The outstanding stock of government debt significantly reduces the risk-weighted assets of the banking system resulting in a strong capital adequacy ratio of 16 percent.

4. The significant pressures expected on bank profitability in the current low interest rate environment have been, to an extent, eased by the decline in deposit rates. The spread between weighted average lending and deposit rates on incremental loans and deposits has actually increased from as low as 270 basis points in December 2015 to 330 basis points in July 2016. Given this structure of spreads, the return on assets (ROA) and return on equity (ROE) of the banking sector are healthy (see Table 5.2).

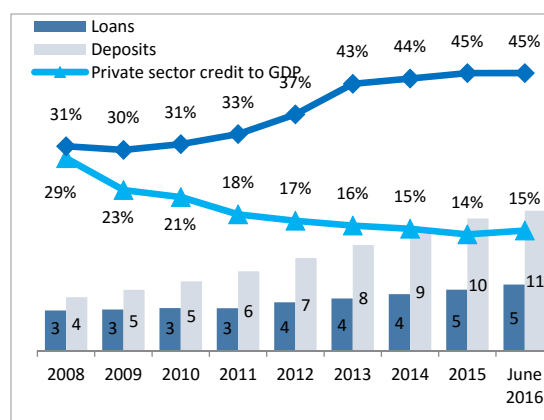


**Table 5.2 Selected Key Indicators of the Banking Sector**

(PKR billion)	Jun-14	Jun-15	Jun-
Profit Before Tax ytd	113	171	162
Credit to Private Sector	3,729	4,003	4,464
(In percent)			
ROA Before Tax	2.1	2.7	2.2
ROE Before Tax	23.5	27.5	24.9
Advances to Deposits Ratio	47.7	45.7	47.0
Liquid Assets/Deposits	60.6	69.5	77.0
Capital Adequacy Ratio	15.1	17.2	16.1
Gross NPLs to Loans	12.8	12.4	11.1
Net NPLs to Loans	2.9	2.7	2.2
6 month KIBOR	10.2	7.0	6.1

Source(s): SBP

**Figure 5.2. Balance Sheet Growth**



Source(s): SBP

5. **Despite its small size relative to financial sector assets, the microfinance sector has grown rapidly.** With 11 regulated MFBs and 38 unregulated MFIs, the sector registered an 11 percent increase in active borrowers, 28 percent growth in gross loan portfolio, 43 percent increase in savers, and 25 percent increase in value of savings in 2014. Portfolio at risk (>30 days) remains low at 1.7 percent.<sup>80</sup> Three main sectors are served: trade (29 percent of borrowers), agriculture (23 percent), and livestock/poultry (16 percent), with a geographic concentration in Punjab and Sindh provinces.

6. **SME credit growth is recovering and asset quality is improving.** The growth in private sector credit has also been reflected in SME credit, as there has been a moderate increase in credit to SMEs since 2014, after a downward trend over the preceding five years. Year-on-year, NPLs in SMEs decreased from 31.6 percent to 26.5 percent of loans and NPLs in the corporate sector decreased from 13.4 percent to 11.8 percent between June 2015 and June 2016.

7. As part of its **development finance activities**, SBP has extensive experience implementing government financing schemes, lines of credit for government programs, and donor schemes through its subsidiary the SBP Banking Services Corporation (SBP-BSC). These schemes have been performing well as shown by overall portfolio quality.<sup>81</sup> Among those schemes are the MCGF. During FY15, funds of around PKR 5.8 billion (US\$55.3 million) have been disbursed by various banks/DFIs to MFBs/MFIs. Eight MFBs/MFIs have benefitted from this facility. This Scheme was revised in FY15 to facilitate weaker MFIs/MFBs by offering them higher guarantee cover of 60 percent instead of 40 percent.

### Financial Review of Potential PFIs

8. A financial review of selected commercial banks, MFBs, and MFIs that could be potential

<sup>80</sup> MicroWatch, Issue 35, Q1.

<sup>81</sup> Audit report concludes that doubtful debts are fully accounted for and the provision for doubtful debts to total loan portfolio is approximately at 2.5 percent. In addition, credit rating of approximately 70% percent of the portfolio is rated as A and above by JCR-VIS and Pakistan Credit rating agency (PACRA).



candidates for participation in the credit facility and the SME guarantee facility was undertaken to determine compliance with the eligibility criteria under OP 10.00 and ascertain which are in-line with the project’s eligibility criteria for PFIs (see annex 2).<sup>82</sup> A Financial Statements Analysis of the Financial Sector is carried out annually by the SBP and is publically available (<http://www.sbp.org.pk/departments/stats/FSA-2011-15.pdf>).

9. The institutions selected meet specified criteria such as adequate profitability, capacity, and managerial autonomy, and include four commercial banks (including one Islamic bank), three MFBs, and one MFI. The key financial and operating indicators are presented in Table 5.3.

**Table 5.3 Selected Key Indicators of Potential PFIs**

	Commercial Banks	MFBs			MFIs		
	Habib Bank Limited	Bank Alfalah	Meezan Bank	JS Bank	NRSP Bank	Khushali Bank	Kashf
Net interest income	78,169	28,647	18,217	5,590	1,313	3,187	781
Profit after tax	35,102	7,523	5,023	2,026	460	824	378
Deposits	1,634,944	640,189	471,821	141,840	7,255	15,584	—
Loans and advances	633,383	327,298	207,569	76,666	8,999	17,247	4,587
Total assets	2,218,423	902,608	531,850	218,476	14,306	26,696	7,078
Net interest margin (%)	3.5	3.2	3.4	2.6	9.2	11.9	11.0
ROA (%)	1.7	0.9	1.0	16.0	3.5	3.4	10.7
ROE (%)	19.9	19.0	20.6	1.0	20.0	18.2	—
Advances to deposits ratio (%)	38.7	51.1	44.0	54.1	124.0	110.7	—
Capital adequacy/tier 1 equity to assets (%)	17.0	13.4	11.0	12.5	21.3	14.7	14.2
Gross NPLs to loans/portfolio at risk (%)	9.8	5.4	3.3	3.8	0.2	1.9	0.9
Provisions (%)	92.3	83.7	116.0	90.7	30.0	65.2	33.3
Net NPLs to loans (%)	1.3	0.9	4.0	0.4	0.1	0.7	0.6
Ratings (Short Term/Long Term)	A-1 +/AAA	A-1 +/AA	A-1 +/AA	A-1 +/A+	A-2 /A-	A-1 /A+	A-3/BBB+
Branches	1,663	653	551	277	70	129	188

Source: Financial statements of selected institutions. Data as of December 2015 or the year ended December 2015.

10. The results of the financial analysis show that while solvency and liquidity indicators are strong, there has been pressure on asset quality as depicted by the wide range of NPLs. As of June 2016, the sector-wide gross NPLs are at 11.1 percent and have forced institutions to take heavy provisioning charges to bring net NPLs to 2.2 percent. As a result, credit appetite was low in recent years, and government borrowing provided a profitable alternate. However, with incremental government borrowing tapering off, there is added pressure on financial institutions to develop their loan portfolio. The SME and consumer market segments, with sufficient credit quality or mitigated credit risk, offer the much-needed profitable portfolio diversification opportunities.

<sup>82</sup> This is a preliminary assessment with the objective of assessing the strength of the industry.



11. **Pakistan Microfinance Investment Company (PMIC) is a newly incorporated microfinance wholesale lender.**<sup>83</sup> With the growth in funding needs of the microfinance sector in Pakistan (estimated at around PKR 160 billion (US\$1.5 billion) by year-end 2018 to double the current outreach to 7 million borrowers), the PPAF is unable to cater to them with its current funding.<sup>84</sup> The PPAF is a nonprofit institution without a shareholding structure, which makes commercial banks and capital markets reluctant to lend to it due to risks associated with enforcement of security. In addition, its nonprofit status bars it from distributing dividends to investors. Furthermore, donors that have traditionally provided funding to the PPAF have been shying away from providing further subsidies. As a result, the microfinance operations of the PPAF were recently spun off into a for-profit, private entity called PMIC.<sup>85</sup>

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<sup>83</sup> As such, it could also be a potential candidate PFI for the microfinance LOC.

<sup>84</sup> The PPAF is mandated by the GOP to alleviate poverty and works with various organizations and microfinance institutions to achieve this goal. A nonprofit institution, the PPAF works with partner institutions that are nongovernmental in nature and provides financing through both grants and/or loans. Social inclusion, gender, and environment are the common themes found in all the PPAF's projects and programs and make up substantive components within all their work. Within its Grants Group, the PPAF has a number of programs. The Financial Services Group operates programs to develop the microfinance sector and manages the microfinance portfolio. As of March 2016, the PPAF has provided 8 million microcredit loans (of which 60 percent to women and 80 percent in rural areas) with a network of 132,000 community organizations and 440,000 credit/common interest groups. The PPAF has recently moved away from microfinance activities, which are going to be taken over by the PMIC.

<sup>85</sup> The PMIC is registered and licensed as an investment finance company with the SECP and is governed under the Non-Banking Finance Companies rules. Besides the PPAF, DFID and KfW are the main shareholders with equity investments of 49, 37, and 14 percent, respectively.



## ANNEX 6: GENDER FINANCE

COUNTRY: Pakistan

### Pakistan Financial Inclusion and Infrastructure Project

1. In-line with the World Bank Group's strategy for gender equality and the Pakistan CPS, the World Bank Group's program in Pakistan has included activities on gender across sectors. A 2013 gender portfolio review highlighted the efforts of the World Bank Group-partnered PPAF, which has specific targets on gender. Approximately 10 million marginalized individuals have benefited from the PPAF's programs, with half of them being women. The flagship national safety net system, BISP, also retains a strong gender focus, contributing to female empowerment by providing women access to national identification cards and making BISP payments to female heads of beneficiary families. The World Bank projects additionally incorporate gender components in emergency relief efforts. Through the Flood Emergency Cash Transfer Project, for instance, female heads of households are eligible to apply for cards called Watan cards, enabling them to receive cash transfers in the emergency case of a flood and improving their financial access.

2. Nonetheless, Pakistan still lags behind regional benchmarks on key indicators of access to finance for women.<sup>86</sup> Only 3.02 percent of women have an account at a formal financial institution (36.75 percent regional average),<sup>87</sup> 0.25 percent of those with an account use it for business purposes (1.71 percent regional average),<sup>88</sup> and only 0.05 percent of women have credit cards (1.25 percent regional average).<sup>89</sup>

3. Studies have shown that financial inclusion benefits women through various financial instruments.

- a. **Microfinance.** Randomized trials in South Africa and India have shown that it can have an impact on women's economic situations and broader indicators of empowerment.
- b. **Financial literacy programs.** A randomized control evaluation in India found that financial literacy and business skills training led to greater uptake of loans and higher business income among Hindu women.
- c. **Other financial instruments.** These include village savings and loan associations, use of nontraditional collateral, women-friendly credit assessments in MSME financing, and economic empowerment programs.<sup>90</sup>
- d. **Savings schemes.** Studies in Peru and the Philippines show that they can improve women's confidence and decision-making power in the household, improve purchasing power, and reduce vulnerability. In Pakistan, CDNS's indicative data shows that almost 50 percent of retail savers are women.
- e. **Financial instruments that facilitate holding and transfer of cash.** The development of mobile phone banking in Kenya led to improvements in women's economic activity and incomes.

4. **Gender actions under the project.** The project will benefit women's financial inclusion and

<sup>86</sup> World Development Indicators, 2014.

<sup>87</sup> World Development Indicators, 2014.

<sup>88</sup> World Development Indicators, 2011.

<sup>89</sup> World Development Indicators, 2011.

<sup>90</sup> Department for International Development, 2012.



women-led/owned/managed enterprises access to finance through gender actions in all components.

- a. **Designing and rolling out financial products that have been proven to benefit women.** Beyond supporting microfinance and allocating 60 percent of financing to women and women entrepreneurs (Subcomponent 3a), the project will focus on improving the use of DTA and DFS for women in particular through digitization of G2P, incorporating the learnings from the BISP program (Subcomponent 1b). DTAs represent an entry point into formal financial services, particularly for low-income and excluded populations. They also allow for the development and delivery of a broad array of low-cost and accessible financial services, including payments, savings, insurance, and credit. The project expects more than 10 million women into the formal financial system through DTAs. This will enable women to better manage their finances and is a necessary first step toward eligibility for credit. There is a substantial untapped potential that the project will seek to fulfill, because the gap between male and female mobile accounts (7.1 percent) is much narrower than the gap for overall accounts (16.1 percent).
- b. **Targeting women-led/owned/managed MSMEs.** The project will also specifically target women-led/owned/managed MSMEs under Subcomponents 3a and 3b.
- c. **Linking women entrepreneurs to financial institutions and creating awareness about financial products.** Under Subcomponent 3b, the project will provide funding to link women entrepreneurs to financial institutions and in conjunction raise understanding and awareness of financial products for businesswomen.
- d. **Gender tracking indicators.** The project will track and report key gender indicators as described in section VII (for example, number of women beneficiaries). The CE surveys will also analyze the project impact on entrepreneurs, including women.

5. **Gender commitment of implementation partners.** Implementing partners for this project include the MOF Pakistan and the SBP. The GOP has expressed its commitment to women's economic empowerment through its 'Vision 2025' document, where it has set a female labor force participation target of 45 percent.<sup>91</sup> The LOC, under Subcomponent 3a, will be channeled through the SBP and on-lent to the PFI. The SBP, which is implementing Components 1 and 3, has appointed a gender focal point as part of the NFIS activities and will provide financial linkages between financial institutions and women entrepreneurs.

6. **Coordination with other projects.** The project is coordinating with partners such as IFC on gender finance and also with the ongoing World Bank TA program, including the planned 2017 workshop on women financial inclusion supported by the FISF TA. The workshop will raise the profile of domestic prospects, present international cases, and discuss policy to support the expansion of women's access to finance.

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<sup>91</sup> "Pakistan 2025 One Nation-One Vision", Ministry of Planning and Development Reforms, Government of Pakistan, 2014.