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IDA/R2018-0377/1

November 26, 2018

**Closing Date: Thursday, December 13, 2018 at 6:00 p.m.**

FROM: Vice President and Corporate Secretary

**Mozambique - Financial Inclusion and Stability Project**

**Project Appraisal Document**

Attached is the Project Appraisal Document regarding a proposed grant to Mozambique for a Financial Inclusion and Stability Project (IDA/R2018-0377), which is being processed on an absence-of-objection basis.

Distribution:
- Executive Directors and Alternates
- President
- Bank Group Senior Management
- Vice Presidents, Bank, IFC and MIGA
- Directors and Department Heads, Bank, IFC, and MIGA

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Report No: PCBASIC0140010

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED GRANT

IN THE AMOUNT OF SDR 29 MILLION

(US$40 MILLION EQUIVALENT)

TO THE

REPUBLIC OF MOZAMBIQUE

FOR A

FINANCIAL INCLUSION AND STABILITY PROJECT

NOVEMBER 20, 2018

Finance, Competitiveness and Innovation Global Practice
Africa Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective October 31, 2018)

| | |
|---|---|
| Currency Unit = | MZN |
| MZN 60.25 = | US$1 |
| US$1 = | SDR 0.7235 |

FISCAL YEAR
January 1 - December 31

| | |
|---|---|
| Regional Vice President: | Hafez H. M. Ghanem |
| Country Director: | Mark R. Lundell |
| Senior Global Practice Director: | Sebastian-A Molineus |
| Practice Manager: | Douglas Pearce |
| Task Team Leader: | Julian Casal |

## ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| BOM | Bank of Mozambique |
| BVM | *Bolsa de Valores de Moçambique* (Mozambique Stock Exchange) |
| CAR | Capital Adequacy Ratio |
| CEDSIF | *Centro de Desenvolvimento de Sistemas de Informação de Finanças* (Center for the Development of Financial Information Systems) |
| CPF | Country Partnership Framework |
| DLI | Disbursement-Linked Indicator |
| DNS | Deferred Net Settlement |
| DPO | Development Policy Operation |
| e-SISTAFE | Integrated Financial Management Information System |
| DGF | Deposit Guarantee Fund |
| FISF | Financial Inclusion Support Framework |
| G2P | Government-to-Person |
| GDP | Gross Domestic Product |
| IADI | International Association of Deposit Insurers |
| INAS | *Instituto Nacional de Acção Social* (National Institute for Social Action) |
| IPF | Investment Project Financing |
| ISSM | *Instituto de Supervisão de Seguros de Moçambique* (Insurance supervisor) |
| KYC | Know Your Customer |
| MEF | Ministry of Economy and Finance |
| MIS | Management Information System |
| MSME | Micro, Small, and Medium Sized Enterprise |
| NFIS | National Financial Inclusion Strategy |
| NPL | Non-Performing Loan |
| PIM | Project Implementation Manual |
| PIU | Project Implementation Unit |
| PSC | Project Steering Committee |
| RTGS | Real Time Gross Settlement System |
| SME | Small and Medium Enterprise |
| SIMO | *Sociedade Interbancária de Moçambique* |
| SOE | State-Owned Enterprise |

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DATASHEET

## BASIC INFORMATION

| Country(ies) | Project Name | |
|---|---|---|
| Mozambique | Mozambique: Financial Inclusion and Stability Project | |
| Project ID | Financing Instrument | Environmental Assessment Category |
| P166107 | Investment Project Financing | C-Not Required |

### Financing & Implementation Modalities

| | |
|---|---|
| [ ] Multiphase Programmatic Approach (MPA) | [ ] Contingent Emergency Response Component (CERC) |
| [ ] Series of Projects (SOP) | [✓] Fragile State(s) |
| [✓] Disbursement-linked Indicators (DLIs) | [ ] Small State(s) |
| [ ] Financial Intermediaries (FI) | [ ] Fragile within a non-fragile Country |
| [ ] Project-Based Guarantee | [ ] Conflict |
| [ ] Deferred Drawdown | [ ] Responding to Natural or Man-made Disaster |
| [ ] Alternate Procurement Arrangements (APA) | |

| Expected Approval Date | Expected Closing Date |
|---|---|
| 13-Dec-2018 | 28-Jun-2024 |

Bank/IFC Collaboration

No

### Proposed Development Objective(s)

The objective of the Project is to increase financial inclusion among underserved groups and MSMEs, while strengthening the overall financial safety net.

### Components

| Component Name | Cost (US$, millions) |
|---|---|
| Increasing usage of transaction accounts and access to finance for MSMEs | 20.00 |
| Financial safety net strengthening | 17.00 |
| Project management, monitoring and evaluation | 3.00 |

### Organizations

| | |
|---|---|
| Borrower: | Ministry of Economy and Finance |
| Implementing Agency: | Ministry of Economy and Finance<br>Deposit Guarantee Fund<br>Bank of Mozambique<br>Instituto de Supervisao de Seguros de Mocambique |

## PROJECT FINANCING DATA (US$, Millions)

### SUMMARY

| | |
|---|---|
| **Total Project Cost** | 40.00 |
| **Total Financing** | 40.00 |
| **of which IBRD/IDA** | 40.00 |
| **Financing Gap** | 0.00 |

### DETAILS

**World Bank Group Financing**

| | |
|---|---|
| International Development Association (IDA) | 40.00 |
| IDA Grant | 40.00 |

### IDA Resources (in US$, Millions)

| | Credit Amount | Grant Amount | Total Amount |
|---|---|---|---|
| National PBA | 0.00 | 40.00 | 40.00 |
| **Total** | **0.00** | **40.00** | **40.00** |

**Expected Disbursements (in US$, Millions)**

| WB Fiscal Year | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|
| Annual | 0.00 | 4.59 | 7.24 | 8.42 | 9.35 | 10.41 |
| Cumulative | 0.00 | 4.59 | 11.82 | 20.24 | 29.59 | 40.00 |

## INSTITUTIONAL DATA

**Practice Area (Lead)**

Finance, Competitiveness and Innovation

**Contributing Practice Areas**

Education, Macroeconomics, Trade and Investment, Social Protection & Labor

**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 | Substantial |
| 2. Macroeconomic | Substantial |
| 3. Sector Strategies and Policies | Low |
| 4. Technical Design of Project or Program | High |
| 5. Institutional Capacity for Implementation and Sustainability | Substantial |
| 6. Fiduciary | Substantial |

| | |
|---|---|
| 7. Environment and Social | Low |
| 8. Stakeholders | Low |
| 9. Other | |
| 10. Overall | Substantial |

## 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 | | ✓ |
| Performance Standards for Private Sector Activities OP/BP 4.03 | | ✓ |
| 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

No later than four (4) months after the Effective Date, or such other date as agreed by the Association, the PIU shall appoint and thereafter maintain throughout Project implementation, a Project accountant under terms of reference acceptable to the Association and described in the Project Implementation Manual.

### Conditions

| Type | Description |
|---|---|
| Effectiveness | The Recipient has adopted a Project Implementation Manual including Financial Management procedures acceptable to the Association. |
| Type | Description |
| Effectiveness | The Recipient has established a Project Implementation Unit and appointed a Project coordinator and financial manager with skills and experience acceptable to the Association. |
| Type | Description |
| Disbursement | Under Category 2 until the Recipient has developed and adopted a manual describing the beneficiaries of the rebate program, eligible expenditures to be financed through project proceeds, terms and conditions for payments, in form and substance satisfactory to the Association. |
| Type | Description |
| Disbursement | For the First Withdrawal Tranche of the Capitalization Fund under Category (3) unless and until the Association is satisfied that the following conditions have been met in respect of said expenditures: (i) the Recipient has developed and implemented a DGF operational manual, and financial management system; (ii) the Recipient has furnished evidence satisfactory to the Association in accordance with the verification protocol set forth in the Project Implementation Manual that the Recipient has achieved the respective DLI Action (DLI #1.1 and #1.2) set forth in the Annex of Schedule 2 to this Agreement against which withdrawal is requested; and (iii) the Recipient has complied with the additional instructions referred to in the Disbursement and Financial Information Letter, including furnished to the Association reports, or reports, supporting eligible expenditures under Category (3). |
| Type | Description |
| Disbursement | For the Second Withdrawal Tranche of the Capitalization Fund under Category (4) unless and until the Association is satisfied that all of the following conditions have been met in respect of said expenditures: (i) the Recipient has implemented and maintained a DGF operational manual, and financial management system; (ii) the Recipient has furnished evidence satisfactory to the Association in accordance with the verification protocol set forth in the Project Implementation Manual that the Recipient has achieved the respective DLI Action (DLI #2.1, #2.2 and #2.3) set forth in the Annex of Schedule 2 to this Agreement against which withdrawal is requested; and (iii) the Recipient has complied with the additional instructions referred to in the Disbursement and Financial Information Letter, including furnished to the Association reports, or reports, supporting eligible expenditures under Category (4). |
| Type | Description |
| Disbursement | For the Third Withdrawal Tranche of the Capitalization Fund under Category (5) unless and |

| | |
|---|---|
| | until the Association is satisfied that the following conditions have been met in respect of said expenditures: (i) the Recipient has implemented and maintained a DGF operational manual, and financial management system; (ii) the Recipient has furnished evidence satisfactory to the Association in accordance with the verification protocol set forth in the Project Implementation Manual that the Recipient has achieved the respective DLI Action (DLI #3.1, #3.2, #3.3 and #3.4) set forth in the Annex of Schedule 2 to this Agreement against which withdrawal is requested; and (iii) the Recipient has complied with the additional instructions referred to in the Disbursement and Financial Information Letter, including furnished to the Association reports, or reports, supporting eligible expenditures under Category (5). |

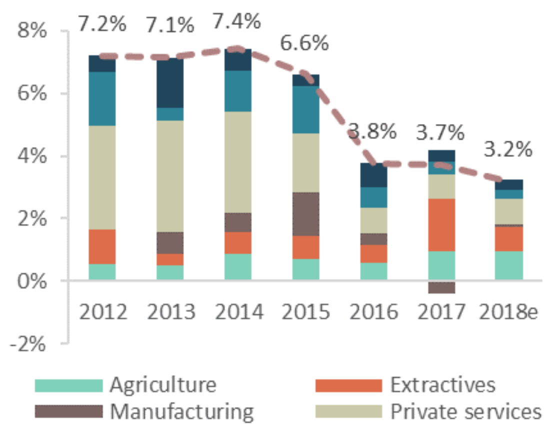
## I. STRATEGIC CONTEXT

### A. Country Context

1. **Mozambique is a low-income country of 29.6 million people located in the south-east corner of southern Africa.** It has a GDP per capita of US$417, which is among the lowest in the world. The economy is dominated by the agricultural sector, which accounts for 25 percent of Mozambique's GDP and employs about 75 percent of the population. Mozambique is developing natural gas and mineral resources, which has the potential to transform the economy. It has been the principle driver of recent economic growth and the main recipient of foreign direct investment. Poverty is high at 48.4 percent in 2015 albeit lower than the 58.7 percent rate registered in 2009.

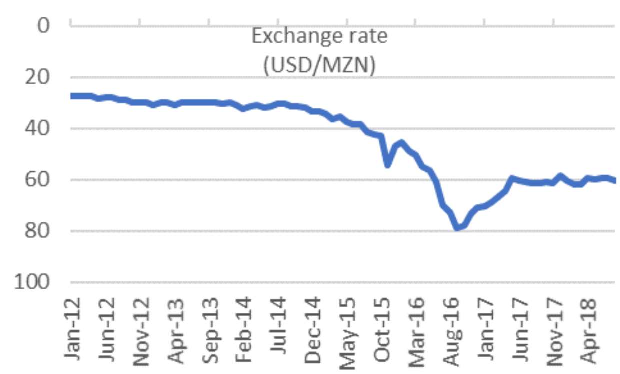
2. **Mozambique has moderated its pace of growth as it continues to confront the downturn that followed the sovereign debt crisis of 2016.**[1]**.** Economic growth fell to an average of 3.8 for 2016 and 2017, down from 8 percent on average over the preceding decade, and is expected to be 3.2 percent in 2018 (see Figure 1). The loss of confidence following the sovereign debt default and volatility in prices have contributed to a fall in private demand, especially for services, which was the largest driver of growth in the years prior to the economic downturn. The extractive sector is not expected to generate enough income opportunities for the net annual inflow of job seekers.

**Figure 1: Annual contribution to growth, 2012–18**




Source: INE; World Bank staff estimates. e = estimate.

**Figure 2: Currency stabilization after rapid depreciation**




Source: World Bank

3. **Mozambique is emerging from a period of macroeconomic volatility and continues to face a constrained fiscal environment with reduced scope for financing expenditures.** Monetary policy helped to stabilize the Metical and bring inflation down to single digits from a peak of 26 percent in November 2016 (see Figure 2). The shift from external financing and stronger Metical have helped to reduce the public debt stock from 128 percent in 2016 to 112 percent by end 2017. External debt fell to 85 percent of GDP in 2017 from 104 percent of GDP in 2016.[2] Domestic debt increased over this period by 2 percentage points of GDP to 27 percent and has continued to grow in 2018. Fiscal pressures are acute with the Government in arrears with value-added tax rebates of US$2 billion (12 percent of GDP).

[1] World Bank. Mozambique Economic Update, October 2018.
[2] In April 2016, previously undisclosed public debt of US$ 1.4 billion (equivalent to 10%of GDP) was made public.

### B. Sectoral and Institutional Context

4. **Financial inclusion and stability are two key enablers for poverty reduction that are highly constrained in Mozambique.** Individuals and MSMEs lack access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance.[3] Macroeconomic volatility has undermined the soundness of the financial system and exposed lenders, primarily banks, to increased risks of default from both private creditors and the state. Addressing these challenges requires a comprehensive effort to increase financial inclusion while promoting the safety and soundness of the financial system.

5. **Being able to have access to a transaction account is a first step toward broader financial inclusion since a transaction account allows people to store money and send and receive payments**. A transaction account serves as a gateway to other financial services, which is why ensuring that people can have access to a transaction account is the focus of the World Bank Group's Universal Financial Access 2020 initiative that includes Mozambique. Transaction accounts also facilitate access to basic services including electricity and water on a pay-as-you-go basis.

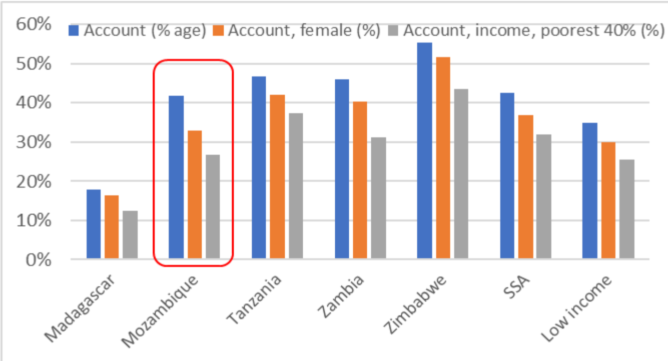
6. **Financial access facilitates day-to-day living, and helps families and businesses plan and responds to unexpected emergencies.** As accountholders, people are more likely to use other financial services, such as credit and insurance, to start and expand businesses, invest in education or health, manage risk, and weather financial shocks, which can improve the overall quality of their lives. The capability to send and receive transfers, pay for basic services, and store money on digital platforms, contributes to economic resilience of individuals and MSMEs.[4]

*Account ownership and usage*

7. **Mozambique has made progress toward financial inclusion with 8 million additional adults having obtained access to an account since 2009.** However, close to two-thirds of adults, or 58 percent of adult Mozambicans, do not have a transaction account according to the latest Findex data.[5] This corresponds with Bank of Mozambique's (BOM) 2016 Financial Inclusion Report, which states that only 36 percent of the adult population have access to bank accounts. Most of the unbanked people include women, poor households in rural areas, and individuals in the informal sector. The gender gap in Mozambique is high with only 33 percent of women owning an account relative to 51 percent for men (see Figure 3), which limits women from being able to effectively control their financial lives.

[3] The General Framework for MSMEs (*Estatuto Geral das MPMEs*) in Mozambique is established by Decree Law no. 44/2011.
[4] World Bank. Payment Aspects of Financial Inclusion, September 2017.
[5] The 2017 Global Findex data is drawn from surveys covering 150,000 people in 144 countries. In Mozambique, the survey involved face-to-face interviews of a nationally representative sample of 1,000 randomly selected individuals between June and August 2017.

**Figure 3. Account ownership, age 15+**




*Source: Findex 2017*

8. **People have a strong preference for cash when settling transactions, particularly in rural areas.** In 2017, only 30 percent of adults in rural areas made or received digital payments. Demand side surveys show that 52 percent of adults do not have an account because they believe they lack sufficient funds, 24 percent because it is too far away, 19 percent because it is too expensive. Identification and trust are also limitations survey respondents saying that they lack the correct documentation (19 percent) or do not trust financial institutions (8 percent).

9. **Mobile money account ownership is growing rapidly with increased mobile phone penetration, but there remains a significant gender gap with only 17 percent of women owning accounts relative to 27 percent of men.**[6] BOM reports 6.6 million mobile money accounts registered in Mozambique. In 2017, there were more individuals with mobile money accounts (405 accounts per 1,000 adults) than bank accounts (297 accounts per 1,000 adults). Ownership does not necessarily translate into usage as only 22 percent of adults use a mobile phone or the Internet to access an account. Most mobile money transactions were *cash-in* and *cash-out* operations (54 percent), while payments for goods and services and other transfers represented 46 percent.

10. **Regulatory measures to encourage growth of financial services in underserved areas include e-money issuance and mobile and banking agents.**[7] In May 2018 there were more than 32,000 mobile money agents. Still, some legal requirements prevent higher levels of financial inclusion. Only 58 percent of adults in Mozambique have the required national identify card to validate identity when opening accounts. People younger than 21 years old are not allowed to open bank accounts, which excludes about 55 percent of the population. BOM is preparing new legal and regulatory frameworks for bank accounts for basic services and for the legal age to open accounts to further expand financial inclusion.

11. **The market for mobile money in Mozambique is expanding but is dominated by one operator.** Since the launch of mobile money in 2011, all three mobile network operators have established subsidiaries for mobile payments (mKesh, eMola, and mPesa) licensed and supervised by the central bank. In mid-2018, mPesa reported 3.5 million active accounts defined as one transaction a month (174,000 for mKesh and 25,000 for eMola). The value of mobile money transactions has increased (18.8

[6] There are 13 million active (90-days) mobile phone subscriptions in Mozambique. Mobile coverage reaches 70% of districts.
[7] To increase trust in e-money as means of payment, BOM strengthened its legal and regulatory framework requiring that: (i) non-bank e-money issuers use trust accounts at banks and; (ii) funds be made available for immediate redemption, withdrawal or other use by customers; and (iii) clients to have priority against other creditors of the e-money issuer.

percent of GDP in 2017 relative 0.24 percent of GDP in 2014). The fee structure for mobile payments is regressive. A withdrawal of US$1 incurs a 7 percent fee whereas fees for larger withdrawals range between 1-2 percent. Bill and merchant aggregators do not exist although the central bank is considering regulations to allow this type of financial service.

12. **There are many obstacles to increase mobile financial services in Mozambique.** These include the lack of full interoperability between mobile money operators and banks (bilateral arrangements exist between large banks and the largest mobile money operator); limited penetration of mobile services outside urban centers; limited awareness and trust, particularly of digital money transfers provided by agents; absence of agents with sufficient cash liquidity, particularly in rural areas; and identification of account owners is challenging as documentation is often non-existent impeding know-your-customer (KYC) compliance.

13. **Many districts have limited physical access points for financial services despite the use of agents.** Only 55 percent of the 154 districts in Mozambique have at least one bank branch relative to 73 percent of districts with at least one e-money agent. Similarly, only 58 percent of districts have at least one ATM relative to 90 percent with at least one point-of-sale (POS) terminal. Maputo City has the highest number of access points followed by the provinces of Maputo and Gaza. The most disadvantaged provinces are Cabo Delgado and Niassa (see Figures 4 and 5).

**Figure 4: Financial access point per 100,000 adults**

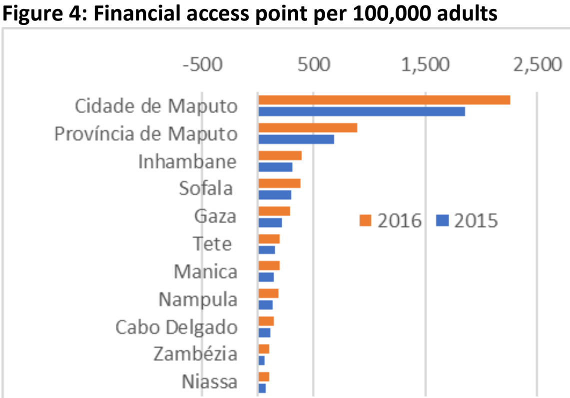
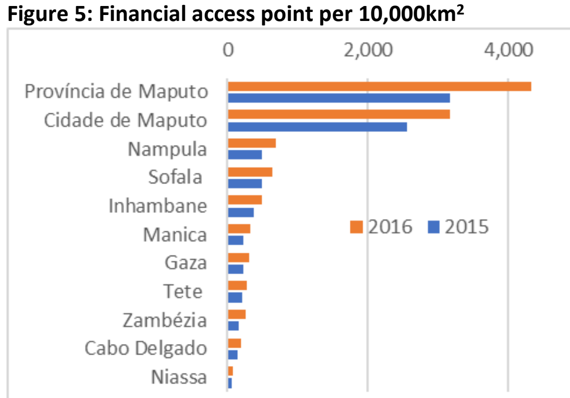



**Figure 5: Financial access point per 10,000km²**




*Source: BOM*

14. **Financial education programs in Mozambique are coordinated by the central bank.** They increase awareness of financial services among consumers, competition among financial service providers, and protection to consumers, particularly those with limited financial literacy. The central bank's program covers several topics related to banking services and numeracy but does not cover mobile money.

15. **Although electronic transfers have been increasing, a significant share of Government payments is inaccessible to the recipient or still made in cash.**[8] About 94 percent of civil servants receive their salaries directly in their bank accounts, but some live and work far away from a bank branch and incur significant costs to withdraw cash. For example, a large share of the 70,000 teachers working in rural areas lack physical proximity to a bank branch or ATM. They can spend as much as a week and the

[8] A financial management system (e-SISTAFE) linked to the treasury single account manages all government payments. In 2017, this platform processed 6.7 million payments, an increase of 25 percent from 2015.

equivalent of 3-5 days wages to collect their salary, which contributes to teacher absenteeism.[9] An additional 10,000 facilitators of an adult literacy program (DIPLAC) and an early-childhood development program (DICIPE) receive cash stipends at high cost to the Ministry of Education.

16. **Payments to beneficiaries of social safety net programs are almost exclusively made in cash.** The National Institute of Social Action (INAS) is implementing three social safety net programs: (i) a social pension covering about 375,000 individuals; (ii) a productive safety net program for households with able bodied members covering 97,000 households, with a plan to scale up to 120,000 beneficiaries in 2019 and 134,000 in 2020; and (iii) the Direct Social Support Program with a component providing timely support in-kind and a second component focused on Post-Emergency Cash Transfers covering 18,500 households in selected drought-affected districts. The implementation of the safety net programs has received technical and financial support from development partner and donors including the World Bank. Despite this, social protection coverage is low with current programs covering less than 500,000 poor and vulnerable households or less than 20 percent of poor households in the country.[10]

17. **INAS has been working to gradually outsource payments to beneficiaries, which is expected to increase transparency and accountability**. The program seeks to improve identification of beneficiaries (e.g., using biometrics and photo IDs), while at the same time serve as an initial verification process of current beneficiaries (e.g., whether beneficiary has migrated or died). However, the costs of third-party payments are high (more than 15 percent of the transfer value) relative to commercial transfers on banking or mobile platforms (about 1 percent).

18. **Government financial management systems can only make payments to bank accounts.** Technical challenges sometimes cause delays in payments. By law, all Government payments must be made to a bank account, with the identity of the owner validated by the banking institution. Payment orders are processed by the central bank, which debits the single treasury account and credits the beneficiary's account. Government payments on mobile accounts would require legal, regulatory and technological changes to the financial management system.

*Financial Intermediation and Stability*

19. **Financial intermediation has declined, and financial stability risks have increased, in Mozambique since 2015**. Credit to the private sector contracted by 9 percentage points to 26 percent of GDP in 2017. In response to risks, banks have allocated more of their holdings to government securities, cash and reserves.[11]

20. **There has been a sharp increase in credit risk since end 2015, which is reflected in the growth of prudential non-performing loans (NPLs) but not in impaired assets (accounting NPLs)**. Prudential NPLs in the banking sector increased from 4.3 percent of gross loans in 2015 to 12.6 percent in June 2018. Such a trend is however not observed for impaired assets (5.2 percent of gross loans at March 2018). Prudential NPL ratios in the three largest banks range from 3 to 20 percent. The regime does not capture

[9] In 2015, 12 percent of teachers that reported absence (i.e., 2.7 percent of all teachers surveyed) argued that they missed classes to "collect salaries" (i.e., to withdraw cash from their bank account at the nearest bank branch).
[10] There are 2.46 million poor households in country. Estimation is based on the IOF 2014/15: 12.3 million people living under the basic needs poverty line in the country, and an average of 5 household members per household.
[11] The three largest banks—two subsidiaries of Portuguese banks and one of a South African bank—dominate the market.

well exposures on state entities. Some banks have started to swap some of their non-performing SOE debt for government bonds with maturities of 10 to 15 years.[12]

21. **Capital buffers increased significantly since 2016 and headline liquidity figures do not indicate signs of stress.** Since January 2014, the industry-wide capital adequacy ratio (CAR) increased 5.5 points to reach 20.1 percent in March 2018 relative to a required minimum of 12 percent. Banks are also liquid, but the volatility of macro-financial environment could rapidly impact liquidity, particularly as a quarter of banks' balance sheet is denominated in foreign exchange and they process large foreign currency flows. The increase in bank capital reflects the shift in portfolio structure with banks placing more of their assets in government securities higher bank profitability and retention of profits (including constrains in distributing dividends abroad to parents). Capital buffers tend to be slightly lower for the largest banks. Moreover, headline capital buffers are overestimated as prudential requirements follow a Basel I regime and do not include operational and market risk charges.

22. **Banking supervision is gradually improving but remains constrained.** There is scope for additional tightening in the treatment of rescheduled and reclassified loans as well as a need for the supervisor to improve implementation of IFRS9 provisioning requirements, which have been mandatory in Mozambique since January 2018.[13] The IMF and the central bank of Norway (Norges Bank) are supporting banking supervision strengthening while the World Bank has provided technical assistance on bank resolution and cross border supervision. A separate agency (ISSM) supervises the insurance and pension sector, but it lacks independence and has limited capacity to carry out its functions. The Bank has been providing technical support to improve its supervision capacity, including preparation of a supervision manual and support for on-site inspections of select insurance companies.

23. **Some off-site supervision platforms are outdated and rely on manual interventions with limited use of automated financial reporting platforms and tools to support risk-based supervision.** Prudential and financial returns from some regulated entities are still transmitted through spreadsheets and processed manually leading to input errors and absorbing scarce supervisory capacity. Off-site supervision is therefore limited and does not adequately reinforce on-site supervision of financial institutions. BOM's IT platform for banking supervision is an exception, with its automatized data processing mechanisms.

*Crisis Management*

24. **The creation of a new financial stability department within the central bank in early 2018 was an important measure, which needs to be complemented with efforts to improve the capacity to manage and resolve a financial crisis.** This involves measures to assess the adequacy of liquidity management framework (instruments, collateral policies); financial safety nets (deposit insurance, lender-of-last-resort arrangements); crisis preparedness and crisis resolution frameworks (bank resolution); and the possible spillovers from financial sector instability.

25. **The failure of two banks in late 2016 revealed the lack of legal instruments to resolve distressed**

[12] In 2017, the Government issued two bond series for a total of MZN 7.4 billion (US$ 116.9 million or 0.9 percent of GDP) directly to commercial banks in exchange of SOE loans that were reaching maturity.
[13] IFRS 9 (financial Instruments) was completed in 2014 and became effective in January 2018. Among other changes, accounting for loan loss provisioning will change from an incurred to an expected loan loss model; expected credit losses will also be recognized from inception and not only when the asset is underperforming.

**banks.** The central bank is seeking to address this gap by undertaking a review of the legal and regulatory framework for bank resolution and deposit insurance, with support from the World Bank and IMF. This review resulted in proposed amendments to the Financial Institutions Law (No. 15/99, last amended in 2004), the central bank organic law, the special insolvency regime for financial institutions, and the deposit guarantee fund decree-law. The proposed changes include making the central bank the statutory resolution authority, introducing resolution powers in line with international guidelines, and expanding the mandate of the deposit guarantee fund.[14]

26. **The absence of resolution funding was a key weakness in the authorities' response to the 2016 bank crisis, particularly as the deposit insurance scheme cannot be used to facilitate resolution.** Authorities had to recapitalize a weak but systemically important bank by drawing on the BOM employee's pension fund, which became the primary shareholder of the bank with 90 percent of its equity.[15]. The episode also shows the lack of operational capacity at the Deposit Guarantee Fund (DGF) an autonomous public institution established by the Decree Law No. 49/2010, of November 11. The staff of the DGF is limited to three administrators nominated by the central bank, finance ministry, and bankers' association, respectively.

27. **Deposit insurance coverage is limited.** Only local currency deposits owned by individual residents in Mozambique are covered up to a limit of MZN 20,000 (US$332). Mobile money issuers are required by regulation to hold custody (trust) accounts with commercial banks, but these accounts are not disaggregated by the deposit insurance agency and are therefore not covered.

28. **The Deposit Guarantee Fund (DGF) covers less than 1 percent of insured deposits relative to a target of 3 percent.** [16] Banks paid their first annual premiums only in May 2017, but these are unlikely to provide the necessary funding in the short to medium-term. The fund's initial capital came from the government (MZN 60 million or US$1 million), the central bank (MZN 30 million or US$0.5 million) and premiums paid by financial institutions (MZN 15 million or US$0.25 million). The government is negotiating with KfW grant financing to contribute an additional US$9.2 million in capital. Even with this grant, the size of the deposit insurance fund is insufficient. There is no fiscal backstop to cover deposit insurance liabilities in a situation where the resources of the fund are insufficient.

*Access to Finance*

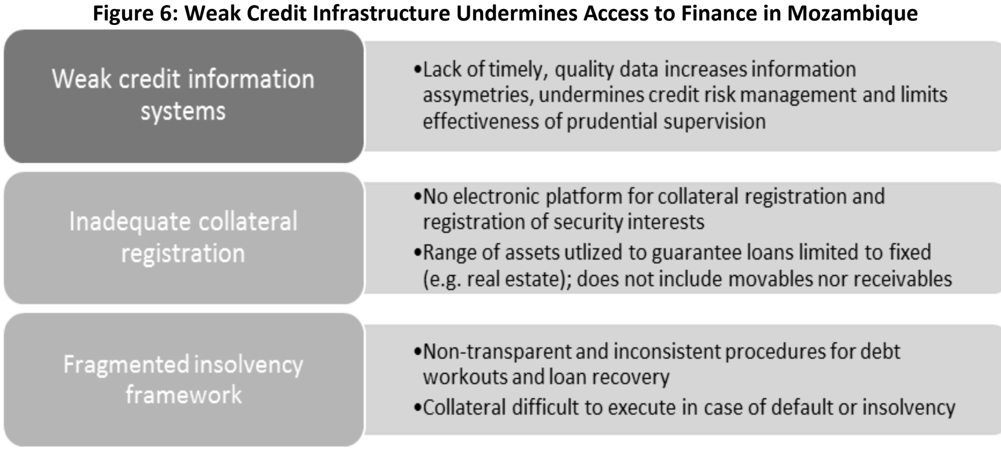
29. **MSMEs and individuals face severe constraints in accessing financing with average commercial bank lending rates in Mozambique above 25 percent.** Demand side surveys show that 50 percent of firms identify access to finance as a major constraint in Mozambique relative 39 percent for the region. Access to finance is constrained by the macroeconomic environment but also by structural issues such as high operating costs, lack of credit information, limited availability of collateral, and limited

[14] The Financial Stability Board (FSB) established the Key Attributes of Effective Resolution Regimes for Financial Institutions, which are the main international guidelines on bank recovery and resolution.
[15] FSB Key Attribute 6.3 states that countries should have in place privately-financed deposit insurance or resolution funds, or a funding mechanism with ex post recovery from the industry of the costs of providing temporary financing to facilitate the resolution of the firm.
[16] This target size is below the average of 8.9% of insured deposits for similar schemes in four lower middle-income countries surveyed by IADI in 2015 that determine their target fund size as a percentage of insured deposits. The average target for all 22 surveyed countries was 3.5%. However, the surveyed countries have more developed financial systems than Mozambique.

competition with only three banks dominating the credit market.

30. **The financial infrastructure necessary to facilitate credit to the private sector in Mozambique is lacking.** The insolvency regime is weak, which undermines the ability of creditors to recover the loans and enforce their claims. The absence of large-scale financial reporting and an inefficient credit reporting system results in suboptimal credit allocation (see Figure 6). This partly explains why banks primarily provide asset-based lending to large firms and offer little cash flow-based lending or start-up financing, and why they provide limited credit to MSMEs.[17]

**Figure 6: Weak Credit Infrastructure Undermines Access to Finance in Mozambique**




31. **The legal framework that currently governs secured transactions in Mozambique is dated, limited and fragmented, and does not support lending based on movable assets**. The process for registering security interests in movable assets is manual and paper-based. The scope of assets over which security interests can be registered is also limited reducing the ability for MSMEs to use many of the assets they have as collateral. IFC is supporting preparation of new legal frameworks for insolvency and secured transactions. The government submitted a collateral registry bill to Parliament for approval in July 2018 and the related draft regulations have been prepared.

## C. Relevance to Higher Level Objectives

32. **The project is aligned with the first focus area of the Mozambique: Country Partnership Framework (CPF) for FY17–FY21, which aims to promote diversified growth and enhance productivity through, inter alia, increased access to finance**. The project contributes directly to the Maximizing Finance for Development agenda by addressing binding constraints to take up of financial services by underserved segments. It supports implementation of the Government's Financial Sector Development Strategy (2013–22), which seeks to improve financial stability, financial inclusion, and the supply of long term finance. It supports implementation of the National Financial Inclusion Strategy (NFIS), which targets and increase in access from 25 percent to 60 percent of the adult population by 2022.[18]

[17] MSMEs contribute to 28 percent of GDP and account for 42 percent of formal employment but most (75 percent) are financially excluded. In 2017, agriculture was responsible for 21 percent of GDP but credit to agriculture represented only 4 percent of lending (down from an average of 12 percent in 2000–2010).

[18] República de Moçambique. 2013. *Estratégia para o Desenvolvimento do Sector Financeiro 2013–2022.* República de Moçambique. 2016. *Estratégia Nacional de Inclusão Financeira 2016–2022.*

33. **Gender considerations will be an integral aspect of project activities and gender indicators will be used to monitor support to women and women-led enterprises and the progress in reducing the gender gap in ownership of transaction accounts** (33 percent for women and 51 percent for men). A 2016 survey showed that women's lack of confidence and interest on new technologies may be an obstacle: the survey showed that women in Mozambique were more likely to say that they do not know how to use a phone and were less interested in accessing mobile Internet; there were no differences in phone ownership between gender.

34. **Activities supported by Component 1 of the project will be disaggregated by gender.** The financial education and awareness program will have modules and outreach materials tailored to women, and at least 50 percent of trainers and beneficiaries will be women. The outreach campaign for the collateral registry will also have materials tailored to women; women-led enterprises will particularly benefit from the registry, as they are more likely to lack immovable property to offer as collateral for a loan. The project will add other relevant gender consideration as needed to address the identified gender gaps.

## II. PROJECT DESCRIPTION

### A. Project Development Objective

**PDO Statement**

35. **The objective of the Project is to increase financial inclusion among underserved groups and MSMEs, while strengthening the overall financial safety net**.

**PDO Level Indicators**

36. **To assess progress towards achievement of the PDO, the project will focus on five key indicators:**

- Teachers in rural areas with access to a mobile money account (number and percentage)
- Targeted recipients of government transfers that make or receive digital payments (number and percentage)
- Adults making or receiving digital payments in the past year (percentage)
- Active mobile money agents (number and percentage)
- MSMEs that received loans secured by movable assets registered in the collateral registry (number)
- Size of the deposit insurance fund (DGF) as a share of total deposits (without contributions from other development partners)

37. **The intermediate indicators are as follows:**

- IT solution that enables Treasury to interface with e-money payment systems installed and operational
- Individuals benefitting from financial literacy awareness program (number);
- Recipients of government transfers reporting satisfaction with the digitized payment method(s)

(percentage) (citizen engagement indicator); [19]

- A centralized, web-based collateral registry established and operational;
- Strengthened bank recovery resolution framework;
- Improved DGF's ability to undertake deposit insurance functions;
- Expanded coverage of deposit insurance;
- Insurance companies among the five largest with integrated connections to the supervisory reporting system (number).

## B. Project Components

38. **The proposed Project seeks to promote measures to increase financial inclusion by providing access to electronic transaction accounts to underserved segments of the population and increase the capacity of the deposit insurance scheme to protect individual depositors and support overall financial stability.** Broadly, this will be implemented through (i) technical and advisory measures to increase the usage of transaction accounts by facilitating the digitization of government payments; (ii) development of a program to improve the ecosystem for electronic transactions, particularly in rural areas, and the enabling environment for its adoption, including investments in financial literacy and awareness; (iii) establishment of a new collateral registry; (iv) provision of capital, TA, and institution support to improve the operational capacity of the deposit insurance scheme; and (v) technical and advisory support to improve surveillance of financial sector risks and deepen capital markets. The project has three components with a total investment of US$40 million.

**Table 1: Description of Project Components (SDR, US$ equivalent)**

| *Component* | *Scope of Activities* | *Outcomes* | *Allocation* |
|---|---|---|---|
| **Component 1: Increasing usage of transaction accounts and access to finance for MSMEs** | | | **US$20m SDR 14m** |
| 1.1 Digitization of government payments | Support for review/update of the legal and regulatory framework for government payments. Expansion of payments capability to enable Treasury to interface with e-money providers. Rebate program to increase the availability and liquidity of e-money agents in rural areas. Technical assistance to facilitate account and identity verification processes for basic/limited financial services (small value) | Payments for targeted groups (teachers, lifelong education facilitators, social protection recipients) paid into transaction accounts, increasing the convenience and access enabling usage. Improved management, transparency and efficiency of payments. Increased financial service access points in rural areas. | US$12m SDR 9m |
| 1.2 Financial education and awareness | Training on mobile money and account management to targeted groups (e.g., rural teachers, social benefits recipients). Training and outreach to agents in underserved areas. | Increased capability of payment recipients to use cashless transactions (measured through the uptake in account ownership and usage). | US$6m SDR 4m |
| 1.3 Enabling environment for access to credit for MSMEs | Centralized electronic collateral registry with proper workflows and rules. | Increased willingness by financial institutions to accept movables as collaterals for loans to MSMEs. | US$2m SDR 1m |

[19] Surveys of recipients of government digital payments will also include request for open feedback. Progress reports will include summaries of this feedback and on whether there is tangible response to the feedback.

| | | | |
|---|---|---|---|
| **2. Strengthening financial safety net** | | | **US$17m SDR 12m** |
| 2.1 Deposit insurance institutional strengthening and capitalization | Institutional capacity building of the deposit insurance agency, including deployment of an integrated management information system<br><br>Capitalization of the Deposit Guarantee Fund | Increased capacity of the deposit insurance agency to fulfill its mandate<br><br>Individual depositors protected | US$2m SDR 1m<br><br>US$12m SDR 9m |
| 2.2 Upgrading financial sector supervisory technology and deepening capital markets | Upgrade the technological platform utilized for supervision<br><br>TA and Institutional capacity building for enhancement of debt issuance and management in the National Treasury. | Improved risk-based supervision of the financial sector<br><br>Enhanced public debt management and issuance in support of deeper and more liquid capital markets | US$2m SDR 1m<br><br>US$1m SDR 1m |
| **3. Project Management, Monitoring, and Evaluation** | | | **US$3m SDR 2m** |
| | | **Total** | **US$40m SDR 29m** |

***Component 1: Increasing usage of transaction accounts and access to finance for MSMEs (US$20m, SDR 14m)***

39. **The objective of this component is to support increased usage of transaction accounts (bank or mobile money accounts) in remote and underserved areas**. It will support the digitization of government payments by introducing the capability to, in addition to bank accounts, deposit directly in mobile accounts, which does not currently exist. It supports the transition from a cash-based delivery model of social benefits and transfers to a digital approach, which will enhance the transparency, efficiency, and convenience of government to person payments. Individuals residing in underserved areas, particularly rural, will benefit as digital payments will supplement the limited access to physical bank branches, ATMs or other financial service access points (e.g. point of sale devices).

40. **Recipients of government transfers will have the option to choose the payment provider that better suits their needs.** The project will provide rebates to (i) providers to set up agents with adequate liquidity in unserved areas; (ii) agents, after they do a cash-out operation; and (iii) beneficiaries, for fees and travel costs. This multiple service provider model creates incentives for better service and considers the local context.

41. **Recipients of government transfers will benefit from lower transaction costs by eliminating or reducing travel time and expenses.** The Treasury will benefit from lower cash management expenses and the reduced scope for fraud. Supported by a financial literacy and awareness campaign (sub-component 1.2) and the introduction of new credit infrastructure (sub-component 1.3), these measures will support greater availability of digital finance and the adoption of transaction accounts in Mozambique, which has the potential to promote greater financial inclusion.

*Sub-component 1.1: Digitization of Government payments (US$12m, SDR 9m)*

- *Funded intervention*: (i) Development of a payment module to enable the Treasury to interface with mobile money providers; (ii) technical assistance to the Treasury to review and update the legal and regulatory framework for government payments and for implementation of the new payment procedures; (iii) development and implementation of a rebate program to facilitate the use of electronic payments in rural areas; and (v) technical assistance to relevant stakeholders to improve account and identity verification processes for basic (small value) financial services.[20]

*Sub-component 1.2: Promoting financial education and awareness (US$6m, SDR 6m)*

42. **This sub-component aims to support the establishment of a financial education and awareness program that will increase the understanding and capabilities of individuals affected by the move to digital payments (e.g. teachers in rural areas and social protection beneficiaries)**. The program will support beneficiaries of government to person payments on how to use personal identification numbers (PINs), how much money they should receive at each payout period, how fees are incurred, how to access the payments, and how to redress any grievances including their rights as financial consumers. These initiatives will encourage improved financial decision making and better utilization of financial products and services for consumption smoothing, risk management, and investment. Financial awareness campaigns will drive behavior changes. This component will benefit from the Bank's experience with financial education and awareness programs.[21]The program will be governed by a committee that will include several stakeholders including the treasury and central bank.

- *Funded interventions*: provision of financial education and awareness, including training on mobile money and account management; provision of training, outreach and communication activities targeting agents of payment service providers in underserved areas.

*Sub-component 1.3: Enabling environment for access to credit for MSMEs (US$2m, SDR 1m)*

43. **Asset registries in Mozambique do not distinguish between ownership rights and security interests from creditors, which impedes the use of movable assets as collateral for bank credit.** They are not digital, based regional (e.g., there are 11 motor vehicle ownership and lien registries across the country), and are not efficiently searchable, providing limited confidence to creditors in the provision of cost-effective access to finance. The lack of a broad-based unitary system creates some ambiguity with respect to priority claims. Some common asset types regularly available to small businesses cannot be registered as collateral under the existing system.

44. **This project will finance the establishment of a centralized online registry of security interests in movable property and enabling credit infrastructure components**. The project will finance awareness campaigns among borrowers, particularly women, on the benefits of asset-based finance. Increasing confidence in market-based asset valuations support credit provision to those that lack immovable property such as MSMEs and women-led firms. This complements ongoing efforts by the IFC to improve the ability for creditors to efficiently and cost effectively enforce their rights in the event of debtor default or insolvency, which is essential to confidence in the provision of credit by financial institutions.

- *Funded intervention*: provision of hardware necessary to operate the registry and training in its application; outreach and communication activities targeting financial institutions and MSMEs.

[20] BOM is considering a tiered KYC approach requiring only basic identification for a limited set of financial services.
[21] World Bank Group. 2018. *Toolkit: Integrating Financial Capability into Government Cash Transfer Programs.*

***Component 2: Strengthening financial safety net (US$17 million, SDR 12m)***

45. **The objective of this component is to increase the capacity of the deposit insurance scheme to protect individual small depositors and contribute to overall financial stability**. This includes capital for the deposit guarantee fund with the financing linked to the achievement of agreed disbursement linked indicators (DLIs). It also provides advisory and technical support to strengthen the institutional capacity of the deposit guarantee fund, as well as financing for upgrading the prudential reporting platform and risk management analytical tools employed for off-site supervision of the financial sector.

*Sub-component 2.1 Deposit insurance capitalization (US$12m, SDR 9m) and institutional strengthening (US$2m, SDR 1m)*

46. **The project will support improvements in the deposit insurance scheme, including an expansion in its mandate to fund bank resolution in select cases ("pay box plus")**, to better align it with the IADI Core Principles for Effective Deposit Insurance Systems**.** This will help provide funding for resolution under the least cost rule. This will involve investments to strengthen the institutional capacity of the DGF to meet its obligations and to serve as a core part of the financial safety net, including technical assistance to improve corporate governance of the deposit guarantee fund, calculation of premiums, improve information sharing between financial safety net providers, and improve payout capacity and recoveries from liquidated banks. The project will finance an integrated system to support the DGF operations and payouts in the event of bank failures.

47. **The project will support an assessment of the regulatory and operational implications of extending deposit insurance to trust or custodial accounts for mobile money operators in commercial banks.** This requires that the regulatory framework for custodial accounts recognizes that the ownership interest "passes through" to the beneficial owners of the accounts and does not stop at the named account holder. Without such recognition, deposit insurance coverage is limited to the account amount, which is insufficient to pay all the underlying claims.

48. **Capitalization of the deposit insurance fund will be based on evidence of achievement of DLIs** (see table below). Disbursement for DLI 1 is expected to take place during the first year of implementation as the draft legal amendments have already been prepared and are scheduled to be submitted to Parliament in March 2019. Disbursement for DLI 2 is expected to take place in the second year of implementation following passage of the legal amendments. Disbursement for DLI 3 is anticipated to take place in the third year of project implementation following the conclusion of a series of technical and financial studies necessary to (a) calculate an adequate coverage ratio; (b) assess the implications of coverage extension; and (c) work out the operational implications of providing "pass through" deposit insurance to custodial accounts held in commercial bank. The adoption of an operational manual, financial management system, and investment policy will be a withdrawal condition.

**Table 2. Disbursement Linked Indicators (DLIs) for Capitalization of the DGF**

| Disbursement Linked Indicator | DLI Action | DLI Action Achievement Date | Amount of the Financing Allocated Per DLI (expressed in US Dollar) |
|---|---|---|---|
| DLI 1: Strengthen bank recovery resolution framework | DLI #1.1 Deposit insurer's mandate expanded to include financial contribution to bank resolution up to the minimum amount paid in case of liquidation (as outlined in the PIM)<br><br>DLI #1.2 Inclusion of an ex post recovery from the banking industry of the costs of providing temporary financing to facilitate the resolution of the firm | DLI #1.1: January 1, 2020<br><br>DLI #1.2: January 1, 2020 | DLI Value for DLI #1.1: 2,000,000<br><br>DLI Value for DLI # 1.2: 2,000,000 |
| DLI 2: Improve DGF's ability to undertake deposit insurance functions | DLI #2.1 The DGF's managing board is constituted by at least three serving independent board members (as defined in the PIM) with no active bankers on the board.<br><br>DLI #2.2 Premium structure for each participating financial institution calculated based on market share instead of underlying growth rate of deposits.<br><br>DLI #2.3 The BOM has shared with the DGF the following data for at least one calendar quarter: (i) the risk profile of all the problem banks in the Borrower's territory as computed by the BOM; (ii) conclusion of supervision reports for banks which are considered problematic based on the current legal framework; and (iii) details on all enforcement actions and compliance related to problematic banks. | DLI # 2.1: April 1, 2021<br><br>DLI #2.2: July 1, 2021<br><br>DLI #2.3: November 1, 2021 | DLI Value for DLI # 2.1: 1,000,000<br><br>DLI Value for DLI # 2.2: 2,000,000<br><br>DLI Value for DLI # 2.3: 1,000,000 |
| DLI 3: Expand deposit insurance coverage | DLI #3.1 The DGF has expanded deposit insurance coverage from MZN 20,000 to MZN 40,000 based on a market and financial assessment.<br><br>DLI #3.2 The DGF has expanded deposit insurance coverage to include legal entities and non-residents.<br><br>DLI #3.3 The DGF has expanded deposit insurance coverage to include deposits denominated in foreign currency.<br><br>DLI #3.4 The DGF has expanded deposit insurance coverage to include "pass through" coverage of mobile money accounts (defined in the PIM). | DLI #3.1: January 1, 2022<br>DLI #3.2: March 1, 2022.<br>DLI #3.3: by July 1, 2022<br><br>DLI # 3.4: November 1, 2022 | DLI Value for DLI # 3.1: 1,000,000<br>DLI Value for DLI #3.2: 1,000,000<br>DLI Value for DLI #3.3: 1,000,000<br>DLI Value for DLI # 3.4: 1,000,000 |
| Total amount | | | 12,000,000 |

- *Funded interventions*: development of DGF strategic plan, investment policy, financial model and operational guidelines and policies; DGF-related outreach and communication activities; provision of an integrated management information system and training to DGF on its application and broader deposit insurance principles and practices; capitalization of the DGF.

*Sub-component 2.2 Upgrading supervisory technology and deepening capital markets (US$3m, SDR 2m)*

49. **To support better risk management and supervision of the financial sector, the project will finance the development and implementation of new supervisory technologies,** to better align them with the Basel Core Principles for Effective Banking Supervision and Insurance Core Principles. This will involve the design and deployment of ICT systems to improve the supervision of insurance and pension entities along the following key processes: information standardization, reception, data storage, data processing

and workflow; data extraction and reporting; supervision and risk analysis. The Project will support training to supervisory staff in the use of the new supervision technologies. The project will also support Treasury to improve debt management with a focus on domestic debt markets.

- *Funded interventions:* design and implementation of supervisory technology, including hardware and software, for the collection and analysis of financial sector data including prudential returns, financial statements, balance sheet information, and public debt; training to financial sector supervisors.

***Component 3: Project management, monitoring and evaluation (US$3 million, SDR 2m)***

50. **Project Management**: Drawing from the experience of the FSTAP, the project will establish a dedicated PIU within the Ministry of Economy and Finance comprised of individuals that can work full time on the project's implementation. This will entail a project coordinator, a procurement officer, a financial management officer, and a monitoring and evaluation officer. To ensure proper coordination and supervision, a Project Steering Committee (PSC) will be established, composed of the principle stakeholders. The PSC will be chaired by MEF and comprised of representatives of BOM, DGF, Ministry of Industry and Commerce, Ministry of Education, INAS, and ISSM. Section IV expands on implementation arrangements.

- *Funded intervention*: salaries and other operating costs of the PIU.

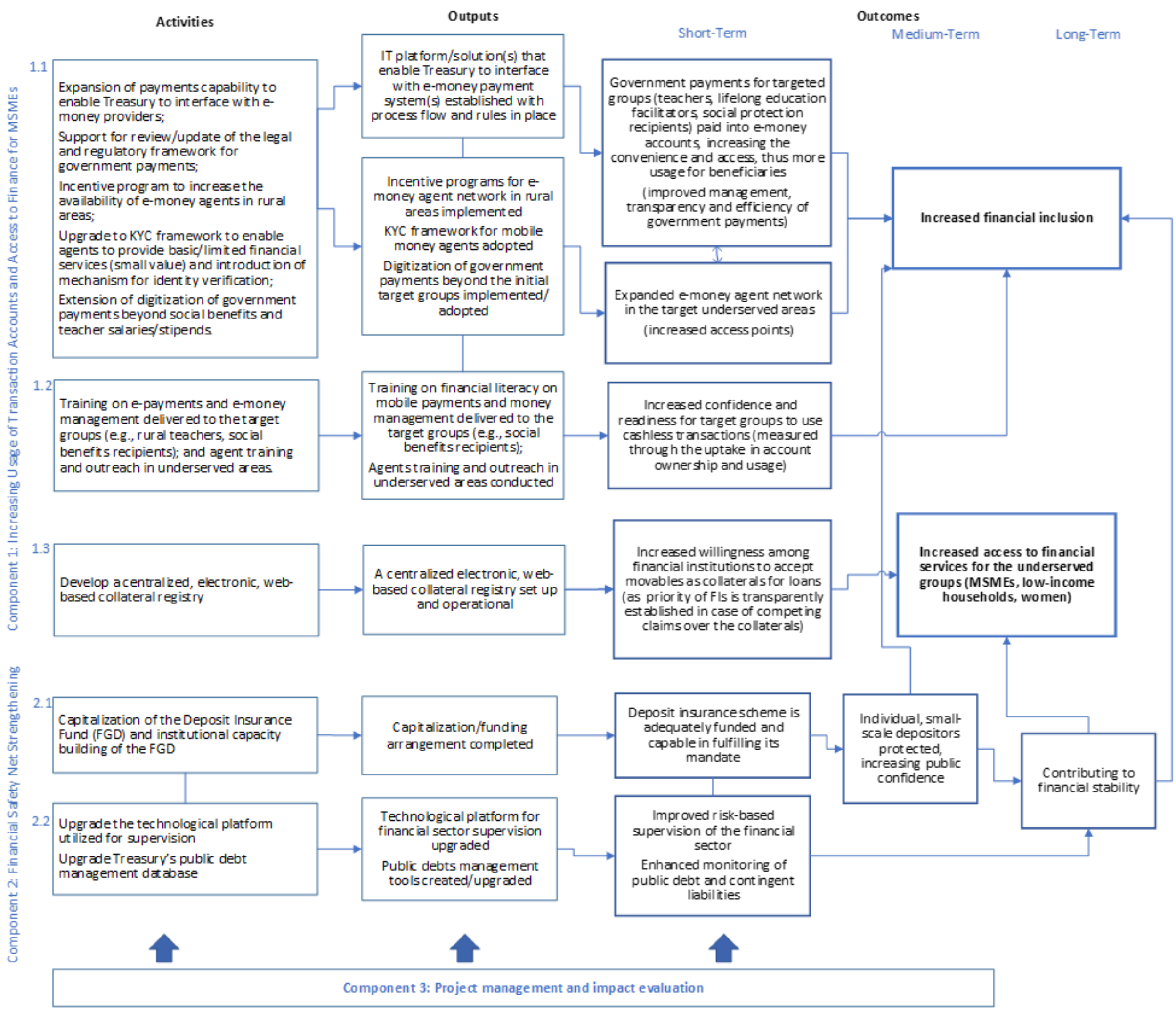
### C. Project Beneficiaries

51. **The project will directly and indirectly benefit financially underserved households and businesses in Mozambique, as well as small depositors and insured persons**. Beneficiaries of government payments will have expanded options to receive and make payments. Banks operating in Mozambique will benefit from the existence of stronger financial safety nets and improved financial infrastructure. Taxpayers will be less likely to shoulder the costs of resolving failed financial institutions. Government and taxpayers will also benefit from administrative and leakage-related savings from digitization of salaries and benefits.

### D. Results Chain

52. **The project will finance infrastructure and initiatives that will help financial service providers better service underserved clients**. Access to transaction and savings accounts has the potential to provide poor people with a safe store of value, an efficient means to execute transactions, and help increase the resilience of household consumption to shocks and productive investment, particularly by women. Capitalization of the deposit insurance fund will reduce the chances of small bank failures becoming a systemic problem. Increased confidence in the financial system will promote domestic savings, which can be mobilized for financing investment by firms and individuals resulting in higher growth, job creation, and poverty reduction.

**Figure 7: Project Results Chain**




## E. Rationale for Bank Involvement and Role of Partners

53. **The World Bank has historically supported financial sector development in Mozambique**, both through technical assistance and operations. Most recently, a 2014-15 Financial Sector Development Policy Operation (DPO) series supported reforms to reinforce financial stability, increase access to financial services, and enhance the development of long-term financial markets. Two US$25 million DPOs were approved in July 2014 and September 2015, while preparation of a third DPO was stopped when World Bank budget support operations were suspended in April 2016. The World Bank has two ongoing technical assistance projects in Mozambique: FISF (P149938) and the FIRST-financed Improving the Enabling Environment for Long Term Finance (P158263). The Bank's expertise in developing financial sectors will help the Government better design their planned interventions.

54. **The choice of components complements ongoing World Bank Group projects and avoids duplication with other development partners**. The IMF is providing technical support on strengthening

surveillance of banking sector, stress testing, and development of an emergency liquidity assistance framework. The Norges Bank has recently started a new 3-year technical assistance program with the BOM, covering areas such as macroprudential supervision and payment systems. KfW is expected to provide €8 million for capitalization of the DGF and €1.5 million for technical assistance. The BOM has requested technical assistance from the United States Department of the Treasury for conducting a national AML-CFT risk assessment.

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

55. **Typical delivery challenges in similar projects include overambitious objectives, poor time allocation and sequencing of tasks, as well as roles and responsibilities not clearly defined**. Experience with the Financial Inclusion Support Framework (FISF) Country Support Program for Mozambique demonstrated the importance of establishing high level steering committees to guide implementation of the NFIS. This suggests the importance of high-level commitment from the MEF, BOM, and other key stakeholders, as well as a coordination platform in the form of a Project Steering Committee led by the Minister of Finance or his/her representative.

56. **The digitization of government payments has shown to reduce transaction costs in other countries**. For example, the per-transfer costs of social transfers by mobile money in Niger were about 20 percent lower than manual cash distribution. This component draws on relevant experience with social protection transfers in Zambia (see Box 1).

**Box 1: Social Protection Transfers in Zambia[22]**

In Zambia, most government transfers are done in cash. To improve efficiency, the Government of Zambia (GOZ), with World Bank support, built a system that empowered participants to make decisions and offered incentives to providers to deliver payments in remote areas. Rather than contracting providers, the model in Zambia provided participants with an incentive (equivalent to 5 percent of the cash payment) to cover the cash-out fee. This new source of revenue for providers combined with participant choice provided an incentive for better service and expansion of access points in rural areas. GOZ also increased the amount paid to participants who had to travel long distances to reach a financial access point to cover their travel costs. This subsidy can be adjusted based on travel time and distance, as more points of service are established.

Because there was no reliable interoperable payments system, GOZ built a workaround to initiate payments with multiple providers directly. GOZ needed to engage with multiple institutions, such as mobile money providers, banks, and the post office, that are outside the existing payment switches and require them to tie into government payments systems. GOZ chose to release the funds through a commercial bank that was a member of the switch and had bilateral agreements with non-associated banks. It also decided on a two-step payments process, first in bulk and then individually, to reduce the number of transactions and overall transaction fees.

57. **The design of the deposit insurance component is informed by several World Bank projects in the Europe and Central Asia region**. At least four other World Bank IPF operations have combined results-based financing and technical assistance to enhance financial stability. Two projects (in Bulgaria and in Serbia) focused on deposit insurance, while the other two projects (in Bosnia and Herzegovina and in Serbia) focus on broader financial sector operations.[23] The Serbia Deposit Insurance Strengthening Project was the first World Bank operation to (re)capitalize a deposit insurance fund, demonstrating a

[22] World Bank and CGAP. Social Protection Transfers in Zambia. May 2018 (unpublished draft).
[23] Bulgaria Deposit Insurance Strengthening Project (P154219), Serbia Deposit Insurance Strengthening Project (P146248), Bosnia and Herzegovina Banking Sector Strengthening Project (P158387), Serbia State-Owned Financial Institutions Strengthening Project (P156837).

different way of engaging in the financial sector and responding to crises. To achieve that, the Project extended OP10's requirements on productive use to include an expenditure into a "fund" as an eligible expenditure. This novel feature has since been used as a model for several other operations. These and other projects have shown that a combination of results-based financing and technical assistance can be an effective instrument for achieving change in a sustainable manner. While the DLIs offer a financial incentive for reform, the technical assistance can support the implementing agency in achieving the DLIs and build long-term capacity. The World Bank Group has developed knowledge products to assist in the challenges of implementing credible deposit insurance systems.[24]

58. **The World Bank and the FIRST Initiative have gathered key lessons from deposit insurance systems in developing countries**, including that (i) operational independence is more important than institutional independence, (ii) an effective deposit insurance system is not free, (iii) preparing for payout is no small task, and (iv) the framework should not be static and should be subject to regular reviews.[25] The project will therefore support the review the current framework, including improvements to the formula for calculation of premiums, and to help the DGF improve its operational independence and its capacity to handle payouts.

59. **The design of the component on usage of transaction accounts will follow the 2016 guiding principles proposed by the international task force on Payment Aspects of Financial Inclusion**: (i) commitment from public and private sector organizations to broaden financial inclusion is explicit, strong and sustained over time; (ii) the legal and regulatory framework underpins financial inclusion by effectively addressing all relevant risks and by protecting consumers, while at the same time fostering innovation and competition; (iii) robust, safe, efficient and widely reachable financial and ICT infrastructures are effective for the provision of transaction accounts services, and also support the provision of broader financial services; (iv) the transaction account and payment product offerings effectively meet a broad range of transaction needs of the target population, at little or no cost; and (v) the usefulness of transaction accounts is augmented with a broad network of access points that also achieves wide geographical coverage, and by offering a variety of interoperable access channels.[26]

## III. IMPLEMENTATION ARRANGEMENTS

### A. Institutional and Implementation Arrangements

60. **The MEF will be the responsible Government counterpart for this project**. The Ministry will be responsible for implementing the project with full fiduciary responsibility. To carry out its responsibilities and effectively implement the project, the Ministry will work with several stakeholders, including the BOM, *Centro de Desenvolvimento de Sistemas de Informação de Finanças* (CEDSIF), the Ministry of Industry and Commerce, the DGF, and the ISSM. Coordination will be supported by the establishment of a Project Steering Committee headed by MEF. Establishment of the PIU will be a condition for project effectiveness.

61. **The MEF will establish a PIU that will be responsible for coordination of responsible persons,**

[24] World Bank. 2017. *Deposit Insurance Systems: Addressing emerging challenges in Funding, Investment, Risk-based Contributions & Stress Testing*. Washington DC.
[25] World Bank. 2017. *Challenges in Building Effective Deposit Insurance Systems in Developing Countries*. Washington DC.
[26] Committee on Payments and Market Infrastructure and World Bank Group. 2016. *Payment Aspects of Financial Inclusion*.

**procurement, financial management, monitoring, evaluation, reporting, and citizen engagement**. The PIU will include at least one project manager, one accountant, one procurement officer, and one monitoring specialist. The PIU will set up financial management systems that meet World Bank requirements and will prepare the project accounts. The PIU will recruit an external auditor to audit the project accounts.

62. **The DGF will be responsible for setting up financial management systems that meet World Bank requirements, preparing financial statements and accounts, managing systems and operational risks, and payment of claims**. The DGF is a legally established institution with fiduciary and operational responsibility for administering the deposit insurance scheme and will have to comply with Bank fiduciary requirements to administer the capitalization funds. The Bank has provided recommendations to the Government on the optimal legal, institutional, and financial structure of the DGF.

63. **Capitalization of the DGF will take place in three disbursements for a total of US$12 million equivalent upon compliance with the DLIs** (see Annex). This capital will be deposited into a bank account identified by the DGF in accordance with the procedures established in the Project Implementation Manual (PIM). It will accumulate interest and capital gains pending calls for payouts to depositors and resolution measures as per the DGF rules. Upon completion of the project, the capital shall continue with the DGF to serve as back-up for payouts to depositors and to support certain resolution measures in case of bank failures.

### B. Results Monitoring and Evaluation Arrangements

64. **The PIU will prepare progress reports with updated information regarding the Results Framework indicators, in form and substance acceptable to the World Bank**, 30 days after the calendar quarter ends until midterm review and every six months thereafter. The PIU's capacity for data collection will have to be built through the project. The PIU will collect most of the data from administrative systems of project components, particularly those related with digitization of government payments and financial education, but also from regular surveys of beneficiaries. Progress reports will include a summary of the beneficiaries' feedback and on actions taken in response to such feedback. The Ministry of Industry and Commerce (or the future manager of the collateral registry) will share information about registered security interests related to MSME loans. The DGF will collect annual data from participating institutions about its coverage and size. The ISSM and Treasury will share progress reports.

### C. Sustainability

65. **Government institutions and systems to be supported by the project will continue operating after the project closes**. The DGF investment policy will be established to ensure that risks are diversified and returns support sustainability; participating financial institutions will continue to pay premiums to the DGF; sustainability of the DGF will also benefit from implementation of a bank resolution framework that applies measures based on the least cost principle. The rebate program for agents is expected to be discontinued after the project is completed but economic viability of newly established agents should benefit from increased transaction volumes and behavioral changes. The financial education program is also expected to be discontinued after the project is completed as better awareness and practice of digital financial services among the population are expected to improve because of the project. Nonetheless, BOM is expected to continue with its financial education initiatives.

66. **The new IT systems will require improved technical skills in government agencies.** Therefore, funding for training has been added to the project. However, this will also require additional funding for operational costs of the systems and there is a risk that the fiscal constraints will impose limitations on this required funding. Building larger maintenance responsibilities in the contracts with the consultants and vendors will help mitigate this risk. This will require close implementation support, particularly on procurement of the necessary IT infrastructure.

## IV. PROJECT APPRAISAL SUMMARY

### A. Economic and Financial Analysis

67. **A strong public-sector rationale has been established for all project interventions.** Table 1 on page 15 describes the expected benefits and costs from the different components. This section highlights the rationale for public sector intervention and the value-added of bank support.

**Table 3: Rationale for Public Sector Intervention by Component**

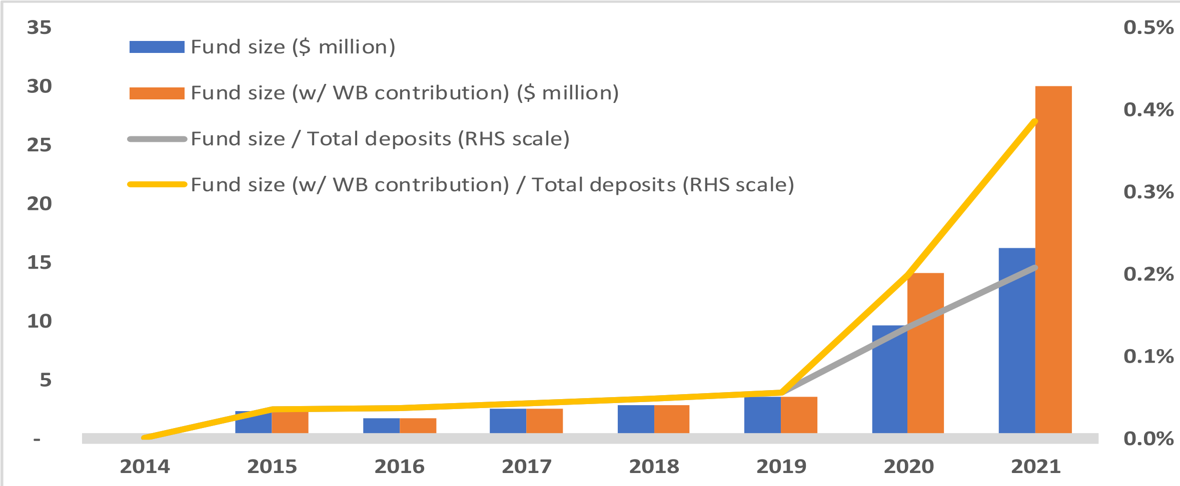
| Component 1. Increasing usage of transaction accounts and access to finance for MSMEs |
|---|
| • **Digitization of government payments.** Yields significant benefits (lower transaction costs, transparency, socialization of e-money, expansion of e-money cash-in/out service points) that can only be unlocked by government action and coordination<br>• **Financial education and awareness.** Government involvement is needed, since messages from private companies are often interpreted as advertisement and financial education is a public good.<br>• **Collateral registry.** Public funding is needed as the registry is a public good, allowing lenders to share information on priority of claims to different types of collateral. |
| **Component 2. Strengthening financial safety net** |
| • **Deposit insurance capitalization and operationalization.** The public sector has a role in ensuring that financial systems are stable, sound, and transparent. The establishment of an effective deposit insurance system provides supervisors with an additional policy tool in case of bank failures.<br>• **Supervisory technology.** Proper reporting information systems help supervisors better monitor systemic risks, thus providing a public good. |

68. **The World Bank can contribute to these interventions** through (i) funding; (ii) technical assistance given its extensive previous experience on financial sector interventions around the world, including in Mozambique; and (iii) its convening power, since many of the activities listed above require close coordination between different government entities and various private sector actors.

69. **DGF coverage is limited and below the international recommended standard.** While an estimated 88 percent of bank depositors have their deposits fully insured by the DGF, only 3 percent of the value of bank deposits is insured. Moreover, if we consider the 3.7 million active mobile money accounts provided by mobile money operators, then the percentage of accounts (both bank and mobile) fully covered by the DGF is only 49 percent.

70. **The DGF needs additional capital to reach an appropriate size**. The annual contributions from participating institutions are small and will not meaningfully increase the fund in the medium term. An expected contribution from KfW (€8 million) will help, but in a scenario where coverage increases (e.g., to legal entities, non-residents, FX deposits), additional contributions will be necessary. If contributions to the DGF capital from the project and KfW materialize, the DGF could reach about 0.4 percent of total deposits by 2021. The project will support an analysis of the optimal target size for the DGF.

**Figure 8: Projections for DGF Size**




Source: Bank staff calculations. Assumptions: current DGF size based on estimated initial contribution of MZN 105 million; deposit growth between 8-10% during 2019-2021; annual contributions from participating banks paid at the end of May; contributions from KfW and World Bank paid at the end of the calendar years 2019 and 2020; DGF annual return from investments is equivalent to the annual average treasury bill rate.

## B. Fiduciary

*Financial Management*

71. **A Financial Management Assessment was carried out in accordance with the Directives and Policy for Investment Project Financing (IPF), the Bank Guidance on IPF with Disbursement-linked Indicators issued on April 17, 2018 and the Bank Guidance on FM in World Bank IPF Operations issued on February 28, 2017.** The PIU to be established under MEF will have overall fiduciary responsibility for implementation of this proposed project. The overall conclusion of this assessment is that that the proposed project's FM arrangements have an overall FM risk rating of Substantial. A detailed risk assessment and mitigation measures have been proposed in Annex 1. The financial management arrangements, with the proposed actions and mitigating measures to strengthen the arrangements meet the Bank's minimum requirements under Bank Policy and Directive for Investment Project Financing; they are adequate to provide, with reasonable assurance, accurate and timely information on the status of the project.

72. **The project funds, expenditures, and resources will be accounted for using the government integrated financial management information system (e-SISTAFE) and the basis of accounting will be Financial Reporting under Cash Basis.** The IDA funds will be disbursed on transaction basis (statements of expenditures) using the following methods: (i) reimbursement, (ii) advances, (iii) direct payments, and (iv) special commitments.

73. **For the capitalization of the DGF, disbursement linked indicators have been identified. The PIU/MEF will open a Designated Account (DA) in US dollars with the Bank of Mozambique with a celling of US$4.0 million.** An initial advance will be made to this DA upon project effectiveness and subsequent advances will be made upon achievement of the DLI for the advance made. The PIU will be responsible for preparation and submission of customized eligible expenditure tables (the format will be

attached to the DFIL), together with the evidence of achievement of the DLIs. The eligible expenditure will be represented by the IDA funds transferred to capitalize the DGF. For this project, there is no need for independent verification agent for the DLIs because verification is straightforward.

74. **The PIU will prepare quarterly unaudited interim financial reports (IFRs) and provide such reports to the World Bank within 45 days of the end of each calendar quarter.** The project financial statements will be audited annually, and the audit report will be submitted to the World Bank no later than six months after the end of each fiscal year.

*Procurement*

75. **Procurement will be managed by the PIU.** The PIU will include a qualified procurement specialist, among other staff. The recruitment of the Procurement Specialist will be done under terms and conditions satisfactory to the World Bank. MEF will include in the PIM a section on procurement which will guide the PIU in carrying out procurement in accordance with the Bank Procurement Regulations. Any procurement required for achievement of DLIs will follow the World Bank Procurement Regulations.

76. **MEF has prepared a Project Procurement Strategy for Development and Procurement Plan, which have been reviewed and approved by the Bank**. The project does not have contracts of large value or of a complex nature. A qualified procurement specialist will be capable of adequately managing the procurement processes. Contract management will require special attention as there will be several contracts for consulting services.

77. **Procurement will be carried out in accordance with the "World Bank Procurement Regulations for Borrowers under Investment Project Financing", dated July 1, 2016, revised August 2018, and the provisions stipulated in the Financing Agreement**. Moreover, the 'Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants', dated October 15, 2006, and revised in January 2011 and July 2016 will apply.

78. **Country practices for making payments abroad may affect the performance of procurement.** The fulfillment of the requirements of the Attorney General's office and the Administrative Tribunal may cause delays in contract signing, after the completion of the evaluation process and of the contract award. Project planning has considered these increased procurement processing times.

79. **The procurement capacity of MEF to implement the project will be assessed once the implementation structure has been established.** After project effectiveness and recruitment of the key staff for the PIU, the Bank will assess the suitability of the arrangements in place and recommend action as needed. The risk associated with procurement processing for the Project is rated as High.

## C. Safeguards

80. **The project does not trigger environmental and social safeguards and is classified as *Low Risk***:

i. **Environmental Safeguards.** Environmental risks are low because project activities are not expected to involve any form of physical investments or negatively impact the livelihoods of affected people. The project activities are designed to be equally accessible to all potential beneficiaries and will not generate (and in fact could potentially reduce) risks to the safety of beneficiaries.

ii. **Social Safeguards.** Social risks are low because project activities are not expected to involve any form of physical investments.

iii. **Grievance Redress Mechanisms**

81. **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 Grievance Redress Service (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*.

82. **Financial institutions offer their customers claims redress services which are expected to be sufficient to address most issues.** In the early stage of implementation, the PIU will prepare a brief report on the grievance redress mechanisms available to project beneficiaries at the local level from financial institutions and service providers and/or from the PIU itself. Based on this report, the project team will evaluate the need to have the PIU implement an additional project level GRM and, if such GRM is needed, agree on an implementation action plan. In any case, the project will include in its communication and education activities, dissemination of information to stakeholders on the locally available redress mechanisms.

## V. KEY RISKS

83. **The overall risk rating for the project is Substantial**. Key risks and mitigation measures are discussed below.

84. **Political and governance risks are rated as Substantial.** Political instability during the electoral cycle in 2018 and 2019 could impact implementation. While not currently anticipated, a resurgence of conflict between political groups during this electoral period could affect the ability of the project to target individuals for digitization of government payments and to carry out financial literacy and awareness programs. This risk is mitigated by the commitment of all parties to the electoral process and relatively peaceful implementation of the municipal and provincial elections in October 2018.

85. **Macroeconomic risks are rated as Substantial**. Mozambique is in debt distress and the financial sector has yet to fully recover from the 2016 crisis. Macroeconomic imbalances could further reduce the risk appetite of financial institutions, which face difficulties in managing credit risks and have a legacy of non-performing loans on their balance sheets. This risk is mitigated by efforts undertaken by the Government to restructure its external debt measures to improve the governance of public debt

including around public investment management, debt management and oversight mechanisms for state-owned enterprises (SOEs). The Government is committed to implement further reforms with support from the Bank and other development partners.

86. **Risks related to sector strategies and policies are Low**. The project is fully aligned with the Government's Financial Sector Development Strategy and National Financial Inclusion Strategy.

87. **Technical design risks are rated as High.** The overall design of the project is complex because the digitization of government payments involves cross-sectoral work with many agencies, which is inherently difficult and requires strong implementing agencies to ensure effective collaboration. This risk is mitigated by having a PSC led by the MEF to coordinate between implementing agencies. The component on digitization of government payments could face resistance to change by banks who might object to a shift to mobile wallets instead of bank accounts. This is mitigated in part by the fact that mobile money operators maintain custodial accounts with all the large banks, so liquidity impact of this shift would be negligible. Government agencies and civil servants may resist the change due to lack of familiarity with the product or lack of confidence in mobile wallets as a store of money. This is mitigated by the financial awareness campaign and potential pass through of deposit insurance to custodial accounts of mobile money operators. The deposit insurance component is technically complex and relatively new for Mozambique where experience with the resolution methods outlined in the draft law (purchase and assumption, good-bank/bad-bank, bridge bank, etc.) are limited. Application of these resolution methods requires advance technical skills both within the BOM and the DGF. This risk is mitigated by the technical assistance program that accompanies implementation of this project and focuses on building skills in these areas. Cyber-attacks may target the IT systems that will be financed by the project. This risk is mitigated by technical assistance on cyber security.

88. **Institutional capacity risks for implementation and sustainability risks are rated as Substantial**. INAS has limited implementation capacity for managing electronic payments. Data on recipients of government social assistance is limited. The deposit guarantee agency has limited institutional capacity and basic skills together with fundamental operating manuals and guidelines need to be established. To mitigate this risk, a PIU will be established within MEF staffed with qualified individuals well versed with the Bank's procurement and financial management procedures. The project staff will be recruited on a competitive basis. The PIU's capacity will be assessed throughout project implementation and adjusted as necessary.

89. **Fiduciary risks are Substantial**, given the lack of experience, particularly at INAS, and the nature and complexity of the activities of Component 1. This is mitigated by the recruitment of a project finance manager with acceptable skills and experience. The project will make use of the government's IFMIS (e-SISTAFE). The project accounting policies and procedures will be documented in the Financial Procedures Manual. The process for budget preparation, execution, and monitoring will be documented in the PIM. Core staff of agencies involved in the budget preparation will be trained. The Bank will review the project IFR and other budget execution reports to ensure their quality. The project will follow the procedures documented in the Financial Management Manual (*Manual de Administração Financeira* – MAF), which has been designed to mitigate internal control risk, and those to be documented in the PIM. The IGF may review the operations of this project. The Bank will conduct regular supervision.

90. **The climate and disaster risks to the project are low**. The project has limited physical investments and comprise the IT solutions that will require a disaster risk plan to prevent floods or other natural

disasters to damage the data servers without appropriate backup.

91. **Strong stakeholder support for the project can mitigate some of these risks**. The project is complemented by a robust, donor-funded financial sector technical assistance program and detailed sectoral strategy for financial inclusion. The inclusion of DLIs in the project design can help mitigate some of the project implementation risks related with the component on deposit insurance.

# VI. RESULTS FRAMEWORK AND MONITORING

**Results Framework**
**COUNTRY: Mozambique**
**Mozambique: Financial Inclusion and Stability Project**

## Project Development Objectives(s)

The objective of the Project is to increase financial inclusion among underserved groups and MSMEs, while strengthening the overall financial safety net.

## Project Development Objective Indicators

| Indicator Name | DLI | Baseline | End Target |
|---|---|---|---|
| **Increasing usage of transaction accounts and access to finance for MSMEs** | | | |
| Teachers in rural areas with access to a mobile money account (Percentage) | | 13.00 | 25.00 |
| Teachers in rural areas with access to a mobile money accoubt (Number) | | 9,100.00 | 17,500.00 |
| Targeted recipients of government transfers that make or receive digital payments (Percentage) | | 0.00 | 25.00 |
| Life-long learning facilitators (Number) | | 0.00 | 2,500.00 |
| Life-long learning facilitators (Percentage) | | 0.00 | 25.00 |
| Beneficiaries of social transfers in urban areas (Number) | | 0.00 | 5,000.00 |
| Beneficiaries of social transfers in urban areas (Percentage) | | 0.00 | 20.00 |
| Beneficiaries of social transfers in rural areas (Number) | | 0.00 | 10,000.00 |

| Indicator Name | DLI | Baseline | End Target |
| --- | --- | --- | --- |
| Beneficiaries of social transfers in rural areas (Percentage) | | 0.00 | 10.00 |
| Adults making or receiving digital payments in the past year (Percentage) | | 34.00 | 42.00 |
| Women (Percentage) | | 27.00 | 40.00 |
| Men (Percentage) | | 42.00 | 50.00 |
| Poorest 40% of the population (Percentage) | | 20.00 | 28.00 |
| Active mobile money agents (Number) | | 25,000.00 | 50,000.00 |
| Districts covered by active mobile money agents (Percentage) | | 77.00 | 90.00 |
| MSMEs that received loans secured by movable assets registered in the collateral registry (Number) | | 0.00 | 3,750.00 |
| **Strengthening financial safety nets** | | | |
| Size of the deposit insurance fund as a share of total deposits (without contributions from other development partners) (Percentage) | | 0.05 | 0.25 |

## Intermediate Results Indicators by Components

| Indicator Name | DLI | Baseline | End Target |
| --- | --- | --- | --- |
| **Increasing usage of transaction accounts and access to finance for MSMEs** | | | |
| IT solution that enables Treasury to interface with e-money payment systems installed and operational (Yes/No) | | No | Yes |
| Individuals benefitting from financial literacy awareness program (Number (Thousand)) | | 0.00 | 1,000.00 |

| Indicator Name | DLI | Baseline | End Target |
|---|---|---|---|
| Recipients of government transfers reporting satisfaction with the digitized payment method(s) (citizen engagement) (Percentage) | | 0.00 | 66.00 |
| A centralized, web-based collateral registry established and operational (Yes/No) | | No | Yes |
| **Strengthening financial safety nets** | | | |
| Strengthened bank recovery resolution framework (Yes/No) | DLI 1 | No | Yes |
| Improved DGF's ability to undertake deposit insurance functions (Yes/No) | DLI 2 | No | Yes |
| Expanded coverage of deposit insurance (Yes/No) | DLI 3 | No | Yes |
| Insurance companies among the five largest with integrated connections to the supervisory reporting system (Number) | | 0.00 | 3.00 |

## Monitoring & Evaluation Plan: PDO Indicators

| Indicator Name | Definition/Description | Frequency | Datasource | Methodology for Data Collection | Responsibility for Data Collection |
|---|---|---|---|---|---|
| Teachers in rural areas with access to a mobile money account | Percentage of teachers working in public schools in rural areas (as defined by the national statistics institute) that have a registered transaction account with a mobile money operator | Annual | Customized survey (nationally representative) | Interview with teachers in rural areas | PIU |

| | | | | | |
|---|---|---|---|---|---|
| Teachers in rural areas with access to a mobile money accoubt | | | | | |
| Targeted recipients of government transfers that make or receive digital payments | The percentage of recipients of government transfers (disaggregated by target groups, such as urban/rural, gender, teachers, lifelong learning facilitators, or social benefits recipients) who report using mobile money, a debit or credit card, or a mobile phone to make a payment from an account, or report using the internet to pay bills or to buy something online, in the past 12 months. It also includes respondents who report paying bills, sending or receiving remittances, receiving payments for agricultural products, receiving government transfers, receiving wages, or receiving a public sector pension directly from or into a financial institution account or through a mobile money account in the past 12 month (% age 15+) | Annual | Findex database or tailored survey. | Representative surveys. | The Findex survey is conducted by the World Bank. The PIU will also finance tailored surveys for specific target groups. |
| Life-long learning facilitators | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Life-long learning facilitators | | | | | |
| Beneficiaries of social transfers in urban areas | | | | | |
| Beneficiaries of social transfers in urban areas | Beneficiaries within two INAS programs: (i) a social pension (PSSB); and (ii) a productive safety net program (PASP) for households with able bodied members. | | | | |
| Beneficiaries of social transfers in rural areas | | | | | |
| Beneficiaries of social transfers in rural areas | Beneficiaries within the productive safety net program (PASP) for households with able bodied members. | | | | |
| Adults making or receiving digital payments in the past year | The percentage of respondents who report using mobile money, a debit or credit card, or a mobile phone to make a payment from an account, or report using the internet to pay bills or to buy something online, in the past 12 months. It also includes respondents who report paying bills, sending or receiving remittances, receiving payments for | Annual | Findex database. | Findex survey of adults (15+) | Findex surveys are conducted by the World Bank. |

| | | | | | |
|---|---|---|---|---|---|
| | agricultural products, receiving government transfers, receiving wages, or receiving a public sector pension directly from or into a financial institution account or through a mobile money account in the past 12 months. | | | | |
| Women | | | | | |
| Men | | | | | |
| Poorest 40% of the population | | | | | |
| Active mobile money agents | Certified agents of electronic money institutions. | Annual | Mobile money companies. | The Bank of Mozambique receives this information from mobile money companies on a regular basis, as part of its monitoring functions. | The Bank of Mozambique is expected to share this data with the PIU. |
| Districts covered by active mobile money agents | | | | | |
| MSMEs that received loans secured by movable assets registered in the collateral registry | Number of individual entrepreneurs and legal entities classified as micro, small, or medium enterprise (as per the existing legislation) that have received a credit from a financial institution that has | Semi-annual | Manager of the collateral registry. | The manager of the collateral registry data is expected to share administrative data with the PIU. | |

| | | | | | |
|---|---|---|---|---|---|
| | registered in the collateral registry a security interest of a movable asset given as collateral by the borrower (individual entrepreneur and legal entity). | | | | |
| Size of the deposit insurance fund as a share of total deposits (without contributions from other development partners) | The fund size is the market value in local currency of the DGF assets. The value of total deposits is the local currency value of the deposits in the banking system. The indicator excludes potential contributions by development partners other than the World Bank. | Annual | DGF and the financial institutions participating in the deposit insurance sheme. | DGF will share data on the fund size and the financial institutions participating in the deposit insurance scheme will share data on deposits. | The BOM and DGF are responsible for collecting data on deposits from the participating financial institutions. DGF will share the value of the indicator with the PIU. |

**Monitoring & Evaluation Plan: Intermediate Results Indicators**

| Indicator Name | Definition/Description | Frequency | Datasource | Methodology for Data Collection | Responsibility for Data Collection |
|---|---|---|---|---|---|
| IT solution that enables Treasury to interface with e-money payment systems installed and operational | The Government's financial management system (eSistafe) is expected to be able to make payments directly into a mobile account. Currently, the system can only make payments to bank accounts. | Semi-annual | Ministry of Economy and Finance | User acceptance reports of the IT solution. | The Department of National Treasury at the Ministry of Economy and Finance. |

| | | | | | |
|---|---|---|---|---|---|
| Individuals benefitting from financial literacy awareness program | Number of individuals that attended a financial education session or event or received specific training on the use of a new payment technology or money management. These events should last at least 15 minutes. | Annual | Project documents | Administrative and survey data | Ministry of Economy and Finance; Bank of Mozambique. |
| Recipients of government transfers reporting satisfaction with the digitized payment method(s) (citizen engagement) | | Annual | Recipients' feedback | Survey of recipients of government digital payments. The surveys will also include request for open feedback. Progress reports will include summaries of this feedback and on whether there is tangible response to the feedback. | |
| A centralized, web-based collateral registry established and operational | A registry for security interests in movable property that is accessible through web and is centrally managed by an authorized body of the Government. | Semi-annual | Project reports. | User acceptance reports of the IT solution. | The manager of the collateral registry will share the project reports with the PIU. |
| Strengthened bank recovery resolution framework | Described in the DLI Verification Protocol | Annual | Official Bulletin. | Described in the DLI Verification Protocol | Ministry of Economy and Finance |
| Improved DGF's ability to undertake deposit insurance functions | Described in the DLI Verification Protocol | Annual | DGF | Described in the DLI Verification Protocol | DGF is expected to provide this information |

| | | | | | |
|---|---|---|---|---|---|
| | | | | | to MEF and the PIU. |
| Expanded coverage of deposit insurance | Described in the DLI Verification Protocol | Annual | Official bulletin; national statistics institute. | Described in the DLI Verification Protocol | DGF |
| Insurance companies among the five largest with integrated connections to the supervisory reporting system | Number of insurance companies (among the five largest by assets) that have a direct application programming interface with the supervisory reporting system for data transmission to the insurance regulator. | Annual | Insurance regulator. | The insurance regulator will share the user acceptance reports of the software solution financed by the Project, which will describe the test results of the interface with the five largest insurance companies. | The insurance regulator will share the project reports with the PIU. |

**Disbursement Linked Indicators Matrix**

| **DLI 1** | Strengthen bank recovery resolution framework | | | |
|---|---|---|---|---|
| **Type of DLI** | **Scalability** | **Unit of Measure** | **Total Allocated Amount (USD)** | **As % of Total Financing Amount** |
| Output | No | Yes/No | 4,000,000.00 | 10.00 |
| **Period** | **Value** | | **Allocated Amount (USD)** | **Formula** |
| Baseline | No | | | |

| | | | | |
|---|---|---|---|---|
| Year 1 | Yes | | 4,000,000.00 | |
| Year 2 | Yes | | 0.00 | |
| Year 3 | Yes | | 0.00 | |
| **DLI 2** | Improve DGF's ability to undertake deposit insurance functions | | | |
| **Type of DLI** | **Scalability** | **Unit of Measure** | **Total Allocated Amount (USD)** | **As % of Total Financing Amount** |
| Output | No | Yes/No | 4,000,000.00 | 10.00 |
| **Period** | **Value** | | **Allocated Amount (USD)** | **Formula** |
| Baseline | No | | | |
| Year 1 | No | | 0.00 | |
| Year 2 | Yes | | 4,000,000.00 | |
| Year 3 | Yes | | 0.00 | |
| **DLI 3** | Expanded coverage of deposit insurance | | | |
| **Type of DLI** | **Scalability** | **Unit of Measure** | **Total Allocated Amount (USD)** | **As % of Total Financing Amount** |
| Intermediate Outcome | No | Yes/No | 4,000,000.00 | 10.00 |
| **Period** | **Value** | | **Allocated Amount (USD)** | **Formula** |
| Baseline | No | | | |
| Year 1 | No | | 0.00 | |
| Year 2 | No | | 0.00 | |

| | | | |
|---|---|---|---|
| Year 3 | Yes | 4,000,000.00 | |

**Verification Protocol Table: Disbursement Linked Indicators**

| | |
|---|---|
| **DLI 1** | Strengthen bank recovery resolution framework |
| **Description** | Deposit insurer's mandate expanded to include financial contributions to bank resolution up to the minimum amount paid in case of liquidation (as outlined in the PIM). Inclusion of ex-post recovery from the banking industry of the costs of providing temporary financing to facilitate the resolution of failed banks. |
| **Data source/ Agency** | Official bulletin. |
| **Verification Entity** | World Bank |
| **Procedure** | Official letter from the Ministry of Economy and Finance confirming that the law and regulation on bank recovery and resolution has been enacted, with a copy of the relevant decision and regulation issued by Parliament and the Council of Ministers attached. |

| | |
|---|---|
| **DLI 2** | Improve DGF's ability to undertake deposit insurance functions |
| **Description** | 1. The DGF's managing board is constituted by at least three serving independent board members (as defined in the PIM) with no active bankers.<br>2. Premium structure for each participating financial institution calculated based on market share instead of underlying growth rate of deposits.<br>3. The BOM has shared with the DGF the following data for at least one calendar quarter: (i) the risk profile of all the problem banks in the Borrower's territory as computed by the BOM; (ii) conclusion of supervision reports for banks which are considered problematic based on the current legal framework; and (iii) details on all enforcement actions and compliance related to problematic banks. |
| **Data source/ Agency** | 1. and 2. - Official bulletin. 3. - DGF. |

| | |
|---|---|
| **Verification Entity** | The World Bank |
| **Procedure** | Official letter from the DGF with evidence of completion of the DLI. |

| **DLI 3** | Expanded coverage of deposit insurance |
|---|---|
| **Description** | Enacted legislation foresees deposit insurance coverage:<br>(i) With a limit of at least MZN 40,000 per depositor per financial institution<br>(ii) Of deposits held by legal entities and non-residents,<br>(iii)Of deposits denominated in foreign currency, and<br>(iv)Of mobile money accounts. |
| **Data source/ Agency** | Official bulletin |
| **Verification Entity** | World Bank |
| **Procedure** | Official letter from the Ministry of Economy and Finance confirming that regulations have been issued covering the following; (i) coverage limit per depositor at a financial institution increased to MZN 40,000; (ii) coverage of deposits held by legal entities and non-residents provided, (iii) coverage of foreign currency deposits provided, and (iv) "pass through" coverage of mobile money accounts provided. |

## ANNEX 1: Implementation Arrangements and Support Plan

**COUNTRY: Mozambique**
**Mozambique: Financial Inclusion and Stability Project**

1. **The Ministry of Economy and Finance (MEF) is the implementing agency for this project**. A PIU will be established within the MEF and will be responsible for implementing the project with overall fiduciary responsibility. The PIU will coordinate, implement, supervise, finalize, and document all the activities related to the project. The PIU will organize regular and inclusive monthly meetings of the technical working group which will provide a forum to coordinate and resolve problems. The PIU Coordinator will report directly to the Minister of Finance as was the case during implementation of the FSTAP project. The PIU will also include experienced and competent fiduciary staff.

2. **The responsibilities of the PIU will include**, among others, (a) managing the implementation of project activities; (b) managing the procurement, financial management, disbursements, and safeguards aspects; (c) coordinating the preparation, adjustments, and use of the project management tools, including the PIM, annual working plan, Procurement Plan, and disbursement projections; (d) coordinating with key stakeholders on the technical aspects of all the components; (e) monitoring the progress of the PDO and intermediate indicators of the Results Framework; (f) preparing project reports; and (g) acting as the main point of contact for the World Bank. The PIM shall be prepared by the borrower and agreed with the World Bank before project effectiveness. The adoption of a satisfactory PIM will be an effectiveness condition of the project.

3. **The PIU will be staffed with qualified personnel for the implementation of the project**. The team will comprise one project manager, one accountant, one procurement officer, and one monitoring specialist. A technical team from MEF and other implementing agencies will provide technical support to the PIU as needed, including the review and approval of relevant goods and services delivered as part of the activities financed by the project.

4. **The Project Steering Committee (PSC) will be led by the Minister of Finance or his/her representative**. It will include members from the BOM (heads of supervision, payments, and licensing and regulation departments), DGF, Ministry of Industry and Commerce, and ISSM. will provide strategic direction to the PIU on project implementation. The PSC will meet periodically to track and monitor the progress of the project. The arrangements will be described in detail in the PIM.

*Financial Management*

5. **A Financial Management Assessment concluded that the project's FM arrangements have an overall FM risk rating of Substantial.** The assessment was carried out in accordance with the Directives and Policy for Investment Project Financing (IPF), the Bank Guidance on IPF with Disbursement-linked Indicators issued on April 17, 2018 and the Bank Guidance on FM in World Bank IPF Operations issued on February 28, 2017. The PIU will have overall fiduciary responsibility for implementation of this proposed project. A detailed risk assessment and mitigation measures have been proposed in the table below. The financial management arrangements, with the proposed actions and mitigating measures to strengthen the arrangements meet the Bank's minimum requirements under Bank Policy and Directive for Investment Project Financing; they are adequate to provide, with reasonable assurance, accurate

and timely information on the status of the project.

## Risk assessment and mitigation measures

**Table 5: Risks and Mitigating Measures**

| Risk factors/Description of Risk | Risk Rating | Risk Mitigating Measures Incorporated into the Project Design | Conditions of Negotiations, Board or Effectiveness (Yes or No) | Residual Risk Rating |
|---|---|---|---|---|
| **Inherent Risk:** | | | | |
| **Country level:** Shortage of human resources, limited capacities for key FM functions, and overall weak control environment may impact negatively the implementation of the proposed project expenditures. | H | The Government is committed to implement further reforms of the country's PFMs with support from the Bank and other development partners. With the Mozambique Public Financial Management for Results Program (P124615), the Bank is strengthening the PFM systems in education and health sectors | No | S |
| **Entity level:** The Ministry of Finance has limited experience and capacity in managing donors' financed investment projects. The lack of experience and capacity may pose a serious challenge to the implementation of the project. | S | A PIU will be established within MEF and staffed with qualified competencies well versed with the bank's procedures.<br><br>The project fiduciary staff will be recruited on a competitive basis.<br><br>The PIU FM capacity will be assessed throughout project implementation and adjusted as necessary. | Yes. PIU will be established prior to the effectiveness and recruitment of project financial manager with acceptable skills and experience will be a condition of effectiveness. | S |
| **Project level:**<br>Project design relatively complex since it involves several agencies. It also involves DLIs, and IPF with DLIs are complex to manage. | H | Clearly defined FM procedures and funds flows, including DLI verification protocols, accountability and reporting will be documented in the PIM. The verification of DLI is straightforward, therefore there is no need of independent verification agent. The project will be periodically supervised by the FMS as well as government institutions. | Yes. Develop and adopt PIM prior to effectiveness. | S |
| **Control Risk:** | | | | |
| **Budgeting:** The New PIU may not be able to produce realistic and comprehensive budget as the project involves many agencies. Weak budget monitoring system can lead to budget overrun. | S | The process for budget preparation, execution, and monitoring will be documented in the PIM. Core staff of agencies involved in the budget preparation will be trained.<br>The Bank will review the project IFR and other budget execution reports to ensure their quality. | No | S |
| **Accounting:** The project accounting function may not be properly discharged due to eventual capacity and financial information system. | S | The MEF will recruit a project finance manager with acceptable skills and experience. The project will make use of the government IFMIS (e-SISTAFE). | No | S |

| Risk factors/Description of Risk | Risk Rating | Risk Mitigating Measures Incorporated into the Project Design | Conditions of Negotiations, Board or Effectiveness (Yes or No) | Residual Risk Rating |
|---|---|---|---|---|
| | | The project accounting policies and procedures will be documented in the Financial Procedures Manual. | | |
| **Internal control:** Non-compliance with key project internal control procedures due to weak internal control environment and oversight mechanisms in the country. In addition, the IGF at the MEF may not be able to cover the operations of the project due to capacity constraints. | S | The project will follow the procedures documented in the *Manual de Administração Financeira* (MAF), which has been designed to mitigate internal control risk, and those to be documented in the PIM. The IGF may review the operations of this project. The Bank will conduct regular supervision. | No | S |
| **Funds flow:** Delays in funds flow may affect implementation of the project, and the achievement of the identified DLIs may be delayed. | S | The disbursement arrangements, including the DLIs, will be documented in the PIM. The funds flow will follow the government system. The Bank team will provide support to PIU/MEF through the project implementation. | No | S |
| **Financial reporting:** The new PIU may fail to implement an adequate accounting system capable of producing required reports to monitor and manage the project. | S | The PIU will use government IFMIS (e-SISTAFE) to account for project funds, expenditures and resources. The Bank will provide support to ensure that required financial reports are produced on time. | No | M |
| **Auditing:** Delays in submission of audit reports. | S | The project financial statements will be audited by the Administrative Tribunal, which is auditing the project financial statements of the most of Bank-finance operations in Mozambique portfolio. | No | M |
| **OVERALL FM RISK** | S | | | S |

*Note*: H = High; S = Substantial; and M = Moderate

### FM action plan

| No. | Action | Responsibility | Completion date |
|---|---|---|---|
| 1 | Appointment of project financial manager with acceptable skills and experience | MEF | By effectiveness |
| 2 | Develop the Project Implementation Manual including FM procedure | MEF | By effectiveness |
| 3 | Appointment of the project accountant with acceptable experience and skills | PIU/MEF | Within four months after effectiveness. |
| 4 | Training in FM and Disbursement for Bank-financed operations to the agency staff | WB/ MEF | At project launch |

**Budgeting**

6. **Budgeting, budgetary control, and budget revisions will follow national procedures requiring that the project budget is inserted as part MEF's budget and approved by parliament.** The PIU will have overall responsibility for preparing annual work plans and budget. In coordination with the Bank of Mozambique, *Centro de Desenvolvimento de Sistemas de Informação de Finanças* (CEDSIF, the government's financial management unit), the Ministry of Industry and Commerce, Deposit Guarantee Fund [*Fundo de Garantia de Depósitos* (DGF)], and the insurance and pensions supervisor [*Instituto de Supervisão de Seguros de Moçambique* (ISSM)] the PIU will lead preparation of annual work plans and budgets, following the budget preparation cycle of the Government of Mozambique. The PIU will ensure that an adequate project budget monitoring system is in place and this will be described in the PIM.

**Staffing**

7. **The PIU to be established under MEF will be responsible for fiduciary aspects of the project.** The PIU FM capacity will comprise a project financial manager and one project accountant. The overall responsibility of project FM matters rests with the project financial manager reporting to the PIU coordinator, to be appointed by project effectiveness date. This is not a decentralized project and the management of project funds will be centralized at the PIU, therefore no funds will be transferred to the beneficiaries. The project accountants should be recruited within four months after project effectiveness.

**Internal control**

8. **Internal controls system and procedures of the project will be based on national procedures, defined in the *Manual de Administração Financeira* (MAF) and PIM.** The project may also be subject to the review of the General Inspectorate of Finance (*Inspeção Geral das Finanças* [IGF]) based at the MEF. For this project, alternative measures such as regular supervision through desk review and field visits (that include expenditures and asset reviews) should be carried out by the Bank to ensure that the implementing agency is maintaining adequate systems of internal controls and key procedures are complied with.

**Accounting**

9. **The PIU will account for all project funds, expenditures, and resources using the government's integrated financial management information system (e-SISTAFE).** The e-SISTAFE is used for most Bank-financed operations in Mozambique portfolio; the Bank is comfortable with e-SISTAFE, which can generate financial information for preparation of the IFR and project financial statements. The project will follow e-SISTAFE's internal control procedures laid down in the government's financial management regulations. The accounting system, policies, and procedures to be employed by the PIU will be documented in the Financial Procedures Manual of the PIM.

**Financial Reporting**

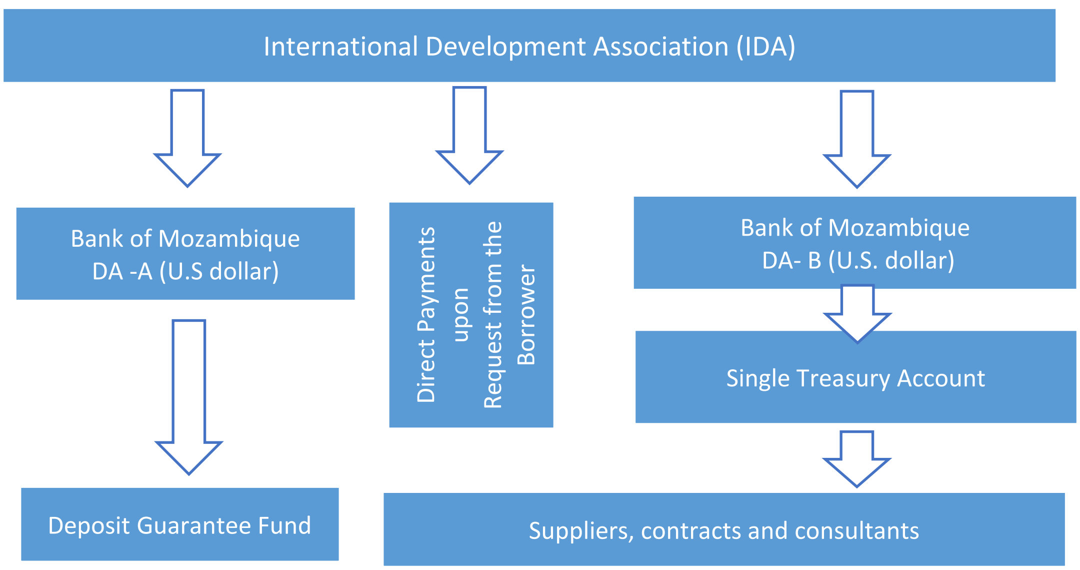
10. **The project implementing agency will prepare quarterly IFRs for the project in form and content satisfactory to the World Bank.** The IFRs will be submitted to the World Bank within 45 days after the end of the calendar quarter to which they relate. At the end of each fiscal year, the PIU will also produce

annual project financial statements (PFS) in accordance with Financial Reporting under Cash Basis of Accounting. In addition, the PFS's components will be outlined in the terms of reference for audit of this proposed project.

**Disbursement**

11. **Funds Flow.** The PIU/MEF will open two Designated Accounts (DAs) in U.S. dollars with the Bank of Mozambique (Central Bank) to receive funds from IDA. The DA-A will receive funds for capitalization of the DGF and the DA-B will receive funds to finance activities of the other (standard) IPF components. From the DA-B, funds will be transferred to the Single Treasury Account (*Conta Única do Tesouro* [CUT]) based on requests from the PIU to the National Directorate of Treasury. Payment of eligible project expenditures will be made from CUT to providers of goods and services. The figure below shows funds flow mechanism for the project activities.

**Figure 9: Project Fund Flow**




12. **Disbursement arrangements.** Disbursements of IDA funds will be done on a transaction basis. An initial advance will be made into the Designated Account B upon the effectiveness of the Financing Agreement, based on the DA ceiling and at the request of PIU. The advance will be based on the estimated cash requirements to meet the project expenditure for the first four months. The option of disbursing the IDA funds through direct payment, reimbursement, and special commitment will also be available. The Bank will issue the Disbursement and Financial Information Letter (DFIL) which will specify the additional instructions for withdrawal of the proceeds of the IPF.

13. **For IPF-DLI sub-component 2.1 (Deposit insurance capitalization), disbursements will be made based on the achievement of results under the identified DLIs for capitalization of the DGF, under the following procedures:**

- An initial advance of up to US$4.0 million to DA-A will be made upon project effectiveness. The funds in the DA-A will be transferred to the DGF for its capitalization upon achievement of the results expected under each DLI, as described in the Financing Agreement. Advances will be converted into eligible expenditures upon evidence that the funds have been credited to the DGF. Subsequent advances for replenishment of the DA-A would be made when the DLI related to previous advance has been met. The advance to the DA-A and the transfer from DA-A for capitalization of the DGF will be reported in the interim unaudited financial reports and in the financial section of the progress reports.

- The eligible expenditures are represented by the IDA funds transferred from the DA-A to the DGF for its capitalization. The customized statement of expenditure (SOEs) in form and contents outlined in the DFIL will be used to document eligible expenditure under the advance method.

- Once the DLIs are achieved, the Government will submit to the Bank the SOEs with the eligible expenditure and evidence of the achievements of the DLIs. The information and supporting documents provided will be accompanied with a disbursement request.

- For this project, there is no need for independent verification agents for the DLIs because the verification of achievement is straightforward. Detailed procedures for the verification protocol, accounting and documentation of eligible expenditures to be submitted by the Borrower will also be outlined in the PIM.

14. **Auditing.** The Administrative Tribunal (the country's supreme audit institution) is mandated to audit all government funds, including donors-financed projects. As such, the Tribunal will be responsible for auditing the whole project (including the IPF-DLIs and confirmation of the eligible expenditures). The project financial statements will be audited by the Tribunal in accordance with International Standards on Auditing as issued by the International Auditing and Assurance Standards Board (IAASB) within IFAC. The audit report together with Management Letter will be submitted to the Bank within six months after the financial year-end; that is June 30th of each following year.

15. **Effectiveness conditions.** The following are conditions of effectiveness: (i) appointment of project financial manager with acceptable skills and experience to handle project FM and Disbursement matters; and (ii) develop and adopt PIM including FM procedures.

16. **Dated covenants.** Appointment of the project accountant with acceptable skills and experience should be complemented with four months after the project effectiveness.

17. **Implementation support plan.** Based on the current overall FM risk of this operation, the project will be supervised twice a year. In addition to desk-based reviews, FM will perform field visit to ensure that Project's FM arrangements operate as intended.

**Procurement**

18. **Applicable procedures.** Procurement will be carried out in accordance with the 'World Bank Procurement Regulations for Borrowers under Investment Project Financing', dated July 1, 2016, revised August 2018, and the provisions stipulated in the Financing Agreement. Moreover, the 'Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants', dated October 15, 2006, and revised in January 2011 and July 2016, will apply.

19. **The Project Procurement Strategy for Development (PPSD) has been prepared by MEF.** The project does not have contracts of large value or of a complex nature. A qualified procurement specialist will be capable to adequately manage the procurement processes. Contract management will require special attention as there will be several contracts for consulting services.

20. **Procurement arrangements.** Procurement will be managed by the PIU, which will include a qualified procurement specialist, among other staff. Recruitment of the Procurement Specialist will be done under terms and conditions satisfactory to the World Bank. MEF will include in the PIM a section on procurement which will help the PIU in carrying out procurement in accordance with the Bank Procurement Regulations. Any procurement required for achievement of DLIs will follow the World Bank Procurement Regulations.

21. **Procedures for the selection of consultants.** Quality and Cost-Based Selection will be the main method for the selection of consulting firms. Occasionally, consulting services may be procured through Consultants Qualifications based Selection (CQS) and Least-Cost Selection procedures, whenever its complexity justify the adoption of such methods in accordance with the PPSD.

22. **Procedures for Goods and Non-Consulting Services**. Goods and Non-Consulting Services, including office equipment, outreach and communication services, among others, will be generally procured through Request for Quotations (RFQ). When the estimated amount exceeds US$100,000, procurement may be done through an Open Competitive Procedure, the Request for Bids (RFB), consistent with the Mozambique Procurement Regulation (Decree 5/2016 of March 8, 2016). International competition is not anticipated.

23. **Procurement Plan.** MEF prepared a Procurement Plan for the first 18 months of project implementation. This plan was agreed between the recipient and the World Bank during negotiations and will be updated from time to time to guide the implementation of procurable components of the Project. The processing of these activities will be done in real time through the World Bank's tracking system—Systematic Tracking of Exchanges in Procurement (STEP).

24. **The following project activities will be subject to the World Bank's procurement procedures.**

- **Goods and non-consulting services:** hardware for collateral registry; outreach and communication under the financial literacy and awareness program and for the collateral registry.

- **Consulting services:** review of legal and regulatory framework for government payments; support streamlining of payment procedures; mapping of all national and local government payments and development of an action plan to extend the digitalization of government payments to national and local levels; IT platform to enable the Treasury to interface with e-money providers; operational support to the deposit insurer; off-site supervision platform; public debt management platform.

25. **Contract management capability**. Major contracts under the project are for consulting services. It is instrumental that proper monitoring of the contractual performance, including contract management issues if any, is established throughout implementation. This is critical for timely implementation of the contracts.

26. **Review by the World Bank of procurement decisions.** The table below indicates the initial values for prior Review by the World Bank. All activities estimated to cost below these amounts shall be treated as post review and will be reviewed by the World Bank during Implementation Support Missions under a post procurement review exercise. Direct Contracting/Single Source Selection will be subject to prior review only for contracts estimated to cost more than the amounts indicated in the Table. The World Bank may, from time to time, review the amounts, based on the performance of the implementing agencies.

**Table 6: Prior Review Thresholds**

| Procurement Type | Prior Review (US$) |
|---|---|
| Goods and non-consulting services | 1,500,000 |
| Consulting Services (Firms) | 500,000 |
| Individual consultants | 200,000 |

27. **Assessment of National Procedures.** The Mozambique Procurement Regulation, approved by the Decree 5/2016 of March 8, has been assessed, as required under the World Bank's Procurement Framework. The assessment indicated that the Country's Regulations are generally consistent with international best practice for the following reasons: (a) there is adequate advertising in national media; (b) the procurement is generally open to eligible firms from any country; (c) contract documents have an appropriate allocation of responsibilities, risks, and liabilities; (d) there is publication of contract award information in local newspapers of wide circulation; (e) the national regulations do not preclude the World Bank from its rights to review procurement documentation and activities under the financing; (f) there is an acceptable complaints mechanism; and (g) maintenance of records of the procurement process.

28. **The request for bids/request for proposals document shall require that bidders/proposers submitting bids/proposals present a signed acceptance at the time of bidding, to be incorporated in any resulting contracts, confirming application of, and compliance with, the World Bank's Anti-Corruption Guidelines**, including without limitation the World Bank's right to sanction and the Bank's inspection and audit rights.

### Environmental and Social (including safeguards)

29. **The proposed project is category 'C' and does not trigger environmental and social safeguards. Environmental risks are low because project activities are not expected to involve any form of physical investments or negatively impact the livelihoods of affected people.** The project activities are designed to be equally accessible to all potential beneficiaries and will not generate (and in fact could potentially reduce) risks to the safety of beneficiaries. Social risks are low because project activities are not expected to involve any form of physical investments.

### Monitoring and Evaluation

30. **The monitoring and evaluation of the project will be carried out by the PIU that will prepare quarterly reports to be submitted to MEF and the World Bank**. These reports will include results indicators, as well as reporting on the implementation of the project components. The World Bank team

will then prepare periodic progress reports, mid-term report and completion reports.

### Role of Partners (if applicable)

31. Not applicable.

### Strategy and Approach for Implementation Support

32. The implementation support strategy will include the following elements:

- **Technical support**. A team of financial sector specialists will provide technical support and guidance to the implementation agency and key stakeholders. The technical team will review and comment on the terms of reference and other technical documents. Technical advice will also be provided during implementation support missions.

- **Financial Management**. A financial management specialist will provide support to the implementation agency. The World Bank will supervise the project's financial management arrangements by reviewing the semiannual project reports as well as the annual audited financial statements. In addition, during implementation support missions, the World Bank will review the financial management and disbursement arrangements.

- **Procurement**. A procurement specialist will provide ongoing guidance to the implementation agency on procurement processes and will join project implementation support missions, post review assessments, and site visits. In addition, the World Bank will review selection processes defined as prior review**.**

- **Operations**. During project implementation, the World Bank will provide implementation support to the PIU staff to prepare, update, and use the project management tools, including the PIM, annual work plan, procurement plan, and disbursement projections

### Implementation Support Plan and Resource Requirements

33. **The table below describes the estimated resource requirements for the Implementation Support Plan**. These requirements will be reviewed periodically to ensure they meet the needs of the project.

**Table 7: Resource Requirements for Implementation Support**

| Time | Focus | Skills Needed | Resource Estimate | Partner Role |
|---|---|---|---|---|
| First year | Task management | TTL/financial sector specialist | 3 months | |
| | Procurement | Procurement specialist | 1 month | |
| | Financial Management | FM specialist | 1 month | |
| | Operations support | Operations officer | 1 month | |
| | Technical support | Financial sector specialist | 3 months | |
| 12–60 months | Task management | TTL/financial sector specialist | 6 months | |
| | Procurement | Procurement specialist | 1 month | |

| | | | | |
|---|---|---|---|---|
| | Financial Management | FM specialist | 0.5 months | |
| | Safeguards | Environmental specialist | As needed | |
| | Operations support | Operations officer | 1 month | |
| | Technical support | Financial sector specialist | 3 months | |

## ANNEX 2: Economic and Financial Analysis

**COUNTRY: Mozambique**
**Mozambique: Financial Inclusion and Stability Project**

1. **The project's development impact is expected to be a higher number of lower-income individuals, particularly women, and small businesses that have access to formal and safer financial services**. Mobile money has helped to accelerate financial inclusion in Mozambique, but this progress is unbalanced and has not yet brought the same level of benefits to women, to the poor, and those living in rural areas. It is unlikely to achieve scale unless there is confidence in the system, which would require a mechanism to safeguard small, individual depositors. This situation is unlikely to change without intervention.

### A. Development Impact

2. **The project costs of US$40 million are necessary to implement the project components**. This will provide transaction accounts to individuals excluded from formal financial services, to provide financial education to at least 1,000,000 people, and to increase the capital of the DGF to an appropriate size. The project's intended benefits are expected to outweigh its cost. The benefits include more financial resilience and productive investment among beneficiaries (which are difficult to monetize or even to quantify).

3. **Providing transaction accounts to those excluded from the formal financial system can improve their lives**. Transaction accounts provide a safe store of value, an efficient means to execute transactions, and a stepping stone to more advanced financial services such as credit. Evidence by Jack and Suri (2014), finds that access to an electronic account increases the resilience of household consumption to shocks. Dupas and Robinson (2013) find that commitment savings accounts increased productive investment by women informal business owners in Kenya by 38-56 percent. Batista and Vicente (2013) report the findings of a randomized mobile money dissemination in rural Mozambique, where financial literacy and trust outcomes were positively affected by the treatment and the marginal willingness to remit increased.

4. **Shifting to electronic payments can benefit the recipients.** Aker et al. (2015) describe a randomized control trial in Niger where social transfers by mobile reduced the recipients' costs and generated benefits when compared with manual cash transfers: household and child diet diversity was better among households who received mobile transfers, whereas recipients travel and wait times for collection were lower (about 2.5 working days over a five-month period) while timing for collection was more flexible. Muralidharan et al (2014) found that electronic transfers combined with biometric identification resulted in significant cost reductions for beneficiaries of social transfers: beneficiaries received payments faster and more reliably, spent less time collecting payments, received a higher proportion of benefits, and paid less in bribes. ADB (2013) found that a new electronic pension payment system through plastic cards in Tajikistan was generally positive for pensioners, with significant improvements in perceived convenience and time spent in collecting pensions; however, the change was less positive for female and rural pensioners and only a small proportion of the rural population was able to use the plastic cards to access their pension accounts by themselves.

5. **Shifting to electronic G2P payments also has potential benefits for Government**. Klapper and Singer (2017) describe how electronic technologies can improve the efficiency of making payments by lowering the cost of disbursing and receiving them, and by increasing the speed of payments. It can increase the transparency of payments and thus reduce chances of leakage between the sender and receiver. Moreover, digitalization can lower the incidence of crime associated with carrying cash. Aker el al. (2015) show that social transfers by mobile had a 20 percent lower cost per-transfer than using cash.

6. **Financial education can consistently improve savings and record keeping, although it does less well in preventing outcomes such as loan default**. Miller et al. (2014) found that financial education can improve behaviors where individuals have the ability or slack to exert greater control, such as savings and record-keeping which are immediate, and consumers have primary control over them. On the other hand, the authors suggest that loan default is imposed by the creditor and hence can only be avoided secondarily or over the long term if financial education leads to more prudent borrowing decisions.

7. **The debtors' ability to use movable assets as collateral when borrowing from banks helps improve access to finance**.[27] Experience in World Bank Group projects provide encouraging evidence. For example, in Liberia the IFC helped establish a collateral registry in 2014; after two years, more than US$237 million of financing had been facilitated, corresponding to registration of 527 security interests, mostly for loans to individuals (of which 51 percent were women). In Ghana, the World Bank Group financed the establishment of the collateral registry: in the first five years of operations, total financing for businesses using only movable assets as collateral was US$1.3 billion and 40 percent of registrations corresponded to women borrowers that received more than US$100 million in financing.

**Box 2: Collateral Registries – an essential contributor to inclusive growth**

Numerous studies have demonstrated the link between credit and economic growth [Mckinnon (1973), King and Levine (1993), Gregorio and Guidotti (1995), Rajan and Zingales (1998), Das and Maiti (1998), Levine et al. (2000), Hassan et. al. (2011), Christopoulos and Tsionas (2004), Mishra et. al. (2009) Pradhan (2010) and Banerjee (2012)]. Collateral is one of the '5 C's of credit' contributing to the confidence of a lender in assessing the creditworthiness of the credit applicant. The remaining four 'C's' comprise character (or credit history), capacity, capital, and conditions.

With formal SMEs contributing up to 60 percent of total employment (including creating 4 out of 5 new jobs) and up to 40 percent of GDP in emerging economies, providing access to finance to SMEs is essential for the advancement of the global economy. With the overwhelming capital stock of SMEs categorized as 'movable assets' and most of financial institutions preferring 'immovable assets', the World Bank Group's secured transactions reform critically target this market failure.

A strong, modern secured transactions regime has two, equally important, components: the law and the registry. The law establishes the rules for secured creditors, such as commercial banks, non-bank and microfinance institutions, leasing companies and other security rights holders to secure their rights over movable property when extending credit or entering other arrangements. The second component is the registry itself. Registration in the collateral registry is the primary mechanism for secured creditors to protect their rights, including to ensure priority and protection in the event of default or insolvency by the debtor.

The registry is a critical component not only for parties to a security agreement, but also to non-consensual creditors, such as judgment creditors and the relevant revenue authority whose rights must also be publicized by registration in the collateral registry. As the introduction of a modern security interest regime usually abrogates pre-exiting security right laws, understanding the importance of the collateral registry – and educating others is a key contributor to improving access to finance and supporting inclusive growth in the global economy.

[27] Using a cross-country micro-level loan data set containing loan-to-value ratios for different assets, Calomiris et al. (2017) found that, in countries with weak collateral laws, loan-to-values of loans collateralized with movable assets are lower (relative to loans with immovable assets) and that lending is biased toward the use of immovable assets.

8. **A credible deposit insurance system increases depositor confidence and thus is expected to limit contagion from banks in distress, contributing to financial stability**. Explicit deposit insurance can also limit the government's commitment to depositors (without explicit commitment, depositors may exert political pressure to force taxpayers to supply unlimited deposit guarantees ex-post). However, several authors have emphasized that explicit deposit insurance has the potential to increase bank risk-taking and should not be considered a panacea to remedy weaknesses in the informational and supervisory environments (Kane and Demigurc-Kunt, 2001). Features such as risk-based pricing are critical to reduce moral hazard (Anginer and Demigurc-Kunt, 2018).

9. **Consideration of alternative interventions**. Other critical interventions to promote financial development and stability are being supported by other development partners. For example, the IMF and the central bank of Norway (Norges Bank) are providing technical assistance to strengthen banking supervision.

10. **Fiscal impact**. With an expanded coverage of the deposit insurance scheme, the Government's explicit contingent liabilities in case of bank failures are expected to increase. However, this could be simply substituting for existing Government's implicit contingent liabilities. An explicit guarantee can also limit the exposure to bank failures. The fiscal impact of the other project components is expected to be negligible, and mostly emanates from maintenance costs of information technology systems. On the other hand, digitization of government payments that are currently made in cash can bring reduction of disbursement costs, leakages, and other efficiencies.

### B. Public Rationale

11. **Public intervention is required to provide opportunities for people excluded from the formal financial system**. The global community has identified financial inclusion as an enabler for seven of the 17 Sustainable Development Goals. In Mozambique financial inclusion remains a challenge, particularly for women, the poor, and those living in rural areas.

12. **Financial development is typically constrained by market failures, particularly information asymmetry, costly enforcement, and restricted risk pooling and participation**. In Mozambique, although SMEs contribute to 28 percent of GDP and account for 42 percent of formal employment (2015), most (75 percent) are financially excluded.[28] Lending to the agriculture sector is particularly limited: in 2017, while agriculture constituted 21 percent of GDP, credit to agriculture represented only 4 percent of lending to the economy (down from an average of 12 percent in 2000–2010). Public intervention is therefore justified to correct these market failures, including through investments in financial infrastructure such as collateral registries.

13. **The public sector has a role in ensuring that financial systems are stable, sound, and transparent**. The establishment of an effective deposit insurance system provides supervisors with an additional policy tool in case of bank failures. Proper reporting information systems help supervisors better monitor risks.

[28] FinScope. *Micro, Small and Medium Enterprises Survey Mozambique 2012*.

### C. World Bank Value Added

14. **The Bank's expertise in developing financial sectors can help the Government of Mozambique better design its planned interventions**. The design of project components reflects good practices identified by the Bank.[29]

15. **The design of the deposit insurance component is informed by several World Bank projects**. At least four other World Bank IPF operations have combined results-based financing and technical assistance to enhance financial stability. Two projects (in Bulgaria and in Serbia) focused on deposit insurance, while the other two projects (in Bosnia and Herzegovina and in Serbia) focus on broader financial sector operations.[30]

### D. Target Fund Size for the deposit insurance fund (DGF)

16. **DGF coverage is limited and below international recommended standards.** Deposit insurance only covers deposits in local currency owned by individual residents in Mozambique and up to MZN 20,000 (US$332 or 84 percent of GDP per capita). While an estimated 88 percent of bank depositors have their deposits fully insured by the DGF, only 3 percent of the value of bank deposits is insured. Moreover, if we consider the 3.7 million active mobile money accounts provided by mobile money operators, then the percentage of accounts (both bank and mobile) fully covered by the DGF is only 49 percent.

17. **The International Association of Deposit Insurers (IADI) recommends that the level and scope of coverage should be set so that most depositors across banks are fully protected while leaving a substantial proportion of the value of deposits unprotected so that large depositors have an incentive to monitor risk**. The IADI has considered that only a small number of very large-scale depositors—e.g., the 5–10 percent of total depositors that hold 30–50 percent of the value of total deposits—are likely to have the ability to effectively discipline bank owners.[31] Moreover, the level and scope of coverage should be limited and designed to be credible, so as to minimize the risk of runs on banks and not undermine market discipline.

18. **The coverage threshold for DGF would have to increase to MZN 50,000 (and legal entities and non-residents would have to be eligible) for the percentage of fully covered bank depositors to be in the optimal range of 90%-95%**.[32] If foreign currency deposits were to be eligible, this new higher threshold would bring the value of covered bank deposits to closer to 10 percent of the total.

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[29] World Bank Group. 2018. *Toolkit: Integrating Financial Capability into Government Cash Transfer Programs.* World Bank. 2017. *Challenges in Building Effective Deposit Insurance Systems in Developing Countries*. Washington DC.

[30] Bulgaria Deposit Insurance Strengthening Project (P154219), Serbia Deposit Insurance Strengthening Project (P146248), Bosnia and Herzegovina Banking Sector Strengthening Project (P158387), Serbia State-Owned Financial Institutions Strengthening Project (P156837).

[31] IADI. 2013. Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage; IADI. 2014. Principles for Deposit Insurance. IADI also recommends that the residency status or nationality of depositors should have no effect on coverage and that foreign currency deposits should be insured if they are widely used in a jurisdiction.

[32] A coverage threshold of MZN 50,000 would be equivalent of about 200 percent of GDP capita, which is the average coverage level in the European Union. See IMF. 2013. *European Union: Publication of Financial Sector Assessment Program Documentation—Technical Note on Deposit Insurance.*

19. **The DGF needs additional capital to reach its current target of 3 percent of insured deposits** and the expected contribution from KfW (€8 million) will help reach this target.[33] However, this considers the current DGF coverage—which is very low and excludes a significant share of deposits—and a target fund size that is likely less than optimal for the Mozambique context. In a scenario where coverage increases to MZN 50,000, to legal entities, non-residents, and foreign exchange deposits, the shortfall would be US$20 million with a fund target size of 7 percent of insured deposits.[34] Contributions from participating institutions will not be enough to bring the DGF fund size to its target size in the next few years.

**Table 8: Target Size for DGF (in US$ million)– Different Scenarios**

| Scenarios | Target Size for DGF | | | |
|---|---|---|---|---|
| | If **3%** of Insured Deposits | If **5%** of Insured Deposits | If **7%** of Insured Deposits | If **9%** of Insured Deposits |
| **Current coverage*** | 6 | 10 | 14 | 18 |
| **Scenario 1** | 7 | 12 | 16 | 21 |
| **Scenario 2** | 11 | 19 | 27 | 34 |
| **Scenario 3** | 16 | 27 | 37 | 48 |

Notes: In Scenario 1, eligibility is extended to non-residents, legal entities, and to deposits in foreign currency; coverage remains at MZN 20,000 per depositor per participating institution. In Scenario 2, eligibility is extended to non-residents, legal entities, and to deposits in foreign currency; coverage increases to MZN 50,000 per depositor per participating institution. In Scenario 3, eligibility is extended to non-residents, legal entities, and to deposits in foreign currency; coverage increases to MZN 100,000 per depositor per participating institution.

* Does not include data from the following banks: Ecobank, Societe Generale, Socremo, and UBA.

Source: World Bank Group staff, based on information shared by commercial banks through the Bank of Mozambique.

33 Assuming current DGF capital of about US$2 million, i.e., less than 1 percent of currently insured deposits.
34 The IADI states that the appropriate fund target size should be adequate to at least cover the potential losses of the deposit insurer under normal conditions; the most common factors to consider when determining the target fund size include: (i) financial system structure and characteristics; (ii) legal framework; (iii) macroeconomic conditions; (iv) prudential regulation, supervision, and resolution regime; (v) availability and accessibility of emergency/backup funding; and (vi) the state of the accounting and disclosure regime.