Report Number : ICRR0021577

1. Project Data

Country
Mozambique

Practice Area(Lead)
Finance, Competitiveness and Innovation

Programmatic DPL
Planned Operations: 0

Approved Operations: 0

Operation ID
P133687

Operation Name
Financial Sector DPL

L/C/TF Number(s)
IDA-55200,IDA-H9750

Closing Date (Original)

Total Financing (USD)
23,759,082.00

Bank Approval Date
15-Jul-2014

Closing Date (Actual)
30-Jun-2015

	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	0.00	0.00
Revised Commitment	25,000,000.00	0.00
Actual	23,759,082.00	0.00

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Operation ID
P151861

Operation Name
Financial Sector DPL II (P151861)

L/C/TF Number(s)	Closing Date (Original)	Total Financing (USD)
IDA-55200,IDA-57290,IDA-H9750	30-Jun-2016	24,923,700.00
Bank Approval Date	**Closing Date (Actual)**	
29-Sep-2015	30-Jun-2016	

	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	25,000,000.00	0.00
Revised Commitment	25,000,000.00	0.00
Actual	24,923,700.00	0.00

2. Program Objectives and Policy Areas

a. Objectives

The Republic of Mozambique First (FSDPO I) and Second (FSDPO II) Programmatic Financial Sector Development Policy Operations were a series of two single-tranche operations, delivered over 2014-16, aimed at reforming and developing the country's financial sector following the "Mozambique Financial Sector Development Strategy for 2013-22" (MFSDS).

According to the Program Documents for FSDPO I (page 4) and FSDPO II (page 3), the program development objective of the FSDPO series was to assist Mozambique "to (a) reinforce financial stability, (b) increase access to finance by households and firms, and (c) enhance the development of long-term financial markets."

A planned third operation (FSDPO III), with the same development objective, was cancelled before concept review in 2016 after it was found that two Mozambique state-controlled companies had secured state-guaranteed external loans worth US$1.16 billion in 2009-14 that were not reported to the International Monetary Fund (IMF) and the Bank. Recognition of these undisclosed loans, including four others worth another US$0.22 million from a bilateral lender, added the equivalent of 10 percent of GDP to the country's debt stock, breaching the government's ceiling on state-guaranteed borrowing, triggering rating downgrades, and resulting in the suspension of both an IMF program and Bank policy-based lending to the country.

b. Pillars/Policy Areas

The FSDPO series had three policy pillars.

Financial Stability aimed to: (a) strengthen the banking safety net and crisis management framework by capitalizing the Deposit Guarantee Fund (DGF) and by undertaking a crisis simulation exercise; and (b) improve the soundness of financial assets by strengthening the Anti-Money Laundering and Combating Financing of Terrorism (AML/CFT) regulatory framework.

Financial Inclusion aimed to: (a) improve access to financial products and services in underserved sectors and areas; (b) increase the efficiency of borrowers' collateral by establishing credit bureaus; and, (c) protect consumers and enhance the transparency of financial information by establishing the minimum requirements for protecting bank card accounts.

Development of Long-Term Financial Markets aimed to: (a) strengthen the primary markets for government securities by requiring the preparation and publication of bond issuance calendars, conducting at least four competitive bond auctions, completing one bond reopening (the issuance of additional amounts of a previously issued bond); and, (b) enhance long-term funding sources in pensions and insurance by setting maximum coverage limits for micro-insurance products.

c. Comments on Program Cost, Financing, and Dates

Program Cost: At appraisal, the cost of FSDPO I was estimated at SDR16.2 million (US$25 million equivalent) and of FSDPO II at SDR18 million (US$25 million equivalent).

Financing: FSDPO I was financed with an IDA grant of SDR8.1 million and credit of SDR8.1 million (Financing Agreement for FSDPO I, page 2). FSDPO II was financed with an IDA credit of SDR18 million (Financing Agreement for FSDPO II, page 2). The IDA credit and grant financing were fully disbursed in single tranches.

Dates: FSDPO I was approved on July 8, 2014, became effective on September 22, 2014, and closed on June 20, 2015. FSDPO II was approved on September 29, 2015, became effective on June 30, 2015 and closed on June 30, 2016.

3. Relevance of Objectives & Design

a. Relevance of Objectives

The program objectives were aligned with the Bank Group's country strategy for Mozambique at the appraisal of the FSDPO I and FSDPO II in 2014 and 2015 respectively and at program closing in 2016.

- The Bank Group's "Country Partnership Strategy for FY12-15 for the Republic of Mozambique" (CPS) committed Bank Group support to the country's poverty reduction strategy organized around three pillars:

(a) competitiveness and employment; (b) vulnerability and resilience; and, (c) governance and public sector capacity. According to the CPS (page 36), the MFSDS, and ongoing and planned operations associated with the MFSDS, which focused on reducing constraints to financial sector growth, were supportive of the first pillar.

- The Bank Group's "Country Partnership Framework for the Republic of Mozambique for the Period FY17-FY21" (CPF) articulated three focus areas: (a) promoting diversified growth and enhanced productivity; (b) investing in human capital; and (c) enhancing sustainability and resilience. The CPF (page 35) linked the FSDPO objectives and a prospective FSDPO III, should the Bank resume policy-based lending to the country, to the first focus area.

The program objectives were relevant to the Bank experience in the financial sector in Mozambique at program appraisal and program closing. Following the findings and recommendations of the joint Bank-IMF "Financial Sector Assessment Program" (FSAP) of 2003 and 2009, the government approved the "Mozambique Financial Sector Development Strategy for 2013-2021" to provide a vision statement and comprehensive plan for reforms in the financial sector in the country. The MFSDS advanced three (of thirteen) strategic objectives --- financial sector stability, financial access, and supply of private capital --- that were essentially reflected in the three policy pillars of the FSDPO series --- financial stability, financial inclusion, and development of long-term financial markets. FSDPO I and FSDPO II implemented key reforms under the MFSDS (ICR, page 1).

The program objectives were relevant to the country context in Mozambique at program appraisal and at program closing. The Program Documents for FSDPO I (page 11) and FSDPO II (page 23) recognized that implementation capacity was generally limited in Mozambique. But, the Program Documents argued, that: (a) the number of reforms were kept to a manageable level; (b) the responsibility for program implementation was assigned to two of the government's key institutions --- the Ministry of Finance and Economy (MEF) and the central bank, the Bank of Mozambique (BDM); (c) the sequencing and pacing of reforms was calibrated to the institutional capacity of the implementing agencies; and, (d) the Bank had mobilized sufficient technical assistance (TA) to support program implementation, with the TA delivered by competent specialists and funded by multiple partners including: the IMF, the African Development Bank (AfDB), Germany's Kreditanstalt fur Wiederaufbau (KFW) and Gesellschaft für Technische Zusammenarbeit (GTZ), the U.K.'s Department for International Development (DFID), and Switzerland's State Secretariat for Economic Affairs (SECO).

The program objectives were generally realistic, being informed by the FSAP of 2003 and 2009, aligned with the direction and priorities of the MFSDS, and supported by extensive technical assistance extended by the Bank and the country's other development partners.

Rating
Substantial

b. Relevance of Design

The results chain was logical. Enhancing banking regulation and supervision, strengthening the banking safety net, and improving the AML/CFT framework would reinforce financial stability. Improving access by consumers and small businesses to financial products in sectors and areas underserved by traditional banking services, increasing the efficiency of borrower collateral, enhancing the transparency of financial information and protecting consumers, and broadening access to payments systems would increase financial inclusion. Strengthening the primary markets for government securities and enhancing the pension and insurance systems would develop the country's long-term financial markets. Greater financial stability, increased access to finance, and better developed long-term financial markets would result in a better developed financial sector.

The prior actions addressed constraints to the development of the financial sector.

Constraints to financial stability	Prior actions
• Bank regulation and supervision lags international standards	• Issue new non-performing loan (NPL) classification system following international best practice • Issue new bank risk management guidelines following international best practice
• Bank safety net and crisis management frameworks are inadequate	• Capitalize the DGF to insure bank deposits • Appoint management of DGF • Approve new regulations for emergency liquidity assistance to banks to enable the central bank to act as lender of last resort • Conduct a crisis simulation exercise
• Banking system is at risk of being exploited for criminal activity	• Enact AML/CFT Law criminalizing terrorism financing • Approve AML/CFT implementing rules
Constraints to financial inclusion	Prior actions
• Access to the payments system is poor	• Separate oversight and operations functions in the national payments system to improve the payments system
• Many sectors and areas are underserved	• Issue regulations on e-money custody accounts to develop branchless banking • Regulate activities of non-bank agents
• Collateral system is inefficient	• Approve draft Insolvency Law • Submit draft law to Parliament creating credit bureaus, to develop credit reporting
• Consumer protection is inadequate	• Establish requirements to protect bank card account holders to strengthen financial consumer protection

Constraints to developed long-term financial markets	Prior actions
• Primary market for government securities is under-developed	• Issue government bond issuance calendar • Conduct two competitive government bond auctions • Announce intent to conduct one bond reopening • Approve operational norms for a Central Securities Depository (CSD) for the Stock Exchange of Mozambique (BVM) • Update money market regulations to encourage active and liquid money markets
• Pension and insurance industries are under-developed	• Set maximum coverage limits for micro-insurance products

The development policy credits and grant were suitable instruments for the programmatic series. Government completion of the prior actions, all fully delivered before the approval of FSDPO I and FSDPO II, would allow the development policy operations to become effective and advance the sector reform program across the three policy pillars.

The macroeconomic framework was adequate. At the time of the FSDPO I appraisal in July 2014, the IMF "Staff Report on the Mozambique Second Review Under the Policy Support Instrument (PSI)" of April 2014 concluded that: the economy remained buoyant, having recovered quickly from the severe floods in 2013; fiscal performance was stronger than earlier predicted; the external current account deficit had narrowed in 2013; program performance under the PSI had been broadly satisfactory; and, the political and security environment had improved. The macroeconomic outlook remained favorable, with the structural reform program on track and with economic growth likely to be sustained in the medium term by the natural resource boom and infrastructure investment. At the time of the FSDPO II appraisal in September 2015, the IMF "Staff Report on the Mozambique Fourth Review Under the Policy Support Instrument" of August 2015 concluded that: strong growth and low inflation continued into 2014; fiscal policy was strongly expansionary; but, pressures had emerged in the foreign exchange market in late 2014. Nonetheless, the economic outlook remained positive, with substantial policy adjustment underway to respond to slippages around the elections and balance of payments pressure from low commodity prices. Fiscal adjustment, greater foreign exchange rate flexibility, and stronger liquidity management would be essential to preserve macroeconomic stability. The debt distress triggered by the discovery of undisclosed debt by two state companies would not occur until April 2016, two months before the closing of FSDPO II in June 2016 (see Section 2.A).

Rating
Substantial

4. Achievement of Objectives (Efficacy)

Objective 1

Objective

To reinforce financial stability.

Rationale

The efficacy of the first objective is assessed as substantial: the program met two of the four outcome targets for the objective to reinforce financial stability.

The target for at least 85 percent of banks, representing not less than 90 percent of total bank assets, to classify their non-performing loans (NPLs) according to new bank regulations --- Aviso #16/GBM/2013 --- by 2017 was not met. The BDM shifted from a compliance-based to a risk-based bank supervision system in line with Basel II, focusing on the supervision of the largest banks instead of conducting on-site inspections of all banks every year. Based on an inspection of the four largest banks, the BDM established that 20 percent of banks, representing 78 percent of total bank assets, classified NPLs following the new regulation.

The target for at least 85 percent of banks, representing not less than 90 percent of total bank assets, to implement new risk management guidelines --- under Aviso #16/GBM/2013 --- by 2017 was not met. The BDM established that 29 percent of banks, representing 80 percent of total bank assets implemented the new risk management guidelines.

The target for the DGF to become operational and insure 90 percent of total deposit accounts by 2017 was met. The DGF, capitalized at MZN 105 million (US$1.75 million), insured 4 million out of 4.5 million deposit accounts, or 88 percent of all deposit accounts, by end-December 2017. The DGF insured deposits of residents of up to MZN 20,000 (US$342); in the baseline (March 2013), Mozambique had no operational deposit insurance system.

The target for Mozambique to amend its AML/CFT Law to criminalize terrorism financing was met. After approving a new AML/CFT law --- Law#14/2013 --- in 2013, Parliament passed implementing regulations --- Decree 66/2014 --- in 2014 to criminalize terrorist financing. In the baseline (March 2013), the AML/CFT Law had not considered terrorism financing as a criminal activity.

The ICR (page 6) contends that the original formulation of the first and second targets ("for 85 percent of banks, representing at least 90 percent of total bank assets" to classify their NPLs and to implement risk management guidelines following new regulations) were no longer consistent and amenable to verification after the BDM adopted risk-based supervision (which stopped the inspection of all banks and focused on the inspection of the largest banks). Hence, the ICR argues (pages ix-x and pages 19-20) that the two targets should be considered "largely achieved" based on the percentage of bank assets criteria. This ICR Review maintains that the targets should have been revised during implementation and does not agree that the two targets were met as originally formulated. However, this ICR Review agrees that the achievement of the four largest banks (which represent 80 percent of total banks assets) --- in classifying NPLs and adopting risk management guidelines following new regulations as planned --- cannot be ignored either. Hence, this ICR Review considers the efficacy rating for the first objective to be substantial.

The rating of substantial is also reinforced by actions cited by the ICR (page 20) as having been taken by Mozambique after the closing of FSDPO I in June 2015 and FSDPO II in June 2016 to advance the objective to reinforce financial stability. In April 2017, the BDM raised banks' minimum capital requirement from US$1.2 million to US$27 million, increased the minimum capital adequacy ratio from 8 percent to 12 percent, and introduced stricter limits on placements abroad. In May 2018, Parliament passed an amendment to the AML/CFT Law to enable the full implementation of U.N. Security Council Resolutions 1267 and 1373 related to the freezing of terrorist assets.

Rating
Substantial

Objective 2

Objective
To increase access to finance by households and firms.

Rationale
The efficacy of the second objective is assessed as substantial: the program met four of the six outcome targets for the objective to increase access to finance by households and firms.

The target for Mozambique to have 500,000 e-money accounts by 2017 (revised from an earlier target of 150,000 e-money accounts by 2016) was exceeded --- 3.8 million people (22 percent of the adult population aged 15 years and above) used mobile phones or the Internet to access their accounts in 2018, according to the 2017 Findex Survey (the Bank's Global Findex Database is a global dataset on how adults save, borrow money, invest, and manage risk). In the baseline (March 2013), there were no e-money accounts in Mozambique.

The target for 25 percent of the population to have access to formal banking services by 2017 was exceeded --- 36 percent of the adult population had a bank account and 38 percent had a mobile money account by 2016, according to the BDM, and 42 percent of the adult population or 23 percent of the total population had an electronic account, according to the 2017 Findex Survey. In the baseline (2009), only 12.7 percent of the population had access to formal banking services.

The target for the BDM to issue a call for proposals to service providers to apply for a credit bureau license or to operate a credit bureau on behalf of the central bank by 2017 was met --- one private credit bureau applied for and obtained a license in 2017 and was expected to start operations in late 2018. The creation of credit bureaus was enabled by legislation passed in 2015 --- Law #6/2015 --- which provided the legal and regulatory framework for the operation of private credit bureaus. After the law was passed, the BDM conducted information campaigns on the credit bureaus in Maputo, Beira and Nampula between October and November 2016. In the baseline (March 2013), there had not been a law providing for credit bureaus.

The target for 80 percent of banks to disclose the effective cost of banking services to their consumers by 2017 was exceeded. The BDM reported that 84 percent of the banks (16 of the 19 banks in the system) posted information on the pricing of their services in their websites in 2017. Earlier, the BDM issued guidelines --- Notice 13/GBM/2017 and Notice 3/GBM/2018 --- requiring financial institutions to disclose pricing information on their banking services, including annual nominal and effective interest rates, and to convey the information to the central bank. In the baseline (2013), no bank had disclosed the effective cost of banking services to its customers.

The target for banks to clear a check in two days both in and outside of Maputo City by 2017 was not met. The clearance of checks still takes two days in Maputo City and six days outside of Maputo City, the values in the baseline (2013). Although allowed by regulation, check truncation (the digitization of a physical paper check into a substitute electronic form for transmission to the paying bank) is not yet available and clearance still requires the physical exchange of checks. The BDM had strengthened the national payment system by separating its oversight and operational functions, but an oversight framework for retail payments has not been established.

The target for 70 percent of transactions to be settled through the Real Time Gross Settlement System (RTGS) by 2017 was not met. The value of payments settled through the RTGS was MZN 293.6 billion in 2017, or 28 percent of all payments settled through the three systems operated by the BDM (the RTGS, the retail clearance and settlement system or CEL, and the check clearance system).

The rating of substantial is also reinforced by actions taken by Mozambique after the closing of FSDPO I in June 2015 and FSDPO II in June 2016 to advance the objective to increase financial inclusion. According to the ICR (page 21), the Council of Ministers approved in July 2018 a draft bill that would modernize the legal framework for secured transactions, create a registry for movable collateral, and encourage movable asset-based lending in the country. meanwhile, the BDM has committed to developing a new RTGS system, is receiving technical assistance from Norway's central bank, the Norges Bank, for the endeavor, and is in the advanced stages of procurement for the new infrastructure.

Rating
Substantial

Objective 3

Objective
To enhance the development of long-term financial markets.

Rationale
The efficacy of the third objective is assessed as modest. None of the four outcome targets for the objective to enhance the development of long-term financial markets was met, although at least two were close to being achieved.

The target for the government to place at least five bond issuances through competitive auctions and one through reopening by 2017 was not met. The government conducted six competitive auctions in 2015, three in 2016, and five in 2017; however, the government did not undertake any bond reopening in 2015-17. In the baseline (2013), there had been two competitive auctions and no reopening.

The target to dematerialize (substitute paper-form securities with book-entry securities) all medium- and long-term debt securities registered in the CSD by 2017 was not met. The target to immobilize (maintain evidence of an investor's ownership of a security in the books or records of a corporate issuer or broker institution) the same securities by 2017 was not met either. By end-2017, 82 percent of securities registered in the CSD (46 of 56) were dematerialized and immobilized. Another 9 percent (5 of 56) were immobilized but not dematerialized. In the baseline (2013), only listed securities were dematerialized.

The target for 50 percent of members of private pension funds to have online access to their individual accounts by 2017 was not met. By end-2017, no member of a private pension fund had online access to his or her account, the same condition as had prevailed in the baseline (2014).

The target for 50 percent of insurance companies to present Key Fact Statements to consumers of their insurance products by 2017 was not met. In 2017, only four of the 20 insurance companies in the country published the required information in their websites (the four companies, the largest of the 20, account for 93 percent of the life and 74 percent of the non-life insurance market). In the baseline (2014), no insurance company had issued its Key Facts Statement to insurance product consumers.

Although Mozambique did not meet the four targets for the objective to enhance the development of the long-term financial markets, it came close to meeting the first two results targets. The government completed five competitive bond auctions as planned in 2017, although it did not undertake a bond reopening. Some 82 percent of securities registered with the CDS were materialized and immobilized, although under the 100 percent target.

Rating
Modest

5. Outcome

The program objectives were substantially aligned to the country partnership framework of the Bank Group with Mozambique: the objectives were aligned with the country's medium-term strategy for the development of its financial sector; relevant to the experience of the Bank in the financial sector in the country; and, consistent with the implementation capacity of the government. The program design was substantially relevant: the results framework was logical; the prior actions were directed at constraints to financial sector growth; the development policy credits and grant were appropriate instruments; and, the macroeconomic framework was adequate. The efficacy of the first objective to reinforce financial stability is rated as substantial, with two of the four outcome targets achieved and two others close to being achieved on a percentage-of-bank-assets criteria. The efficacy of the second objective to increase financial inclusion is rated as substantial, with four of the six outcome targets achieved. And, the efficacy of the third objective to develop the long-term financial markets is rated as moderate, with none of the four outcomes targets not achieved, but with two targets close to being achieved.

a. Outcome Rating

Moderately Satisfactory

6. Rationale for Risk to Development Outcome Rating

The risks to the sustainability of the program development outcomes are substantial:

<u>Institutional Capacity Risk</u>: Despite having trained staff, the MEF and the BDM face implementation capacity constraints in advancing financial sector reforms that are bound to become highly technical and increasingly complex as the reform program matures. According to the ICR (page 25), the Bank plans to help mitigate the capacity risk by continuing to extend TA to Mozambique, including in coordination with other donor countries and institutions, to support future sector reform operations. Following the closing of FSDPO II and the cancellation of FSDPO III in 2016, the multi-donor facility FIRST approved the Mozambique Bank Resolution and Deposit Insurance Project in July 2017 as a TA project to support the BDM's efforts to strengthen the regulatory framework for bank resolution and the capacity for the implementation of the deposit insurance scheme.

<u>Macroeconomic Risk</u>: The IMF "Staff Report on the Mozambique 2017 Article IV Consultation" concluded in early 2018 that the economic outlook for Mozambique remains challenging. Absent further policy action, real GDP growth is expected to decline over time. Growth had averaged 3.7 percent in 2016-17, from 6.6 percent in 2015, weighed down by the fall in commodity prices, adverse weather conditions, and the effects of the undisclosed loans in 2016 and the ensuing freeze on donor support for the country. The fiscal deficit is projected to expand and public debt to accumulate, crowding out credit to the private sector. Fiscal consolidation, including through broadening the tax base by eliminating VAT exemptions and reducing current spending, would be necessary to close the primary deficit. And debt restructuring would be important to restore debt sustainability.

Political Risk: According to the ICR (page 25), unresolved political conflicts render the political situation in the country fragile. The political dialogue is at risk of being consumed by political conflict at the expense of policy making. Moreover, frequent episodes of local unrest and violence, as well as labor protests, could severely disrupt economic activity.

Governance Risk: Governance in Mozambique is weak, as reflected in the country's declining scores on several of the Bank's Worldwide Governance Indicators (WGI), which measure a country's performance on six dimensions of governance, including voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption. To help mitigate governance risk, the CPF for FY17-FY21 emphasizes interventions that address constraints to the effective and timely achievement of the development objectives of Bank programs in the country.

a. Risk to Development Outcome Rating

Substantial

7. Assessment of Bank Performance

a. Quality-at-Entry

The Bank drew on extensive analytical work covering Mozambique's financial sector to help inform the program's design, including from the Bank and the International Monetary Fund's (IMF's) "Mozambique Financial Sector Assessment" (2003) and (2009); the Bank's "Mozambique Diagnostic Review of Consumer Protection and Financial Literacy" (2012); and the non-profit FinMark Trust's "Mapping the Retail Payment Services Landscape in Mozambique" (2012), "FinScope Mozambique Micro, Small and Medium Enterprise (MSME) Survey" (2012), and "FinScope Consumer Survey Mozambique" (2014). The ICR (page 11) also reports that the Bank drew on analytical work produced by the Bank's multi-donor funded Financial Sector Reform and Strengthening Initiative (FIRST) facility and Financial Inclusion Support Framework (FISF) program to inform the design of reforms to enhance the development of long-term financial markets and to increase financial inclusion.

The Bank coordinated closely with other donors supporting Mozambique's financial sector reform program, including the IMF, the AfDB, Germany's KFW and GTZ, the U.K.'s DFID, and Switzerland's SECO (see Section 3.A). The Bank used the Financial Sector Working Group and the Private Sector Working Group of the country's donors --- the G-19 group of donor countries and institutions that provide budget support to Mozambique (the donors have provided a quarter of Mozambique's budget in recent years) --- to exchange information, assess reform proposals, and coordinate the policy dialogue related to financial sector reforms.

The Bank mobilized technical assistance (TA) to support program preparation. The IMF provided TA on risk-based bank supervision, AML/CFT regulations, and asset classification and loan provisioning guidelines. The KFW provided TA on capitalization plans for the deposit guarantee fund, and, together with the GTZ, on the development of new financial instruments and expansion of the investor base for corporate bonds. The DFID provided TA on reforms to promote access to finance. And the SECO extended TA on movable collateral bills and their regulation. Altogether, the ICR (page 12) lists TA support in the amount of US$6.4 million over three years targeted at eight reform areas, with some of the donor TA being delivered through the Bank's FIRST facility and FISF program.

At entry, there was a moderate shortcoming with the Bank's performance. Although it extended a TA program to help the government make highly technical decisions regarding the priority and sequencing of policy reforms, the Bank did not fully identify gaps in the institutional capacity of the government for program implementation (ICR, pages 26-27).

Quality-at-Entry Rating

Moderately Satisfactory

b. Quality of supervision

The Bank maintained an active field presence in the country that enabled it to interact intensively with the government to supervise program implementation. The Bank team kept regular communication with the Technical Advisory Committee and the Implementation Support Unit for the MFSDS. The Bank also coordinated closely with the other donors in tracking progress with program implementation, participating in the meetings of the Mozambique G-19 Financial Sector Working Group and Private Sector Working Group to assess progress with the reform program. According to the ICR (page 27), cooperation between the Bank and the IMF, and between the Bank and other development partners, was "excellent".

The Bank filed two Implementation Status and Results Reports (ISRs) for FSDPO I, in July 2014 and June 2015, and one ISR for FSDPO II, in February 2016. TA support provided through FIRST and FISF enabled the Bank to undertake regular supervision missions to monitor program implementation. According to the ICR (page 14), separate reports (both back-to-office reports and Aide Memoires) were filed for three FIRST-supported and another three FISF-supported missions.

There were shortcomings with supervision, however. The Bank could have revised the first two results indicators during program implementation --- that 85 percent of banks representing 90 percent of total banks assets classify NPLs and adopt risk management guidelines following new rules --- considering that the BDM had shifted from a compliance-based bank supervision system examining all banks to a risk-based system examining the largest banks. The Bank could also have more explicitly discussed program implementation issues in its ISRs (ICR, page 27).

Quality of Supervision Rating

Moderately Satisfactory

Overall Bank Performance Rating

Moderately Satisfactory

8. Assessment of Borrower Performance

a. Government Performance

The government was strongly committed to financial sector reform and development. The government had been pursuing financial sector reform since the early 1990s, participating in comprehensive sector surveys and assessments conducted by the Bank, the IMF and other donors, including the FSAP of 2003 and 2009, and completing a national strategy for sector reform, the MFSDS.

Since the completion of the FSDPO II in June 2016, the government has continued to advance the reforms advocated by the program. To support the objective for reinforcing financial stability, the government has: increased minimum capital and solvency thresholds for banks; placed limits on asset placements abroad; prepared a new bank resolution law to address financial institution weaknesses and to strengthen the role of the deposit insurer. To support the objective to enhance financial inclusion, the government has: prepared new legislation for secured transactions; and, finalized a new retail payments strategy. And to support the objective to develop the long-term markets, the government has: issued a calendar of public auctions to improve the transparency of government bond issuances; worked on technical improvements to allow bond reopening; worked to improve the operations of the CSD. The foregoing actions would have been triggers to the third operation, the FSDPO III, which was cancelled in 2016 however (see Section 2.C). Nonetheless, these actions reflect continuing government commitment to financial sector reform and development.

The failure by the government to correctly report on government debt in 2009-14 resulted in the cancellation of the planned FSDPO III in 2016. The error should not be counted against the performance of the government under this program. Nonetheless, the government ultimately bears the responsibility for this misstep. For this program, the consequence was a cancelled third operation.

Government Performance Rating

Moderately Satisfactory

b. Implementing Agency Performance

The MEF (formerly the Ministry of Finance) was the principal implementing agency both of the MFSDS and the FSDPO series.

For the MFSDS, to which the FSDPO series was linked, the governance structure consisted of: a Steering Committee chaired by the MEF Minister and tasked with policy decision making and overall implementation supervision; a Technical Advisory Committee chaired by the MEF National Director of Treasury and tasked with all technical aspects of program implementation; and, an Implementation Support Unit within the MEF tasked with the coordination of implementation activities and with the reporting on progress with program implementation.

For the FSDPO series, the BDM was the implementing agency for reforms related to the financial stability and financial inclusion objectives; BVM, for reforms related to capital markets under the long-term financial market development objective; and the Insurance Supervision Institute of Mozambique (ISSM), for reforms related to pensions and insurance under the long-term financial market development objective.

According to the ICR (page 29), the BDM, BVM and ISSM were instrumental with the completion of the 10 prior actions for FSDPO I and 10 prior actions for FSDPO II. The BDM was key in the implementation of reforms related to banking regulation and supervision, bank risk management, and the payments systems, and generally cooperated closely with the Bank on program implementation.

Delays with the BDM completing two triggers to FSDPO II --- raising the minimum capital requirements for banks and establishing a crisis management committee --- were a minor shortcoming with the BDM's performance. The BDM would eventually complete the two actions, which then counted as triggers to FSDPO III.

Implementing Agency Performance Rating
Moderately Satisfactory

Overall Borrower Performance Rating
Moderately Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design
The M&E plan called for the FSDPO series to use the M&E governance structure for the MFSDS (see Section 8.B) for reporting on the progress of the FSDPO reforms. The Implementation Support Unit under the MEF would prepare progress reports for review and approval of the MFSDS Steering Committee and for transmittal to the government's Council of Ministers. The Implementation Support Unit would draw data for the reports from the implementing agencies --- the BDM, BVM, and ISSM --- including from the implementing agencies' regular data collection work and from special surveys conducted to measure progress specifically with financial inclusion.

The Program Documents for the FSDPO I (page 26-28) and FSDPO II (pages 40-45) detailed four outcome indicators to measure the degree of achievement of the first objective to reinforce financial stability; six, of the second objective to increase access to finance; and, four, of the third objective to enhance the development of long-term financial markets (see Sections 4 - Objectives 1, 2 and 3).

b. M&E Implementation

According to the ICR (pages 13-14), the FSDO was monitored according to plan. The government tracked progress with the FSDPO outcomes using the M&E system for the MFSDS. For its part, the Bank conducted M&E with its supervision activities and missions, including those supported by FIRST and FISF.

The government and the Bank could have adjusted the first two indicators (that measure the enhancement of financial stability) during program supervision and M&E implementation. With the BDM shifting from a compliance-base to a risk-based supervision system and stopping the annual on-site inspection of all banks in favor of the inspection of the largest banks, the two indicators measuring the percentage of all banks adopting new NPL classification and risk management guidelines were no longer relevant (see Section 4 - Objective 1 and Section 7.B).

c. M&E Utilization

According to the ICR (page 14), the M&E data were reported in the annual State Budget and in the Government Economic and Social Plan. The ICR did not provide further details.

M&E Quality Rating

Substantial

10. Other Issues

a. Environmental and Social Effects

Environmental Safeguards: The program was not expected to have any direct negative impact on the environment, although financial inclusion initiatives supported by the program that led to increased economic activity by households and small firms could have some environmental effects. In this regard, the Program Documents for the FSDPO I (pages 21-22) and FSDPO II (pages 34-35) argued that the legal framework for environmental protection was relatively well developed in Mozambique, with the country's environmental laws --- Law No. 20/97 and Decree 45/2004 --- providing the general principles for the proper management of the country's natural resources. The Program Documents also stated that the Environment Ministry (MICOA) had the technical capacity to oversee the implementation of the country's environmental laws. Moreover, a Strategic Environmental Assessment conducted by the Bank in conjunction with the Mozambique Climate Change Development Policy Operation in 2013 concluded that there was "a substantial degree of equivalence" between Mozambique's and the Bank's environmental safeguards procedures, the latter as articulated in OP/BP 4.01. Separately, the ICR (page 24) cites a potential positive impact on environmental governance from AML/CFT regulations supported by the program. AML/CFT laws would help identify, locate, and recover illicit revenues gained by criminals from illegal logging and wildlife trafficking, including of ivory and rhino horns.

Social Effects: Financial inclusion was expected to benefit the poor directly by expanding agency banking and mobile money accounts in underserved areas, promoting the use of credit bureaus in rural areas where land could not be used as collateral, and strengthening consumer protection to benefit less sophisticated consumers. Women were expected to more likely benefit from reforms that improved access and use of financial services. Similarly, other reform plans were expected to contribute to poverty reduction: (a) the DGF would protect the savings of small depositors; and, (b) stronger pensions systems and insurance firms would reduce the vulnerability of the aged to economic shocks. Although the Program Documents cited the foregoing links between financial sector reform and poverty reduction, the government did not measure these social effects more systematically.

b. Fiduciary Compliance

Financial Management: The Program Documents for FSDPO I (pages 22-24) and FSDPO II (pages 35-37) determined that Mozambique's public financial management (PFM) system was adequate to support the two operations. Although there remained challenges to the PFM system, the country had made improvements since 2006 in multi-year planning, annual budgeting, procurement, accounting, internal controls, auditing and public access to fiscal information, according to the "Public Expenditure and Financial Accountability (PEFA) Assessment of Public Finance Management of Mozambique" of 2015. The program financing would be disbursed following standard IDA disbursement procedures, with the funds deposited in a dedicated foreign exchange account of the BDM. In this regard, a safeguards assessment conducted by the IMF had earlier determined that the BDM's control, accounting, reporting and auditing systems were adequate and aligned with international standards. The IDA reserved the right to request an audit by a private independent audit company under terms of reference agreed upon with the government.

c. Unintended impacts (Positive or Negative)

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d. Other

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11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Moderately Satisfactory	Moderately Satisfactory	---
Risk to Development Outcome	Substantial	Substantial	---
Bank Performance	Moderately Satisfactory	Moderately Satisfactory	---

Borrower Performance	Moderately Satisfactory	Moderately Satisfactory	---
Quality of ICR		Substantial	---

Note
When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

12. Lessons

Two lessons are drawn from the ICR (pages 29-30), with some adaptation, and a third is added by this ICR Review.

Solid analytical grounding, close donor coordination, and extensive technical assistance are important in the preparation and implementation of structural reforms in the financial sector, particularly where institutional capacity is weak. Challenges to the stability and development of the financial sector in Mozambique were daunting, but the country's capacity to plan and implement sector reform programs was weak. The Bank, the IMF and other donors extended TA to the government to help upgrade the implementation capacity of the BDM and BDM capably issued regulations to improve risk management in banks. However, the BDM faced capacity constraints proceeding to the next set of reform measures and was delayed in raising the minimum capital requirements for banks and in establishing a crisis management committee, two measures that were designated as triggers to FSDPO II but instead delayed as triggers to FSDPO III.

Governments must make mid-term assessments of a programmatic series and be flexible to adjust course if necessary. The moderate accomplishment of the third objective suggests that the government could have carefully assessed progress with the implementation of the reform plan before the closing of FSDPO II in mid-2016 to determine whether the program had not made enough progress with the third objective to develop the long-term financial markets, before proceeding with plans for the FSDPO III. Following the cancellation of FSDPO III, the government returned to focus on a more elementary concern associated with the first objective to reinforce financial stability by securing approval for the Bank Resolution and Deposit Insurance Strengthening Project financed by FIRST. The focus on banking stability would turn out to be appropriate considering that two banks failed in 2016 --- Moza Banco, the country's fourth largest bank, in September, and O Nosso Banco, a small bank about 77 percent-owned by the ISSM, in November.

Good governance in both the public and private sectors are essential in a reform program. In view of the heavy damage inflicted on the economy by the government's failure to correctly report on its public debt, it is imperative that development programs in Mozambique, including this financial sector reform program, continue to emphasize good governance principles and practices in both the public and private sectors. The imperative becomes even more urgent considering reports that the undisclosed loans were not only concealed, but also misused (indictments were handed out in January 2019 against several government officials, bankers and private persons). Issuance of new bank NPL and risk management standards and passage of the AML/CFT law and rules under FSDPO I were a good start at promoting good governance in banks.

13. Assessment Recommended?

No

14. Comments on Quality of ICR

The ICR provides a comprehensive record of the project. The ICR adequately documents the context of the project (pages 1-3), the results framework (pages 4-5 and 59), and the project design (page 5-9). The ICR also details the analytic work supporting program design (pages 10-11 and 38) and the technical assistance conveyed by multiple donors to the program (pages 11-12).

The assessment of the program's results is evidence-based. The ICR provides a useful summary of the operational performance, set within the results framework for the project (pages 17-18). The ICR also offers a detailed narrative supporting the efficacy ratings of the program (pages 19-22), and detailed accounting of the prior actions and triggers to the operations (pages 40-42).

The analysis of the project outputs and outcomes is candid. The ICR elaborates on both the positive and negative factors that affected program outcomes (pages 19-22), the Bank's performance (pages 26-27), and the government's performance (pages 28-29).

Considering that the program was heavily supported by TA provided by many donors both for program preparation and program implementation, it would have been informative for the ICR to secure the comments of the other donors on the program results. The ICR's Section 7 would have been helpful for informing the future course of the sector reform effort, a minor shortcoming.

a. Quality of ICR Rating
Substantial