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Annexe 1a. FSD Africa

REGIONAL FINANCIAL DEVELOPMENT STAGE

Across the continent, there has been a significant but uneven increase in access to financial services amongst individuals and households. Between 2011 and 2017, access to formal financial accounts among adults across sub-Saharan Africa (SSA) increased from 23% to 43%, with all SSA countries (where data exists) experiencing an improvement[1]. This trend has been largely driven by a rapid expansion of mobile money, which rose (in terms of population with an account) from 12% to 21% between 2014 and 2017. However, progress is uneven; in South Sudan, the inclusion rate is 9%, compared to 82% in Kenya. Within countries, differences in access remain and, in some instances have increased. In 2017 women made up 56% of the unbanked compared to 52% in 2011. The less educated, poorest and rural continue to be left behind[2]. While 87% of adults with an account made a deposit or a withdrawal within the last year, recent research highlights the need to make progress on account usage, especially related to cost, reliability and relevance to needs.

Credit markets are constrained. SSA private credit as a percentage of GDP is low - 29% in 2018 compared to 47% for developing countries in Asia and the global average of 129%[3]. This has inhibited growth; with entrepreneurs and farmers struggling to finance inventory, inputs or lease machinery; ordinary people unable to pay for housing; and low-income households without the means to smooth consumption in the face of moderate shocks and economic volatility. Across the continent, 60% of bank lending is for a tenor of less than a year[4], which is not well-suited to paying for longer-term growth strategies. Interest rate spreads are 1.5-2 times higher than elsewhere in the world[5], highlighting banking inefficiencies and contributing to high non-performing loans in countries such as Tanzania (>10%), Ghana (>20%) and Ethiopia (thought to be close to 40% in State-owned banks)[6]. The situation is worse in fragile states, where private credit/GDP ratios are one third of those elsewhere in SSA[7]. The low levels of credit are partly due to a lack of domestic savings (19% of GDP, vs global average of 25%[8]) but also because governments are borrowing heavily, crowding out the private sector.

In particular sectors, credit is severely limited. Housing mortgage lending is minimal (<1% of GDP in SSA (excl South Africa), compared to 50% for Europe and 70% for the United States)[9] and finance to SMEs is far lower than is needed for economic growth and job creation. The IFC estimates a total of 23.1m enterprises, or 52% of all micro-, small- and medium-sized firms in SSA, have an unmet financing need of $331bn every year[10]. There is also a significant and well-publicised gap in infrastructure funding in Africa. According to the United Nations Economic Commission for Africa[11], the continent's infrastructure deficit lowers Africa's per capita economic growth by 2% and firm productivity by 40% a year.

Regulation has had a negative impact on credit extension in some markets. Credit market development is often undermined by different regulators being responsible for different sub-sectors of the market (e.g. banks, non-

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[1] Source for all figures on financial inclusion: Demirgüç-Kunt, Asli, Leora Klapper, Dorothe Singer, Saniya Ansar, and Jake Hess. (2018). *The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution. World Bank: Washington, DC.*

[2] Methodological constrains have prevented the World Bank from calculating a rural vs urban breakdown on financial inclusion. However for all SSA countries, the rural population do have a lower rate of financial inclusion to the rest of the population (an average of 3 percentage points, with a range of 0-10 percentage points).

[3] Source: International Monetary Fund, International Financial Statistics and data files, and World Bank and OECD GDP estimates. Data accessed here

[4] Source: World Bank (2011). Financing Africa; Through the crisis and beyond

[5] Source: International Monetary Fund, International Financial Statistics and data files. Data accessed here

[6] Source: International Monetary Fund, Global Financial Stability Report.

[7] Source: International Monetary Fund, International Financial Statistics and data files, and World Bank and OECD GDP estimates.

[8] Source: World Bank national accounts data, and OECD National Accounts data files. Data accessed here

[9] Source: World Bank (2011). Financing Africa; Through the crisis and beyond. Figures for 2010. More recent disaggregated figures show a similar story; In 2017 only 12 out of 54 SSA countries have mortgage debt to GDP of more than 5%

[10] IFC (2018), MSME Finance Gap

[11] United Nations Economic Commission for Africa (2015). Industrializing through trade

banks, SACCOs) and the fact that most countries lack regular and consolidated statistics covering all aspects of the market.

African governments have found it relatively easy to access local and foreign currency debt. In total, 22 African countries have now issued Eurobonds which have helped finance infrastructure or shift away from high-cost short term debt. But proceeds in some countries have been used for recurrent expenditure and more questionable capital projects. Eurobonds have also introduced foreign exchange risk and this has increased concerns over debt sustainability; in 2018, 16countries were considered at high risk of debt distress or being in debt distress, compared to only 6 countries in 2014[12]. The lack of liquidity in sovereign bonds and over-reliance on short term debt has meant clear yield curves have not emerged. This makes it challenging to price private sector debt, which impacts on the tenor and availability of this.

African governments have shown increasing interest in developing their capital markets which, outside of South Africa, remain small, fragmented and highly illiquid. There are now 30stock exchanges in Africa, up from 5 in 1989. However the annual volume of stocks traded is less than 10% of market value for most countries, compared to a global average of 104%[13]. Initial Public Offerings (IPOs) remain infrequent; there have been less than 1 per exchange per annum over the last decade. Private equity dwarfs the public market as a potential source of available equity capital for companies. The SSA corporate bond market is highly underdeveloped at less than 2% GDP, considerably lower than other developing markets and corporate bonds and a tenth of the size of sovereign bond markets[14]. In general, long-term green financing is nascent, although both Nigeria and Kenya have been active in developing green bond markets with Nigeria issuing a recent sovereign bond, and Kenya issuing a recent corporate bond.

Insurance markets remain under-developed at the household, enterprise and sovereign levels. Insurance premiums in SSA (including the South African market, which constitutes 70% of all African premiums) are only 3% of GDP compared to 6% globally. At the same time, over 90% of all public and private losses from natural disasters in Africa are uninsured, compared with 45% in North America. Similarly, over 50% of all adults in Nigeria, Ghana, Kenya and Rwanda experienced an insurable risk in the last year, but only 1% made a formal insurance claim[15]. Instead, they relied on alternative, often negative coping mechanisms, e.g. high cost borrowing, reducing expenditure (food and education) or selling productive assets.

Pioneering financial solutions and intermediaries are beginning to emerge, challenging market incumbents and regulators. Spurred by the technological development, the availability of data and payment system advances, there has been a proliferation of innovation in financial services. However, there remain relatively few examples of outright success that demonstrate business model scalability and sustainability. While these innovations hold the promise of increased competition for the banking sector and improved access to financial services and capital for consumers and small businesses, there are associated risks, too e.g. loan accessibility and subsequent indebtedness amongst vulnerable groups and data protection breaches. The growth in the number and diversity of these financial innovations has tested the capacity of regulators across SSA to create and enforce the right rules and incentives. Some regulators (e.g. in Mozambique, Sierra Leone) have demonstrated a flexible approach to market development through the use of regulatory sandboxes and innovation offices.

Informal finance continues to play an important role but remains difficult to scale. The non-traditional financial sectors provide a valuable function for many communities. For example, savings associations are strong in Rwanda, Sierra Leone and Kenya and are the dominant form of finance for many sectors, particularly housing. However, their structures and regulations currently limit their ability to scale or offer more innovative forms of finance. Governments and regulators continue to remain committed to the potential inclusive role of

[12] IMF (April 2019) Regional Economic Outlook. Sub-Saharan Africa
[13] Source: World Federation of Exchanges database. Data accessed here.
[14] Mu et al (2013): Bond markets in Africa. FSDA estimates put the size of SSA corporate bond markets outside South Africa at $10bn.
[15] All figures on insurance from FSDA (2019). Insurance for inclusive and sustainable growth

community-based financial service providers, such as savings groups, and increasingly accommodate them in national financial inclusion strategies.

Payment systems and the banking sector remain fragmented and inefficient, leading to higher costs and levels of risk. Typically, SSA's banks are relatively small, making it difficult to attract long-term capital and offer long-term finance for borrowers. There have been bank failures in several SSA countries in recent years – e.g. in Ghana, Uganda and Kenya – mainly as a result of undercapitalisation and weak corporate governance. Ethiopia's banking sector remains closed to foreign ownership, despite political changes in the country. Intra-regional trade, which African countries recently committed to boosting through the ratification of the African Continental Free Trade Agreement, is made more expensive because of inconsistent regulatory frameworks and the lack of integrated payment systems. Fragmentation also raises the cost of remittances – an important source of finance (totalling 3% of GDP for SSA) and foreign exchange. Remittance transfer costs for SSA are on average 9% of funds transferred (compared to 7% globally and the highest of any region in the world)[16]. Overall more than $3bn is paid per annum in fees to transfer funds to recipients in SSA[17].

Fragmented markets, prone to under-investment and elite capture, create fertile conditions for corruption and financial crime and thus an overall weakening of the financial system. This contributes to greater (and increasing) illicit financial flows. Africa is estimated to lose $50bn a year from illicit financial flows[18], increasing risks related to terrorism and crime. As a result, international banks have sharply reduced (de-risked) their exposure to Africa. The loss of corresponding banking relationships for African banks makes it more difficult for them to access the global financial system and support their corporate clients. Four African countries – Ethiopia, Botswana, Ghana and Tunisia – are described by the intergovernmental body Financial Action Task Force (FATF) as "jurisdictions with strategic deficiencies" in the way the integrity of their financial systems is being addressed.

FSD PROGRAMME, ACHIEVEMENTS AND LESSONS TO DATE

Since its creation in 2012, FSD Africa (FSDA) programme has:

- **Pursued a broad-based programme for financial sector development that has successfully integrated financial inclusion into a reform agenda for the wider financial system**. FSDA has ensured that "finance for growth" and "finance for all" are not seen as exclusive but, rather, reinforce and depend on each other. This has stimulated a shift in thinking on how the donor community can best support financial sector development to reduce poverty.
- **Developed a large pan-African programme in capital market development**. FSDA has supported regulators and other agencies in 28 SSA countries, on capital markets strategy, institutional capacity building and regulation. It has stimulated the introduction of new products, such as green bonds, and supported the introduction of new regulatory frameworks (e.g. Islamic finance) and infrastructure (e.g. exchanges).
- **Launched an investment fund for concessional investment capital**. FSD Africa (Investments) (FSDAi) – the investment arm of FSDA – complements FSDA's market-building work by making investments in financial firms or funds, that bring innovation to financial markets. To date it has invested £22m in five investments and has a large and growing pipeline. This investment activity has added a new and powerful instrument to the grants and technical assistance that FSDA typically uses and helped mobilise several hundreds of millions of pounds in third-party capital. In September 2019, FSDAi received an additional commitment of £90m to scale up its investments to crowd in further third party capital to companies heling to build financial markets through innovation.
- **Supported technology-led innovation in the financial sector.** FSDA has led efforts to grow the African crowdfunding industry and has supported regulators with sandbox (or similar) regulatory approaches. Its work on remittances has focused on supporting digital-to-digital money transfer methodologies rather than the traditional cash-to-cash approaches.
- **Tackled complex challenges**. FSDA has worked to build interbank lending markets, which remain thin across the continent. It has supported credit market development by systematising data collection and analysis. It

[16] KNOMAD (April 2019). Migration and Development Brief 31
[17] FSDA calculation based on WB data
[18] UNECA (Illicit Financial Flow: Report of the High-Level Panel on Illicit Financial Flows from Africa.

has supported change management processes in financial institutions, contributing to 3.6m people with improved access to financial services, including 1.5m women.

- **Actively pursued opportunities in Fragile and Conflict Affected States, and with the most marginalised**. FSDA has a footprint in Zimbabwe, Sierra Leone and the Democratic Republic of Congo and works closely with forcibly displaced communities in Rwanda, Uganda and DRC in partnership with other FSD programmes. Programmes of work are also underway with savings groups, young entrepreneurs in urban slums and market traders.
- **Supported the FSD Network with technical resources.** In this FSD Network strengthening role, it has coordinated knowledge-sharing across the Network through conferences, working group meetings, newsletters and other services e.g. consultant database, an online knowledge repository and tool kits
- **Responsive partner to DFID as new policy priorities have arisen**. This includes activity in remittances, capital markets (highlighting the role of the City of London) and climate finance. It has worked closely with DFID offices and other HMG departments across Africa (e.g. Ethiopia, Ghana, Côte d'Ivoire and Senegal) to support strategy work to develop new financial sector interventions in those countries.
- **Developed a sophisticated approach for measuring the impact of markets system change programmes**, with many of these adopted by the FSD Network, CGAP and its working group on financial inclusion measurement.

Lessons to date include the following:

- **Despite progress in several areas, huge challenges remain**. We cannot create jobs, help people get access to basic services like housing or clean energy, and create a fair and liveable world unless we confront the intractable financial sector issues that undermine investment and household resilience. FSDA has therefore chosen to frame its future activities around these issues which are at the heart of poorly performing financial markets in SSA: lack of long-term local currency finance; dysfunctional credit markets; lack of risk mitigation instruments and risk management; the lack of early-stage and risk-bearing capital; and fragmented markets.
- **There needs to be a sharper focus on real sector outcomes**. Improving the financial system is necessary to achieving increased economic benefits, however it is insufficient on its own. In order to achieve the tangible real sector and societal benefits that we seek we need to move to. Accordingly, FSDA will favour more intentional, interventionist sector or instrument-led approaches that drive for specific outcomes.
- **A different approach to capacity. There needs to be more emphasis on advocacy to bring about change.** While FSDA has been successful at both output and outcome level, more can be done to advocate for specific financial market changes that benefit businesses and households. FSDA intends to leverage its investment in results measurement and communications to create a more effective advocacy capability.
- **FSDA can do more to support UK linkages and government priorities.** FSDA already has solid UK-based partnerships – e.g. with the Financial Conduct Authority, large firms such as Prudential and the London Stock Exchange, as well as with fintechs and professional services organisations, and academic institutions, such as the University of Cambridge – but more can be done, including in partnership with other DFID-managed programmes, such as the Global Finance programme. FSDA will also seek to deepen its relationships with other HMG departments, e.g. the Department for International Trade, with which it has already collaborated on insurtech; and FCO, where it is expected there will be opportunities to work together on financial integrity**.**

WHAT MORE NEEDS TO BE DONE?

African economies are not keeping pace with the growing youth labour market. About 60% of Africa's population is under 25 years old and, by 2050, Africa will be home to 452 million people between the ages of 15 and 24[19]. Rapid urbanisation is drawing young people into the cities, and while in theory the cities offer better economic possibilities for young people than in rural areas, there are simply not enough formal jobs to go around. In 2018, the Kenyan economy created only 78,000 net new formal jobs, despite GDP growth of 6.3%[20], with almost a million young people coming into the labour market. Increasingly, employment in Africa is

[19] Mo Ibrahim Foundation 2017 Forum Report – Africa at a Tipping Point
[20] Kenya National Bureau of Statistics (Economic Survey 2019)

becoming both informal and urban in character and government or donor-led financial market interventions aimed at creating jobs or boosting incomes need to take this into account. New technology-led distribution channels might make it easier to serve young people directly, but we also need to consider how better infrastructure in the urban environment (including access to markets and technical advice) could help young people improve incomes.

Micro, small and medium enterprises are considered to be the engine for growth and job creation in Africa – but survival rates are low due to the risky operating environment. A total of 49% of SMEs across SSA cite access to finance as a barrier, yet only 29% of formal SMEs have access to credit[21]. Constraints to the development of the sector include the lack of collateral, the lack of fully functional credit bureaus, and a poor contract enforcement environment. The non-bank sector (e.g. leasing, invoice discounting) is underdeveloped because of poor (or absent) regulation, the lack of long-term finance and the dominance of incumbent banks. Technology-led innovation (in credit scoring and distribution) should bring costs down and make lending to MSMEs viable but there is a need for investment in experimentation to identify sustainable models.

Regional economic integration will increase opportunities for some, while more integrated regional payments systems should also remove a costly barrier to trade. The African Continental Free Trade Agreement has helped underscore the importance of adopting strategies for financial sector development that are regional in nature. E-commerce is intrinsically borderless and there are currently high hopes that African platforms such as Jumia, Konga and Kilimall can gain traction. It is estimated that African e-commerce could create as many as three million new jobs by 2025[22]. However, for this opportunity to be realised, there needs to be considerable investment in regulatory and technical support in order to improve payment system interoperability within countries and between neighbouring countries and economic regions. Facilitating these new markets will require strong contextual analysis and consensus-building between market actors as to what the appropriate economic models are for these payment systems of the future, both at wholesale and retail levels.

Africa has a massive affordable housing deficit. There is an estimated backlog of well over 50 million units across Africa, with 22 million in Nigeria alone[23]. Fixing Nigeria's backlog would require investment of $16bn annually in the medium term[24]. Housing provides privacy, security and dignity to those who have it. However housing is also an economic asset that can be collateralised to raise a loan, or used to run a small businessfrom. It is important that we innovate with new housing finance products (e.g. construction mortgages, smart rental models or remittance-based models) and ensure that capital markets are able to deliver the long-term finance that lenders need.

Africa is the most climate vulnerable region in the world yet receives only a fraction of global climate finance. 28 of the 40 most climate vulnerable countries are African[25]. Yet, in 2015-16, Africa received only $12bn of the estimated annual $460bn of global climate finance[26]. At the same time, climate finance for adaptation (which Africa needs because of its climate vulnerability) is a fraction of what is being invested in reducing emissions. There is a significant opportunity for using (in particular) long-term finance instruments and insurance markets to build climate resilience and bring about environmental benefits – for example, encouraging pension funds to invest in green bonds, or using insurance to build urban resilience against flooding. There may be opportunities in conservation finance to support carbon sequestration and enhance the livelihoods of communities. Few African governments have enacted national climate finance policies and lack the capacity to access global climate financing, such as through the Green Climate Fund.

In response, FSDA will refocus its programming to tackle the following five intractable financial market challenges:

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[21] IFC (2018), MSME Finance Gap
[22] Boston Consulting Group (2019): How Online Marketplaces Can Power Employment in Africa
[23] Press comment (africa.com) from the head of the Federal Mortgage Bank in Nigeria, Ahmed Dangiwa, June 2019. The Centre for Affordable Housing Finance quotes him in early 2018 as putting the deficit at 17-20 million units, growing at 900,000 per annum
[24] ibid
[25] UNCTAD Commodities and Development Report 2019
[26] Climate Policy Initiative (2018). Global Climate Finance: An Updated View 2018

1. **Lack of long-term finance in local currency.** FSDA will continue to tackle a range of capital market constraints including: a weak policy and regulatory environment, the lack of investment products for long-term investors, such as pension funds, and weak (or absent) market infrastructure (e.g. exchanges). It will continue to support enhancements to the ecosystem that are non-sectoral, e.g. in government bond markets and the money markets, because (i) they have a direct influence on the stability of financial markets, and (ii) they allow us to participate in conversations around macroeconomic policy which has a significant influence on the effectiveness of financial markets in the real economy. However, FSDA will increasingly focus on catalysing demonstration transactions in the real and social sectors, supporting regulators, intermediaries and investors in the use of instruments such as Real Estate Investment Trusts and Green Bonds. Recognising that capital markets, as well as retail financial markets, are going through a profound technology-led transformation, FSDA will also provide technical support to enable regulators to take advantage of RegTech and also licence new fintech business models.
2. **Dysfunctional credit markets.** FSDA will build on current progress in improving the quality, availability and analysis of credit market information to enable strategic, evidence-based policy formation aimed at increasing the volume of productive, responsible credit in SSA economies. This will be coupled with dedicated research (e.g. on interest rate policy) and advocacy initiatives to highlight the importance of credit market development and encourage peer-to-peer learning among regional regulators and policymakers. It will support innovation in credit markets, providing technical assistance to promising pilot programmes, e.g. in supply chain finance, and emerging lending platforms. There will be a sectoral focus on housing (FSDA will continue its support for the Centre for Affordable Housing Finance) and enterprise finance (provision of finance to "alternative lenders" and microenterprises). FSDA will partner with funders and technical service providers interested in supporting entrepreneurship, including in the informal sector.
3. **Lack of risk management and transfer instruments.** FSDA will build on a programme of insurance-related work that has combined support for micro-insurance (1.2 million individuals have been reached through partnerships with six insurance firms) with the generation of market insights and diagnostics that have identified opportunities for improving policy and regulation including in the supervision of insurance companies. FSDA will implement a programme that aims to build resilience and de-risk investment, especially in agriculture (e.g. using price and weather index insurance), climate financing and health (e.g. by supporting innovation to allow lower income consumers to manage health risks and, selectively, supporting public/private initiatives to expand hospital insurance at scale). It will work with insurance intermediaries and, besides insurance, will support the use of non-insurance instruments to mitigate risk, such as remittances and derivatives. FSDA will help regulators adopt risk-based approaches for regulating insurtech innovations.
4. **Lack of early-stage and risk bearing capital.** There is a significant gap in the supply of, and demand for, capital in the financial sector in SSA. Mainstream Development Finance Institutions tend to have an appetite for lower risk and larger deal sizes than those that FSDA sees in the market. FSDAi has purpose to; (i) provide capital to innovative financial firms (and funds) to enable their growth, and (ii) further the development of financial markets by demonstrating the feasibility of new business models. Thus, through its investment activities, FSDAi will play a direct role in helping to deliver FSDA's overall strategy, whilst at the same time building an investment portfolio.
5. **Financial market fragmentation.** In order to help overcome the problem of fragmented markets that discourages investment and creates favourable conditions for corruption, FSDA will develop a programme that combines activities on: (i) regional payments integration (including remittances); illicit capital flows (e.g. supporting regulatory work to help countries with AML enforcement, or acting as an "observatory", working with partners to bring to light new evidence of financial crime); cross-border banking sector integration – specifically, countering the negative impact of de-risking; and regional policy and regulation (e.g. harmonising around regional standards).

FSDA will pivot its activity towards four specific economic and social sectors, with a stronger focus on multi-dimensional poverty reduction and the SDGs. The locus of FSDA's programming will remain anchored within the financial sector. However, to ensure that financial market development translates to tangible impact against global goals (as described in the SDGs) and poverty in all its dimensions (increased incomes, access to basic

services, fairness of opportunity and a clean environment), FSDA will orientate a significant proportion of its programming towards: affordable housing, small enterprises, health and climate.

FSDA will significantly scale up the deployment of its investment capital. This Business Case Addendum will enable DFID's country offices, FSDA and the wider FSD Network to create new opportunities for FSDAi to successfully deploy capital directly into priority financial sub-sectors, and indirectly into key economic and social sectors.

FSDA will recalibrate its relationship with the FSD Network. During the first phase of FSD programmes (2002-2019), country FSD entities evolved autonomously, loosely affiliated through a type of 'club' arrangement, facilitated (from 2013) by FSDA. Under the new FSD2.0 strategy, members of the FSD Network will actively collaborate around key domain areas, intensifying impact, learning from each other and contributing to a collective body of learning. This will enhance FSDs' overall value for money, both at a country and regional level. This increase in efficiency and effectiveness will be achieved by more systematic and joint FSD Network governance, programming and operational support, which will require more proactive management and facilitation by FSDA itself.

FSDA will expand its programming footprint in fragile states and communities. FSDA's involvement in fragile states has been growing but greater investment is required to take its work to new countries and communities where it is needed most (e.g. forcibly displaced people, informal settlements, urban slums, states that are extremely fragile), build a compelling track record, and crowd-in other FSDs and donors. FSDA will work with new partners, e.g. NGOs, on explicitly pro-poor interventions such as graduation programmes and enterprise grants.

Gender and women's economic empowerment remain a key strategic objective. FSDA will capitalise on work it has coordinated with the FSD Network and other partners to mainstream gender into FSDs' programmes, advocate for women's economic empowerment and support innovation that directly benefits women and girls. It will seek to secure substantial co-funding from like-minded partners in order to maximise impact and build sustainability.

FSDA will create new opportunities for collaboration across the UK government and for the UK's private sector. FSDA will be more purposeful in developing strategies to facilitate the exchange of knowledge between SSA and the UK, harnessing UK private and public sector expertise, as well as academia. It will continue to support non-DFID UK government departments' objectives, where there is a strong overlap with FSDA's development mandate and where collaboration is consistent with ODA principles.

PROPOSED INTERVENTIONS UNDER FSD 2.0

FSDA will structure its interventions into five technical delivery pillars, combining sector-specific interventions with sector-agnostic (ecosystem) financial sector development activities. Illustrative detail is provided in Table 1.

Table 1. Proposed Interventions by Sector

	Interventions by Programme				
Teams	**Housing**	**MSME**	**Health**	**Climate**	**Sector-agnostic (Financial Market Ecosytem)**
Long Term Finance	● Specific product and instrument developmen t e.g. property funds, REITs, social REITs	● n/a	● Specific corporate bond market development including social impact bonds	● Green bond market development ● Climate finance twinning ● Regulator capacity building	● Government debt market development ● Money market development ● Market infrastructure development e.g. OTC exchanges
Credit & Small Enterprise	● Innovation in credit supply ● Housing finance research and data ● Ecosystem developmen t	● Support to FSPs, aggregators and platforms ● Ecosystem developmen t	● n/a	● Disclosure on green loan portfolios	● Alternative credit ecosystem development ● Strengthening credit market data and analysis ● Responsible finance frameworks
Risk	● Housing supply chain insurance provision ● Mortgage risk insurance		● Micro-insurance supply and take up ● Underwriting and scheme administration via PPPs ● Cross-border remittance add-ons	● African Cities Resilience programme ● Index-based insurance products ● Climate Risk Assessments	● Risk-based regulatory approaches ● InsurTech regulation ion ● Micro-pension platform support
Early stage and risk bearing capital (FSDAi)	● Investment in housing finance companies and funds	● Investment in fintechs, alt credit firms, platforms	● Investment in health financing innovations	● Investment in financing renewable energy	● Ecosystem support, e.g. capacity building
Fragment-ation		● Regulatory work to support e-commerce, cross-border trade finance	● n/a	● n/a	● Regulatory work on AML/CFT ● De-risking ● Regional policy harmonisation

FSDA will expand the capacity of cross-cutting delivery teams in strategy and results measurement to enhance the effectiveness of its technical delivery pillars and explore new themes.

- The Strategy and Advocacy team will comprise: (i) a strategy and advocacy function (to include a Chief Economist, knowledge management, and UK partnerships); (ii) an external relations function (including corporate and programme-related communications); and (iii) the fragile states and communities team.
- The Measurement team will be expanded to enable both FSDA and the FSD Network to better determine collective impact and drive learning and programme adaptation. A data management function will systematise data collection and assure data integrity. An evidence mainstreaming function will analyse data and ensure insights are captured. A technical assistance function will provide support to FSDA and FSD Network teams. In addition, FSDA will enter into a contractual, institutional relationship with an independent entity (i.e. a university or consulting firm) to ensure there is independent oversight of FSDA's measurement effort and that FSDA has regular access to technical support.

FSDA will strengthen existing FSD Network support activities into a new unit to host, manage and coordinate new forms of technical and operational collaboration between FSDs. The FSD Network Delivery Unit will coordinate and drive the planning and delivery of new collaborative work between FSDs. It will also: (i) host and manage the FSD Academy (the FSD Network's internal skills development unit) and FSD Network-orientated communications work; (ii) provide support to the FSD Network Council as it administers new governance arrangements; and (iii) engage new potential funders who may be interested in working with the FSD Network as a whole.

FSDA will invest in its operational functions, in-housing resources where appropriate and ensuring it can deliver shared services on behalf of the FSD Network. The hire of a Chief Financial Officer (CFO) in October 2019 has already created momentum behind the build-out of a financial management unit (currently outsourced), which will include finance, legal, internal audit, company secretary and risk functions. A new Corporate Services unit will host human resources, IT, administration and procurement functions.

Table 2. Proposed Interventions by DFID Priority Theme

Theme	Proposed Activity	Rationale for DFID intervention
Investment *(SDG Inclusive Growth Cluster)*	• New investments by FSDAi investment • Catalysing investment through instruments such as green bonds and Real Estate Investment Trusts • Reducing investment risk through insurance (or insurance-like) products • Policy and regulatory work	• Encouraging innovation and competition in financial markets • Creating demonstration investments and transactions • Mobilising third party capital, especially local capital in local currency • Creating investment products for local pension funds and other institutional investors • Creating regulatory certainty for investors; stronger investment climate and so synergistic with other UK funding entities' interests (e.g. CDC) or DIT • Job creation • Additionality – relatively few donors are involved in capital market development. Opportunity for thought leadership across donor community
Inclusion *(Basic services Cluster)*	• Fragile states and communities – strategies targeting the most excluded and vulnerable • Building better data on credit markets • Housing finance innovation	• "Leave no one behind" – household resilience • Ensuring developmentally important sectors (housing, agriculture etc.) are better understood for policy-making and regulatory purposes • Reduce costs of cross-border trade • Ensuring SSA retains access to international financial system

	● Regional financial sector integration, including cross-border banking integration	
Integrity and stability *(Inclusive growth cluster)*	● Illicit capital ● Credit market development and responsible credit ● Capital and money market development	● Unstable financial markets are hugely costly for society; failed financial systems affect the poor the most ● Financial systems that lack integrity are unstable ● Financial crime directly affects UK interests ● Better functioning and more transparent credit markets assure investment and job creation while reducing risks of overindebtedness and predatory lending ● Capital markets improve governance standards ● Money markets (the interbank market) provide liquidity to financial institutions and so act as a safety valve
Innovation *(Inclusive growth cluster)*	● Regulating for innovation in capital markets, enterprise finance and insurance ● Enterprise finance pilots ● Insurance sector innovation	● UK fintech and regulatory expertise can be mobilised ● More innovation leads to more competition and better, and more affordable, choices for consumers ● More credit, delivered through innovative channels, to small businesses increases demand for jobs ● UK insurance sector expertise can be mobilised ● Insurance can crowd in investment and build resilience

LOCAL GOVERNANCE ARRANGEMENTS

Oversight is provided by a Board, which includes non-executive directors (NEDs), with an investment, banking, development, and critically African market knowledge and expertise. The Board is supported by four committees: an Investment Committee, a Development Committee, Finance, Audit and Risk Committee and a Nominations and Remuneration Committee. CDC is represented on the Investment Committee, bringing synergies across the respective portfolios.

DFID has strong oversight of FSDA and FSDAi. The DFID SRO sits on both the Board and all Board Committees. As the sole member of the parent company, DFID also has ultimate veto and can shape the strategic direction of FSDA, as well as appoint and remove directors. The DFID shareholder representative is separate from the DFID SRO of the programme to avoid any conflicts of interest.

The Financial Audit and Risk Committee (FARC), provides oversight of FSD Africa's audit and risk functions. These functions are being actively strengthened. The procurement of an Enterprise Resource Planning (ERP) system has been approved. This will systematise procurement and payments.

COLLABORATION WITH THE FSD NETWORK

FSDA is committed to contributing 20% of its annual budget to collaborative programming with other FSDs. High priorities for this contribution include: climate, youth, housing and the marginalised.

EXPECTED RESULTS

Indicator definition	2 years	5 years
# jobs (informal/formal employment, livelihoods and microenterprise) created or improved/sustained through FSD-supported initiatives, whose average earnings are (i) above the national minimum wage, and (ii) 20% above baseline	6,700	22,000
# people facilitated to access basic services	237,000	804,000
# people with improved access to financial services	712,000	4m
# businesses (informal micro/small enterprises and formal micro/small enterprises) with improved access to financial services"	475,000	2.7m
Private and public co-investment mobilised (£ million)	17.8	43.1
Number of policies and regulations developed or refined through FSD Africa support	7	22

THE PROFILE OF ESTIMATED COSTS*

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
Thematic area	**£ m**	**£ m**	**£ m**	**£ m**	**£ m**	**£ m**
Finance for investment	6.9	7.5	8.2	6.0	5.2	33.8
Financial access	4.2	6.6	6.1	4.5	4.2	25.5
Financial stability	1.1	1.5	1.8	1.4	1.3	7.2
Financial innovation	0.3	0.3	0.4	0.4	0.4	1.8
Financial integrity	0.2	0.2	0.5	0.3	0.0	1.2
Programme spend	**12.4**	**15.7**	**16.5**	**12.5**	**10.9**	**69.6**
Overhead	2.4	2.9	3.2	3.2	3.3	15.0
MRM	1.1	1.0	1.1	1.1	1.1	5.4
Grand Total	**16.1**	**20.0**	**21.1**	**17.0**	**15.8**	**90.0**

** Some budget figures from tables have been rounded for presentational purposes. The accompanying spreadsheet has the precise budget figures*

DFID ADVISOR AND PROGRAMME MANAGEMENT RESOURCING

0.7 x A1 Senior Adviser

0.10 x 3 A2 Advisers in Financial Services Team

0.6 x B1 Programme Manager

0.7 x B2 Programme Officer

Annexe 1b. Access to Finance Rwanda

COUNTRY'S FINANCIAL DEVELOPMENT STAGE

Rwanda's growth over the past 15 years has been remarkable. Rwanda has risen from the second poorest country on the continent during the first half of the 90s to a GDP per capita position which places it ahead of more than 20 countries in the region. Poverty rates have fallen from 77.2% in 2001 to 55.5% in 2017.

Financial sector development has played an important role in Rwanda's growth trajectory. Rwanda has a relatively diversified financial structure compared to the size of its economy. As of June 2018, the formal financial sector consisted of 527 institutions – 16 banks, 473 MFIs, 16 insurers, 11 pension funds, and 11 active venture funds or angel investors.[27] The sector is dominated by commercial banks, which account for approximately two-thirds of financial sector assets (65.5%) followed by the pension funds, insurance companies, and microfinance institutions (MFIs). An insurance penetration[28] of 1.7% underlines the sector's underdevelopment, especially if compared against South Africa, the continental leader with an insurance penetration of 11.8%, and Kenya, the EAC leader with an insurance penetration of 2.6%. The capital market was launched in 2011 and is still nascent. It offers equity (currently eight listed companies) and very limited debt instruments outside of government bonds.

Rwanda has made significant progress on financial inclusion over the last 10 years. 89% of the adult population (or 5.2m adults) were financially included in 2016 compared to 48% in 2008 (Figure 1). While only 26% of the population is banked, mobile money and the non-bank financial sector have driven much of the increase in formal inclusion.[29] Whilst formal access to finance has increased overall (from 21% in 2008 to 68% in 2016), the usage of formal products has seen a far greater variability and an unevenness in adoption. In addition to this, 72% of the adult population still relies on informal mechanisms such as savings groups to meet their financial needs.

Whilst access is important, the breadth of access and usage needs to be enhanced to ensure that Rwandan households and businesses are resilient to shocks and able to contribute and benefit from economic growth. Thus, while 68% Rwandans are formally included, only 40% of all Rwandans are "broadly" served, defined as using two or more financial services categories such as payments, savings, credit, or insurance *(source: Finscope 2016)*.

Rwanda has demonstrated a real appetite to catch up and embrace modern technologies and innovation. Payment system infrastructure has been undergoing a process of modernization and the government is pushing towards becoming a "cashless economy." The number of ATMs and POS terminals has increased in recent years, and mobile money providers have started to play a significant role in facilitating payments, savings, and credit in partnership with formal financial institutions. Ten banks and one MFI currently offer mobile banking services, and growth in mobile money agents is providing easy access to previously excluded segments. The share of mobile phone subscribers that make use of mobile money services rose to 40% - or nearly 33% of Rwandan residents - by 2018.

Despite impressive aggregate financial inclusion trends, patterns of marginalization and unequal access to finance have started to become more pronounced. Geography plays a role, with a significant variation in the level of financial inclusion among provinces. In addition, the likelihood of being amongst the 11% (0.7m) of Rwandans that are excluded increases if individuals fall into groups such as women, youth (aged 16 to 17), the elderly (60 years and above), people whose main income is from piecework, and those without formal education.

The positive trends in financial sector depth and financial inclusion are yet to translate into adequate financing of the private sector. Despite considerable growth in market players and assets (which have expanded from

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[27] *These include: Beyond Capital, The Howard G. Buffett Foundation, The Sorensen Impact Foundation, The Blue Haven Initiative, DOB Equity, The Medical Credit Fund, MCE Social Capital, Greentec Capital Partners, The Acumen Fund, The Voxtra East Africa Agribusiness Fund and The IGNITE Fund.*

[28] *Gross written premiums as a percentage of GDP*

[29] *Microfinance institutions (MFIs and SACCOS) have the widest reach of all formal financial institutions across the country. Through their cross-country penetration, MFIs have proven to be critical enablers of financial inclusion, especially for the rural population. As at June 2018, the microfinance sector consisted of 473 institutions, consisting of: 416 Umurenge SACCOs (U-SACCOs), 38 non-Umurenge SACCOs and 19 SACCOs with limited liabilities.*

33.8% of GDP to 54.3% in 2017) driven by the government and regulators' efforts to promote financial sector development, access to finance remains a major constraint to enterprises. Domestic credit has been stagnating at around 20% of GDP, well below the SSA average of 47%, and Kenya the regional leader. In addition, financial products remain traditional and credit is highly-concentrated in a small number of sectors, notably real estate. Agriculture, the sector which still employs about 70% of the population, receives credit amounting to less than 2% of GDP.

Rwanda has demonstrated strong management to ensure macro- and financial sector stability. Rwanda's public investment-driven growth had rapidly increased debt from 20% in 2012 to 50% of GDP by 2019. This remains within the IMF and WB threshold for low risk of debt distress. Despite this trajectory a recently agreed IMF policy support instrument is granting higher deficit ceilings.[30] This stresses the need to sustain high growth and to maximise return from strategic investment projects. A new banking law came into action in 2017. This provides the foundation for compliance with the Basel supervision principles and despite contextual realities, Rwanda has rapidly adopted Basel II&III banking standards. While the sector remains stable and sound, the banking sector's exposure to mortgages (35% of credit) remains the main risk due to low occupancy rates of commercial real estate and the increased supply of high- and middle-income housing. Risks of high household debt remain minimal. The performance of private insurers on both solvency and profitability has been extremely poor up to 2017 at which point the central bank put in place remedial measures to prevent excessive price competition on the very limited number of traditional - and mostly mandated - insurance products (e.g., automotive insurance).

Figure 1: Sectoral Distribution of Loans

FSD PROGRAMME, ACHIEVEMENTS AND LESSONS TO DATE

DFID Rwanda has invested a total of £17m in the Access to Finance Rwanda (AFR) programme since 2010, and an additional £4m will be disbursed up to January 2021, when AFR's second phase will come to an end. AFR's current phase started in 2016 and has a total funding envelope of $31m which is supported by MasterCard Foundation, Swedish International Development Cooperation Agency (SIDA), and USAID alongside DFID.

AFR is perceived by stakeholders as a strong supporter and facilitator of financial inclusion, especially for low-income households and hard-to-reach groups. AFR has successfully supported financial sector players to develop and test new business ideas. This has led to a diverse portfolio of more than 25 projects that have strengthened the core and supporting function of the financial sector as well as conducive and prudent regulatory change. AFR is respected for its role as a provider of market intelligence, specifically via the Finscope survey and other research and market studies which have fed into the development of interventions or been leveraged to convene stakeholder discussions around integration or regulatory change.

Overall, AFR has incentivised and supported market players to expand access to an additional 1.5m clients between 2010 and mid-2019. AFR has played a significant role in strengthening non-bank financial institutions and community-based finance models to support underserved groups. Examples include:

- Infrastructure and technical support to enhance service delivery and oversight of SACCOs
- Promotion of linkages of informal savings groups to the financial sector
- Private sector incentives for financial inclusion of women and refugees.

While AFR has not managed to significantly shift the needle on aggregate credit flowing into the agricultural sector, the programme has successfully piloted models which have helped Financial Service Providers (FSPs) to better understand and service the sector. These **agricultural value chain financing initiatives** have included

[30] *A 5.5% five year rolling average instead of a 3% deficit which will allow the present value of debt to converge to 50% of GDP*

support for the establishment of dedicated agricultural lending units as well as the introduction of digital platforms to overcome information asymmetries in selected value chains. Both types of initiatives have increased agricultural loan portfolios of participating FSPs and a more tailored product offer has led to productivity and business growth for borrowers (mainly microentrepreneurs and cooperatives).

On **digital innovation**, AFR's support and industry guidance on interoperability and agency banking has the potential to be particularly transformative. If successful, this initiative would fundamentally change the customer experience with regards to financial services. Similarly, it has the potential to facilitate a significant shift from informal and semi-formal financial mechanisms to formal options.

Work on **resilience** has focused on inclusive insurance and the establishment of a long-term savings scheme. Against a background of low innovation appetite and skills, AFR's challenge fund, technical assistance, as well as regulatory advice, has led to Rwanda's first microinsurance product being launched last year. The AFR supported national long-term savings scheme was launched in 2018 and provides the first mechanism for all Rwandans, including formal and informal sector workers, to save for old age and to mitigate against shocks. The scheme also has the potential to strengthen Rwanda's aggregate savings rate while contributing towards enhanced financial intermediation.

In-house technical thought leadership is key for market development programmes. Occasionally, AFR has struggled to attract the right talent for key leadership and advisory positions. Consequently, the team has been stretched and the quality of work has at times varied in line with downstream suppliers. Market facilitation also requires excellent influencing skills and tactics. While the programme has a number of strong examples, political economy analysis and tailored influencing approaches will have to be strengthened and fully embedded across the organization.

The deepening of the M4P approach into the programme, as well as efforts to better integrate MRM and technical functions, has over the past year meant that interventions are more consistently being assessed with a market system focus. This also means that evaluations are being undertaken to support and scale up interventions that have the ability to deliver significant systemic change to Rwanda's financial market system. In this respect, AFR has leveraged the FSD Network's expertise to strengthen its results management system (including its overall theory of change).

AFR has also sought successful thematic network collaborations to leverage additional expertise. One example is AFR's refugee project which emanated from a topical FSD Africa initiative. AFR has also tapped into FSD Africa's capital market expertise to commission work on the enabling environment for asset-backed securities and to assess the feasibility of supporting such transactions in housing and energy.

Specific technical expertise in AFR encompasses financially-inclusive G2P payment systems, interoperable payment systems, community-based finance, and microfinance sector support.

WHAT MORE NEEDS TO BE DONE?

Rwanda's medium- to long-term objective is to sustain strong growth while also meeting poverty reduction and shared prosperity objectives. Rwanda's ambition is to reach lower-middle-income status by 2024 and upper-middle-income by 2035. To achieve this, investment levels will need to increase beyond the current rate of 25%, to which the private sector is contributing a modest six to 8% of GDP. To drive this process, the Government introduced the National Strategy for Transformation and Prosperity, with the aim of creating 1.5m decent and productive jobs by 2024, and significantly increasing domestic savings and investment rates.

However, in recent years, growth has become less labour intensive, as investment has mainly targeted capital-intensive sectors which are only expected to generate returns in the long-term. **As a result, the supply of off-farm jobs is not keeping up with demand, and combined with low-productivity growth, this has slowed down economic transformation. In addition, low agricultural productivity and more frequent climate events pose livelihood risk to 92% of the poor who live in rural areas.** These developments have made poverty reduction less responsive to growth than in other strong-performing countries, and the poverty rate, as defined by the international poverty line of US$1.90 a day, is higher in Rwanda than in many of its regional peers with similar incomes. Ensuring that growth is pro-poor is thus a critical priority for Rwanda.

Against this background there is a need for the financial sector to: (a) more effectively mobilise investment into sectors that can become drivers of economic transformation[31] while reducing access to finance barriers for enterprises, and (b) put in place and strengthen mechanisms to ensure household resilience as well as a step change in meaningful financial inclusion for marginalised and vulnerable groups (mainly poorer rural women, youth, refugees, and people with disabilities).

Growth diagnostic work has confirmed that financial sector development can best support inclusive growth and improved sustainability by focusing on finance for investment in agriculture and light manufacturing.[32] Both sectors are currently starved for finance while having the potential to deliver significant "pro-poor" growth. Agriculture employs 70% of the population while manufacturing has the potential to create low-skilled, off-farm jobs at scale. The capital-to-labour ratio of both sectors is relatively low and adequate financing will raise exports and productivity while creating additional and more productive jobs. **More broadly, the financial sector needs to start serving enterprises in an adequate manner**. Access to finance is the number one constraint reported in enterprise surveys. This manifests through excessive collateral requirements and limited access to long-term credit and working capital finance from banks. This requires firms to resort to financing their investments through savings, equity, short-term products, or informal means. High operating cost, sectoral risk exposure, and a steep government bond yield curve is keeping interest rate spreads high while the short-term nature of the bank's main funding source (deposits) constrains the tenor of loans.

To drive progress, financial intermediation needs to be enhanced to better channel savings into these critical investment areas. To that end, insurance and pension markets need to be deepened. Players should be supported to develop adequate investment instruments for insurance and asset management. The gradual development of a commercial local currency debt market and the support of an enabling environment for more sophisticated products - such as asset-backed securities - will provide investment funds and life insurers with the option to contribute to Rwanda's economic transformation. **In addition**, enhanced value chain finance, leasing models, increased use of the capital markets, and new types of investors will help provide a more tailored financial offer to enterprises in different stages of their development. Financial technology, data-driven risk-based loan assessments, efficient guarantee schemes, and insurance will also go a long way in easing access to finance constraints for enterprises. In addition, the development of green finance solutions will enhance the sustainability of investments.

Secondly, there is a need to drive more meaningful financial inclusion and resilience. This can be achieved by: tackling marginalization; facilitating a formalisation of financial inclusion; and driving increased usage of different financial products, most notably those supporting poor households to evolve from consumption-smoothing to sustainably-increasing incomes. Marginalization will have to be tackled by understanding and addressing geographical, gender, age, and financial inclusion gaps of vulnerable groups such as persons with disabilities and refugees. While technology, savings, loan, and insurance products will play a significant role, a sectoral focus on affordable housing finance has the potential to significantly improve basic services of poorer-consumption quintiles.

While the lion's share of support on financial stability and integrity is covered by partners such as the IMF and the WB, there is need for AFR's continued support of the regulator. This, specifically, applies to research and advice on regulation which is safeguarding consumers and conducive for market entry, expansion, and innovation. Another cross-cutting need is a continued focus on research- and data-driven innovation.

Access to finance has been confirmed as the main cross-cutting constraint in DFID Rwanda's recent country development diagnostic. The suggested shift in focus is supportive and complementary of DFID Rwanda's economic development portfolio, which seeks to support economic transformation by supporting off-farm job creation in tradable and export-friendly sectors, well-managed urbanization processes, and increased agricultural productivity. In addition, the office is supporting a poverty graduation model and financial inclusion of the poorest population quintiles will enhance resilience and growth transmission mechanisms.

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[31] *Sectors with the potential to generate substantive levels of: foreign exchange (overcoming supply-side problems on material balances), demand (overcoming demand-side problems at right exchange rate), economies of scale (lowering cost of unit production), learning (imported technology, production methods, on-the-job), employment (labour-intensive), revenues (ability to tax large firms that are easy to monitor), spill-overs*

[32] *Electronics assembly, pharmaceutical, soaps & detergents, packaging materials, wooden furniture, and insecticides as well as textiles and garments*

Currently there are two programmes with a similar mandate to AFR. However, there is no guarantee that these programmes will continue or would be able to fill AFR's space. DFID is well placed to support AFR to transition into this new strategy while maximising lessons learnt and synergies between AFR's efforts and DFID's broader portfolio. **A key risk is for AFR to spread themselves too thinly across a wide range of areas** which require in-house technical expertise. To mitigate against this risk, we will incentivise and support AFR to attract and retain the right talent in the two sectoral focus areas (agri-processing and manufacturing) as well as in relevant technical areas such as enterprise finance, regulation, innovation and technology, insurance, community-based finance, and research. In other areas we are not expecting AFR to become thought leaders, but we will aim to make some contributions to green finance through the broader enterprise work, as well as though network collaborations on capital market development, green finance, and affordable housing. Youth will remain an AFR focus and a further area for network collaborations.

PROPOSED INTERVENTIONS UNDER FSD 2.0

The table proposes a number of indicative interventions areas and activities which will have to be confirmed and amended after a more in-depth analysis of constraints, opportunities, and comparative advantage. This proposed draft strategy responds both to the five strategic shifts of the DFID Financial Sector development refresh (see brackets after headings of proposed intervention areas), as well as the SDG outcome focus of FSD 2.0. (see brackets after objective description).

1. Intervention area	Agricultural value chains *(investment, inclusion, innovation)*
Objective	Increase productivity and value addition of agricultural value chains with the potential to grow farms, agro-processors and other enterprises resulting in job creation and higher incomes using sustainable methods. *(Inclusive growth and sustainable futures)*
Sample activities	- Ease regulatory constraints to improve lending for the agri-processing sector: Evaluate the enforcement of creditor rights to drive private sector lending - Strengthen the capacity of FSPs to assess and lend to the agri-processing sector: Build business models for lending to agri- processing and incentivise broader market uptake, train FSPs on risk evaluation and management tools, TA on process redesign for major FSPs, enhancing credit facility for asset and working capital financing, piloting various financial instruments applicable for agri-processing, setting up of a collateral registry - Use data to improve ability of FSPs to cater to the agri-processing sector: Incentivise private sector-led digitization of value chains, and provide TA to integrate credit reference bureau into bank's decision making
2. Intervention area	Light manufacturing *(Investment, Inclusion, Innovation)*
Objective	Increase off-farm job creation by boosting lending to the light manufacturing sector *(inclusive growth and sustainable futures)*
Sample activities	- Enable lending to the light manufacturing sector by unblocking policy and regulatory constraints: Detail regulations while also removing unnecessary high-prudential regulations and providing clarity (for example on tax) on trade financing, evaluating the impact of regulations on plastic on the competitiveness of Rwandan packaging industry, support Export Growth Fund in intermediating the growing saving stock from pension funds and insurance companies into long-term, affordable credit to private sector - Increase capacity building for FSPs to lend to light manufacturing: Pilot new financial products for light manufacturing (such as leasing) that moves away from products relying on collateralized credit; build capacity in banks to undertake risk

	assessment of light manufacturing SMEs; learn from regional experience in industrial finance intermediation
3. Intervention area	Affordable housing *(Investment, Inclusion, Innovation)*
Objective	Develop financial solutions for the housing market on both the supply and demand side to provide growth opportunities for local enterprises, create jobs, and increase appropriate housing options for low-income people. *(Inclusive growth, basic services & sustainable futures)*
Sample activities	- In partnership with the Centre for Affordable Housing Finance in Africa (CAHF), identify the key financial gaps preventing the production, maintenance, and purchase of affordable housing. Activities could include: developing prototypical bankable projects for low-income housing that target housing the lowest quintile(s); building banking capacity to develop financial products for both supply- and demand-side users of low-income housing; building capacity of banks/housing finance institutions and SACCOs to invest in low-income housing; and reviewing options for long-term funding for housing
4. Intervention area	Digital finance *(inclusion, innovation, stability)*
Objective	To build on the gains in the digital finance and fintech landscape, to help formalise financial inclusion, and to drive increased usage by the youth as well as marginalised and vulnerable groups while protecting users from inappropriate market conduct *(inclusive growth and basic services)*
Sample activities	- Support innovations around digital microinsurance products; advise and support with PPP for inclusive payment platforms; creation of an innovation environment through the strengthening of the regulatory sandboxes and innovation competitions to reach marginalised groups; work with regulators to develop appropriate market conduct, integrity, data privacy; and open finance policies and regulations

Local Governance Arrangements

AFR is a locally registered non for-profit company limited by guarantee. KPMG and DFID are the company's legal members, and DFID performs the role on behalf of AFR's development partners. Funders have signed a memorandum of understanding which confirms that DFID will only exercise member rights and duties in agreement with all funders. DFID chairs AFR's board and sits on the investment committee.

EXPECTED RESULTS

	Results category	Indicator	2 year	4 year (24/25)
1	Jobs - SDG 8	# jobs (informal/formal employment, livelihoods and micro-enterprise) created or improved/sustained through FSD-supported initiatives, whose average earnings are (i) above the national minimum wage, and (ii) 20% above baseline	1,838	20,000
2	Access to basic services - SDG 1	# people facilitated to access basic services Disaggregated by: country, gender	4,900	1,720

3	Financial Sector Development - SDG 8	# of people with improved access to financial services Disaggregated by: country, gender, age	14,700	333,333
4	Financial Sector Development - SDG 9	# of businesses with improved access to financial services Disaggregated by: country, and gender and age of proprietor	9,800	10,000
5	Financial Sector Development	Private and public co-investment mobilised (£m) Disaggregate by: tenure (short-term and long-term investment); source of investment (local and foreign, private and public)	£0.72m	£5.85m
6	Financial Sector Development	Number of policies and regulations developed through FSD support		4

THE PROFILE OF ESTIMATED COSTS

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£ m	£ m	£ m	£ m	£ m	£ m
Finance for investment		0.28	0.83	1.10	0.55	2.76
Financial access		0.09	0.27	0.36	0.18	0.90
Financial infrastructure for innovation		0.07	0.22	0.29	0.14	0.72
Financial stability		0.03	0.09	0.12	0.06	0.30
Financial integrity		0.01	0.04	0.05	0.02	0.12
Monitoring & Results Measurement		0.06	0.08	0.09	0.07	0.30
Programme Management for services retained by Country FSD		0.18	0.21	0.23	0.20	0.82
Total retained by FSD		**0.72**	**1.73**	**2.24**	**1.23**	**5.93**
Centralised services shared overhead		0.010	0.021	0.027	0.016	0.075
Grand Total		**0.735**	**1.755**	**2.265**	**1.245**	**6.00**
Programmatic funding split:						
Country core		0.333	1.089	1.467	0.711	3.60
Collaborative working		0.147	0.351	0.453	0.249	1.20

RESOURCES

The Country Office commits to support this jointly managed programme with 15-20% of the time of an economic/PSD advisor.

Annexe 1c. FSD Ethiopia

COUNTRY'S FINANCIAL DEVELOPMENT STAGE

Ethiopia has had nearly two decades of double-digit GDP growth. This has mostly been driven by heavy public debt-financed investment in infrastructure and "mega projects". The *developmental state* model previously pursued saw major consolidation of the economy in state and parastatal economic entities with limited private sector participation. The current administration is looking to open-up the economy, including divesting of State-Owned Enterprises (SOEs), as it seeks to pursue more private sector driven growth.

The financial sector needs to undergo major reform to support the economic reform agenda. It was primarily set-up to finance the investment programme of the SOEs and mega projects, with banks mandated to purchase Government debt. As a result, the private sector struggles for access to finance as roughly two-thirds of the asset base is controlled by state banks (which primarily finance state projects) and foreign sources of debt capital are only permitted for the state.

Ethiopia's financial sector is highly uncompetitive, and its institutions are weak when compared to others in the region. There are 16 commercial banks (in addition to the 2 State Owned banks) but the market is segmented, with **banks largely protected from external competition**. There are 17 insurance companies, but **insurance penetration is extremely low**. Due to regulatory, technical and business constraints, product innovation is low and use of non-traditional distribution opportunities is limited.

Despite the expansionary fiscal policy, public debt remains around 60% of GDP. However, underperforming exports, high levels of imports and currency controls means a significant lack of Forex (cited as the number one barrier for businesses). This has also led to the IMF rating **Ethiopia's external debt burden as a high risk of distress**. Inflation has also remained high (average of 15% from 2005-19), with the resulting **negative interest rates further discouraging financial savings**.

The **capital market is virtually non-existent**, with no supporting infrastructure. There is no stock exchange for facilitating equity investments, no clear market price for public or private sector debt. The limited availability of long-term finance from capital markets is further compounded by limited private sector participation in the pension sector, and limited investment options for pension funds. Currently, pension fund agencies are required to invest solely in government securities.

A financial sector roadmap is being developed with support from the World Bank and should give Ethiopia a blueprint to transform towards a more market-based allocative financial system. While we don't expect to see an easing-up of the restriction on foreign banks, we have seen some reform from the central bank, such as a newly appointed leadership and board, the permission for a foreign leasing firm to enter the market, permission for diaspora Ethiopians to own shares in banks and the formation of Islamic banks. Meanwhile, proposals to tackle the forex crisis are being developed and the development of a capital market is being pursued under the roadmap.

Financial inclusion has been on the agenda but with little progress seen to-date. Financial inclusion is lower than elsewhere in SSA (35% of Ethiopian adults have an account at a Financial Institution compared to 43% across SSA). Under the government's intention to create a digital economy there has been a push on the central bank for reforms in this area. Together with the process of liberalising the telecommunications sector, we should see increased investment and market activity around financial inclusion, creating a need for an FSD to support the process.

To enable the shift from state to private sector driven growth, **it is necessary to deepen the breadth and depth of Ethiopia's domestic financial sector** and set up mechanisms and instruments that enable foreign sources of capital for investment in domestic businesses.

FSD PROGRAMME, ACHIEVEMENTS AND LESSONS TO DATE

There is no FSD in Ethiopia, though the DFID funded PEPE programme has had a financial sector component (delivered by Enterprise Partners). This delivered;

(a) TA support to help mobilise $400m of WB credit lines for women entrepreneurs and lease financing innovations
(b) Innovative models of reaching the unbanked including developing a pilot for bank-issuance of IDs
(c) A financial education and marketing tool for banks specifically targeted at women

(d) Unblocked large-scale investment by private equity and DFI investors via a private capital facility for local businesses
(e) Supported investment promotion efforts of the investment commission, which unlocked significant investments by FDIs in manufacturing.

A key lesson learnt has been the benefit of *blending finance and real economy* approaches in one programme, especially in the area of financial sector contribution to job creation (SME Finance, manufacturing, trade finance, housing finance).

WHAT MORE NEEDS TO BE DONE?

Ethiopia still has very low financial inclusion. Efforts to develop the important agricultural sector (31% GDP/ 66% employment) hinge on the presence of financially-included farmers, both in terms of developing agricultural markets (input and output markets) as well as making on-farm investments (e.g. irrigation). Reaching the last miles of financially-excluded populations should go hand-in-hand with rural and agricultural development initiatives.

Ethiopia's government has bet big on manufacturing and Ethiopia appears to be the front-runner for Asian manufacturers to "test-out" whether manufacturing in Africa can drive down costs. As a result, major firm-level investments in SMEs and ancillary urban sectors will be needed to ensure that the industrial parks don't become "duty-free enclaves". Meanwhile, regional cooperation via trade corridors (e.g. for textiles) will be key to developing economies of scale needed for an African manufacturing sector to become competitive.

Financing urban development will be key as Ethiopia rapidly urbanises (5.4% urbanisation rate per annum according to the World Bank). Innovative financing and payment approaches that bring the private sector into this space can help resolve many growing pains (housing, transportation, utilities) currently being experienced in industrial hubs like Hawassa.

Financial sector development

The GoE has indicated **a strong willingness for financial and economic reform** including; the agreement to privatise several State-Owned-Enterprises, the establishment of a PPP directorate and associated pipeline of projects, and a commitment to a clear pathway for market-determined pricing of government bonds (planned for end of 2019).

While the proposed actions will all look to facilitate poverty reduction in Africa's second most populous country, they also **align well with the wider UK Government strategy**, which sees increasing opportunities for UK trade (£370m in 2017) and investment (UK is no.1 G7 investor in Ethiopia) from a financial system more open to private sector and external finance.

The **key constraints** for the financial sector are;

***Lack of skills and weak regulatory environment*:** The Central Bank lacks independence from GoE and lacks adequate capacity at all levels. The closed nature of the Ethiopian economy means there is a skills deficiency across all actors in the financial ecosystem.

A regulatory environment shaped for cheap sovereign debt rather than private sector investment: Banks are currently required to purchase government bonds in proportion to their commercial loan book, resulting in cheap sovereign borrowing. However, it also means less lending to the private sector. Private sector credit relative to GDP is 9% in Ethiopia compared to 20% in sub-Saharan Africa. There's little or no inter-bank lending, limiting the stock of capital available for the private sector.

***Domination of state-owned banks*:** The two state-owned banks (SOBs) represent c. 69% of total banking assets. Appointments of officials and loan beneficiaries are often politically motivated, the combination of which has led to poor project selection, weak risk management and a concentration in asset portfolio composition in some SOEs. This has created significant risks and vulnerabilities in the system; non-performing loans (NPLs) in the state banks are in excess of 40%.

***Lack of suitable innovative products from banks and other financial players*:** Ethiopia's banks face little competition and are providing a limited range of services; mostly simple deposit accounts, short-term loans, guarantees and letters of credit for importers. Thus, the financial ecosystem does not adequately provide finance for SMEs and there are no capital markets to enable the expansion of larger corporates. Less than 1% of adults use mobile money and use of loans, savings and insurance is much lower than regional comparators.

Key opportunities to act;

Building on the PEPE programme, DFID Ethiopia has agreed a £1.5m programme of support (implemented by FSD Africa) from September 2019 until December 2020. This will focus on diagnostics in the areas of;

(a) Equity markets, including the establishment of a stock exchange
(b) Credit markets, including provision of market statistics and pricing strategies
(c) Money markets, including support for greater inter-bank lending
(d) Regulating for innovation, including mobile money
(e) Pension funds – improving the efficiency and coverage of pension systems and broadening their investment options.

Outputs from the diagnostics will inform the detailed design of the programme beyond December 2020. We think the most likely interventions will be focussed on;

- **Driving institutional reforms across key institutions**, notably the central bank. This will support the current political push for economic reforms, seeking to ensure institutions and structures strike an appropriate balance between providing a supervisory function and promoting the development of the financial sector.
- **Improving firm level access to productive finance** - including development of credit markets and capital markets
- **Improving financial inclusion for the most marginalised**.

The interventions above will be designed and delivered to support real economy outcomes, particularly in the areas of **agriculture, manufacturing and urban development.**

Additionality of FSD programming in Ethiopia

The **World Bank are the most active development partner** in this area and are looking to drive significant change through a ($1.2bn) Development Policy Loan with conditions related to financial sector reform, including the establishment of capital and government bond markets.

The Ethiopian government has requested DFID to support its financial sector reform efforts. DFID is supporting sector reforms through World Bank and IMF Trust funds which are providing advisers to the Ministry of Finance and Central Bank on privatisation, treasury bond issuance and a review of assets (mostly of SOEs). Other development partners active in the country include UNCDF, Better than Cash Alliance, Mastercard and Gates Foundations on; financial inclusion, mobile money and SME credit.

DFID with UNCDF, Gates Foundation and World Bank initiated discussions with the central bank to set up a Development Partners' Working Group on Financial Inclusion (DPWG) as a platform for exchanging information and coordinating financial inclusion interventions in Ethiopia. Through the governance arrangements of the DFID-supported start-up programme implemented through FSD Africa, we will look to develop a more formal mechanism to ensure development partners remain coordinated and aligned to Government's ambition going forward.

In a country with significant political and economic changes, an in-country programme will enable flexibility and agility in responding to Government priorities, while ensuring alignment of interventions with local context.

Notable risks include;

***Debt sustainability*:** Moving to market-determined money and bond markets poses a risk in terms of debt-sustainability and macroeconomic stability.

Lack of skills capacity in institutions: There is a risk that with the magnitude of reforms being pursued, the structural reforms get ahead of the capacity and skills of the individuals and institutions – both in the public and private sector.

Political risk: Delivering the necessary reforms will require strong political leadership. Prime Minister Abiy has shown strong support for such reforms, although it is a risk that this support wanes or there is a change of leadership (elections scheduled for 2020). There is also a risk in the Central Bank, as the main institution driving financial sector reforms.

Mitigation: The above risks will be managed through a measured approach to reforms. Interventions will be designed with flexibility in terms of both timeframes and approaches taken, with extensive monitoring providing evidence as to when changes are needed. Wider advocacy and support on the need for fiscal prudence will also reduce debt sustainability risks.

PROPOSED INTERVENTIONS UNDER FSD 2.0

The specific proposed interventions are aligned to the five strategic themes of the DFID Financial Sector Development refresh, as summarised below:

Intervention and Theme	Proposed Activities	Rationale for DFID intervention
Institutional support for policy and regulatory reform **Themes:** - Financial stability - Financial integrity	- Capacity building of key institutions in the financial sector i.e. NBE, Ministry of Finance and possibly, Prime Minister's Office. - Technical assistance (TA) for: a review of regulatory architecture, institutional capacity assessments, strategy development processes (e.g. a masterplan for capital markets, a national climate finance strategy), regulatory impact assessments. - Technical assistance support for short-term and long-term advisers, including embedded advisers. - Facilitation of conferences and workshops involving public and private sector actors, as well as development partners, to build consensus on reform processes.	Building the capacity of key institutions will support decision-making on foundational policy, regulatory and institutional questions for the future of the financial sector in Ethiopia.
Increase access to productive capital for firms **Themes:** - Finance for investment - Financial stability	**Capital market development:** - Support the development of policies and regulations for the establishment of a stock market, support operationalisation of the stock market by building the capacity of potential issuers and market intermediaries. - TA to regulators in determining appropriate regulatory models, supervision and in navigating technical and fiscal challenges. - TA for implementation of pension sector reforms, including diversified investment of pension funds, and support to regulators in oversight of pension fund investments. - TA to the government and market actors in issuance of climate-friendly investment instruments e.g. green bonds. **Credit market development:** - TA to NBE in implementation of a credit monitoring programme. - TA to NBE in regulation and supervision of credit markets, including design and implementation of a consumer protection framework. - Design, implementation and monitoring of partial credit guarantee schemes for priority sectors. - TA to the regulator in supporting the development of alternative financing models e.g. private equity and venture capital and for innovative fundraising models e.g. crowdfunding. - TA for policy and regulatory reform, strengthening of financial infrastructure and developing capacity of FSPs in green finance and alternative SME finance models e.g. leasing, factoring, energy finance, gender finance, supply chain and value chain finance.	- Capital markets are needed to mobilise, channel and accumulate long-term, local currency finance for investment in real-economy opportunities. - Credit market reforms will improve the ability of the financial sector to allocate capital to productive sectors of the economy. - Policy and regulatory reform that enables the emergence of a variety of financing models and institutions will increase the pool of domestic and foreign capital available for SMEs in Ethiopia.
Increase financial inclusion particularly for	- Support for a regulatory sandbox to assist the development of innovative ideas from providers of remittance services, payment services and micro-insurance products. - TA for policy and regulatory reform to enhance formal remittance flows in Ethiopia.	- Increased access to finance will increase the ability of households to improve their

Intervention and Theme	Proposed Activities	Rationale for DFID intervention
marginalised groups **Themes:** - Financial access - Financial infrastructure for innovation	- Support the capacity building of people, micro-enterprises and SMEs on digital financial services to promote their uptake. **Leave no one behind:** - Support design and piloting of cash transfer and graduation programmes for identified population groups. - Support design and piloting of enterprise grants for people and microenterprises in key economic sectors including marginalised segments such as youth and women. - Support design and piloting of refugee finance solutions.	incomes, livelihoods and resilience. - Increased access to formal remittances will increase incomes, resilience and provide opportunities to harness remittances for productive investment.
Support the development of a digital economy **Themes:** - Financial access - Financial infrastructure for innovation	- TA for implementing Ethiopia's Digital Payments Systems Strategy and the National Financial Inclusion Strategy. - Support implementation of NBE's directives for the licensing and authorisation of payment instrument issuers, and directives for the use of agents. This will entail supporting regulatory impact assessments of these directives to assess their impact on financial inclusion and commercial sustainability of agent models. - Support demand-side research in the context of the Digital Payments Systems Strategy e.g. financial diaries of households and agents; - TA for policy and regulatory reform on the national digital ID system.	- Supporting development of digital payment systems will increase delivery of financial services for the Ethiopian population. This work also underpins other work in the agricultural sector and in urban development.
Support the agricultural sector **Themes:** - Finance for investment - Financial access	- TA to support credit lines for SMEs e.g. agro-processors in the agricultural sector. - Support design and piloting of innovative models to improve efficiencies in the provision of finance for inputs, agricultural services and market linkages for smallholder farmers in Ethiopia. - Support design and piloting of innovative agricultural risk management models e.g. index-based agricultural insurance. - Support design and piloting of innovative financing models for the agricultural sector e.g. trade finance, value chain finance and asset finance for investment in agricultural assets.	- To increase the availability of capital to support the development of the agricultural sector, a priority sector in the government's homegrown reform agenda.
Support the manufacturing sector **Themes:** - Finance for investment	- Building on PEPE's access to finance work, provide TA to support credit lines for SMEs in the manufacturing sector. - Support design and piloting of innovative models in SME finance to increase the pool of working capital available for SMEs in the manufacturing sector. - TA for the issuance of long-term bonds to finance industrial park activity e.g. logistics, working closely with organisations such as Trademark East Africa. - TA to build the capacity of Ethiopia's Industrial Park Development Corporation	- To increase the availability of capital to support the development of the manufacturing sector, a priority sector in the government's homegrown reform agenda.
Support urban development **Themes:** - Finance for investment - Financial access	- Support design and piloting of innovative housing finance models that increase the supply of affordable housing in urban areas e.g. rental housing for industrial park operators, incremental housing models such as construction mortgages and remittance-linked housing finance. - Support design and piloting of innovative financing models in transport, Water, Sanitation and Hygiene (WASH) and household energy, in urban areas of Ethiopia.	- To promote innovative financing models that contribute to improved provision of basic services to vulnerable groups in

Intervention and Theme	Proposed Activities	Rationale for DFID intervention
		urban areas in Ethiopia.

NETWORK COLLABORATION

As FSD Ethiopia supports implementation of a digital finance strategy, there will be opportunities to benefit from the expertise and experience of FSD Kenya and FSD Tanzania on mobile money, agent networks and interoperability. Further, FSD Ethiopia will leverage FSD Africa knowledge on development of capital markets and credit markets. On the other hand, there will be opportunities for other country FSDs to benefit from PEPE's experience on job creation, manufacturing and SME finance.

IMPLEMENTING PARTNERS

To operationalise FSD Ethiopia, a local special purpose vehicle for the programme will be established. In contrast to a fly-in-fly-out model, a local FSD programme will enable depth of relationships with local stakeholders. A key lesson learnt from PEPE is the significance of the political economy of institutions to successful implementation. Establishing a local presence ensures close monitoring of the political economy environment, while leveraging specialist expertise from FSD Africa and other FSD country offices on specific topics.

Further consultation is needed to determine the most appropriate implementation model, taking into consideration value for money, legal registration and taxation requirements in Ethiopia. With the FSD Africa start-up programme and the PEPE / EP Programme, much of the expertise to build an FSD exists in-country and we expect it to have a fast start as a result.

EXPECTED RESULTS

FSD Ethiopia is expected to contribute the following outputs:

	Results category	Indicator	Targets (2-Year)	Targets (5-year)
1	Jobs	# jobs (informal/formal employment, livelihoods and micro-enterprise) created or improved/sustained through FSD-supported initiatives	8,250	50,000
2	Access to basic services	# people *facilitated to* access basic services	36,667	150,000
3	Financial Sector Development	# people with improved access to financial services	110,000	5,000,000
4	Financial Sector Development	# of businesses (micro/small enterprises) with improved access to financial services	73,333	7,000
5	Financial Sector Development	Private and public co-investment mobilised (£m)	£4.07m	£50m
6	Financial Sector Development	Number of policies and regulations developed through FSD support		12

THE PROFILE OF ESTIMATED COSTS

All funding from central/ PSD.

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£ m	£ m	£ m	£ m	£ m	£ m
Finance for investment	0.19	1.87	2.43	2.43	2.43	9.36
Financial access	0.12	1.17	1.52	1.52	1.52	5.84
Financial infrastructure for innovation	0.06	0.60	0.78	0.78	0.78	3.00
Financial stability	0.03	0.31	0.41	0.41	0.41	1.56
Financial integrity	0.00	0.05	0.06	0.06	0.06	0.24
Monitoring & Results Measurement	0.03	0.25	0.33	0.33	0.33	1.25
Programme Management for services retained by Country FSD	0.07	0.68	0.90	0.90	0.89	3.43
Total retained by FSD	0.49	4.93	6.42	6.42	6.42	24.68
Centralised services shared overhead	0.01	0.07	0.08	0.08	0.08	0.32
Grand Total	**0.50**	**5.00**	**6.50**	**6.50**	**6.50**	**25.00**
Programmatic funding split:						
Country core	0.30	3.00	3.90	3.90	3.90	15.00
Collaborative working	0.10	1.00	1.30	1.30	1.30	5.00

RESOURCES

Country office staff resource commitments:

1. 20% of an A2 Adviser – (one day per week)
2. 10% of a B2 programme manager (1/2 a day per week)

Annexe 1d. EFInA

COUNTRY'S FINANCIAL DEVELOPMENT STAGE

Financial inclusion in Nigeria increased from 47% in 2008 to 63% in 2018 (Access to Finance Survey 2018). However, Nigeria still lags significantly behind its peers in Sub-Saharan Africa.[33] A quarter of Nigerians still rely on informal institutions. The inclusion figures also mask large cross-sectional disparities. Exclusion levels remain largely concentrated in the North and are persistently higher for women, rural dwellers, and youth. The depth and quality of financial services remain weak (only 8% have a pension, while only 2% have insurance).

Traditional banking still dominates the Nigerian Financial Sector (77% of financial sector assets), but it is poorly placed to support inclusion. The majority of balance sheets and profits are linked to Government loans and to the oil and gas sector. In addition, high levels of non-performing loans, and an over reliance on regulatory forbearance point to structural problems.[34] Banking assets are equivalent to only 30% of GDP in 2018, while the microfinance sector only has assets of 0.3% of GDP. So far mobile money has failed to create the step change in financial inclusion seen in countries like Kenya, owing to the primarily bank-led approach to date. Only 3.3% of Nigerians have mobile money accounts, although 85% have mobile phones.

Due to these weaknesses, as well as the high-risk business environment, and crowding out by government borrowing (T-bills at around 13%), **commercial interest rates are up to 25% p.a, and require high levels of collateral to access**. The cost of finance is at the heart of Nigeria's financial exclusion and precludes finance for long-term investment. Government schemes to direct lending towards the real sector have not achieved success at scale. Since 2016 the supply of credit to the private sector and to households has declined[35]; overall, only 5.3% of SMEs have access to bank credit.

Financial sector regulation is generally protectionist and inefficient, but recent changes are positive. Highly burdensome, costly and uncertain approval processes for new products and services substantially reduce incentives for innovation. Telcos have been excluded from participating fully in the financial sector, while traditional banks have been unable to launch mass market mobile money. However, the recent 'approval in principle' of three telco-led 'Payment Service Banks' (PSB) licenses indicates new opportunities.

Macro-economic policy and currency management create costs and risks for investors, including investment into the financial sector. Turnover on the NSE amounts to only 18% of GDP. International investors in Nigeria are put off especially by capital controls (such as the restriction of access to US dollars for purchases of certain categories of imports), and fears of devaluation. However, there is also a small but thriving universe of capital market innovations that are developing despite/because of the difficult environment. These include developments in sukuk, green bonds (supported by FSD Africa), local currency bonds and guarantees. The UK Government is also deepening its relationship with the CBN, including the recently established working group to support offshore local currency bonds.

There are growing innovative activities, driven by Fintechs and other third parties, to develop new types of products, including alternative financing and digital financial products**. Lagos in particular is home to a thriving tech sector, with dozens of 'tech-hubs',** including those set up by traditional banks to capture new innovations**.** Many financial service providers are focused on new digital financial services, enabled by real time payment system that has been established. The new PSB licences, and the willingness of both the CBN and the Nigerian Interbank Settlement System to explore sandbox approaches, are all cause for guarded optimism.

In summary: Despite the size and importance of Nigeria's economy and population, it lags its competitors in financial inclusion. Progress has been very slow over the last five years, limited by regulatory challenges, weaknesses within the economy, and the banking sector. However, entrepreneurs in non-traditional sectors are active in developing work-arounds, while the chances of improving on some fundamentals also appear to be better than in recent years.

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[33] *37% of Nigerians do not have access to any financial services compared to 7% in South Africa, 17% in Kenya and 11% in Rwanda.*

[34] *IMF Article IV Nigeria 2019, pp19-21, which reports some slight recent improvements*

[35] *ibid, p 36*

FSD PROGRAMME, ACHIEVEMENTS AND LESSONS TO DATE

DFID's Financial Sector Development Programme in Nigeria has two main components:[36] **EFInA** and a grant to the IMF that supports the CBN's financial stability work. An independent review of both components is currently underway.

The IMF/CBN component has delivered a sophisticated banking early warning system and capacity building on banking supervision and Basel 2 and 3. Progress and potential gains appear substantial, though embedding cultural change and practice remains a challenge.

EFInA was established in 2007 and has four main tools: i) grants to financial firms to stimulate expansion of pro-poor products; ii) advocacy/dialogue platforms to resolve regulatory barriers, and to identify opportunities/partnerships; iii) research, data and evidence such as the Access to Financial Services in Nigeria survey; iv) capacity building of private and public sector actors to develop products and services to reach the excluded. EFInA can claim some significant successes. For example, three million people have used products supported by EFInA grant, and EFInA has established peerless, well-used and influential set of data in the Access to Financial Services in Nigeria Survey. EFInA strongly contributed to putting financial inclusion on the CBN and Government's agenda, and promoted the development and adoption of the CBN's National Financial Inclusion Strategy, and has provided substantive support and influence on enabling regulations for mobile financial services, payment service banks, agent networks, microinsurance, and other topics. More recently, EFInA has established expertise and influence on FinTech in Nigeria (including through conducting foundational research and launching a FinTech Challenge Fund).

EFInA has learned lessons and adjusted its approach over the past decade, including making improvements to its grants programme, strengthening collection and use of primary data generated, and improving engagement with local stakeholders. In the coming years, EFInA may re-consider its approach to advocacy, particularly whether a more direct approach would be more effective in accelerating the arrival of market-oriented regulation. The trade- off with EFInA's 'neutral broker' positioning is still under review. Experience has also shown that fundamental weakness in the overall banking sector have limited the potential for EFInA to create impact, even when technologies have been available and regulation allows. Operationally, EFInA has been relatively dependent on outsourced consultancy work: its new strategy recognises the need to build internal capacity, management systems and staffing. The contribution of FSD Africa has been positive, but coordination with EFInA has been poor on occasion, which should improve under FSD 2.0.

Further lesson learning will be derived from the forthcoming independent review. The new funding period should see EFInA develop a new focus on how critical reform wins can be best achieved.

WHAT MORE NEEDS TO BE DONE?

Nigeria has the highest absolute number of poor people in the world (nearly 90m). Although this is linked to issues beyond the financial sector[37], financial sector development remains central to achieving inclusive economic growth, sustained poverty reduction and creating new markets. The IMF estimates that improving Nigeria's financial system would increase growth by 0.8% per annum which, at current rates, would accelerate economic growth beyond population growth. Also, FSD 2.0's new priorities of supporting lending to the real economy and financing basic services, such as health and education, offer new opportunities to improve livelihoods through financial services.

Therefore, for the next phase of DFID's financial sector development support to Nigeria, more work is required across all five of FSD 2.0's thematic areas. Financial access and innovation remain most relevant for the FSD Network skills and experience, with some targeted transformational activities in other areas**.** To support achieving the government financial inclusion targets, priority areas for FSD participation continue to be increasing access to financial services, and leveraging innovations to accelerate gains in quality, depth and

[36] *A third recent component started in 2019 to fund World Bank technical assistance to the Development Bank of Nigeria*

[37] *Notably conflict, macro-economic volatility, corruption and the chronic under investment in infrastructure and public services*.

reach.[38] There are also emerging opportunities to build on some early successes in supporting capital market development, and mobilising investment into productive sectors.

- **With the recent introduction of PSB regulations, Nigeria has the potential to experience the Mobile Money revolution witnessed in other African Countries.** However, there are still restrictions on how these new institutions can operate. EFInA needs to continue to engage on regulatory issues and support successful deployment of PSBs. In the next strategy period, the licensing of PSB's should allow for more rapid progress in financial inclusion. EFInA is well placed to support this next phase from both an innovation and regulatory perspective.

- **The anticipated growth of mobile payments infrastructure offers a significant opportunity to unlock inclusive new business models directly targeting the poor (e.g. affordable credit, savings and microinsurance, and financing for basic services or in agriculture)** – by making serving these markets commercially viable. EFInA will identify opportunities to work with Fintechs which use technology and innovation to offer affordable products/services which support households and businesses manage other development challenges (e.g. school fees payment and collections, education loans, accessing health grants and products, off-grid solar, payment for water and sanitation services, agri-finance). EFInA will be expected to lean-in on the experiences of other DFID programme and thought leaders in basic services financing (e.g. CGAP and GSMA) to determine meaningful entry points for financing in the value chains.

- **To achieve these gains, it remains important to balance financial integrity with financial inclusion.** Many Nigerians, particularly in marginalised communities, have difficulty proving their identify identities, excluding them accessing financial services. EFInA has an opportunity to support integrity by supporting innovations in 'Know Your Customer' ('KYC') processes and requirements and helping to ensure the right balance of protection and access is driving KYC policy and practice. **Low levels of financial literacy and market education** – this includes consumers but also regulators and industry actors. There is little consumer protection and or few market conduct discipline mechanisms.

- **Given the size of the Nigerian economy, there is significant potential for the capital markets to play a role in mobilising investment into productive sectors, for infrastructure and innovation.** Capital market development, banking supervision and improved governance must all play a role in enabling Nigeria's major financial institutions to be part of the development process. The new funding period should see more explicit cross portfolio partnerships with the broader DFID programming portfolio, and DFID's growing capital market development work. It will identify entry points for capital market reforms to improve the funding flows to projects with high development impact (such as supporting the further development of the green bond market).

- **EFInA will continue to provide high-quality information on access and usage of financial services,** and produce studies market studies that innovators use to design products targeted at the base of the pyramid and regulators to design policies. Its long running Access to Financial Services in Nigeria Survey is seen as an industry leading source of information. There is insufficient credible data to support strategy development, to understand the dimensions of financial exclusion and make product decisions.

- **The regulatory and supervisory system requires substantial improvement in both design and operation.** DFID is currently supporting work with the IMF on banking supervision, the completion of IFRS 9, and Basel II and III implementation. There will be important opportunities to support the effective regulation of new financial businesses, such as PSBs. The CBN also plans to improve confidence in the financial sector through implementing a consumer protection framework. It current Financial Inclusion Strategy runs out in 2020, offering a new opportunity for FSD strategic engagement on policy.

These priorities align with those of the Nigerian government, which has emphasised the importance of digital-led and market-led growth, working off a foundation of macroeconomic stability. The government aims to drive

[38] *Financial inclusion should continue to be funded until a point at which the commercial sector can be seen to be taking on the necessary new investments without public funding support (perhaps at around 80% basic inclusion, up from 60% currently).*

economic growth and improve livelihoods through focus in key areas such as agriculture and MSME development; this investment aims to unlock key financial constraints to doing so.

There is a strong case for FSD intervention to complement the work of others. The World Bank and IFC are primarily focused on high level financial sector and macroeconomic reform, and large-scale infrastructure investment. EFInA's comparative advantage is its strong relationships with the government (central bank and regulators), the private sector, actors within the innovation ecosystem. It is building stronger ties with international thought leaders (such as CGAP and AFI). A major focus for the new funding period will be increased cooperation with such organisations and other DFID programmes, particularly with regards to the real sector work. The DFID funded IMF team are currently exploring the potential for further financial stability support with the CBN. Gates and DFID will continue to coordinate funding.

The table below indicatively summarises the estimated level of effort across EFInA, the FSD network, and other partners by theme.

	Innovation	**Inclusion**	**Investment**	**Integrity**	**Stability**
EFInA	***	***	**	**	*
FSD Africa/FSD network	*	*	***	*	*
World Bank/IMF/Non-FSD			**	***	***

* = contributor/interested party; ** = strong/substantial contribution; *** = lead

Challenges, Risks and Mitigation Measures

In addition to the risks set out in the main document, the following risks are noteworthy.

Challenges/Risks	**Mitigation measures**
Political economy: For instance, arbitrary change in policies; mitigated by regular horizon scanning and close partnerships with regulators.	Provide actionable research informed by political economy analysis, and continue to use platforms for formal exchanges of ideas between the public and private sectors (e.g. through its working groups).
Lack of regulatory capacity and coordination with responsibility shared across various actors	Build capacity of regulators. Leveraging experiences of FSD Network, sharing responsive research/case studies. Supporting peer-to-peer learning.
Marco-economic stability and security: Conflict and economic volatility, FX controls.	Mitigated by regular horizon scanning, and flexing strategy and project work plans in response to intelligence.
Delivery capacity: EFInA fail to recruit senior expertise (technical and operational). Operational risks not managed	Ongoing recruitment programmes (supported in future by FSD Africa). High quality shared services and support provided by FSD Network and FSD Africa reduces operational risk
Network integration: FSD Network/FSD Africa/EFInA relationship fails to generate synergies and imposes additional coordination costs.	Careful development and implementation of governance arrangements.

Low capacity of financial institutions (particularly fintechs): limits them in growing the market shares and accessing follow-on funding.	Support with targeted, high-quality technical assistance.
Low levels of financial literacy	Ensure innovative businesses supported have good consumer protection practices in place.

INDICATIVE INTERVENTIONS UNDER FSD 2.0

The programme will be adaptable to respond quickly to fast developing agendas and emerging opportunities.

Theme	**Potential activities (EFInA led unless otherwise stated)**
Finance for inclusion	- Grants to fintechs and players in PSB space to expand and improve product offerings for the excluded; - TA/Grants targeting expansion of digital financial services for women and other excluded groups - TA and public-private dialogue to avoid unnecessary regulatory limitation, especially of PSBs; - Grants and technical capacity building to support the development of services directed at the poorest, such as cash transfers, or pro-poor health/education innovations - Access to finance surveys *Potential activities feed into the following SDG clusters: Inclusive growth; basic services*
Finance for investment	- Capacity building and public-private dialogue around insurance and pension markets - [FSD Africa and EFInA] TA for Securities and Exchange Commission to support more, larger, and lower risk share issues - [FSD Africa] Green bond market development – TA, potentially anchoring investments - [FSD Africa/other DFID] Bond market development - eg jollof bond work *Potential activities feed into the following SDG clusters: Inclusive growth; sustainable futures*
Finance for innovation	- Grants/TA for businesses looking to launch innovative new financial service products, especially relating to 'real sector' and MSME access to finance; - Partnerships with other DFID programming focused on increasing access to finance for businesses in agri/health/education/renewables; - New research on boundaries of, for example, ag finance. *Activities feed into the following SDG clusters: Inclusive growth; basic services; sustainable futures*
Finance for integrity	- TA for improved regulatory environment for KYC; TA packages to businesses trying to implement them more efficiently - [FSD Africa/IMF/others] TA to CBN to support better identification and management of illicit finance. *Potential activities feed into the following SDG clusters: Inclusive growth; sustainable futures*
Finance for stability	- [IMF/others] support to CBN on banking supervision/monetary policy etc *Potential activities feed into the following SDG clusters: Inclusive growth*

Local Governance Arrangements

EFInA is a company limited by guarantee formed under Nigerian Companies Law. It has a senior management team that run day-to-day operations, and a board who provide strategic oversight. Major donors attend these Board Meetings as observers.

EXPECTED RESULTS

Results for FSD 2.0 common indicators have been calculated on results sheets using assumptions drawn from past experience and EFINA's new strategy, and are currently high level estimates. The jobs target refers mostly to extension agent employment, rather than downstream impacts of improved access to finance.

EFInA has a good reputation for the quality of its disaggregated data, and its strong focus on women and the North where exclusion is deeper. The new funding period should develop stronger skills in measuring and tackling other forms of exclusion such as disability.

Indicator definition	2 years	5 years
Number of direct FTE (Full Time Equivalent) jobs created/sustained courtesy of FSD support to (i) MSMEs; (ii) agricultural value chains; (iii) housing value chains (iv) health value chains; (v) other (to specify).	2,349	8,000
Number of people, who through an FSD's support, are able to access basic services from a private or public service provision system that meets human basic needs including housing, drinking water, sanitation and hygiene, energy, mobility, waste collection, health care, education and information technologies.	52,200	265,000
Number of adults (15 years and older) with an account at a bank or other financial institution, or with an account at a payments service provider, or use a remittance channel, or have a loan or credit line, or have an insurance policy that has been supported by an FSD.	156,600	1,650,000
Number of formal and informal businesses with an account at a bank or other financial institution, or with an account at a payments service provider, or use a remittance channel, or have a loan or credit line, or have an insurance policy that has been supported by an FSD	104,400	700,000
Public and private sector funds (in GBP million) crowded into investments or grant initiatives originated by an FSD.	£3.92m	£4.5m
Number of policies and regulations developed or refined through FSD support that include rules governing: a) inclusive finance AND b) finance for growth.		5

PROFILE OF ESTIMATED COSTS

The current annual budget is £4.4m, with a possibility of downwards revision. The profile below assumes a budget at historical levels, with an increase towards Year 3 with new strategies and approaches coming fully on stream. The tail-off in Years 4 and 5 reflects an assumption that DFID funding may not continue beyond 2025 (if inclusion and depth are at peer-group levels with commercial entities taking on the necessary investment opportunities).

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
Thematic area	**£ m**	**£ m**	**£ m**	**£ m**	**£ m**	**£ m**
Finance for investment	0.14	0.24	0.30	0.22	0.21	1.11
Financial access	1.18	1.52	2.01	1.59	0.98	7.28
Financial stability	0.04	0.04	0.04	0.04	0.04	0.22
Financial infrastructure for innovation	1.48	1.74	1.91	1.74	0.92	7.79
Financial integrity	0.03	0.05	0.05	0.00	0.00	0.13
Monitoring & Results Measurement	0.17	0.21	0.25	0.21	0.12	0.95
Programme Management for services retained by Country FSD	0.40	0.50	0.60	0.50	0.30	2.31
Total retained by FSD	**3.44**	**4.31**	**5.17**	**4.31**	**2.58**	**19.80**
Centralised services shared overhead	0.03	0.04	0.05	0.04	0.03	0.20
Grand Total	**3.48**	**4.35**	**5.22**	**4.35**	**2.61**	**20.00**
Programmatic funding split:						
Country core	2.38	2.77	3.27	2.65	1.55	12.61
Collaborative working	0.50	0.83	1.05	0.95	0.61	3.93

RESOURCES

DFID Nigeria will provide 20% of an A1 or A2 PSD Advisor or Economist's time to oversee the FSD's activities in Nigeria in accordance with the DFID governance arrangements for funding under this business case. This person will be supported by the West Africa Regional Advisor, who will also have SRO responsibilities for WAEMU FSD activities. DFID Nigeria will also provide programme management resourcing of 10% of a B2 Programme Manager's time to support compliance through certain in-country activities. This work will be overseen by 5% of a B1 Programme Manager's time.

Annexe 1e. FSD Southern Africa - FinMark Trust

SADC REGION FINANCIAL DEVELOPMENT STAGE

The SADC financial sector is still relatively under developed, and domestic credit to the private sector as a percent of GDP is below 50% for 13 out of the 16 SADC countries, that is except for South Africa, Namibia and Mauritius. These three countries (and Seychelles) also have the most liquid banking sectors, confirming the size and depth of their respective financial sectors when compared to other regional countries. Conversely the depth of the financial sector is particularly low in Madagascar, Malawi, and Zambia.

The region's financial sector is dominated by South Africa, both through its disproportionately larger value of deposits and loans and the many South African financial institutions (banks, non-banks and retailers) entering and providing financial services in other SADC countries. The primary sources of domestic resources in the region are private savings and public revenues, while workers' remittances have also become an important source of domestic resources. The region has one of the lowest national savings rates on the continent, underscoring the need to expand the coverage, competitiveness, and affordability of financial services. There is high use of informal financial services.

Stock markets across the region are small, with the exception of South Africa and Mauritius, which have significant market capitalisation. There is a need to develop long-term, local currency finance for investment alternatives.

Among the key challenges in the region is the limited access to finance for investment, trade, and working capital. For example, more than a third of firms in Angola, Lesotho, Malawi, and Zimbabwe identify access to finance as a major constraint to doing business. On the consumer front there is also significant financial exclusion with only 57% of the population included in the formal financial system,[39] while digitisation is low (e.g. only 27% of adults in SADC use mobile money). Other important challenges include youth unemployment (some estimates being >50%) despite high youth literacy rates, poor access to basic services (health, energy and education), and high vulnerability to climate change.

SADC Regional financial integration has been prioritised, and the SADC Secretariat commissioned FinMark Trust (FMT) in 2016 to assess progress made[40]. The findings were mixed. On the positive side, the assessment recorded significant increases in cross-border institutional investment and capital flows, especially between South Africa and the rest of SADC, and decreasing cost of remittances. On the negative side, regional investment platforms (SADC stock markets and cross-listings) continued to be weak and non-existent in some countries.

To support intra-region trade flows, the SADC Committee of Central Bank Governors (CCBG) established a regional Real Time Gross Settlement (RTGS) system, the **SADC RTGS,** to facilitate the settlement of cross-border transactions and payments. Collaborative efforts to reduce the cost of **cross border remittances** have been supported, and in the last few years costs have declined from over 20% of remitted value to around 13%, but much remains to be done to bring it closer to the G20 target of 5%. A number of projects to support **policy and regulatory harmonisation** have also been implemented, notably the regional mobile money guidelines.

With a majority of countries in the region belonging to more than one regional economic community, harmonizing arrangements **across regions** can further boost trade, particularly through the Tripartite Free Trade Area (COMESA, SADC, East African Community) and the African Union Continental Free Trade Area (ACFTA).

FMT PROGRAMME ACHIEVEMENTS AND LESSONS TO DATE

FMT has a **strong track record** in the region. FMT's catalytic role in **cross border remittances** has resulted in policy shifts that have benefitted the poor across the region, particularly through increased competition, increases in formal low value remittance flows, and cost reductions. On the market side, FMT supported the development of cross border remittances products, for example between South Africa and Lesotho, which have achieved costs of 2.4% of remitted value in a major win for low-income remittance receivers – 70% being

[39] *Financial Inclusion in the SADC Region, FinMark trust, 2018. Available at http://finmark.org.za/wp-content/uploads/2018/08/Final-Fact-sheet_Financial-Inclusion-in-the-SADC-Region-2018.pdf*

[40] *State of Regional Financial Integration in the Southern African Development Community, Genesis Analytics, Prepared for FinMark Trust, 8 February 2016*

women. The model is being duplicated to five other corridors under the current DFID programme and the South Africa – eSwatini corridor has just gone live.

To support **trade and capital flows** within the region, FMT supported the development of the regional high value settlement (SADC RTGS) platform established in 2013. The system currently settles approximately $1.4bn per month, contributing to efficiency and reduced risk. FMT is now supporting the development of an integrated regional clearing house, which will include non- bank players such as mobile money providers.

In the area of **financial system integrity,** FMT has played a pivotal role in the progressive developments on AML/CFT in South Africa, the region, and globally, and this work has had lasting impact. Much of the current work is focused on helping countries to respond to FATF recommendations in an appropriate and proportional manner having regard to the need to protect financial inclusion, most recently through Risk Based Approaches for low value bank accounts and cross border remittances. This is further supported by initiatives for the development of digital financial identity to promote access.

Digital technologies will play a major role in the coming years and FMT developed the SADC **Mobile Money Guidelines** for the SADC CCBG. They support a conducive regulatory environment for mobile money and interest payments to encourage low value savings.

To support increased financial inclusion, FMT's **demand side survey** (FinScope consumer and SMME) is a pioneer in its field and remains the most comprehensive demand side instrument of its kind[41]. It has been implemented across most SADC countries, and is complemented by the development by FMT of country **financial inclusion strategies** and policies across the region, as well as by the regional financial inclusion strategy for SADC on behalf of the SADC Secretariat.

Existing and past collaboration with other FSDs

1. **Data and information.** FMT provides technical assistance on demand side data and measurement to Enhancing Financial Innovation and Access (EFInA) in Nigeria, Access to Finance Rwanda, FSD Mozambique, and FSD Uganda, with FSD Zambia in planning for 2020.
2. **Innovation hackathons.** FMT is collaborating with 5 out of the 10 FSDs in the insight2impact's (i2i) DataHack4FI Innovation Competition.
3. **SADC Gender workshop and follow up work.** FMT co-convened the inaugural SADC Women in Financial Inclusion workshop with FSDT, FSDM and FSDZ; and provided training to FSDs on gender data.

Lessons learnt

- **Regional stakeholder engagement.** FMT's work to date has highlighted the importance of stakeholder involvement in catalysing and embedding change within the appropriate regional convening mechanisms. The regional convening is crucial both with the key policy makers and regulators, at regional level being the SADC Secretariat, SADC CCBG (and other sector based Committees), and the SADC Banking Association; and at country level the financial sector policy makers, regulators, and FSP's.
- **Balance between regional and in-country engagement.** FMT in general focuses on regional guidelines, standards, and approaches with country participation being through the regional structures. This is augmented by implementation in selected countries and joint convening to take advantage of economies of scale - e.g. annual SADC financial inclusion forum and regional training on Risk Based AML Framework.

Expertise / experiences with potential to impact the wider FSD network

- **Digital payments and cross border remittances**: FSDs (except FMT) work nationally and do not consider cross border remittances, which are a key source of inflows for growth.
- **The Risk Based Approach (RBA) to AML/CFT and digital financial identity**: Not many FSDs (i.e. other than FMT) have worked on this agenda, although it is a key constraining factor for access to finance.
- **Results measurement and M&E frameworks**: Over the last five years, FMT has developed new measurement frameworks for financial access, as well as M&E frameworks for a number of countries. This FMT data capacity is potentially an important resource for the FSD network.
- **Demand side data collection and analytics for consumers and MSMEs**: FMT conducts FinScope survey for most FSDs, which will be adapted to measure FI2.0 outcomes.

[41] *FinScope Consumer Survey Review: Financial Inclusion Methodology, 2015, A FinMark Trust report prepared by Eighty20*

WHAT MORE NEEDS TO BE DONE?

Based on the analysis of the **SADC Industrialisation Strategy** and Roadmap 2015 – 2063, the **SADC financial inclusion strategy,** and various country status and focus areas, five areas have emerged as offering the best opportunity to a) support **economic growth and the jobs** agenda in the region, b) expand access to basic services, and c) help secure a sustainable future, while d) best utilising the existing and adjacent capabilities of FMT.

Agriculture is a major contributor in most SADC economies, both in terms of GDP and through employing a disproportionately high number of people compared to other sectors. The development of agri processing and agri value chains therefore provides an opportunity to increase productivity, value addition, jobs, and "pro-poor" growth.

Building on existing FMT expertise on MSMEs, there is also potential to develop the capacity of enterprises in the **light manufacturing and services industries** to increase value addition and employment for youth, which is a major concern across the region.

Likewise building on the FMT track record in remittances, there is potential for further expansion into informal **cross border trade, social transfers, and remittances**. Reducing the cost of cross border remittances will increase income (especially of poor women) and ease payments for informal cross border traders to improve their sustainability in support of the growth agenda. The South African Reserve Bank (SARB) recently requested FMT assistance to lower the cost of remittances from 13.5% of remitted value to the G20 target of 5%.

The expansion of **inclusive digital financial services** offers the potential to increase access to basic and financial services, using digital means to reduce cost and improve scale and convenience. Savings was highlighted earlier, and there are also opportunities to extend access to insurance, health, and (clean) energy.

Lastly, there is need to support SADC **financial system integrity and stability**, especially through the RBA / AML interventions which will help secure a sustainable future by supporting lower costs and increasing reach, transparency, accountability, and governance of the financial system.

Within the above context, **financial sector development** needs to be supported over the next five years in the following critical areas to support the opportunities identified:

- Harmonising financial sector regulation to support trade and investment;
- Developing policy and regulations to enable / strengthen digitisation;
- Developing capital markets;
- Supporting and enabling fintech and innovation; and
- Increasing and sustaining financial integrity.

DFID has already invested a great deal in the region through FMT, with great progress as outlined earlier and many opportunities ahead. While donors are active in specific SADC countries, there are no other donors active in a major sense in the proposed types of SADC level inclusive finance activities. At country level existing donors are working on a number of focus areas outlined under FI 2.0, especially in SMME development, agriculture development, and education. FMT will work with these projects to strengthen the financial access components and to create a regional platform to share and learn from this work across the region.

The proposed work will strengthen in-country efforts by FSDs in the region and create new learnings to support FSDs in other regions. The proposed project is in line with DFID strategy.

Alignment to UK strategy. In the UK's new Partnership with Africa outlined in 2018, the vision of shared prosperity and shared security will be supported by strengthening the financial sector to support the vision, the fight against corruption and dirty money, and boosting resilience against climate change. The UK also emphasises the **Rising Powers Agenda**, where South Africa will need to be strengthened to uplift SADC and play a strong role in global governance.

Alignment to DFID financial sector priorities. The DFID sector refresh suggests five strategic shifts relevant for the coming years, all of which align to the identified interventions. This programme also aligns with DFID's UK-South Africa development partnership prosperity objectives, in particular to reduce the cost of cross-border remittances and improve access to finance.

Given existing relationships, track record and expertise, FMT is already perfectly placed, especially at a regional level, to build on the progress made to date. The cost of entry of a new player at regional level is high.

Additionality. A number of players such as the World Bank and IMF (as mentioned earlier) are supporting various governments at country level on financial sector development, financial stability, and other financial aspects. FMT currently supports these initiatives through bringing a demand side view on financial inclusion. However, at SADC level FMT is the only regional player focussing on regional financial inclusion approaches, regional financial integration, and more recently inclusive financial sector development. The regional approach is useful to build and encourage common approaches and standards, and to take advantage of economies of scale. Other players at regional level (USAID, GIZ, USAID, etc.) are focused on improving the broader business, trade, and investment climate, which will complement the proposed work.

Challenges and risks. The operational modalities for this project are already in place and have delivered substantial results since 2002. The major risks anticipated in the programme include the limited ability to influence the envisaged outcomes, as the implemented actions require the full cooperation of third parties including governments, other donors, and financial service providers. FMT operates in this environment and hence is well placed to minimise this risk by being proactive and focused on win-win outcomes. Further, the linkage between activities and poverty / growth outcomes is not always straightforward, and thus FMT will partner with other FSDs in developing mechanisms to enhance and measure such linkages. Last, the risk of duplication with country-based donors is present, and will be managed through informal and formal (through SADC) donor relationships.

Opportunity to deepen FSD network collaboration. There is an opportunity for deeper FSD Network collaboration to support in-country objectives – in areas such as gender building on the Gender Workshop, cross border trade for high value and informal traders, measurement and data work to support measurement in FI 2.0, cross border remittances, and learning from other FSD's. South African experience and influence will be exploited in the SADC context for learnings that will be applicable across the wider FSD network.

Support to poverty reduction and growth. The work proposed has been laid out in the context of the SADC industrialisation strategy, the primary aim of which is growth in the region. In ensuring that the work is actually implemented, a key issue is our choice of the specific areas for focus, which is based on our understanding of the political economy and institutional issues in the region. The strategy speaks to issues of concern at regional and national level, particularly the selected pathways such as agriculture, technology and SMMEs, and contains significant capacity building measures to ensure implementation and impact.

"Leave no one behind". FMT is already focused on the poor. The log frames will reflect outcomes directly related to marginalised groups – including those related to gender, age, sex, disability, and geography. Youth represent a particularly important segment in the region, and thus will be prioritised in jobs targets and as targets for access to basic services.

PROPOSED INTERVENTIONS UNDER FSD 2.0

The proposed interventions focus on activities at regional level, and at country level in selected non FSD countries where FMT has worked in over the last five years (Lesotho, Eswatini, Botswana, and Madagascar, with additional countries to be agreed with DFID as necessary). South Africa, as the rising power in SADC, will leverage opportunities as a multiplier in the region.

Regional Programmes are defined as those relating to cross border activities within the region - e.g. cross border remittances, regional harmonisation work with regional institutions, and working with multiple countries simultaneously to broaden our impact and take advantage of economies of scale. A summary of potential interventions, indicative results, and accompanying budget appears below, though these are liable to change as specific areas of work are agreed with DFID following the submission of this Annexe.

Interventions	Outcome	Potential Activities	FMT Positioning
Agriculture Value Chains *(Investment, Access, and Innovation)*	Increase productivity and value addition in agricultural value chains with the potential to grow farms, agro-processors, and other enterprises, resulting in job creation and higher incomes using sustainable methods.	Evidence suggests that generic financial solutions (e.g., micro-credit) have little effect on productivity or welfare. Activities will focus on solutions tailored to farmer/value chain context, and may include: - Strengthening FSP understanding of the needs of small farmers and agribusiness through provision of data and opportunities for direct engagement (e.g., exploring use of off-take agreements as an alternative form of collateral) - Direct engagement with off-takers/larger processors (e.g., to explore closed-loop models where off-takers provide finance to farmers in exchange for steady supply) - Programming to increase credit information and credit evaluation using alternative approaches and data, diversity of lending channels (e.g. VSLA's, SACCOs) - Private blended finance models with donor risk sharing - Digitisation of value chains, including payments and other supply chain solutions (e.g., quality control) - Insurance and other products to deal with climate change - Surfacing and sharing existing models in the region and elsewhere, testing new business model pilots in selected non FSD countries for demonstration / learning	Existing, strong relationships with regional players like SADC Secretariat, DFRC, SADC Banking Association and regional agricultural bodies; existing footprint in 6 SADC countries enabling the convening of relevant players including country based donors; and FinScope based data including on the rural / agriculture sectors) which forms a strong basis for engagement
Light manufacturing and services industry, *(Investment, Inclusion and Innovation)*	Improve enterprises in the light manufacturing and selected services industries to increase value addition and employment for youth	As with agriculture, generic financing solutions generally have no or little effect on SME growth, employment, or profitability – in large part because they do not take into account sector- and location-specific SME growth challenges/opportunities. Narrowing focus to light manufacturing and selected services (with significant employment potential) will allow for greater efficacy, potentially: - Exploring the use of technology platforms such as e-commerce to expand finance and market linkages - Fintech solutions to address information asymmetries between suppliers and those requiring funding - Engagement with off-takers and FSPs to explore opportunities for targeted financing (e.g., financing to build capacity of informal panel-beaters to serve local insurers providing vehicle insurance) - Innovation ecosystem support to better surface promising ideas / innovations - Providing demand and supply side data to regulators and FSPs for better understanding of the constraints and improved product development	FMT's SMME demand side survey in 7 SADC countries and SMME diagnostic (supply and demand) in 2 countries with a 3rd being planned; FMT is also developing an alternative credit scoring methodology in SA and working with a fintech to deal with information asymmetries between demand and supply. Regionally, FMT has convened a number of SMME financing sessions.
Cross border trade, social transfers, and remittances *(Innovation,Access,)*	Further reduce the cost of cross border remittances (G20 target of 5%) to increase incomes, especially of poor women, and ease	While the cost of remittances has dropped substantially, it remains high in comparison to other regions. Expanding the existing work into more corridors and additional products will increase competition and lower costs. Activities could include: - Digitising cash into and out of existing products, which are still largely cash based - Working with regulators to identify and reduce regulatory hurdles to promote payments using existing remittance products for informal traders - Working with authorities and SADC Banking association to identify constraints to repatriating social payments and work to address them	FMT has worked on remittances over the last decade, opening regulatory blockages, reducing cost, and piloting different models; existing relationships with key FSP's; FMT's repository comprises most data on cross

Interventions	Outcome	Potential Activities	FMT Positioning
	informal cross border trade		border remittances in the region.
Inclusive Digital Financial *Services (Innovation, Access, Stability)*	Increased access to basic and financial services using digital to support reduced cost and improve scale and convenience.	SADC has a low savings rate compared to other regions and digital services can help increase accessibility, convenience, and inclusion for low income customers. Activities may include: - Work with regional and selected country regulators to further implement the SADC mobile money guidelines to improve savings and other value add products - Investigate opportunities where digitisation and fintech will extend access to insurance, health, and (clean) energy - Document and share experiences across the SADC region and look for opportunities to scale local digital solutions. - Develop consumer protection standards in the region to be translated into national regulatory frameworks.	Existing work on SADC Mobile Money guidelines at CCBG and in four countries; existing relationships and access to regional bodies, country regulators, and FSP's which position FMT well for implementation.
Sustainable future through financial system integrity and stability *(Innovation, Integrity)*	Increased integrity in the financial system, transparency of transactions, and sustainability	There is a large opportunity to build regional SADC regulatory capacity in this area. Activities may include: - Support SADC regulators and supervisors to adopt risk-based approaches to AML/CFT off the back of our work in this regard in SA funded by DFID - Support FSPs to implement RBA methodologies. - Further develop current work on digital financial identity with a vision to create an SADC digital financial passport, standards and guidelines, and to ease access burden of migrants and refugees.	FMT work on AML to reduce impact on financial inclusion including a risk-based AML methodology, which is being shared across the SADC region; work on digital financial identity.

EXPECTED RESULTS

The table below provides estimated overall targets for the programme.

Indicator definition	Baseline	2 years	5 years	Reasoning
Number of direct FTE (Full Time Equivalent) jobs created/sustained courtesy of FMT support to (i) MSMEs; (ii) agricultural value chains; (iii) trade (iv) health and energy value chains; (v) other (to specify)	0	718	2 000	Estimated cost to create jobs varies by country and industry. The World Bank quotes and average of $20 000 to create a new job. Given the nature of the region and level of skills, we expect to use less than $10 000 per new job. We will target around 375 jobs per country.
Number of people, who through FMT support, are able to access basic services from a private or public service provision system that meets human basic needs including housing, drinking water, sanitation and hygiene, energy, mobility, waste collection, health care, education and information technologies	0	32,333	200 000	This is directly linked to the number of adults we will formally include in the indicator below on the back of payments systems and digital rails. This will be driven through our mobile money work to increase access to savings accounts and to increase payments for services; in combination with other digital finance interventions across the 4-5 countries we should get to these numbers.

Indicator definition	Baseline	2 years	5 years	Reasoning
Number of adults (15 years and older) and microenterprises with an account at a bank or other financial institution, or with an account at a payments service provider, or use a remittance channel, or have a loan or credit line, or have an insurance policy that has been supported by FMT	0	97,000	300 000	57% of adults formally served in the region of a population of 180m. Based on our focus countries, such as Eswatini with an adult population of 600 000, we aim to increase the number of adults included by the target number. ~62 500 in each of the 4 countries by year 3.
Number of SMEs with an account at a bank or other financial institution, or with an account at a payments service provider, or use a remittance channel, or have a loan or credit line, or have an insurance policy that has been supported by FMT	0	64,667	75 000	The estimated average number of MSME for the region that are financially excluded sits at 50%. Only 2.3 % have access to bank credit. Using this low base, we intend to increase access by the target amount - ~12 500 per country.
Public and private sector funds (in GBPm) crowded into investments or grant initiatives originated by an FSD	0	£0.38m	£1m	We estimate that we will be able to crowd in 10% of the total budget.
Number of policies and regulations developed through FSD support	0		9	FMT has historically successfully supported policy and regulatory development, and the process is time intensive for particular regulations to be developed. The focus of the policy interventions will be in the area of AML/KYC and digitisation to support impact. The figures are based on our experience in the region.

THE PROFILE OF ESTIMATED COSTS

The budget below is organised along the five strategic shifts of the DFID Financial Sector Development refresh. Please note that numbers may not add up due to rounding – please see accompanying excel for exact figures.

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£ m	£ m	£ m	£ m	£ m	£ m
Finance for investment	0.53	0.53	0.53	0.32	0.21	2.1
Financial access	0.50	0.50	0.50	0.30	0.20	2.0
Financial stability	0.10	0.15	0.10	0.08	0.08	0.5
Financial innovation	0.34	0.34	0.34	0.34	0.34	1.7
Financial integrity	0.54	0.36	0.36	0.36	0.18	1.8
Monitoring & Results Measurement	0.13	0.12	0.11	0.09	0.06	0.51
Programme Management for services retained by Country FSD	0.34	0.32	0.31	0.24	0.17	1.38
Total Retained by FSD	**2.47**	**2.31**	**2.25**	**1.72**	**1.24**	**9.99**
Centralised services, overhead costs	0.04	0.03	0.03	0.02	0.02	0.13
Grand Total	**2.51**	**2.34**	**2.28**	**1.74**	**1.26**	**10.13**
Of which:						
Country core	1.60	1.50	1.46	1.11	0.80	6.48
Collaborative working	0.40	0.38	0.37	0.28	0.20	1.62

Annexe 1f. FSD Ghana

COUNTRY'S FINANCIAL DEVELOPMENT STAGE

The level of access to formal financial services in Ghana is relatively high – the most recent Global Financial Inclusion Index (Findex) 2017 shows that the percentage of Ghanaians with registered financial accounts was 58% in 2017, compared with 41% in Cote d'Ivoire, and 43% sub-Saharan Africa average. The percentage with mobile money accounts increased from 13 to 39% between 2014 and 2017. The northern regions remain the least financially included, and women and rural residents rely more heavily on non-bank financial institutions such as savings and loans associations or microfinance institutions.

The relatively strong performance on financial inclusion metrics captures breadth of coverage rather than the range and quality of services used. For example, most digital financial firms offer payment through mobile phones, with limited offerings on other products such as savings, pensions, insurance, credit, etc.

The banking sector is dominant in Ghana's financial sector, commanding a significant percentage of total assets of the financial sector. Commercial banks have assets equivalent to 47% of GDP in 2016, as compared with 9.4% for the fund management sector, and 9.2% for the pension sector.
There are also many formal and informal non-bank financial institutions (e.g., savings and loans associations, and microcredit institutions), and expansion of usage of mobile phones to access financial services.

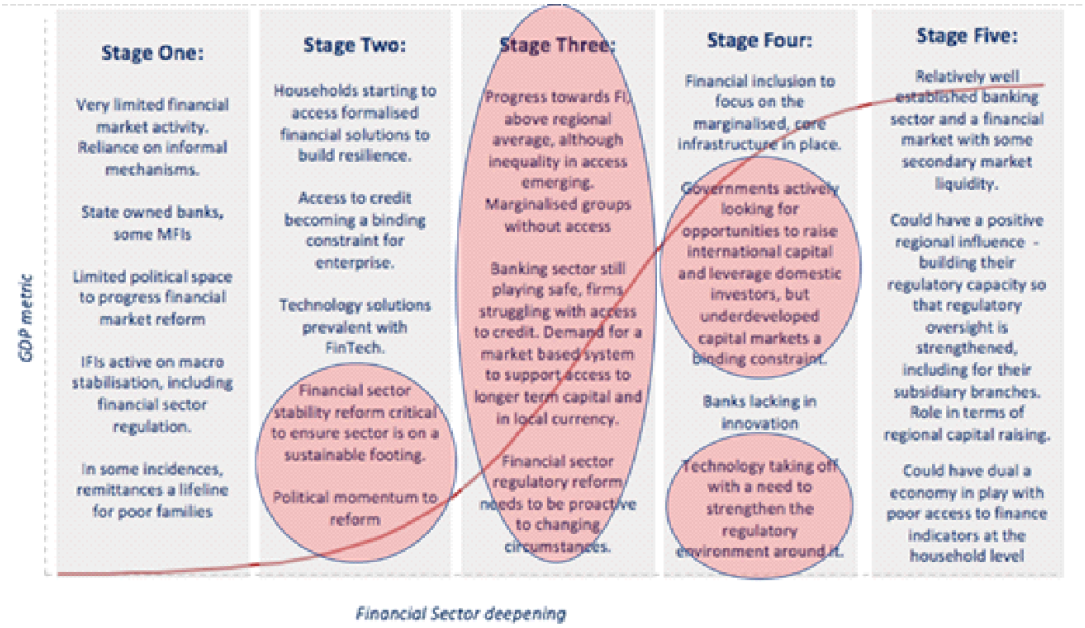
Severe financial stability issues remain, **stemming from the repercussions of the banking sector consolidation exercise completed in 2018**, and the expected consolidation of microfinance, savings and loans associations, and rural and community banks. The instability in the financial sector is linked to broader public finances and governance issues in state-owned enterprises. The non-performing loan (NPL) ratios for financial institutions are high, as many of their borrowers are either state contractors or state-owned enterprises facing financial difficulties. The high level of policy interest rate, driven by the Government of Ghana (GoG) borrowing, means that commercial lending rates remain high, risking accumulation of non-performing loans (NPLs).

Businesses, especially SMEs, remain highly credit constrained with limited access to long-term capital. The lending rates for SMEs to access bank loans are upwards of 25%. This is driven by the relatively high policy rate (16%) but also the lack of reliable data to enable risk-based lending decisions for corporate entities and individuals. The corporate bond market is undeveloped, and businesses do not have access to long-term sources of capital which results in using expensive short-term working capital loans for longer term projects.

The insurance sector is underdeveloped, covering a very small percentage of the population and a limited number of large businesses. Only 1% of Ghanaian adults reported using insurance to cope with a financial shock in the last Finscope survey (2010). Small enterprises do not have insurance coverage, and insurers do not play a role in supporting business clients to manage risks.

Despite these constraints, there is innovation to develop new types of products, including green finance related and digital financial products. There is a government initiative on a sovereign green bond, as a potential option for project borrowing in an environment of strained public finances. There are some banks offering lending at special rates for businesses in climate mitigation and adaptation industries. In the digital space, innovation appears to be taking place to develop new services to reach a broader range of consumers, for example through micro-insurance or micro-pension products.

The diagram below shows Ghana's stage of financial sector development in the stages of the DFID Financial Sector Development refresh:



FSD PROGRAMME, ACHIEVEMENTS AND LESSONS TO DATE

There is no existing FSD Ghana programme, but FSD Africa has been working in Ghana on improved financial inclusion, and building evidence to inform policy making. For example, FSD Africa is supporting Fidelity Bank's "Project 5by5" to reach 5m people with financial services in five years. FSD Africa has also recently been working with the SEC and Bank of Ghana (BoG) to develop diagnostic studies for the credit market in Ghana, and build institutional capacity.

There are other DFID centrally managed programmes active in Ghana, which have built up strong networks and demonstrated results. For example, through the Prosperity Fund Global Finance programme, there is a peer-learning partnership between Bank of England and BoG, providing timely and targeted support in topical areas such as bank resolution. The Harnessing Innovation for Financial Inclusion programme has worked with MTN Mobile Money to increase their reach, and supported the GoG to develop a digital financial services policy.

DFID Ghana's current work on financial sector development is focused on stability and regulatory capacity. There are partnerships with the Ministry of Finance and Securities and Exchange Commission (SEC) to support policymaking and regulatory capacity, work with BoG to support banking and non-bank supervision. This work is largely delivered in partnership with the World Bank (WB) Financial Sector Team.

FSD Africa's activities in Ghana have generated a strong evidence base and developed a network of relationships that a new in-country programme will greatly benefit from. The following projects in particular provide a strong starting point to inform and develop new interventions:

- Partnership with the SEC to support an institutional capacity assessment
- FSD Africa investees, Frontclear, and Africa Local Currency Bond Fund have activities ongoing in Ghana to develop the corporate bond market, and interbank lending markets, for capital markets deepening
- A diagnostic on the credit market in Ghana, with results expected in December 2019
- A market study on the insurance sector, completed by FSD Africa partners Cenfri in December 2018

WHAT MORE NEEDS TO BE DONE?

Financial sector development is identified as a key opportunity to unlock development in the Ghana Country Development Diagnostic. There is a high level of policy interest from GoG to transform the financial sector, creating a window of opportunity to support change. The government is developing a comprehensive set of new policies and plans related to financial sector deepening. These include the National Financial Inclusion and

Development Strategy, a masterplan for Capital Markets development, new initiatives on mortgage financing, and the introduction of a new Deposit Insurance scheme.

The high cost of accessing finance and financial sector instability are key constraints to private sector growth in Ghana, as highlighted in the Country Development Diagnostic for Ghana. This is particularly the case in the agriculture sector, where agribusinesses face prohibitively expensive lending rates. Given the potential for poverty reduction impact in this sector, the new FSD Ghana will particularly seek collaboration with DFID Ghana's agriculture sector programming to support linkages to financial services providers and innovation for access to finance and building climate resilience.

The financial sector is a priority sector in the HMG Prosperity Strategy for Ghana. It is one of six thematic areas of focus for UK-Ghana cooperation agreed upon by the UK-Ghana Business Council, the UK Minister for Africa, and the Vice President of Ghana. DFID in Ghana is committed to supporting the Ghana Beyond Aid Strategy, which sets out the President of Ghana's vision for economic transformation and self-financing of development. The programme will engage with a range of objectives for DFID in Ghana, including capital market development, climate financing, women's economic empowerment, inclusion in Northern Ghana, and macro-stability.

A scoping exercise with key stakeholders from different parts of the financial services ecosystem took place in May 2019 to help inform how DFID can build on its offer on financial sector development in Ghana. Many of the current channels of support come to an end in the next 12-18 months. The exercise identified room to build a more systematic and scaled up approach in Ghana.

Constraints:

The major constraints for financial sector development in Ghana are as follows:

- **Weak regulatory capacity and coordination:** In particular, the SEC appears to be weak and does not have adequate capacity to undertake its supervision and market development mandates. There are also issues of coherence and coordination, with examples of one regulator's actions undermining the objectives of another.
- **Low levels of financial literacy and market education:** This includes consumers but also regulators and industry actors. There is limited understanding of financial services and investment products beyond the most basic ones. There are no functional consumer protection and market conduct mechanisms.
- **The lack of unique national identification and availability of data:** These are key constraints for increasing responsible lending and have implications for financial inclusion, integrity, and stability.
- **The high interest rate environment and sector stability challenges are limiting the incentives for innovation:** The high level of the policy interest rate is driven by high levels of government borrowing. This limits product development, as institutional investors all invest in government bonds. Regulators tend to demand a gold standard of product without giving room for the market to develop.

Opportunities:

- *Investment*: There is a high level of policy engagement and willingness to enact reforms from the GoG, who see capital market development as a critical ingredient for a more resilient economy. There is also a large pool of long-term capital available from the pension funds, and a number of initiatives ongoing with DFID and FSD Africa partners which are well-placed to provide a platform for scaled up support.
- *Financial Inclusion*: There will be opportunities to build on initiatives to improve consumer and business data, especially given the drive for a national identification scheme. Ghana's National Financial Inclusion and Development Strategy is to be launched in 2020.
- *Stability and Integrity*: The work on quality of data cuts across the inclusion, integrity, and stability themes. BoG is committed to reducing the flow of new NPLs for financial institutions, and developing a new set of Environmental, Social and Governance principles for the banking sector.
- *Innovation and Building Markets for Green Products*: the high levels of mobile phone penetration creates opportunities for expanding the range of digital financial services available, especially for hard to reach and rural populations. There is appetite to explore opportunities for green bonds and project financing options through sovereign and credit bond markets.

Additionality of FSD Ghana:

There is limited donor activity in Ghana on financial sector development. The WB has recently expanded its work in this area, focusing on support to GoG for implementation of the National Financial Inclusion Strategy. The IMF and AFDB work on some aspects of capital market development, and support to Bank of Ghana on monetary operations. There is limited bilateral donor activity in this sector - SECO (Swiss Development Cooperation agency) supports farmer credit mechanisms, and GIZ works on insurance.

The feedback from the WB and other donors during the scoping exercise was that an FSD Ghana would have the following advantages:

- Local presence to facilitate collaborative working with government and other stakeholders, rather than a "fly-in, fly-out" model
- The ability to build partnerships with business and industry associations
- Flexibility to provide responsive support on a range of thematic areas using a combination of local and international expertise, and grant and investment instruments
- Support for innovation to develop new financial products for inclusion and investment objectives

Expected Outcomes:

The expected outcomes of the proposed activities are as follows:

- Increased availability of long-term capital in Ghana's economy for business and infrastructure growth
- Improved access to credit and insurance services for SMEs
- Increased coverage of poor and remote populations with a wider range of financial services (e.g., savings, credit, pensions, and insurance)
- Increased trust in the financial sector by consumers and improved responsible business practices by financial service provider firms
- Development of markets in new climate finance and digital products to support inclusion and climate resilience – such as sovereign and corporate green bonds, micro-pensions or climate insurance products.

Key risks:

There are two major risks for this programme:

1. Deterioration in the macroeconomic conditions in Ghana e.g. any events that result in a downgrading of the sovereign credit risk rating, further repercussions from the bank and microfinance sector consolidations, etc.

Mitigation: DFID Ghana's work on public financial management and tax, and our influencing of our multilateral partners works to mitigate the likelihood of macroeconomic shocks. The FSD programme's work on financial sector stability will contribute to improving macroeconomic conditions.

2. Elections in 2020 result in reduced political will for financial sector development issues. Financial sector development is currently a high priority for the GoG because of the Minister of Finance taking a particular interest in the sector. A change of government or change of minister could result in decreased momentum for reform.

Mitigation: The programme will be designed flexibly to be able to adapt interventions in case of shifts in policy priorities. It will also include a mix of interventions with government and the private sector, and build networks with regulators and senior officials in addition to the political leadership.

PROPOSED INTERVENTIONS UNDER FSD 2.0

The scoping exercise highlighted several areas of focus for a scaled-up DFID offer on financial sector development. These findings are summarised below, set out under the five strategic shifts of the DFID Financial Sector Development refresh:

Theme	Proposed Activity	Expected Real Economy Impact
Investment	- Support regulatory capacity at SEC - Facilitate development of new capital markets products (real estate investment trusts, local currency bonds, inter-bank lending products)	• Increased availability of long-term capital in Ghana's economy for business and infrastructure growth • Contribution to macroeconomic and financial sector stability *SDG cluster - Inclusive growth*
Inclusion	- Invest in improving credit data - Forge new industry partnerships for new products to increase coverage e.g., work with digital firms on micro-pension or insurance products, work in specific sectors such as supply chain finance for agriculture, affordable housing finance products - Improve access for SMEs to credit and insurance e.g., partner with Association of Ghana Industry's new "seed fund"	• Improved access to credit and insurance for SMEs • Increased coverage of poor and remote populations with a wider range of financial services, to enable management of risks and fluctuations in income, for sustainable poverty reduction *SDG Cluster - Inclusive growth and Basic Services*
Integrity and stability	- Support to develop policy measures to regain public trust in the financial sector such as consumer protection measures - Support improved data to enable compliance with "know your customer" rules - Risk-based supervision for AML/CFT compliance (in collaboration with DFID Ghana anti-corruption interventions) - Improve credit data to support efforts for stopping the flow of new NPLs	• Increased trust in financial sector by consumers leading to increased financial inclusion • Ghana compliant with international standards on AML/CFT, improving investor confidence • Enhanced financial stability reducing risk of macroeconomic shocks *SDG Cluster – Inclusive Growth and Sustainable future*
Innovation in green finance and digital products	- Build regulatory capability - Facilitate sovereign and corporate green bonds - Support development of climate insurance products - Business development and investment facilitation for digital finance businesses	New digital products contributing to deeper financial inclusion, climate resilience, and business growth *SDG Cluster - Inclusive growth, Basic Services, and Sustainable Future*

In addition, there are cross-cutting issues that are not recommended as a standalone intervention, but rather to be incorporated into each of these areas of intervention as appropriate:

i. Financial literacy and market education
ii. Improving regulatory coordination and coherence

Opportunities for deeper FSD Network collaboration

- It is expected that FSD Ghana will draw on specialist international expertise from across the FSD Network, and FSD Africa in particular, on specific areas such as supporting the development of climate finance products, new capital markets products, housing finance, and insurance, etc.

- In future years, there may also be opportunities for intensive collaboration with other FSD country chapters set up in West Africa, given the GoG ambition for Ghana to operate as a regional financial services hub.

LOCAL GOVERNANCE ARRANGEMENTS

The proposed governance arrangement is to set up a stand-alone institution in Ghana, which will be accountable to an SRO in DFID Ghana and to the FSD Africa Investment Committee. A project steering committee comprising key government and industry stakeholders in Ghana is proposed to support the identification and design of programme activities on an advisory basis. This will ensure that there is a depth of local understanding and relationships. Specialist international expertise will be used as needed through the FSD Network collaboration.

The FSD in Ghana will be expected to make a significant contribution to the UK influencing priorities in Ghana and collaborate with initiatives from other HMG departments where they align with the programme objectives.

DFID Ghana is currently supporting a six-month inception phase for FSD in Ghana (October 2019 to March 2020), which will include setting up the foundations for registering as a legal entity in Ghana, identification of potential project team, and the membership for the advisory project steering committee.

EXPECTED RESULTS

The outcome-level results targets will be in line with the six indicators agreed across the FSD Network. An indicative set of results targets is presented below. It should be noted that these outcome-level targets will be revisited as a key output of the inception phase for FSD Ghana (Nov 2019-Mar 2020).

Indicator	2-year target	5-year target
Jobs – Number of Direct FTE jobs created	581	1,667
Number of people facilitated to access basic services	31,000	135,000
Number of people with improved access to financial services	93,000	675,000
Number of businesses with improved access to financial services	62,000	200,000
Private and public co-investment mobilised (£ m)	£2.33m	£5.0m
Number of policies and regulations developed or refined		5

PROFILE OF ESTIMATED COSTS

DFID Ghana expects to commit £10m of country office funding for FSD Ghana. This will all be RDEL - if any returnable capital instruments are considered for use during programme implementation, these would need to come from the central PSD funds.

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£ m	£ m	£ m	£ m	£ m	£ m
Finance for investment	0.80	0.50	0.50	0.50	0.20	2.50
Financial access	0.40	0.40	0.40	0.40	0.40	2.00
Financial infrastructure for innovation	0.50	0.75	0.50	0.50	0.25	2.50
Financial stability	0	0.30	0.20	0	0	0.50
Financial integrity	0	0.10	0.20	0.20	0	0.50
Monitoring & Results Measurement	0.10	0.10	0.10	0.10	0.10	0.50
Programme Management for services retained by Country FSD	0.37	0.27	0.17	0.28	0.28	1.37
Total retained by FSD	**2.17**	**2.42**	**2.07**	**1.98**	**1.23**	**9.87**
Centralised services shared overhead	0.033	0.034	0.025	0.024	0.016	0.133
Grand Total	**2.20**	**2.45**	**2.10**	**2.00**	**1.25**	**10.00**
Programmatic funding split:						
Country core	1.26	1.56	1.38	1.20	0.60	6.00
Collaborative working	0.44	0.49	0.42	0.40	0.25	2.00
Programme management, monitoring and overhead	0.5	0.4	0.3	0.4	0.4	2.00

To note, these are indicative cost breakdowns and will be revisited during the inception phase for FSD Ghana and at regular intervals thereafter.

RESOURCES

The proposed country office staff resource commitments are provided below. It should be noted that this commitment is subject to DFID Ghana's resource and operating cost allocation for future years.

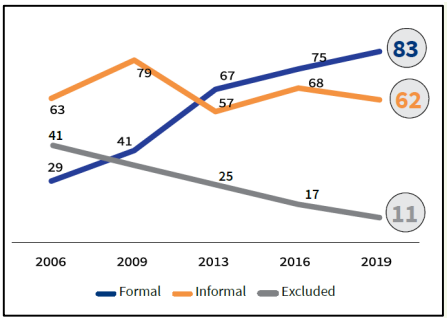
1. Economic Advisor (30% FTE up to June 2020 to support set up, 20% FTE thereafter i.e. 1 day per week on average)
2. B2 Programme Manager (10% FTE – ½ day per week)

Annexe 1g. FSD Kenya

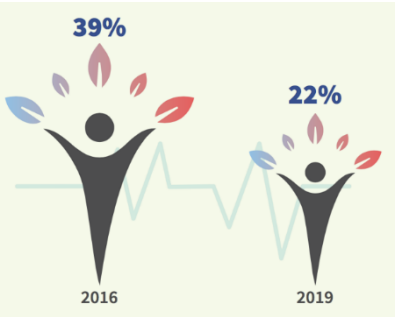
COUNTRY'S FINANCIAL DEVELOPMENT STAGE

Kenya is ahead of its peers in Sub-Saharan Africa in formal financial inclusion expanding from 29% in 2006 to 83% of adults with a formal account in 2019. However, these figures hide nuance with regards to quality of access and use; for a third of the formally included population, limited mobile wallets represent their sole formal account and 62% of Kenyans continue to use informal financial services filling gaps left by the formal financial sector. Despite gains in formal financial inclusion, financial health – the ability to manage day to day, cope with risk and invest in the future has decreased from 39% in 2016 to 22% in 2019 (FinAccess).

Financial access



Financial health



Mobile money and the banking sector dominate the formal financial sector. Banking sector assets account for 49.5% of GDP, while Kenyans moved about 44% of GDP through their mobile phones in 2018[42]. Banking sector consolidation continues with the acquisition of National Bank of Kenya by the KCB Group, and the merger between NIC Bank and the Commercial Bank of Africa. However, credit markets have been constrained by the interest rate cap with domestic credit to the private sector at 28% of GDP[43] with a disproportionate impact on micro, small and medium enterprises (MSMEs) with knock-on negative effects on economic growth and job creation. MSMEs continue to be marginalised with limited access to debt or equity. Only 5.6% use bank loans while 80.6% use family/own funds as their main source of capital with 6% get loans from other sources[44].

Kenya's capital market is the most developed in East Africa and ranks third in financial markets in Africa, but only eighth in market depth. Structural issues contribute to the low level of capital market development with limited product diversity being a key constraint. Short-term treasury bills account for 40% of all local currency debt in Kenya making it harder to build a broader market.[45]

Mobilising green/climate finance is increasingly a priority of the Government. Kenya is ranked 13th out of 233 countries for direct risks arising from extreme weather[46]. Extreme climatic events could cost the economy between 2.6% - 7% of GDP per annum[47], which would hinder Kenya's ambitions of becoming a middle-income country by 2030. The government created a Climate Finance Unit at the National Treasury and already has both a National Climate Finance Policy and Climate Change Action Plan. In October 2019 Kenya launched its first green bond (the third in Africa, following issuances in South Africa and Nigeria), raising 4.3bn shillings (circa £35m) to invest in building affordable and environmentally-friendly student accommodation across Nairobi. FSD Africa has supported the Capital Markets Authority since 2015, helping them create the regulatory framework for the Kenya green bonds programme, also endorsed by the Central Bank of Kenya, and National Treasury. The bond, which is certified by the UK Climate Bonds Initiative, also included a partial guarantee to reduce risk to investors from GuarantCo (majority DFID-funded**)**.

Government is similarly increasingly interested in the digital economy and digital finance. The launch of the Digital Economy Blueprint (2019) by the Kenyan President and recognition of Digital Finance as a flagship project highlight the importance of the financial sector developing to support. Kenya continues to be considered at the

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[42] *Central Bank of Kenya (2019), The Kenya Financial Sector Stability Report, 2018*
[43] *World Bank (2018)*
[44] *KIPPRA (2019), 'Characteristics of Kenyan MSMEs Relevant to the Proposed Kenya Credit Guarantee Scheme'*
[45] *Absa (2018), Absa Africa Financial Markets Index 2018*
[46] *Centre for Global Development (2018). Commitment to Development Index 2018*
[47] *Kenya National Climate Change Action Plan 2013-2022*

frontier in Africa, particularly given the scale and role of mobile money and fintech in both driving financial inclusion but also creating new areas of concern. FinAccess 2019 revealed that mobile money users have substantially more challenges than users of regulated financial services like banks and mobile banks, with nearly 30% experiencing loss of money or fraud. Thus, Kenya's financial stability is linked to innovation both in the financial sector and more broadly. PWC's Africa Business Agenda 2019 indicated that Kenya is number 1 in Africa in the growth of innovative companies. A key area of focus going forward in Kenya will be to drive for financial stability and market integrity particularly with regards market conduct, while supporting financial innovation that drives inclusive growth.

FSD KENYA PROGRAMME, ACHIEVEMENTS AND LESSONS TO DATE

DFID Kenya invested a total of £29.17m in the FSD Kenya programme from 2001 to 2016. FSD Kenya started as a DFID project implemented by DFID Kenya but was spun out as a multi-donor trust in 2005. FSD Kenya's programme contributed directly to achieving an unprecedented level of expansion in financial inclusion through a broad-based programme. Many of the developments supported have impacted far beyond Kenya now widely regarded as the leader in inclusive finance on the continent.

FSD Kenya support led to a shift in the government's financial sector development **policy** from 2005 to formally encompass financial access as a policy priority alongside efficiency and stability. A trusted partner of the National Treasury, FSD Kenya has been directly engaged in the development of successive Vision 2030 medium-term plans for the financial services sector. Recent FSD Kenya technical support led to the creation of a new government Digital Finance flagship project and the incorporation of these principles into the Digital Economy Strategy.

Work on **regulation** by FSD Kenya helped established the new enabling regulatory frameworks which have underpinned the expansion of financial inclusion and fintech innovation in Kenya. This has included regulation for deposit-taking microfinance and financial co-operatives, the regulatory response which enabled the emergence of the M-Pesa mobile-money platform, agent banking, electronic payments and the first regulatory sandbox for fintech in Kenya (under the Capital Markets Authority). Competition work has resulted in enhanced disclosure in both digital and non-digital realms. Reflecting Kenya's success in encouraging the development of digital finance, regulators from across the continent and beyond have sought to learn from the Kenya approach facilitated by FSD Kenya in collaboration with the FSD Network.

Significant gains have been achieved in improving financial **infrastructure**. FSD Kenya was involved in the inception of credit information sharing which now encompasses most of the formal financial system although more work is needed as credit markets continue to evolve. Support for interoperability in the payments system resulted in the creation of a new proto-national switch by the Kenya Bankers Association which has already resulted in market price improvements. FSD Kenya pioneered the use of the financial sector to deliver social protection payments in Kenya through support of the UKAid initiated Hunger Safety Net Programme and used that experience to support the launch of the government's *Inua Jamii* programme to 1.2m low-income beneficiaries. This is now being looked to as a model for delivery of G2P payments across Africa. FSD Kenya initiated the first comprehensive market survey on financial inclusion (FinAccess) and supported it to becoming a sustainable part of the government statistical architecture. FSD Kenya's investment in research has produced work which is widely used and referenced globally including seminal studies on the impact of mobile money and financial diaries revealing the financial lives of the poor.

Innovation has been a centre-piece of the FSD Kenya programme from the outset and today Kenya is positioned globally as a leading innovator in financial inclusion and fintech. FSD Kenya provided long-term support for the development of Equity Bank as a low-income market focused financial institution, whose success forced all the other major network banks to address the market. Equity has since expanded its model across the region and is currently in seven other markets in Africa. Direct support for the development of the CBA/M-Pesa M-Shwari digital savings and credit solution (25.8m accounts opened since inception) has resulted in highly competitive market for digital finance. This solution has been replicated in many additional markets across Africa and beyond. Investment in establishing a novel shared management services network for 38 financial services associations (village banks) serving 300,000 low-income rural households most with no access to the formal financial service providers (except M-Pesa). FSD Kenya helped created new models to scale-up improved community-based savings groups – currently used by over 1m poor households in Kenya. This work has been leveraged by other FSDs in Mozambique and Zambia. More recent work has supported experimentation with fintechs working at the intersection of finance and real-economy areas like agriculture and health.

Kenya's recent experience has demonstrated the **transformative potential of technology** on the financial system. Peer country comparison shows that the availability of new information and communications technologies do not inexorably lead to improved financial inclusion. FSD Kenya's, **long-term** programme of **coherent market systems development** encompassing policy, regulation, infrastructure and innovation has been able to deliver significant, sustainable impact. However, Kenya's experience has also revealed the limits of (i) a largely supply-side driven approach, and (ii) a narrow focus on financial inclusion. The progress made in **financial inclusion is necessary but not sufficient** to exploit the full potential of the financial system to contribute to inclusive developmental outcomes. Greater attention is now needed to understand how finance impacts on low-income populations both directly and indirectly.

Work on finance for **marginalised communities** has been a focus for FSD Kenya notably through its long experience in creating payment solutions for government social protection programmes and in developing community-based finance models. Its long-term research programmes and grounded know-how have positioned FSD Kenya to work on developing improved and sustainable financial solutions leveraging formal and informal mechanisms to impact on rural communities and tackle barriers to participation by other marginalised groups. Much of the work with marginalised communities has had an intentional focus on gender and has looked more recently at the challenges of matching youth with economic opportunities. The focus on women is informed by the fact that women constitute the majority of both the unemployed (64.5 %) and under-employed (61.8%) population. [1] Women are also less financially healthy than men, are less likely to complete secondary education than men and are more likely to earn their living through farming or a microbusiness.[2] In the youth demographic, the focus is on 18-25 years because of rising numbers of out-of-school youth due to increasing school and college drop-out rates and unemployment[3],[4].

FSD Kenya has been at the forefront of efforts to develop genuine solutions for **enterprise finance** as a catalyst to **inclusive growth**. FSD Kenya engaged in action research in areas such as leasing, factoring, supply-chain finance and data enabled finance. Through learning and research, FSD Kenya designed and implemented capacity building programmes informed by the understanding that data is the key to developing and scaling enterprise finance. FSD Kenya's strategy now focuses on deepening understanding of how enterprises function in supply chains and ecosystems to design bespoke financial solutions that improve efficiency and add real value.

Specific technical expertise in FSD Kenya encompasses **policy and regulation** (e.g., market conduct, competition, payments and fintech), **payments systems**, **government payments**, **credit markets**, **community-based finance, enterprise finance, digital finance, fintech** and **research**.

WHAT MORE NEEDS TO BE DONE?

Economic growth and the expansion of financial inclusion over the last decade have yet to translate into sufficient impact on poverty reduction. Between 2005/06 and 2015/16, the share of Kenyans living below the international poverty line ($1.99 per day in 2011 Purchasing Power Parity) fell from 46.8% to 36.1%[48]. However, due to significant population growth over the same period, the *number* of people living in poverty remains unchanged. Rural to urban, and regional disparities exist, with poverty headcount lowest in Nairobi, at 16.7%, compared to 79.4% in Turkana (Northern Kenya) in 2016[49]. Further, according to UNDP's Multidimensional Poverty Index, while Kenya has the lowest portion of the population living in severe multidimensional poverty (in terms of health, education and standard of living) in East Africa (13.3%), Kenya has the highest population percentage vulnerable to slipping into multidimensional poverty (34.9%).[50] A more inclusive growth path is needed which establishes a virtuous cycle of effective investment in growth and human development to produce sustainable impacts on the livelihoods of the poor. This includes understanding the persistence of the gender gap especially in financial health and economic wellbeing and addressing the growing challenges of meeting the needs of the expanding youth demographic. The financial system has a crucial role to play in determining how

[1] *KNBS (2018), Labour Force Basic Report*
[2] *FSD Kenya (2019). Inclusive finance? The gender gap, internal document*
[3] *Ministry of Public Service, Youth and Gender Affairs (2018). Kenya Youth Development Policy 2018.*
[4] *KNBS (2018), Labour Force Basic Report*
[48] *World Bank (2018). Kenya Economic Update, Edition 17*
[49] *Development Initiatives (2018) The Needs of Kenyans by County: Exploring the Latest Poverty Data*
[50] *UNDP (2019). The 2019 Global Multidimensional Poverty Index (MPI)*

resources are allocated to achieve this growth path. It is not simply the depth or levels of access to the system – conventional indicators of **quantity** – which will determine the impact. Progress needs to be made in improving the **quality of finance** measured in terms of responding to the opportunities for broad-based growth and development. This is a challenge not only for Kenya but for the entire continent. Kenya has the potential to build on its position at the frontier of inclusive finance to create solutions which will impact across Africa.

At a sectoral level, economic and social priorities such as agriculture and housing, both Government of Kenya "Big Four" priorities[51], are not receiving the **investment** needed. For instance, over 80% of the population depends on predominantly primary agriculture for their livelihood[52]. Value addition, required to raise incomes, is limited, with only 16% of the country's raw agriculture is processed[53]. Access to finance is a key barrier - agriculture accounted for only 4% of commercial bank lending in 2018 according to the Kenya Bankers Association[54]. Furthermore, the largely informal segments of these sectors that impact directly on the lower income are not sufficiently well **integrated** with the formal. The financial system is falling short in its pivotal functions of resource allocation, risk transfer and payments. Looked at from the enterprise or household level many of the financial services currently offered provide limited value to users. The challenge can be seen by looking at three dimensions: **usefulness**, **affordability** and **trust**. While the availability of formal credit to households has expanded at a rapid rate over the past decade much of it is short-term and high cost, unsuited to solving long-term needs. Few MSMEs are able to access sufficient liquidity or capital needed to underpin long-term business growth. The costs of using the much celebrated low-value retail payments platform in Kenya are too high for low-income consumers to use for all but a fraction of the transactions in which they engage. Deepening participation in more sophisticated financial solutions – such as long-term investment – requires a higher degree of trust.

Greater impact through financial sector development needs to be based on addressing opportunities for growth or welfare gains in the real economy. These opportunities rarely rely on looking simply at the immediate needs of individual low-income households or individual enterprises for existing financial services. **End-to-end inclusive financial solutions** are needed such that the necessary investments can be achieved which will drive productivity improvements and simultaneously enable low-income people to participate fully as producers, workers or consumers. A financial system able to support these changes is unlikely to emerge without significant changes across the policy and regulatory environment, industry infrastructure and innovation system.

Kenya is uniquely well positioned to build on its early gains in digitisation to create an open, digital financial system to stimulate the next generation of **financial innovation**, **reduce transaction costs** while simultaneously **building and maintaining trust** across participants. While this clearly has direct significance for Kenya, it also offers the prospect of providing a test-case and model for replication across Africa. The opportunity is presented by the government's flagship project on digital finance which can be explicitly linked to supporting the broader goals for Vision 2030. Practical realisation of this vision requires coherent developments across multiple interconnected layers. These encompass not only purely financial sector elements – such as improved functioning of the payments system or the interbank market – but economy-wide – such as the rules and mechanisms for data exchange or establishment of identity. From a market development perspective change is needed at the level of the rules – formal policy and regulation together with the informal business models, rules and norms of finance – and the supporting functions – the infrastructure and business services from linked markets. Shaping developments to deliver value-adding finance requires broadening the perspective from a pure financial sector supply-side 'push' approach to include a significantly stronger demand-side 'pull'.

PROPOSED INTERVENTIONS UNDER FSD 2.0

FSD Kenya's strategy, creating value through inclusive finance, has considerable synergies with the five strategic shifts of the DFID Financial Sector Development refresh and consistent with the vision under FSD 2.0 to support the real economy. The proposed interventions aim to maintain and expand Kenya's leadership position on the continent, providing a core resource for the entire FSD Network. As FSD Kenya's experience has shown pushing the frontiers of financial system development is not easy and involves considerable uncertainty inherent in any

[51] *Vision 2030 Third Medium Term Plan (2018 – 2022)*
[52] *FAO (n.d). Kenya at a Glance*
[53] *Agricultural Sector Transformation and Growth Strategy 2019-2029*
[54] *Kenya Bankers Association*

innovation process. Significant investment will be needed to take genuinely new ideas to fruition. Past experience has shown the importance of maintaining a diversified portfolio in order to increase the prospects for breakthrough. The table below proposes five indicative interventions consistent with DFID Kenya's priorities where there are gaps in the development of the financial sector.

Interventions	Objective	Sample activities
Agricultural value chains - *Investment* - *Inclusion* - *Innovation*	Increase productivity and value addition of agricultural value chains with the potential to grow farms, agro-processors and other enterprises resulting in job creation and higher incomes using sustainable methods. *(Inclusive growth and Sustainable futures)*	In partnership with players like Msingi and Invest Africa, identify the financial barriers that are holding the agriculture value chains back. Activities could include: i) SME finance for up and coming farms, feed mills, transporters, and processors; ii) Embedded supply chain finance for out-grower schemes at the "beginning" of the chain to retailer finance and the players in between; iii) Risk mitigation tools related to climate change, disease etc. There are many other potential real economy facilitators, including DFID-funded entities, working in agricultural value chains who would be good counterparts in this work to identify demand-side needs and co-create relevant financial solutions.
Affordable housing - *Investment* - *Inclusion* - *Innovation*	Develop financial solutions for the housing market on both supply and demand side to provide growth opportunities for local enterprises, create jobs and increase appropriate housing options for low-income people. *(Inclusive growth, Basic services & Sustainable futures)*	In partnership with the Centre for Affordable Housing Finance in Africa (CAHF), identify the key gaps preventing the production, maintenance and purchase of affordable housing. Activities could include i) Work with the newly formed Kenya Mortgage Refinancing Corporation (KMRC) to ensure that affordable and sustainable mortgage are designed and offered by banks and SACCOs to increase offtake of affordable housing; ii) Support an exemplar of how affordable finance can be developed in a way to maximise quality jobs in construction and manufacturing and improve productivity; and iii) Advise a platform to create a competitive marketplace for low-income people in the housing supply chain by addressing information asymmetries. Potential partners include the Sustainable Urban Economic Development Programme (SUED).
Trade platforms - *Investment* - *Innovation*	Stimulate development of financial solutions that can increase market access and investment in productivity for small and medium enterprises leading to improved profitability and generating higher-quality jobs. *(Inclusive growth)*	Interventions could include: i) demand-side research that identifies how enterprises currently finance growth and how the needs could best be met through the spectrum of potential financial solutions; ii) In partnership with TradeMark East Africa (TMEA), identify opportunities for enterprises to leverage the increasing trade infrastructure to grow through trade financing solutions including de-risking; and iii) leverage the digitisation of data and processes through technology-enabled platforms to stimulate supply chain financing solutions.

Interventions	Objective	Sample activities
Climate finance - *Investment* - *Inclusion* - *Innovation* - *Stability* - *Integrity*	To stimulate interest and action in both "greening finance" - mainstreaming climate and environment factors as a financial and strategic imperative in the financial sector and "financing green" - mobilising private finance for clean and resilient growth. *(Sustainable futures)*	In partnership with FSD Africa and the potential FSD Network climate finance domain, activities could include i) Work with regulators and financial institution associations to create the market for climate finance disclosure and verification in line with Task Force on Climate-related Financial Disclosures (TCFD) and other environmental, social and governance standards; ii) Promote the development of financial solutions for reducing negative climate externalities within enterprises such as manufacturing and transportation; and iii) Support financial solutions for mitigating risks, rehabilitation and increasing resilience due to climate change.
Digital finance - *Inclusion* - *Innovation* - *Stability* - *Integrity*	To build on the gains in the digital finance and fintech landscape to help financial inclusion translate into positive financial health outcomes, by continuing to develop the digital financial infrastructure and protecting financial service users from inappropriate market conduct *(Inclusive growth and Basic services)*	Build on and expand existing activity to develop a financial system that delivers real value to low-income people and meets the needs identified in the FSD 2.0 shift to real economy issues including the ones mentioned above. Activities could include: i) Support National Treasury and Central Bank on the execution of the Digital Finance Flagship Project alongside the joined up implementation of the cross-government Digital Economy Strategy; ii) Advise Government Digital Payments on how to address emerging challenges; iii) Partner with others to accelerate the development of robust credit market infrastructure and data sharing; iv) Support the design of financial solutions that bolster financial health; and v) Work with regulators to develop appropriate market conduct, integrity, data privacy and open finance policies and regulations.

Local Governance Arrangements

DFID Kenya is a founding member of FSD Kenya's Programme Investment Committee (PIC) and would continue to play that role in its advisory capacity.

Opportunities for deeper FSD Network collaboration

Kenya has been at the frontier of many aspects of financial sector development for over a decade. FSD Kenya will scale up and formalise its position as a lead resource to the FSD Network, enabling Kenya to be used as a source of new ideas and practical demonstration of workable and replicable solutions to the rest of the continent. The proposed interventions here are clustered around the exploitation of digital technology to develop next generation financial solutions to the most pressing real-economy problems faced by African economies. The learning from FSD Kenya and the Kenyan market will be provided directly to the Network. It is planned that FSD Kenya will host the collaborative working group on digital finance / fintech for the Network. As a founding member of the FSD Network, FSD Kenya will itself benefit from collaborative working especially in the areas of climate finance and affordable housing. FSD Kenya is also keen to participate in the ongoing learning around how best to address gender gaps and empowerment and enable opportunities for youth employment across its programme. Finally, FSD Kenya will participate in the shared services including joint implementation of an enterprise resource planning system with FSD Africa.

EXPECTED RESULTS

The table below provides estimated targets for the current indicators as defined by the cross-FSD Network monitoring results and measurement working group. They will be further refined as activities are designed in line with annual business plans and the further development of strategy. In addition to these cross-network metrics, FSD Kenya will track the other quantitative metrics such as those around financial health as well as tracking qualitative indicators around sustainability, public private partnerships, and enabling policy and regulation especially on topics related to market conduct, data protection and privacy and enabling fintechs.

Indicator definition	Baseline	2 years	5 years
Number of direct FTE (Full Time Equivalent) jobs created/sustained courtesy of FSD support to **(i) MSMEs; (ii) agricultural value chains; (iii) housing value chains** (iv) health value chains; (v) other (to specify)	0	9,544	31,250
Number of people, who through an FSD's support, are able to access basic services from a private or public service provision system that meets human basic needs including **housing**, drinking water, sanitation and hygiene, energy, mobility, waste collection, health care, education and **information technologies**	0	46,667	300,000
Number of adults (15 years and older) and microenterprises with an account at a bank or other financial institution, or with an account at a payments service provider, or use a remittance channel, or have a loan or credit line, or have an insurance policy that has been supported by an FSD	0	140,000	630,000
Number of SMEs with an account at a bank or other financial institution, or with an account at a payments service provider, or use a remittance channel, or have a loan or credit line, or have an insurance policy that has been supported by an FSD	0	93,333	25,000
Public and private sector funds (in GBP m) crowded into investments or grant initiatives originated by an FSD	0	£2.59m	£7m
Number of policies and regulations in place that include rules governing inclusive finance and finance for growth developed or refined through FSD support	0		4

(Note: areas of interest for DFID Kenya have been indicated in bold for the first two indicator definitions)

THE PROFILE OF ESTIMATED COSTS

Funding for FSD Kenya would be allocated from central resources. The proposed resource allocation reflects FSD Kenya's envisaged role as a regional hub on financial innovation for development. Sufficient resourcing is essential to achieve impact. Although Kenya has made strong progress in many aspects of financial sector development – it is still far from achieving its promise for impact. The level of investment here is based on the level of expertise and need for in-depth experimentation required to push the frontiers of finance for development. The budget below is organised along the five strategic shifts of the DFID Financial Sector Development refresh although the priority interventions cross-cut these topics as described above. The largest area envisaged is related to finance for investment where extensive work is planned on the priority areas of agriculture, affordable housing, trade and climate finance.

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£ m	£ m	£ m	£ m	£ m	£ m
Finance for investment	1.80	1.90	1.90	1.70	1.70	9.00
Financial access	0.25	0.25	0.25	0.25	0.25	1.25
Financial stability	0.20	0.20	0.20	0.20	0.20	1.00
Financial innovation	0.30	0.50	0.50	0.50	0.30	2.10
Financial integrity	0.10	0.10	0.10	0.05	0.05	0.40
Monitoring & Results Measurement	0.17	0.18	0.18	0.17	0.16	0.86
Programme Management for services retained	0.45	0.50	0.51	0.47	0.43	2.35
Total retained by FSD	**3.26**	**3.64**	**3.64**	**3.33**	**3.08**	**16.96**
Centralised services, overhead costs	0.05	0.05	0.04	0.04	0.04	0.23
Grand Total	**3.31**	**3.69**	**3.69**	**3.38**	**3.13**	**17.19**
Of which:						
Country core	1.99	2.21	2.21	2.03	1.88	10.31
Collaborative working	0.66	0.74	0.74	0.68	0.63	3.44

RESOURCES

Country office staff resource commitment:

- Private Sector Development Adviser (20% FTE).
- Programme Manager (10% FTE), otherwise predominantly relying on the centralised programme management provision under FSD 2.0.

Annexe 1h. FSD Mozambique

COUNTRY'S FINANCIAL DEVELOPMENT STAGE

Mozambique GDP growth expanded at an annual average rate of 7.2% between 2000 and 2016, making it one of the fastest-growing countries in Sub-Saharan Africa. The economic expansion has boosted incomes and living standards. Growth has been supported by rebounding agricultural transport, communications and financial services sectors; bolstered by relatively stable economic performance large-scale foreign investments projects and significant donor support. More recently, however, growth slowed to 1.8% in 2018 and is expected to remain relatively slow (3.3%) in 2019 due to occurrence of cyclones in March 2019, macroeconomic factors, decreased public investment, and discovery of hidden external loans of $2bn which significantly affected fiscal and monetary indicators.

Within this context, **Mozambique remains the seventh poorest country in the world and at the bottom of human development index** (185th HDI, out of 187 countries). The national poverty headcount sharply declined from 69% in 1997 to 54% in 2003 but has stagnated at 50%. There is little evidence that the income distribution has changed dramatically, and most of the rural population still live on less than £0.44 a day, lack basic services such as clean water supplies, and access to health facilities and schools. Poverty remains concentrated in rural areas, and girls disproportionally affected.

In recent years Mozambique has made significant progress toward developing and strengthening the financial sector and improving central bank operations. The authorities have implemented a comprehensive financial sector reform program, they promulgated new laws strengthening bank supervision; introduced International Financial Reporting Standards (IFRS) for banks; and laid the foundations for risk-based supervision.

However, progress in financial deepening has been less satisfactory. While the ratio of private credit to GDP has increased rapidly, this was from a very low base, and credit is still relatively low in comparison to similar countries. Most of the population and businesses do not have access to financial services, 60% of adult population is excluded from the financial sector of which 62% are women and 69% live in rural areas[55].

At 28% average commercial bank lending rates in Mozambique are excessively high for most of the private sector and remain above peer countries. As a result, access to finance, particularly for SMEs and agriculture producers, is constrained. The lending–deposit spread increased to 10.6% in 2017 from an average of 6.2% in 2010–2015, higher than regional and income group medians. The spread reflects structural issues such as high operating costs, lack of credit information, limited availability of collateral and limited competition. NPLs increased to 10.6% by end-2017 from 4.3% in 2015. Lending to agriculture has fallen from 20% in 2000 to 6% in 2010. Based on the 2008 survey for agriculture, only 2.7% of farmers had access to credit mainly due to lack of collateral[56] and high interest rates. In urban areas, lack of housing finance is also a major problem resulting in shortage of affordable houses.

Digital finance is emerging with the rapid growth of mobile money accounts, which are helping improve access to financial services particularly in urban areas. According to the IMF Financial Access Survey, in 2016 there were more individuals with mobile money accounts than those with a bank account (370 Vs 332 accounts per 1,000 adults). However, ownership of accounts does not translate into usage. According to the Findex 2017 survey, only 22% of adults use a mobile phone or the Internet to access an account. Women make less use of digital banking financial services compared to men but use more (21%) informal financial products compared to men (18%). Less than 10% of women have savings products from a bank compared to 21% who use savings groups for savings as well as loans.

The insurance sector is small and highly concentrated. Insurance penetration is low with 4 of the 19 licensed insurance companies accounting for 87% of premiums issued. Most coverage is of general, mandatory products (third party motor, workers compensation, etc.). The *Instituto de Supervisão de Seguros de Moçambique* (ISSM) supervises the insurance sector but lacks independence as most regulatory decisions, including sanctions are referred to the Minister of Economy and Finance.

[55] *FINSCOPE 2014*

[56] *The newly approved law (published on 28th December 2018) on movable assets may reduce this challenge.*

The number of women with bank accounts is increasing but the gender gap between men remains high; women are particularly active in informal financial systems named *xitique (*informal savings and credit) and ASCAS (Rotative Savings and Credit Scheme) where memberships have more than double since 2009.

FSD PROGRAMME, ACHIEVEMENTS AND LESSONS TO DATE

DFID has been supporting the financial sector in Mozambique since 2013 through a programme which aims to increase access and improve the quality of financial services for more than 2.5m people, and one thousand Micro Small Medium Enterprises (MSME) by March 2020. Through FSDMoç, the UK has provided £13.5m and Swedish Sida £3.6m to provide greater access to financial services for more men, women and businesses in Mozambique, particularly in rural areas. FSDMoç has provided support for: (i) policy reforms; ii) financial infrastructure to expand access to financial platforms such as mobile banking and mobile money; and (iii) the development of new financial products, such as savings, insurance, tailored to the rural poor. Through a competitive process, DAI was selected as the program implementor and ensured that DFID procedures were respected. Key results so far are: (i) 1.5m unbanked people using new or additional financial products, of which 1.3m people using financial services via mobile money; (ii)1100 SMEs financially included; (iii) 14000 people reached through agent banking and; (iv) 3800 people reached through informal savings groups. Overall, projects are achieving their intended outcomes. FSDMoç developed the Gender Equality and Social Inclusion Strategy (GESI) to ensure the programme delivers equitable and fair access and usage of financial products and services to women, men, youth and people living with disability. The program has scored A on performance in successive Annual Reviews with moderate risk.

FSDMoç activities have generated a strong evidence base and developed a network of relationships from which the next phase of the programme could benefit, building on the following:

- The successful adoption of the PAYGO model by companies allowing customers to overcome the challenge of high upfront costs for off-grid electricity and irrigation systems. There is potential to extend this model to other basic services like education and water as well as payment in humanitarian contexts, with the possibility to extend to neighboring countries.
- **Ongoing partnership with the Central Bank which has led to the establishment of the Regulatory Sandbox:** This initiative is promoting innovation developed by Fintech companies, under the supervision of the central bank, to strengthen the regulatory approaches necessary to be supportive and adaptive to those innovations. FSDMoç is also building the Fintech Ecosystem through establishment of Fintech Association.
- **Unleashing the power of data:** through FSD interventions it became evident that data availability and accuracy are essential for Development Financial Institutions planning and decision making. More specifically data produced from GIS work may influence decision on new product development, policy or regulation changes which will ultimately impact on final beneficiaries, e.g. georeferenced data is useful to identify places with no financial access.
- **Bank and non-bank agent networks**: Recognizing that agent networks can play an important role in reaching the financially excluded, especially in rural and peri-urban areas, FSDMoç supported the expansion of bank and non-bank agent networks. The non-bank agent model has proved to be successful, whereas the expansion of bank agent models is still limited, and regulation is not yet adapted for this category. As a result, FSDMoç conducted a study to understand the ecosystem and inform regulators and other players, on the agent models suitable for Mozambique considering the digital environment.
- **Fostering Innovation and expansion**: the extensive work on innovation including building capacity to understand financial inclusion in the digital era, as well as cashless alternatives for consumers through education and awareness of digital financial services; supporting Fintech start-ups and innovators; engage regulators to build capacity to respond innovation; climate finance and housing.
- Facilitation of the process of building **alternative financing instruments for SMEs**: support the design of new types of debt instruments (municipality, green bonds) and strengthen the development of the capital market ecosystem.
- There is a need to continue influencing central bank and **foster interoperability** with other players in the ecosystem, including agents and payment providers. FSDMOç will continue play its facilitation role in the creating a multilateral interoperability between bank, and mobile money operators (MMOs) and other key players in this area.

WHAT MORE NEEDS TO BE DONE?

The need to expand levels of people and companies' access to formal financial services in Mozambique has always been part of the Government economic policies. Its relevance has been growing, as the role that financial inclusion plays in stimulating financial savings is recognized at the global level, to finance the economy and, consequently, expanding economic activities, income generation and poverty reduction. In the last five years the Government has developed several policies including the Government Plan 2014/19, Financial Sector Development Strategy 2013/23 and the National Strategy for Financial Inclusion (ENIF) 2016/22 and is open to implement necessary reforms to enable environment for financial transactions. However, reforms can be slow and Government post October elections may prioritize other of reforms.

The financial sector is a priority sector in the UK Prosperity Strategy for Mozambique and has been identified in the Country Development Diagnostic as one of the main sectors to unlock Mozambique development. DFID Mozambique support to financing the agricultural sector is one of the priorities for DFID Mozambique business plan in line with the Government of Mozambique's vision for economic transformation. Other key donors are also looking to support FSDMoç going forward. KfW acknowledges the need for a solid and efficient financial system, focusing its support on private sector development and increase of income, with emphasis on MSMEs in rural areas and the agriculture sector. Sweden included FSDMoç program in the country strategy under the pillar "Better opportunities and tools to enable poor people to improve their living conditions", looking particularly at "Increased access to services and support for women and young people in rural areas".

Constraints:

1. **Low levels of financial literacy and market education**: This includes consumers but also regulators and industry players. There is limited understanding of financial services and investment products beyond the basic ones. There are no functional consumer protection mechanisms nor literacy and market education driven by the market.
2. **High interest rates constrain access to finance, particularly for SMEs and agriculture producers**: The real cost of borrowing in Mozambique is high compared to peer countries.
3. **Weak regulatory capacity and coordination**: For instance, in the capital market, there is low level of coordination between the Ministry of Economy and Finance, the Central Bank and the Stock Exchange. Although a MoU signed between the central bank and the Telecom regulator exists, there is still a need for ongoing coordination between telecommunication and financial sector regulators to take advantage to benefit from the existing technological developments in the telecom sector, considering the importance of Digital Financial Services (DFS) on the acceleration of financial inclusion.
4. **Lack of appropriate products that meet customer needs**: For example, in the insurance sector there is low capacity of the regulator to catalyse the development of microinsurance products. Moreover, there is weak capacity of Financial Service Providers to design digital financial services/products oriented to consumer needs.
5. **No clear approach from Government and different stakeholders on how to use the enormous potential of informal savings groups** as a mechanism for financial inclusion, especially in rural areas – these groups cover most of women in rural areas and can be used as a tool for female economic empowerment and capacity building tool for community development.
6. **The low access to a national ID and other documentation required to open bank accounts** represent a key constraint for expansion of financial services to target groups, particularly in rural areas.
7. **The lack of a Digital ID, including the absence of a unique citizen identification number** is a foundational identification for the digital economy and has implications for financial inclusion, integrity and stability.
8. **Lack of intermediation of funds for SMEs,** which is non-bank based and can channel funds that are adequate to meet these enterprises' needs, particularly in the agricultural sector.

Opportunities:

- **Investment**: The government of Mozambique is increasingly aware of capital market development as an alternative for finance. FSDMoc, with support from FSD Africa, is developing 10-year master plan for the capital market which will be useful to determine initiatives for Ministry of Economy and Finance to establish a capital market independent supervision authority.
- **Access/Usage**: There is a need to reach vulnerable people with physical impairment through innovative and accessible products and services that will be used to influence inclusive policies. FSDMoç will address financial inclusion through usage and access of financial services with emphasis on digitalization as a mechanism to reach excluded people from financial and basic services.

- **Stability and Integrity**: The work on data privacy protection and usage as well as consumer protection is essential for enabling stability and integrity of the Mozambican financial market. It is commonly assumed that digital ID will create a foundation to strengthen financial integrity.
- **Innovation** - High levels of mobile phone penetration create opportunities to expand digital financial services, especially for the hard to reach rural population. Continue exploring Fintech, ensure that the regulation is conducive to development of innovative solutions in diverse areas, including remittances transfer; Involve academic community to strengthen DFS professionals on skills and technologies.

Additionality of FSD Mozambique:

DFID and other donors have been working in the financial sector in Mozambique collaborating and distinctively. The World Bank and African Development Bank are focused on technical assistance to Government on policy and reforms, other bilateral donors have individual interventions and DFID has created FSDMoç. FSDMoç activities have evolved over recent years from facilitator role to become an advisor and reference on financial inclusion working in close collaboration with the Central Bank on the country's financial inclusion strategy. Its international network of FSD programmes in different countries is a natural and competitive advantage which places FSDMoç as the ideal mechanism to centralise, discuss and continue addressing financial inclusion in Mozambique. FSDMoç is one of the implementing bodies[57] of SADC financial inclusion strategy.

Expected Outcomes:

(i) Increased and diversified coverage of an appropriate range of financial services to vulnerable and remote populations; (**ii)** Improved consumers' trust and awareness regarding the financial sector; **(iii)** Development of market finance and digital financial products/services such as sovereign, municipal and green/blue bonds, climate and insurance products; (**iv)** Improved access to credit and insurance services for SMEs; and **(v)** Improved availability of financing mechanisms for agriculture.

Key risks: A major risk for this programme will be the deterioration of the macroeconomic conditions in Mozambique[58]. If the external debt contracted in 2016 is not well managed it may result in a downgrading of country sovereign credit risk rating, with further repercussions in the financial sector. Other possible risks are slow pace of Government reforms. It is also worth mentioning possible delays in the establishment of new legal institution (FSDMoç Foundation) due to ambiguity in current law which does not specify the Government body to approve Foundations. A medium risk of not having in place the Governance structure of Foundation due to transition difficulties from FSDMoç as a project to FSDMoç Foundation and a possible risk of fraud since the program management will change from DAI to another entity.

Mitigation: DFID Mozambique works on public financial management and tax, and its multilateral partners work to mitigate the likelihood of macroeconomic shocks. DFID works in sectors such as electricity, water and sanitation, youth which will help to achieve real sector objectives and contribute to the selected SDGs. DFID, KfW, Sweden and FSDMoç are working with Government to seek for alternative solutions for timely legal approval of the Foundation and KfW is leading on the consultancy services to design the appropriate governance structure for the foundation. To ease fraud risk there is a need to perform due diligences, follow closely systems in place for new entity and ensure that systems a fully compliant with DFID systems including safeguarding.

PROPOSED INTERVENTIONS UNDER FSD 2.0

FSDMoç will continue to guide its interventions through strategic partnerships to offer financial services and products developed through comprehensive research, a challenge fund and the HCD approach. Cross cutting initiatives will include gender, policy and regulations, financial and digital literacy and innovation aiming at contributing to achieve the SDGs in Mozambique. The FSD 2.0 programming will be aligned with the three levels of financial inclusion (access, usage/adoption and quality of life) and with the Mozambican government and UK/DFID development priorities, as well as with other financial sector priorities, including financial access, stability, integrity and investment.

[57] SADC bank association, SADC Central bank governors committee and FSDs of different countries

[58] The cyclones reduced the economic growth forecast from 3.3% to 1.8% and primary balance after grants from -1.4% to -2.5% of GDP. Annual inflation is now forecasted at below 5% which allowed the central bank to reduce the interest rate from 14.25% to 12.75%.

DFID Areas	Description	Proposed Activity
Finance for Investment	Agriculture (whole value chain), commerce (trade) and housing finance were identified as areas that can contribute to the inclusive growth. Climate change will be implemented in collaboration with all FSDs as crosscutting area within FSD Network. All the activities are linked to the SDGs particularly related to inclusive growth to drive progressive change with impact on poverty reduction and prosperity.	- Creation and implementation of a master plan for capital market development - Facilitate development of new capital markets products (municipality bonds, green/blue bonds, financial instruments for climate change); - Implement the ISSM insurance roadmap aiming for more products being delivered in the market; - Develop a supply chain finance model for agriculture; - Promote the development of affordable housing finance products; - Alternative financing mechanisms - crowd in finance model, capital markets, private equity, factoring, invoice discount, crowdfunding, asset finance; - Provision of Technical Assistance and capacity building of financial service providers; - Conduct studies to understand financial needs of the low-income groups to inform product design.
Finance for Access/ usage	Interventions to improve access and use will focus on the following areas: agriculture, basic services (water, education, energy, etc.), commerce, and housing finance and will allow that farmers, SMEs, women, youth and people with disabilities have access to affordable financial services. *(Basic services and inclusive Growth)*	- Improve access for SMEs especially to credit and insurance (e.g. working with insurance companies, agriculture funds, microfinance institutions, etc.); - Expand digital solutions for payments to different sectors including humanitarian cash transfers, pay as you go on water (including irrigation), education and energy sectors; - Strengthen informal savings groups and use the platform as vehicle for women economic empowerment and to implement selected SDGs at community level; - Support creation of appropriate financial products and services for people with impairment and climate change sensitive; - Reinforce the activities of financial and digital literacy to ensure uptake of investments. - Provision of Technical Assistance and capacity building of financial service providers; - Conduct studies to understand financial needs of the low-income groups to inform product design.
Financial Integrity	The interventions will have an impact in all sectors. (*sustainable future)*	- Support the development of policies to implement digital ID to ensure confidentiality, transparency and consumer protection - Strengthen mechanisms to facilitate the easy identification of licit and illicit digital financial transactions; - Support interventions on data improvement and protection. - Continue facilitating implementation of cybersecurity (Telecom, financial); - Continue working on the establishment of Tiered E-KYC (know your costumer) for different amounts and risks - Promote affordable products and services as well as transactional costs; - Implementation of new agent networking models; - Deliver capacity building in matters related to financial security.

DFID Areas	Description	Proposed Activity
Financial Stability	The interventions will have an impact in all sectors. *(inclusive growth and basic services, sustainable future)*	- Continue working with the central bank for the regulation of fintech's and agent networks; - Work with the insurance regulator to create an enabling environment for the development of digital solutions for insurance. - Tiered KYC for different amounts and risks. Work with regulators to define pricing for financial service providers products and incentive models for agents; - Support improvement of regulation to allow development of innovative solutions; - Capacity building of the consumer protection regulators and policy makers to improve their skills; - Work with regulators and policy makers to design appropriate regulations considering climate change and green finance, considering the 4 P's (Provision, Promotion, Prevention and Protection); - Conduct studies to understand financial needs of the low-income groups to inform policy design.
Infra-structure for Innovation	The interventions will have an impact in all sectors. *(inclusive growth and basic services, sustainable future)*	- Push the growth of fintech ecosystem to accelerate financial inclusion. - Continue support to fintech companies on business development, support to regulators to ensure innovation have conducive legal environment; - Engage with the academy to promote capacity building and skills development in 4th industrial revolution technologies at universities; - support establishment of fintech association to empower fintech's; - Create an infrastructure to promote cross border trade and remittances as well as the promotion of e-commerce; - Strength the establishment of the fintech ecosystem; - Conduct studies to understand financial needs of the low-income groups to inform product design.

Opportunities for deepening the FSD Network collaboration

- A MoU was signed between the Ministry of Economy and Finance, FSD Africa, and FSDMoç, aiming to support the development of a capital market master plan. FSDMoç will continue to support the Mozambique Stock Exchange, particularly in the provision of new/improved innovative stock exchange products.
- In future, there may be opportunities for collaboration with other FSDs in the region especially on trade, cross border remittances and e-commerce. FSDMoç will continue to collaborate with the network to mainstream gender, youth and people with impairment within each partners' strategies, including the Central Bank to advance gender inclusive finance.
- Under the FSD Africa partnership to advance gender inclusive finance, FSD Network prepared a joint proposal on Gender submitted to the Bill and Melinda Gates Foundation and all FSDs collaborated in the development of the proposal submitted by FSD Africa. FSDMoç received support of FSD Africa and FSD Zambia to develop its GESI strategy.
- FSD Network provides support to strengthen capacities of FSDs such as: (1) monitoring and result measurement (MRM), (2) VfM framework and guidelines (3) Training on DFS and Making Markets Work for the Poor (M4P).

Local Governance Arrangements

The recommended delivery model is to set up a legal independent institution which will be able to receive funds from donors as well as raise funds on its own. Currently**,** FSDMoç Foundation is in the process of setting up, awaiting Government approval. Regarding the operation models of this Foundation, DFID together with KfW and Sweden have requested an independent consultant to provide alternatives for a governance model that will best fit FSD 2.0 vision, in line with the Mozambican regulation. The Foundation will enable FSDMoç to continue to be a reference in the financial sector by delivering advisory, facilitating and implementing roles, working at micro, meso and macro levels with different stakeholders. It also ensures that there is a local in-depth understanding, relationship and the ability to bring in international specialist perspectives through the FSD Network collaboration.

EXPECTED RESULTS

Indicator definition	2 years	5 years
1. Number of people through FSD's support, able to access basic services from a private or public service provision system for basic human needs including housing, drinking water, sanitation and hygiene, energy, mobility, waste collection, health care, education and information technologies.	44,467	*1,200 ,000
2. Public and private sector funds (GBP m) crowded into investments or grant initiatives or partnership as a result of FSDMoc intervention (This indicator will provide the total amount of funding leveraged by FSDMOç activities/initiatives)	£0.68m	£1.75m
3. Number of SMEs with access to alternative finance and account at a bank or other FSP; with an account at a payments service provider; use a remittance channel; have a loan or credit line, green bond, capital market, supply chain finance, credit insurance, or have an insurance policy supported by FSDMOç	88,933	7,000
4. Number of direct FTE (Full Time Equivalent) jobs created/sustained through FSD support to (i) MSMEs; (ii) agricultural value chains; (iii) housing value chains (iv) health value chains; (v) other (to specify)	4,096	**10,500
5. Number of adults and microenterprises with an account at a bank or other FSP, or with an account at a payments service provider, or use a remittance channel, or have a loan or credit line, or have an insurance policy that has been supported by FSD	133,400	2,600,000
6. Policies and regulations in place that include rules governing a) inclusive finance AND b) finance for growth.		4

Notes:

*Assuming that programme will continue working with informal finance (eg: savings groups) by promoting services to people living with disabilities and improving literacy via digital tools and growth of fintech ecosystem will accelerate financial inclusion by improving the uptake and usage of new products and services.

**The number of FTE jobs is estimated based in the fact that one of the major contributor's sector is agriculture value chain and most of the jobs are seasonal within sector.

THE PROFILE OF ESTIMATED COSTS

DFID Mozambique will not commit funds from the country office. However, at the country level there is a partnership with KfW and Sweden, who have committed to transfer funds to FSDMoç, once a legal independent entity is created.

Indicative cost breakdowns will be revisited during the inception phase and at regular intervals thereafter.

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£ m	£ m	£ m	£ m	£ m	£ m
Finance for investment	0.54	0.95	1.09	0.69	0.54	3.81
Financial access	0.63	0.80	0.95	0.59	0.40	3.37
Financial infrastructure for innovation	0.44	0.70	0.92	0.58	0.42	3.06
Financial stability	0.40	0.48	0.57	0.37	0.34	2.16
Financial integrity	0.23	0.39	0.55	0.34	0.31	1.82
Monitoring & Results Measurement	0.12	0.16	0.20	0.13	0.10	0.71
Programme Management for services retained by Country FSD	0.29	0.44	0.55	0.34	0.27	1.89
Total retained by FSD	**2.65**	**3.92**	**4.83**	**3.04**	**2.38**	**16.83**
Centralised services shared overhead	0.040	0.056	0.059	0.037	0.031	0.223
Grand Total	**2.69**	**3.98**	**4.89**	**3.08**	**2.41**	**17.1**
Programmatic funding split:						
Country core	1.70	2.53	3.10	1.96	1.53	10.86
Collaborative working	0.54	0.80	0.98	0.62	0.48	3.42

RESOURCES

Country office staff resource commitments: (i) Private Sector Advisor (20% up to June 2020 to support set up, 10% thereafter); (ii) Programme Manager (5%)

Annexe 1i. FSD Sierra Leone

SIERRA LEONE'S FINANCIAL DEVELOPMENT STAGE

Sierra Leone's financial sector is one of the least developed in Sub-Saharan Africa. Sierra Leone lags behind its peers in both financial breadth (inclusion) and depth (size of capital markets). 87% of people are excluded from the formal financial system. Women and rural populations are more likely to be excluded. Credit to the private sector is on a downward trend, declining from 7.5% of GDP in 2011 to 5.1% in 2017. The Sub-Saharan African average is 17%. 40% of firms state access to finance as their biggest obstacle to doing business – twice the Sub-Saharan African average.

Weak financial systems are a significant constraint to inclusive economic growth. 57% of people live in poverty, rising to 72% in rural areas. 59% of people are reliant on subsistence agriculture. High poverty rates are reflected in an informal, underdeveloped and unproductive private sector. A well-functioning financial sector would give people the confidence to save and invest, and enable a more efficient allocation of money towards growing the private sector. Products and services provided by a growing financial sector would help individuals and businesses to better manage their cash flows, invest in economic and human capital and increase their resilience to financial shocks.

Fragility affects Sierra Leone's capacity to provide basic financial services. Uncertainty in the future increases risk-aversion. Information asymmetries, including limited credit worthiness data, and weak legal and institutional structures further increase risk. These factors combined with unfavourable macroeconomic indicators, including high inflation rates and erratic growth, mean financial institutions struggle to offer affordable and appropriate financial services. Financial service providers prefer short-term and relationship-based credit targeting a limited customer base over long-term, standardised financial transactions. This disproportionately impacts Sierra Leone's poorest and MSMEs.

There is significant scope for intervention across FSD 2.0's five thematic pillars: finance for investment, financial access, financial stability, financial innovation and financial integrity.

Finance for investment (building capital markets)

High public-sector borrowing crowds-out domestic lending to the private sector. Commercial banks, which provide almost all credit to the domestic private sector, concentrate most of their assets in short-term government treasury bills. In 2015, bank credit to the public sector was double that of the private sector – the highest ratio among the 159 countries for which data is available. 37% of credit to the private sector is concentrated in construction and trade finance. The share of bank lending to agriculture, forestry and fishing is relatively small despite these sectors accounting for nearly half of Sierra Leone's GDP growth and most of the employment. Sierra Leone's capital market is still in its infancy. The Sierra Leone Stock Exchange, established in July 2009, has six listed companies including Rokel Commercial Bank, Standard Chartered Bank and two insurance companies.

Credit market development is hampered by weak financial infrastructure. There is no national switch enabling efficient financial transactions between different financial institutions. Only 1% of individuals are in the B credit registry. The low credit registry coverage coupled with limited capacity to adequately assess risks limit banks' willingness to expand lending to new customers and sectors. Weak legal frameworks and enforcement further increase lending risk. Financial institutions struggle to seize collateral, with enforcement costs averaging 40% of the claim value.

Financial access (improving livelihoods, reaching the marginalised)

There is unmet demand for financial services. While usage of formal lending products is approximately 4%, 49% of adults have borrowed money in the past year. Similarly, while about 5% of adults use formal savings products, 54% of adults have saved money in the past year.

The millions of unbanked people are disproportionately female, poor and reside in rural areas. 11% of women report owning a deposit transaction account compared with 18% of men. Among the bottom 40% of income earners, just 6% have an account compared to 20% among the top 60%. 10% of rural residents report owning a deposit or transaction account with a regulated financial institution.

Community banks, Financial Service Associations (FSAs) and Microfinance Institutions (MFIs) are the primary branch-based financial service providers in rural areas. These institutions primarily focus on MSMEs and agricultural lending. Women make up 44% of loan recipients in the case of FSAs. Community banks and FSAs account for less than 1% of assets in the financial system.

Financial stability (market conduct regulation)

While relatively stable, Sierra Leone's banking sector is exposed to risks from other sectors of the economy. High sectoral loan concentration, high rates of Non-Performing Loans (NPLs) and high degrees of dollarization are the key risk transmission channels from the real sector to the banking sector. The accumulation of government arrears is a major challenge to the quality of commercial banks' loans. An undiversified economy with government revenues and foreign exchange heavily reliant on iron ore extraction further increases risk.

NPLs represented 32% of total gross loans in 2015 – 5x the Sub-Saharan African average. This reflects fragility in the private sector, weakness in supervision, weak credit risk management, fiscal arrears and governance issues in the two state-owned banks, Rokel Commercial Bank (RCB) and Sierra Leone Commercial Bank (SLCB), for which NPL ratios were 74% and 48% respectively.

The two large state-owned banks pose challenges to financial stability. Despite the entrance of several foreign private banks over the past decade, RCB and SLCB continue to dominate the market, together holding 29% of assets, 36% of deposits and 24% of credit. Both RCB and SLCB had to recognize large and long-standing asset problems in 2014, which resulted in an erosion of their capital base. The Bank of Sierra Leone (BoSL) intervened taking over their management and limiting new corporate lending. The Government is currently determining how to proceed with their restructuring.

Financial innovation (digital financial services)

Mobile money is growing rapidly and is likely to be the primary mechanism for improving access to financial services in the short to medium-term. There are now 1.9m customers using mobile cash-in/cash-out transactions, with about 94,000 mobile wallet customers. As of December 2017, AfriMobile and Orange Money were the dominant mobile money providers which together held 92% of accounts (down from 97% in 2016), 33% of which were active customers.

Leveraging innovations in fintech is a priority of the BoSL to expand financial services to a larger share of the population. The BoSL has provided clarity for actors involved in the provision of mobile money services through the Mobile Financial Services Guidelines. This framework needs updating, however, to reflect the fast-changing mobile financial services environment.

A National Switch could support the growth of the Digital Financial Services (DFSs) in Sierra Leone. Lack of a national switch currently means that interoperability between DFS providers and other service providers is limited to bi-lateral agreements. This hampers the migration of cash-in/cash-out mobile money customers to other, more productive accounts. The World Bank is providing support to procure and implement a National Switch, which is expected to be operational in early-2020.

Financial integrity (licit and illicit financial flows)

The Government of Sierra Leone has prioritised combatting illicit financial flows. The National Development Plan 2019-23 highlights this as crucial for alleviating extreme poverty and boosting private sector growth and development. In practice, the challenge expands beyond the financial system. Sierra Leone ranks 130/180 in the Corruption Perception Index. An estimated 50-90% of the diamond trade is lost through smuggling. The most lucrative economic opportunities, including mining, industrial fishing and public procurement are characterised by opaque agreements and transactions. A recent technical audit revealed $1bn in unaccounted funds between 2015 and 2018.

FSD PROGRAMME, ACHIEVEMENTS AND LESSONS TO DATE

FSD Africa's Fragile States Unit has provided light-touch support to Sierra Leone since 2016. This support has consisted of one person working half a day a week and has spent £173k to date. Working closely with the BoSL and UNCDF, the Fragile States Unit has developed relationships and a portfolio of interventions with the view to transitioning to a fully functional entity.

FSD Africa's interventions have focused on four areas. These are detailed in the table below. A Memorandum of Understanding (MOU) between FSD Africa and the BoSL was signed in February 2019, which is demonstrative of the trust FSD Africa has gained in-country.

Intervention	Description	Results
Fintech Challenge Fund	Technical assistance to the BoSL to launch a Fintech Challenge Fund to encourage innovation in the Fintech Sector.	InvestEd won a grant to scale-up their mobile phone-based financial literacy and entrepreneurship education app, linked to microfinance via mobile money. 500 clients trained on app; 300 completed lessons; 180 users registered for loan. MOU signed with Orange Money for bulk payments by mobile money. Work is also underway with a second company, Data Pool Ltd, to scale up their product.
Credit Market Development Project	Technical assistance to improve financial stability, consumer protection and financial sector development through: a credit market diagnostic study; design and implementation of a formal framework for credit market; reforms to relieve structural constraints to credit market growth and FSD.	Comprehensive Credit Market Overview completed. This study informed the development of a terms of reference for a credit Market Diagnostic Study, which will commence in October 2019.
Regulatory Sandbox	Technical assistance to BoSL to develop and implement a "regulatory sandbox" – a mechanism championed by the UK's Financial Conduct Authority, whereby DFS providers can develop and test new products that are not protected by current regulation.	Four companies – Noory, iCommit, InvestEd and MyPay have been developing their products through the Sandbox. Stronger understanding and acceptance of the Sandbox methodology within the BoSL
Data Management and Analytics Project	TA to Sierra Leone Commercial Bank, iDT Labs and Africell/Activa to enhance their data management and analytical capabilities.	Still early stages. Capacity building on new product development to SLCB. Agreement with Africell to develop new life insurance product.

A key lesson learnt is that resource and capacity constraints within the BoSL and private sector limit the effectiveness of light-touch technical assistance. FSD Africa's Fragile States Unit has laid the foundations for a more comprehensive financial sector development programme. However, resource and capacity constraints both in the BoSL and private sector limit the ability of light-touch TA to deliver systemic, large-scale results. Given the size and complexity of the challenges, continuing this minimal-cost approach is likely to prove a false economy in the Sierra Leone context. A more comprehensive package of support is required to enable DFID's financial sector development work in Sierra Leone to make a meaningful impact, in line with FSD 2.0s results framework.

Following a successful pilot, the DFID-managed Prosperity Fund Global Finance is scaling up its financial stability support to the BoSL. Since January 2018, this programme has enabled the Bank of England to provide training to the BoSL on financial markets and market operations, financial stability functions, banking supervision and regulation, inflation forecasting, stakeholder management and communication, and governance of the central bank. The scale-up on this work on financial stability would be complementary to FSD 2.0's proposed work in Sierra Leone.

WHAT MORE NEEDS TO BE DONE?

More work is required across all five thematic areas, however financial access and innovation are most critical. Sierra Leone's nascent financial sector relative to its regional peers warrants a stronger focus on the fundamentals: financial inclusion through increased access to financial services and innovation in new products and services that reach large segments of the population. The table below sets out FSD Sierra Leone's prioritisation against DFID's thematic areas.

FSD 2.0 Thematic Area	FSD Sierra Leone Priority
Finance for investment	**Medium.** Dutch NGO Cordaid is the only major provider of local currency debt and equity to SMEs in Sierra Leone. There is potential to use FSD 2.0's DevCap offering to crowd in more commercial financing into the Sierra Leone's private sector.
Financial access	**High.** This prioritisation reflects the scale of financial exclusion in Sierra Leone and its disproportionate impact on marginalised groups. While UNCDF is doing some work on financial literacy, there is scope for significantly more work under this thematic pillar.
Financial stability	**Low.** The IMF and the Bank of England are providing support on supervision and reforms. UNCDF and the US are supporting strategy and regulation development.
Financial innovation	**High.** This prioritisation reflects the high potential of digital financial services to increase financial inclusion for individuals and MSMEs.
Financial integrity	**Low.** The prioritisation reflects Sierra Leone's nascent financial sector and the relative importance of the other thematic areas.

The proposed prioritisation aligns with BoSL National Strategy for Financial Inclusion. The BoSL's strategy focuses on six objectives: access to financial services/products, lending to MSMEs & agriculture, financial literacy, DFSs, savings, and demand for financial services. There is strong alignment with DFID's Financial Access, Financial Innovation and Finance for Investment pillars.

Demand and supply-side interventions to increase individuals and MSME's access to financial services and products are a top priority. On the demand side, financial literacy, management and entrepreneurship training is required to increase the demand for formal financial products, while also reducing the rates of NPLs. This is required at all levels, from individuals and microenterprises to medium sized enterprises. On the supply side, there is significant scope to increase the efficiency and effectiveness of the financial service providers that serve individuals and MSMEs through system strengthening and new product development. If pro-poor products were made available in the market, it is estimated that the demand for financial services will be 87% of the economic active population.

DFSs should be supported as the most feasible modality for large scale formal financial inclusion in the short to medium-term. DFS providers account for 90% of the financial access points in Sierra Leone. With better regulations, cooperation framework and investments, DFS can strengthen the financial sector, provide liquidity and propel the development of the financial services infrastructure necessary for resilient growth. DFS also introduces new risks, however, which should be addressed on an ongoing basis in partnership with the relevant regulators and industry bodies.

Development partners should look beyond grants to increase local currency financing to Sierra Leone's SMEs. The public sector's crowding-out of domestic lending is a binding constraint to firms' access to finance. However, this constraint is a result of structural macroeconomic factors that will take several years to resolve. In the short to medium-term, there are limited options to systemically increase Sierra Leone's SMEs to access finance (i.e. through commercial market actors). Development interventions to date have been heavily focused on the provision of grants, however these can distort the structure and priorities of businesses at the cost of long-term commercial viability. Development partners should look to provide concessional debt and equity products that better prepare recipient firms to attract commercial financing in the future.

There is a strong case for DFID intervention to complement the work of others. The World Bank, UNCDF, IMF and US are the key actors supporting financial sector development in Sierra Leone. The World Bank's Financial Inclusion Project is the most substantive, which is currently focusing on procuring and implementing a National Switch. Future activities are still being developed however it is expected that they will focus on strengthening the state-owned banks and subsidising banks' operating costs (e.g. point of sales devices, bank cards) to increase financial inclusion. DFID's intervention should capitalise on the critical infrastructure financed by the World Bank.

Future work with the BoSL should focus on regulation implementation rather than drafting. UNCDF and the US have provided support on drafting strategies and regulations, with a particular focus on agent banking, e-money, micro-finance and Know Your Customer (KYC). Future support to the BoSL should be cautious about drafting more regulations. Instead, support should focus on the effective implementation of the existing regulations in a manner that enables the market to grow.

PROPOSED INTERVENTIONS UNDER FSD 2.0

Interventions under four of the five thematic areas are listed below. An intervention under the financial integrity pillar is included as potential opportunity for collaboration with FSD network.

Intervention & Objective	Example Activities
Local currency finance market development (*Investment, Inclusion).* Increase domestic credit to the private sector by supporting both the GoSL and private sector to alleviate the constraints to local currency lending.	- Using TA and FSD Africa's DevCap to deploy debt and equity capital. - Crowding in other investors through blended finance investment structures. - TA to firms enable absorption of debt/equity. - TA to improve the credit registry and bureau's data collection, systems and analysis.
Agricultural value chains (*Investment, Inclusion, Innovation).* Demand-side interventions to increase the use of formal financial products and services within agriculture value chains.	- Support to individuals and MSMEs to increase their productivity (incomes) through better use of financial products and services (e.g. trade finance, pricing information, payments and transfers). - Targeted financial literacy training.
DFS enabling environment *(Inclusion, Innovation).* Support to the BoSL to ensure the implementation of regulation covering DFSs enables the growth of the market.	- TA to implement risk-based Know Your Customer (KYC) regulation. - TA to support effective implementation of digital identification systems.
Financial product development (Inclusion, Innovation). Supporting financial service providers to increase their product offering and efficiency.	- Identification of well-governed, high growth-potential community banks, FSAs and MFIs. - Digitisation of rural banks, FSAs and MFIs using TA and grant financing. - TA to develop new digital financial products and services (e.g. remittance products).
Revenue disclosure (Integrity). Support Sierra Leone's participation in the Automatic Exchange of Information agreement.	- Technical assistance to help the GoSL develop the systems and collect the data required to meet the agreement requirements.

Local Governance Arrangements

As there is currently no FSD in Sierra Leone, FSD Africa will incubate the FSD in Sierra Leone during the first year of operations. Year 1 funding will go to FSD Africa incubate an FSD entity (SPV) in Sierra Leone to a point where it is strong enough to spin-off into its own independent structure. This will include setting up the operating platform while implementing intervention activities parallel. Once FSD Sierra Leone is set up, FSD Africa will continue to provide core operational services including: monitoring and evaluation, HR and talent management, internal audit, shared accounting and enterprise resource planning systems, and international consultant procurement.

EXPECTED RESULTS

Indicator	2 years	5 years
# jobs created or improved through FSD-supporting initiatives	1,533	5,775
# people facilitated to access basic services	34,933	577,500
# people/microenterprises with improved access to financial services	104,800	247,500
# SMEs with improved access to finance	69,867	1,650
Private and public co-investment mobilised (GBP m)	£2.62m	£3m
Number of policies and regulations developed through FSD support		2

THE PROFILE OF ESTIMATED COSTS

FSD Sierra Leone will cost £15,000,000 over five years. An estimated cost profile is in the table below. FSD Sierra Leone will be centrally-funded for the first five years.

Thematic Area (£m)	%	20/21	21/22	22/23	23/24	24/25	Total
		15%	20%	20%	22.5%	22.5%	
Finance for investment	20	0.45	0.60	0.60	0.68	0.68	3.01
Financial access	25	0.56	0.75	0.75	0.84	0.84	3.74
Financial stability	25	0.56	0.75	0.75	0.84	0.84	3.74
Financial infrastructure for innovation	5	0.11	0.15	0.15	0.17	0.17	0.75
Financial integrity	5	0.11	0.15	0.15	0.17	0.17	0.75
Monitoring & Results Measurement	5	0.11	0.15	0.15	0.17	0.17	0.75
Programme Management for services retained by Country FSD	14	0.31	0.41	0.41	0.47	0.47	2.06
Total retained by FSD	99	**2.21**	**2.96**	**2.96**	**3.34**	**3.34**	**14.80**
Centralised services shared overhead	1	0.03	0.04	0.04	0.04	0.04	0.20
Grand Total	100	**2.24**	**3.00**	**3.00**	**3.38**	**3.38**	**15.00**
Programmatic funding split:							
Country core	60	1.34	1.80	1.80	2.02	2.02	8.99
Collaborative working	20	0.45	0.60	0.60	0.68	0.68	3.00

RESOURCES

DFID Sierra Leone will dedicate 20% of an A2 PSD Advisor or Economist's time to oversee the FSD's activities in Sierra Leone. This role would include overseeing the setting up of the SPV, refining the FSD's strategy, approving interventions, ensuring monitoring and evaluation meets the needs of DFID Sierra Leone and stakeholder engagement. The FSD will include enough programme management resource for non-advisory activities (e.g. arranging meetings, taking minutes, arranging visas). DFID Sierra Leone will provide 10% of a B2 Programme Manager's time to ensure in-country compliance on branding, delivery chain mapping, fraud reporting, asset management and risk registering. This work will be overseen by 5% of a B1 Programme Manager's time.

Annexe 1j. FSD Tanzania

TANZANIA'S FINANCIAL DEVELOPMENT STAGE

Tanzania continues to post relatively stable economic growth averaging 6.9% for the last five years. This has resulted in only a modest reduction in basic needs poverty[59] from 28.2% to 26.4% between 2012 and 2018. Food poverty has also improved marginally from 9.7% to 8.0% during the same period. This scenario suggests that the growth achieved has not been strongly inclusive. Inflation remains moderate at below 3.1% on account of relatively lower food inflation.

Tanzania's financial sector comprises of commercial banks, pension funds, insurance, financial cooperatives, capital markets, microfinance, savings groups, aggregators, telecom companies, fintechs and regulators. The banking sector is the strongest and oldest while others such as fintechs and aggregators are quite nascent in the market. Telecom companies introduced mobile money and have been the main force behind digital finance in Tanzania. Overall the financial sector is relatively small at 3.7% of GDP, a level which has been relatively unchanged over the last decade.

Where Tanzania has posted tremendous progress is in financial inclusion. The outcomes seen have been led by high technology adoption and digitization. Tanzania posted an impressive growth in financial inclusion from 17% in 2009 to 65% in 2017, driven by mobile money. The progress made is accounted for by a conducive macro-economic environment, commitment by the Government and BoT to financial inclusion, pragmatic approach by policy-makers and regulators, digital financial services, technology and investments by private sector. However, of concern is that following the huge progress made in reducing exclusion over the period from 2007 to 2013 - reducing from 55% to 27% - it has remained unchanged since (according to data from the latest FinScope survey in 2017).[60]

The financial sector has not provided significant finance for investment to the priority economic and social sectors; in 2017, agriculture received just 6.7% of overall credit, while manufacturing and building/construction received 10.6% and 4.9%, respectively. Credit to the private sector is however recovering, reaching 10.6% in April 2019, the highest growth since October 2016 and surpassing the target growth of 10.2% by end June 2019. Overall, the aggregate commercial banks' asset quality (NPLs ratio) remained high at 11.1% in April 2019 (compared to 11.6% in the previous 12 months), and significantly beyond the Bank of Tanzania (BoT) target level of not more than 5.0%. Access to insurance remains low at 15% of the adult population with less than 2.5% contribution to total financial assets in the market. Conversely, the pension system makes around 27.5% contribution to total financial assets from lower coverage of just 4% of the adult population. Both a capital markets and mortgage operations are weakly developed with long-term development finance options available far from satisfying growing market needs. Bond markets are still at a nascent stage. Whilst government borrowing has been on the rise (local and foreign currency) in recent years to finance big infrastructure projects, a small proportion of the borrowing utilizes the bond markets and are listed in the stock exchange. There is little evidence to suggest that government borrowing is distortive, crowding out resources for private sector lending by financial services providers. Overall, the level of intermediation is still very low compared to the size of the economy; it is clear that the financial system is yet to serve the needs of the economy, individuals, firms and government. The main question remains the changes required in the financial sector to deliver value to the economy and society as a driver, enabler and catalyst.

FSD TANZANIA, ACHIEVEMENTS AND LESSONS TO DATE

FSD Tanzania has established itself as a valuable partner in the financial sector in Tanzania. It has been very effective in facilitating changes that lead to a more inclusive and effective financial system. Evidence is strong that FSD Tanzania has made a significant contribution to efforts to provide a sound policy and regulatory environment for financial services that contributes to enhanced financial inclusion and financial sector development in general.[61] In addition, FSDT has played a leading role in driving innovations and infrastructure developments for financial sector. Below is the summary of examples of where FSDT has been successful.

Creating a vision for financial inclusion in Tanzania: Support to the BoT and the entire financial sector in it is efforts to develop the National Financial Inclusion Framework. FSDT's policy and resource has been publicly recognised by regulators and private sector players. The impact has been an explicitly inclusive vision for the financial sector, based on an understanding of the need to address significant structural and systemic issues at the macro, meso and micro levels.

[59] Tanzania Household Budget Survey 2017/18
[60] The figure recorded of 28% suggests a marginal worsening but this size of change is too small to be confidently measured under the FinScope survey methodology.
[61] The FSDT commissioned an independent retrospective Impact Assessment 2005-2015, implemented by ITAD.

Payments ecosystems and infrastructure: Support to design and implement the **National Payment Systems Act:** FSDT supported the Ministry of Finance (MoF) and BoT to develop the legal and regulatory framework for payment systems under the National Payment Systems Act of 2015 and National Payments Systems Strategy.

Interoperability of mobile money in Tanzania: FSDT supported the financial sector to introduce interoperability for mobile money, working with mobile network operators, regulators and other stakeholders. Tanzania is the first country in the world to achieve a universal interoperable mobile money network for peer-to-peer (P2P) transfers. The impact has been a major increase in mobile solutions uptake and utilisation.

Data, analytics and insights that drive policy and innovation: FSDT has pioneered the disaggregation and analysis of data to support innovations and policy change. The national survey on financial inclusion in Tanzania, FinScope, initiated and developed by FSDT, has been cited as important evidence in policies such as the National Financial Inclusion Framework and the National Payment Systems Act. It has prompted a renewed focus on financial inclusion by the Government and BoT and facilitated the setting of policy targets. Complemented with other deep dive analytics, research work has also supported innovations and is increasingly becoming instrumental in changing the behaviour of decision makers in the financial sector.

Encouraging the development of innovative financial solutions: FSDT has been driving initiatives to encourage the development and uptake of digital financial services through learning to catalyse the development of the mobile money industry, strengthening data and evidence on the mobile money market and its potential, speeding up the launch of mobile banking in Tanzania, building an algorithm model to use MNO data to assess user risk levels for credit. The model has since been replicated by several digital credit organisations in Tanzania.

Wider policy dialogue: FSDT has built strong relationships with other government institutions, including the Ministry of Agriculture (through the work on Agricultural Finance Markets Scoping - AgFiMS) and the Ministry of Industry and Trade (through the micro, small and medium enterprise, MSME survey and work on SME Policy and business environment). This has enabled FSDT to support financial education-related interventions, through the Financial Capability Baseline Study to define financial capability in the context of Tanzania, and in revising the National Financial Education Framework.

Lessons learned: Despite the impressive developments in the financial inclusion trajectory, FSDT research has revealed that the usage of financial solutions in Tanzania is limited by a failure to ensure that products offered are relevant, appropriate, convenient and affordable. Furthermore, users have insufficient trust in providers and systems. It is also notable that Tanzania's persistent financial exclusion (at 28%) is highest among farmers, women and youth. For enterprises, the main challenge is accessing money to grow their businesses. Financing options, particularly finance for priority real sector investments (such as agro-businesses and agriculture value chains) and growth are limited. There is a need to encourage a deeper level of innovation across the financial system to address the under-supply of finance to real-economy and social sectors with high potential to impact on inclusive growth and development. Improved cohesion is needed in financial sector policy approaches based on re-thinking how finance can add value to priority sectors. As technology and digitization expands its reach to more sectors and communities there are new risks created for consumers and the wider economy. The stability and integrity of the financial system needs to be given a high priority. FSDT has experience in areas like interoperability, driving innovation through evidence and facilitation, which could be useful to the FSD Network in driving the "Inclusive finance" agenda in our markets and Africa.

WHAT MORE NEEDS TO BE DONE IN TANZANIA?

Tanzania's economic development path continues to rely on agriculture, being the largest single sector GDP contributor at 30% as well as by being the main source of livelihoods for 52% of its citizens. The aspiration to become a middle-income country through industrialization assumes that agriculture will play a leading role as the supplier of raw materials and act as an incubator for basic value addition investments in households and communities. This aspiration is guided by: i) the Five Year Development Plan (5YDP) that prioritises agricultural and enterprises transformation and industrialization and ii) Agricultural Support Development Programme (ASDP II) with a focus on commercialization, innovation, technology, value addition, infrastructure, investment and markets.

Whilst Tanzania has recorded stable economic growth, the expansion of financial inclusion over the last decade has yet to translate into sufficient impact on poverty reduction. A more equitable growth and inclusive development path is needed which establishes a virtuous cycle of effective investment in growth and human development to produce sustainable impacts on the livelihoods of every Tanzanian especially the poor. Understanding the main drivers of this goal and the mechanisms to generate sustainable impacts will lead to strategic choices for interventions. This includes understanding the agricultural sector and how its transformation encapsulates all the critical elements that will ensure

poor households will benefit proportionately from it. Equally, the persistent gender gap - especially in financial health and economic wellbeing - and growing challenges of the expanding youth demographic need to be addressed.

The financial system has a crucial role to play in determining how resources are allocated to achieve this growth path. It is not simply the depth or levels of access to the system – conventional indicators of **quantity** – which will determine the impact. Progress needs to be made in improving the **quality of finance** measured in terms of responding to the opportunities for broad-based growth and inclusive development. In this regard, finance will play a pivotal role as a driver, enabler or catalyst in accelerating equitable economic growth for inclusive development.

As noted above, many of the financial services currently offered provide limited value to users. This is evidenced by the existence of numerous products offered by financial services providers which are not taken up or used by customers (i.e. demand-supply gap). The challenge can be seen by looking at several dimensions: **relevance, appropriateness, convenience, affordability and confidence/trust**.

Much of the modest credit expansion observed over the past decade is short-term and high cost and unsuited to solving long-term needs such as investments in agriculture. Few small and medium scale enterprise are able to access sufficient liquidity or capital needed for long-term business growth. The costs of accessing and using low-value retail payments in Tanzania are high for low-income consumers. Appropriate risk management tools for sectors like agriculture, are not available exacerbating risk aversion by financiers. In some instances, this is due to the lack of data and information about producers, users and markets required to inform the design of appropriate solutions for those users. The sheer lack of capacity in financial institutions to address the needs of agriculture, enterprises and households is a constraint. As a response, capacity building, evidence generation and innovation directed towards key sectors such as agriculture and smaller-scale enterprises are needed. Climate change also must be prioritized to ensure future sustainability. There is a dire need to ensure financial solutions are affordable; financial sector infrastructure should be designed not only to address the convenience question but also ensure costs of delivering finance are lowered. Finally, deepening participation in more sophisticated financial solutions – such as long-term investment – requires a higher degree of trust. The policy and regulatory environment needs to evolve to underpin increased confidence in the financial system.

The attainment of greater impact (using SDGs as a reference for real impact) through the financial sector requires a paradigm shift from simply deeper financial systems to "inclusive finance" with a sacrosanct "value proposition" to relevant segments of the markets and the economy as a whole. The journey that Tanzania is embarking on now aims to ensure that the financial sector development is based on addressing opportunities for growth or welfare gains in the real economy and social sectors. These opportunities should go beyond looking simply at the immediate needs of individual low-income households or individual enterprises for existing financial services which has been largely the focus of the financial inclusion agenda over the past decade. The financial system needs to re-embrace the essence of its intermediation function to ensure inclusive **financial solutions** are created such that the necessary investments can be achieved to drive productivity improvements and simultaneously enable low-income people to participate fully as producers, workers or consumers. With this in mind, it is possible to advance appropriate financing tools and solutions for the agricultural sector. For this to be realized, Tanzania needs a financial system with the capability to deliver requiring changes across the policy and regulatory environment, industry infrastructure and innovation system.

The progress Tanzania has made in technology adoption and digital finance promises greater future impact by stimulating the next generation of **financial innovation** and **reducing transaction costs**. With appropriate financial capability and technology enabled regulatory oversight, such innovations will be instrumental in **building and maintaining trust with financial services providers** across participants. Currently, Tanzania is implementing its second National Financial Inclusion Framework (2018-2022) linking specific markets to prioritize for supporting the broader goals for Vision 2025. The implementation of the Agricultural Sector Development Program (ASDP II) provides important avenues with regard to commercialization of agriculture, value addition, markets, innovation, information, technology and financial integration. In addition, the Government launched the Microfinance Policy and enacted the respective legislation for microfinance.

FSDT acknowledges that the practical realisation of this vision requires coherent developments across multiple interconnected layers. From a market development perspective change is needed at the level of the rules – formal policy and regulation together with the informal business models, rules and norms of finance – and the supporting functions – the infrastructure and business services from linked markets. Shaping developments to deliver value-adding finance requires broadening the perspective from a pure financial sector supply-side 'push' approach to include a significantly stronger demand-side 'pull'.

Ongoing technology driven developments in Tanzania, the region and beyond provide strong encouragement. Innovative solutions for real and social sector needs such as agriculture, e-commerce, health, education are already underway. E-

commerce platforms are emerging for both broad based and more narrowly focused value chains especially those linked to agricultural sector. Supporting these developments requires an enabling digital financial infrastructure. This calls for Tanzania to address the challenges of digital ID, ensure the payments ecosystem is effective, capital markets are vibrant, the financial system is transparent and has high integrity, consumers are protected and have control of their own data, and the market remains open and competitive.

FSD TANZANIA PROPOSED INTERVENTIONS UNDER FSD 2.0

Tanzania's economic agenda aims to take the country to the middle-income status in line with its Vision 2025, implemented through its various development plans. In the agricultural sector, ASDP II articulates the vision and key priority areas such as commercialization, agro-processing, marketing, technology and information. In addition, it articulates the role of public and private sector players with financing vehicles and instruments being part of the innovation journey. In the financial sector, Tanzania is currently implementing its second National Financial Inclusion Framework (2018-2022) that seeks to ensure that enterprises, women, youth and rural dwellers derive value by using financial solutions regularly. The FSDT future strategy (2020-2025) will align with the new narrative that delves into creating value through inclusive finance. This aspiration connects well with the five strategic shifts identified in DFID's recent policy note on financial sector development and the vision under FSD 2.0 to support the real and social sectors of the economy.

The summary below shows the priority interventions to address the gaps in the development of the financial sector in Tanzania.

Interventions	Objective	Sample activities
Agricultural value chains - *Investment* - *Inclusion* - *Innovation*	Increase productivity and value addition of agricultural value chains with the potential to grow farms, agro-processors and other enterprises resulting in job creation and higher incomes using sustainable methods. ***Inclusive growth and sustainable future***	i) Support development of end-to-end financial solutions across agricultural value chains such as edible oils, primary food crops, horticulture, cotton and cashew nuts leveraging data flows and new risk tools. ii) Work with partners (such as the Tanzania Agricultural Development Bank) to design financing solutions for investment in appropriate technologies to improve farm productivity and reducing post-harvest losses iii) Identify and support policies and regulations relevant for agricultural transformation including those articulated in Agricultural Support Development Programme- II, NFIF 2018-2022, Gender & Youth and other development strategies. iv) Support initiatives that will provide useful insights from research, data analytics or learning from other markets in the manner that benefit the agricultural markets in Tanzania.
Affordable housing - *Investment* - *Inclusion* - *Innovation*	Develop financial models and solutions for the housing market to provide growth opportunities for local enterprises, create jobs and increase appropriate housing options for low-income people. ***Inclusive growth*** ***Basic services*** ***Sustainable futures***	i) Research and analytics to provide evidence and prospects of housing markets in Tanzania in collaboration with Centre for Affordable Housing Finance in Africa (CAHF) ii) Support the development of affordable housing models for both low-income and emerging middle class, iii) Work with organizations such as Tanzania Mortgage Refinancing Corporation (TMRC) to ensure that affordable and sustainable mortgage are designed and offered by financial services providers to increase offtake of affordable housing; iv) Support initiatives that will optimize quality jobs in construction and manufacturing and improve productivity; v) Support efforts to create a platform that can be used a competitive marketplace for low-income people in the housing supply chain by addressing information asymmetries. vi) Support policy and regulatory innovations that are necessary for the development and uptake of low-cost housing models

Interventions	Objective	Sample activities
Enterprises with a focus on e-commerce/ trade platforms - *Investment* - *Innovation* - *Stability*	Stimulate the development of financial solutions that can increase market access and investment in productivity for small and medium enterprises leading to improved profitability and generating higher-quality jobs. ***Inclusive growth***	i) Identifying and/or scaling e-commerce platforms to embed financial solutions for their suppliers, wholesalers, warehouses, transporters, and end buyers (i.e. platform economies, merchant solutions). This will require extensive work with fintechs, technology firms and data analytics. ii) From the shared domain thinking, explore the opportunities for driving cross border trade using E-commerce platforms and logistics (i.e. SADC, EAC and bilateral) and appropriate technologies and financing options (working with partners such as TradeMark EA). iii) Selectively, identify policy and regulatory imperatives that require addressing to support the e-commerce system to work iv) Support initiatives to utilize the capital markets infrastructure and other options to mobilise long term financing needed for long term investments, including retail bonds v) Drive innovations for solutions targeting women and youth owned enterprises
Climate finance - *Investment* - *Innovation*	Drive the conversation to create the vision on climate change for Tanzania and design actions for the financial sector. ***Sustainable futures, Inclusive growth***	i) Work with regulators and financial institution associations to create the market for climate finance disclosure and verification in line with Task Force on Climate-related Financial Disclosures (TCFD); ii) Promote the development of financial solutions (such as 'green bonds') for reducing negative climate externalities focusing on priority areas of agricultural practices, urbanization, manufacturing transportation and renewable energy. iii) Action research on how finance can support rehabilitation such as sustainable forestry, ecotourism and links to carbon markets.
Digital finance - *Innovation* - *Stability* - *Integrity*	To accelerate the benefits of technological advancements and digitization beyond financial sector. Digitization should benefit real and social sectors and improve both government and business effectiveness and efficiency. ***Inclusive growth*** ***Basic services***	i) Drive the thought leadership on defining and designing Tanzania's Digital Vision and define the strategy for driving digital economy, taking advantage of the technological transformation and digitization opportunities. ii) Support the market to implement the basic infrastructure for effective and efficient delivery of financial sector including National Switch (TIPS), digital ID for development and financial services registry (FSR). iii) Drive the innovations of models and solutions targeting specific markets such as women, farmers, youth, rural dwellers and entrepreneurs. For example, working with Tanzania Social Action Fund (TASAF) to digitize payments to beneficiaries, majority of whom are women; scaling up of health insurance for women and rural dwellers while crop related risk management tools will focus on farmers. iv) Support platforms that will provide opportunities for FSPs and other players to use data and analytics to drive innovations (FinSights Lab, Innovation Challenge funds, data disrupts, etc.) v) Support the design of regulatory oversight that will promote financial integrity, market conduct through, RegTech, anti-money laundering and illicit flows enabled by digital ID, payments ecosystem and mobile phone linked service delivery. These will also benefit from regulatory sand box to be launched. vi) Support the market to deliver and implement financial consumer protection to bolster financial health, data privacy and open finance policies and regulations.

Local Governance Arrangements

FSD Tanzania is a trust with governance structures that involve a Trustee, Programme Investment Committee (PIC), Finance Manager and Management. The Trustee is the legal representation of the Trust primarily charged with the

fulfilment of the Trust's objectives and fiduciary responsibilities subject to a no objection from the PIC. The PIC is constituted of funders contributing at least US$1m (or equivalent), Bank of Tanzania and the Ministry of Finance and Planning. DFID Tanzania was a founding member of the PIC but following the expiry of its funding agreement, DFID has not been part of the PIC since 2016. With the envisaged new funding, DFID will re-join the PIC sitting alongside co-funders from Global Affairs Canada, Embassy of Sweden, Embassy of Denmark and the Bill and Melinda Gates Foundation. With an exception of Bank of Tanzania and Ministry of Finance, all funders currently sitting on PIC have contributed more than US$15m each since 2013.

Opportunities for deeper FSD Network collaboration

As a founding member of the FSD Network, FSD Tanzania will benefit from collaborative working especially in the areas of climate finance, agriculture, e-commerce and affordable housing, identified as priorities for future intervention above. There are significant gains in prospect for FSD Tanzania from collaboration in these areas. Agricultural finance has proven among the most intractable challenges in inclusive finance across Africa and sharing experiences offers the prospect of more effectively exploiting the most promising new solutions. E-commerce is fast evolving in East Africa and in SADC regions in particular and will require the deployment of scarce technical know-how which can be most cost-effectively engaged collectively. Finally, collaboration will offer a more rapid engagement in the relatively new areas for FSD Tanzania of climate finance and affordable housing. FSD Tanzania is also keen to participate in the ongoing learning around how best to address gender gaps and empowerment and enable opportunities for youth employment across its programme.

Tanzania is among the leading countries in Sub-Saharan Africa financial sector development especially in the mobile money space. Tanzania will continue to contribute the learnings to other markets especially those with newly established FSDs through the Network. For example, Tanzania is very advanced in the area of mobile money interoperability, an area many countries are now figuring out. Finally, FSD Tanzania will participate in the shared services under this business case based on the agreed areas to be shared through FSD Africa.

Tanzania's financial sector development is supported by other development partners such as AfDB, World Bank, IFAD, AGRA, USAID, MasterCard and CGAP. Each one of these usually has specific areas of intervention as opposed to FSDT which takes a market systems approach. FSDT has worked with some of these in the past through collaborations. In future, FSDT will figure out strategic opportunities that can benefit from partnerships especially with the major shift to "inclusive finance" with a focus on real and social sectors. Some of these have access to expertise or influence needed to deliver the changes FSD 2.0 is promising.

EXPECTED RESULTS

Indicator	Baseline	2 years	5 years	Explanation
# jobs (informal/formal employment, livelihoods and micro-enterprise) created or improved/sustained through FSD-supported initiatives, **whose average earnings are (i) above the national minimum wage, and (ii) 20% above baseline.**	0	8,500	22,500	Considering the investments in access to finance and finance for investments of £8m, in conjunction with previous assessment of job creation initiatives, our best estimate is conversion rate of 0.1%.
# (million) people *facilitated to* access basic services *Disaggregated by: country, gender*	0	41,800	200,000	From 2011 to 2017, general access to electricity increased to 29%, which roughly translates to 800,000 households. FSDT intends to increase the national natural growth by 10%.
Number of people with improved access to financial services" *Disaggregated by: country, gender, age*	0	125,600	700,000	FSDT assumes that at minimum of 4 key agricultural value chains e.g. Cotton, Coffee, Sisal and Sea weed will be serviced through various formal financial services (payment, Insurance and savings).

Indicator	Baseline	2 years	5 years	Explanation
"Number of businesses (informal micro/small enterprises and formal micro/small enterprises) with improved access to financial services"	0	83,000	21,000	Taking into consideration increase to access of finance of business owners of 2013 to 2017 which saw a yearly increase of 70,000 businesses. FSDT anticipate to increase natural growth by 10% on yearly basis.
Private and public co-investment mobilised (£ million) *Disaggregate by: tenure (short-term and long-term investment); source of investment (local and foreign, private and public)*	0	3.9m	£9m	Based on the overall investment, FSDT anticipate a 30% investment match by other source. E.g. year I & II, we anticipate to invest £12 M which we foresee to be increased by £ 0.8m.
Number of policies and regulations developed or refined through FSD support	0	1	4	Development of the policies and regulations will be in the areas of Business environment, Consumer Protection, Market conduct, Digital strategy, Land polices.

THE PROFILE OF ESTIMATED COSTS

The FS The budget breakdown in line with the DFID guidelines are given below.

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£ m	£ m	£ m	£ m	£ m	£ m
Finance for investment	0.89	1.13	1.19	1.05	0.57	4.83
Financial access	0.54	0.76	0.94	0.62	0.35	3.21
Financial infrastructure for innovation	0.38	0.46	0.50	0.38	0.19	1.92
Financial stability	0.15	0.18	0.20	0.13	0.07	0.72
Financial integrity	0.23	0.31	0.36	0.25	0.17	1.32
Monitoring & Results Measurement	0.14	0.18	0.20	0.15	0.08	0.75
Programme Management for services retained by Country FSD	0.37	0.48	0.55	0.42	0.23	2.05
Total retained by FSD	**2.70**	**3.49**	**3.93**	**3.01**	**1.66**	**14.80**
Centralised services shared overhead	0.04	0.05	0.05	0.04	0.02	0.20
Grand Total	**2.74**	**3.54**	**3.98**	**3.05**	**1.68**	**15.00**
Programmatic funding split:						
Country core	1.76	2.27	2.55	1.95	1.08	9.60
Collaborative working	0.44	0.57	0.64	0.49	0.27	2.40

RESOURCES

The main DFID support for this programme will come from an A2 PSD adviser based in Nairobi (undertaking a regional role), providing around 10% of the time. This will include sitting on the Programme Investment Committee (PIC).

Annexe 1k. FSD Uganda

A. Country Financial Development State

Uganda's economy is witnessing a proportional output shift but no labour shift away from agriculture. In 2017/18 the economy grew by 6.1% with FY 2018/19 growth being projected at 6.3%[62]. Majority of this growth is expected to come from manufacturing, construction and services[63] collectively contributing 75.8% to GDP in contrast to agriculture which contributes around 24% to GDP despite employing nearly 70% of Ugandan households (directly and indirectly)[64], majority of whom survive on subsistence farming.

Uganda halved financial exclusion[65] from 43% in 2006 to 22% in 2018 (Finscope 2018), with formal account ownership, largely driven via mobile money, at 59% of adults. However, in terms of 30-day transaction activity – a key indicator of usage – only 36% of Ugandan adults use their mobile money account, while only 7% adults use their bank account monthly.

Uganda's financial sector is comprised of a large number of formal and informal providers. Uganda's banking system is resilient, despite witnessing the closure of 7 banks between 1993-2017. Twenty-three commercial banks constitute Tier I of the Bank of Uganda's licensing and supervisory regime, while the four credit institutions and five deposit taking Microfinance Institutions (MFIs) form Tier II and Tier III respectively. The thirty non-deposit taking MFIs, 1997 operational Savings and Credit Cooperatives (SACCOs)[66], and 221 licensed money lenders are now regulated by the newly formed Uganda Microfinance Regulatory Authority (UMRA).

Other non-bank financial services in the country include capital markets (two securities exchanges), insurance, pension, provident funds, payment providers, and numerous investment clubs[67]. Uganda's payments landscape is dominated by mobile money providers – largely, telecom providers. The mobile money market is oligopolistic, with two providers holding nearly 95% of market share. In terms of access point infrastructure, there were 106 times more mobile money agents than bank ATM and branch access points, in 2017. This, however, is changing with the new agent banking regulations issued in 2017. Active bank-agent penetration is currently estimated to be around **5000 unique active agents compared to 60-70,000 unique mobile money agents.**

The 0.5% tax on value of mobile money cash withdrawals introduced in 2018 has had an adverse effect. Average value of mobile money transactions has gone down by 7.6%, while average balances on mobile wallets left by registered customers has drastically reduced by 35%.

Uganda's capital markets are small, underdeveloped and decreasing in activity. Over eight years, capital totalling $232 million[68] was raised through the capital markets. Public and business awareness of opportunities presented by the capital markets for long-term wealth creation and capital to achieve scale respectively, is extremely low. This is exacerbated by rigid regulatory framework and high costs of issuance[69].

Insurance penetration remains low at 0.81%, with 930,323 policies sold. In the non-life market four companies hold 70% of the market share. The non-life market share is three times that of the life insurance market and is centred around motor, fire and health insurance (IRA, 2018).

Albeit from a low base, the retirement benefits sector has been growing. Retirement benefits asset to GDP ratio stood at 10% which compares behind 14% in Kenya and 11% in Tanzania. Coverage is also improving, reaching 14% of

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[62] *Uganda Financial Sector Development Strategy, Ministry of Finance, Planning and Economic Development*
[63] *Services contributes 40% while industry contributes 20% to GDP,*
[64] *Finscope 2018*
[65] *Traditionally defined as access to formal accounts (bank or non-bank), savings, credit, payments, insurance and other financial products and services*
[66] *SACCOs or savings and credit cooperatives are membership based, self-governing organizations formed by members who are bound by a common theme – e.g. same economic activity, religious group, living in the same community, etc.*
[67] *An investment club is a group of individuals who meet for the purpose of pooling money and investing; members typically meet on a periodic basis to make investment decisions as a group*
[68] *2019 September exchange rate of 3689 to the dollar.*
[69] *Source: Ministry of Finance, Financial Sector Development Strategy 2019.*

Ugandans in 2017, up from only 6% in 2014. This is larger than the 10% in Tanzania but is still short of the 20% coverage in Kenya.

B. FSD Program, Achievements and Lessons to Date

DFID Uganda has made a £12.47 million commitment to FSD Uganda until 31st March 2021. FSDU started as a program within DFID and spun out as a Ugandan company limited by guarantee (equivalent to a not-for-profit) in 2015. Up until 2018, FSDU's programmatic efforts have resulted in access to financial services to over 558,344 individuals (49% of whom are women), and 3,380 small enterprises.

B.1 Major achievements

Strong market positioning, with great convening and facilitative power in a short span of four years: FSDU has MoUs with key macro and meso institutions, example - the central bank, insurance and capital market regulators, microfinance regulator, ministry of finance, trade, ICT, industry associations and more. FSDU has successful acted as a neutral facilitator in the market This has positioned FSDU as the 'go-to-partner' for the public and private sector when it comes to financial inclusion efforts. Another example of FSDU's strong position in the market is that it **is the only** financial sector development partner that has a seat on the Financial Markets Development Committee – an interinstitutional committee chaired by the Governor, Bank of Uganda.

Led key policy and regulatory shifts, impacting the market positively: FSDU has and continues to provide guidance and inputs into various financial sector policies, bills and regulations. Notable among them are – FSDU co-led the development of the first National Financial Inclusion Strategy (NFIS) with Alliance for Financial Inclusion (AFI). FSDU is the only institution supporting the central bank in NFIS implementation. FSDU co-led the development of Uganda's first Financial Sector Development Strategy with the World Bank and is now supporting the Ministry of Finance in its implementation.

Provided significant technical leadership that led to innovative industry-wide infrastructure: FSDU has been at the forefront of building cash deposit, withdrawal and payment access points that allow for greater access to formal financial services. FSDU's leadership and early stage de-risking grant to the Uganda Bankers Association led to the establishment of Africa's only shared agent banking platform. Today, over 11 banks have joined this shared platform, allowing one agent to service customers of multiple banks. FSDU's technical assistance and grant support crowded-in IFC which has committed to investing $1MN (via Hi-Fi another DFID funded initiative) in strengthening the platform.

Supporting early stage Innovation that leads to disruption, and better customer value: FSDU plays a big role in de-risking innovation through grants and technical assistance. FSDU's grant investments and advisory efforts to date have led to over half a million Ugandans accessing financial products and services (49% of whom are women). Key innovations that FSDU supported in the past have been formally linking savings in community based groups to mobile wallets or banks, cross-border remittance solutions, models that allow for non-collateralized lending by the financial sector, payment digitization across agriculture and other value chains allowing for data trails that the financial sector can then use to learn more about the under/unserved.

B.2 Regional Activities:

FSDU is collaborating with other FSDs, beginning with FSD Africa on common areas that benefit the network or both organizations. Current examples include the £1.15 million GBP refugee innovation challenge between FSDA-FSDU. Additionally, FSDU is engaging FSD Africa and FSDZ in thinking through more gender inclusive financial sector programming for in-country and cross-network programs.

B.3 Key Lessons

A market systems approach is key to building an inclusive, sustainable and resilient financial sector. However, a market systems approach requires patient de-risking capital (both in terms of direct grants, as well as small scale funding like zero interest loans / returnable grants). The returns can be transformative, however depending on the type of entity or intervention – this could take around five years[70].

Different markets have different stages of maturity. Of the five financial sector development stages, Uganda is in stage III, with progress on financial inclusion above regional average, although inequality in access is emerging. The banking

[70] *A Fintech start up for example will take at least a year / year and half to test a minimal viable product and get the requisite licenses. It will then take at least 2.5 years - to sign contracts with distribution partners, run a pilot, retool the product, change pricing based on feedback, upgrade customer service, gain funding (grant or others) to obtain a salesforce to acquire and onboard larger number of customers. Efficiency gains start kicking in only around year 4 or 5.*

sector still plays it safe and access to credit for business growth is extremely limited. Financial sector reform, though changing needs to be more proactive.

Redefining financial inclusion is necessary. In the case of Uganda, while nearly 59% of the adults have some form of formal accounts most of the gains in financial inclusion have been driven from domestic remittances or payments. According to Finscope 2018 data only 4% of all adults have access to formal credit, only 18% adults have access to formal savings, only 1% adults have any access to formal retail insurance. Meaning, that while access has increased, true depth of financial inclusion has not been achieved. Therefore, measurement of access only as a success indicator while necessary is insufficient.

B.4 Specific expertise and experience

Widest public sector relationship of any development partner in the financial sector: As highlighted above, FSDU has partnerships with ten public institutions – three ministries, and six regulators in the financial sector. Moreover, FSDU is also represented and is an advisor on four major public sector committees – the interinstitutional committee on financial inclusion, inter-institutional committee on financial sector development strategy, the presidential taskforce on the fourth industrial revolution, and the financial markets development committee.

Only entity in the market that takes a markets systems approach to financial inclusion: Uganda has a crowded donor space with bilateral, multi-lateral and private foundation donors. The primary institutions of note **in the financial sector** are the World Bank, International Monetary Fund (IMF), African Development Bank (AfDB) that unlike FSDU[71] almost exclusively through macro and meso institutions i.e. central banks, regulators or Tier I commercial banks. The Bill and Melinda Gates foundation's financial inclusion work is channelled entirely via FSDU. Other development partners that play an adjacent role around financial inclusion include USAID, UNCDF, European Union, KFW, Abi Trust, and IFC. However, their programming does not take a systemic view of the financial markets for the poor.

FSDU has developed significant expertise and understanding in finance for marginalized communities. This is exemplified through the support FSDU has extended on linkage banking (i.e. connecting community-based savings groups to the formal financial sector via digital movement of funds), and its current support to the scale up of old-sage social protection programming.

Excellent understanding on digital financial solutions to address problems of credit, payments, and insurance for the underserved. FSDU has built solid expertise on digital financial services, via technical assistance, grants and research that have provided ground-up learning on solutions ranging from payment digitization across value chains, alternative credit scoring models[72], micro insurance, agent banking, and more.

By investing in learning and research, other areas that FSDU has built expertise around include- policy and regulation, market conduct, competition, data privacy and data sharing models[73], and business models between private sector actors that can lead to more affordable products and services for people and businesses.

C. WHAT MORE NEEDS TO BE DONE?

Uganda's economic growth and expansion of financial inclusion have not translated to poverty reduction. According to the Uganda Bureau of Statistics, and IMF, GDP per capita has stalled in the most recent years (up to 2017) in comparison to neighbouring countries. **A refresh is necessary** in terms of how we look at success. Indicators that measure access alone are insufficient, and serious progress needs to be made in terms of quality of finance (usefulness, affordability, trust) and how financial access converts to increased usage of financial services – leading to overall well-being of individuals, businesses and households.

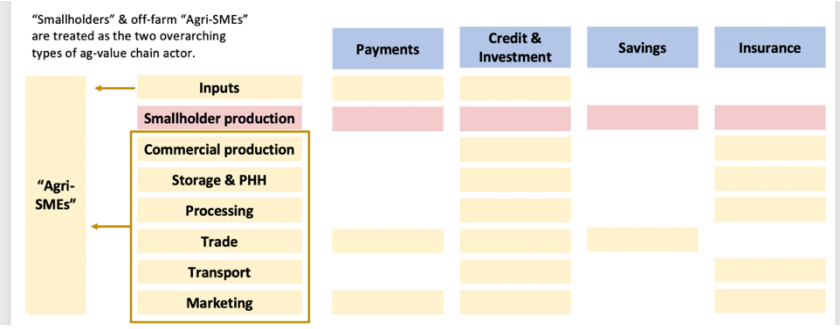
[71] *FSDU also works with industry associations, small startups, all types of microfinance institutions, Fintechs, not for profits in the financial space, etc.*

[72] *Alternative ways of scoring a borrower – especially the underserved since financial markets have the least amount of information on them.*

[73] *Business models that ride on data trails derived from payment transactions that inform providers of the income and outflow patterns of individuals and provide customized solutions*

What would the new approach look like?

Given that Uganda is still at stage three out of five of financial market development, FSDU programming will continue to invest in addressing supply side issues. Additionally, FSDU will also invest in understanding how the financial sector can more effectively serve the needs of real economy sectors like agriculture and agro-processing, trade, as well as social sectors like education, and affordable housing that have a direct impact on income generation and asset creation. As illustrated, FSDU will need to examine the value chain of the sectors that it focuses on and examine the gaps in payments, savings, credit, investment, savings and insurance needs of the various actors in the value chain.



FSDU's end objective is the upward economic mobility and increased resilience to economic shocks of households and businesses through competitive and well-functioning financial markets.

As a first step in this new programming, FSDU will invest in understanding existing country programs by other partners that are targeting key real economy and basic services sectors. This will help FSDU ascertain where and how its efforts can be truly transformative. Additionally, this research and its subsequent analysis will be a good framework to identify key sectors to focus on.

C.1 Finance for Investment:

a. Addressing the capacity gap of policy making, regulatory and industry bodies: FSDU has embarked on a multi-year digital transformation work with multiple regulators, expanding their supervisory, and compliance capacity and toolkit that allows for innovation without compromising on stability and consumer protection.

b. Value chain and enterprise financing in nationally identified, high employment multiplier sectors. Uganda's Vision 2040, National Development Plan-III, and Green Growth Development Strategy documents have identified agriculture and agro-processing, labour-intensive light manufacturing, tourism and forestry, and trade as key sectors for employment growth. Examples of potential FSDU interventions in the agriculture space could range from scaling up DFID Uganda's NU-TEC[74] (and other centrally managed programs on commercial agriculture) program to financial interventions like tractor leasing models for small holder producers to enterprise finance (factoring, receivables based financing models) for agro-processers, input suppliers, etc. Similarly, interesting opportunities are arising in addressing small business credit needs using digital data trails that are being generated by trade platforms (e.g. Jumia).

c. Making MSMEs investment worthy. Strong and sustainable micro, small, and medium enterprises (MSMEs) are essential to economic growth, job creation, and reduced inequality. FSDU's new programming will target supporting MSME growth and longevity[75] in two ways – a. investing in the growth of young enterprises in the real economy via key incubators[76], and b. developing Uganda's capital markets as an avenue to access long-term financing.

d. Productive asset financing models: FSDU is already exploring affordable consumer financing models around income generating assets (e.g. automobiles, bicycles, sewing machines, ovens, etc.) that will help micro entrepreneurs become owners and increase take-home incomes.

C.2 Finance for Access:

a. Finance for marginalized groups (Social Protection and Refugee programming): In order to ensure continued increase in household level resilience, FSDU will continue its ongoing work on Social Protection (SAGE, Persons with Disabilities) with the Ministry of Gender, Labour and Social Protection. FSDU will also continue its existing refugee financing work in

[74] *Northern Uganda – Transforming the Economy through Climate Smart Agriculture*
[75] *Ugandan firms have a high mortality rate and most of them rarely survive past age three.*
[76] *Three of the largest banks in Uganda (Stanbic, DFCU, Centenary) have set up incubators supporting MSME growth*

collaboration with FSD Africa.
b. Accessing affordable Housing: This is a common focus across the FSD network. The aim of the partnership between the Centre for Affordable Housing and FSDU would be to increase access to affordable housing for low-income earners, with the aim of increasing asset ownership.
c. Financing solutions for access to basic services like education and clean energy: FSDU interventions in the off-grid sector would focus on consumer financing models (lease-to-own, pay-as-you go) that not only allow for asset ownership but act as key platforms upon which these companies offer additional solutions like school fee loans, bundled insurance and more to deepen customer value proposition. Similarly, FSDU will test financing models that could help bridge the $163.8 million credit and working capital gap in Uganda's education space.

C.3 Fintech Innovation:

a. Retail payment system architecture Infrastructure: Examples of multi-year programming includes providing advisory and funding support of the new retail payments system with the Bank of Uganda (BoU), co-financing with the Uganda Bankers association and BOU on the industry wide set up of real time electronic KYC, introducing governance, operating, supervisory, and revenue rules for data sharing models as well as widening the usage of the two existing credit reference bureaus.
b. Additional innovations could include supporting shared cash-in/cash-out access points, open data sharing models as well as supporting FinTech's via technical assistance through the set-up of Fintech labs, and innovation funds.

C.4 Financial Stability and C.5 Financial Integrity:

FSDU's programming will focus on issues surrounding market conduct, competition, and consumer protection – with the aim of building consumer trust in the financial system. FSDU will also be supporting new ways of ensuring tiered KYC for digital solutions (e.g. mobile money or using blockchain technology for identity for refugees), as well as robust anti-money laundering and financial intelligence monitoring.

D. Challenges, Risks and Mitigation Measures to FSDU Interventions and in the market

Challenges and Risks	Mitigation Measures
Political Economy: Challenges include regressive taxation, excessive government borrowing resulting in higher financing costs and non-performing loans (NPLs).	Aligning ourselves to key public sector and market making private sector institutions and investing in these relationships will allow FSDU to anticipate potential political economy risks and shape programming accordingly.
Limited regulatory capacity and coordination: Limited understanding or appreciation of new technology, and how that can both positively and negatively impact the economy (depending on regulator/policymaker)	Investment in regulatory exposure, learning from peer-regulators, as well as multi-year phase-wise change in regulations, systems and processes has seen greater ownership and acceptance by regulators. Increasingly, we are witnessing regulators proactively reaching out to FSDU to try to catch-up with shifting markets.
Low levels of financial education	FSDU will have to invest in consumer education as well as establishment of industry standards.
Basic banking, insurance and mobile money products (throttling MSME growth and customer adoption)	FSDU's efforts will have to focus on reducing the high credit of cost in the economy and work with non-traditional actors to demonstrate how uncollateralized models can help in MSME growth and income smoothing – eventually leading to crowding or strategic alliances with banks and such traditional financial actors.
Poor capacity of MSMEs (including FinTech's)	FSDU will have to invest in increasing the longevity and growth of MSMEs – so that a higher percentage of its disproportionately large micro enterprise base converts into small, medium and large businesses over time.

E. PROPOSED INTERVENTIONS UNDER 2.0

Area	FSD Uganda	In collaboration with FSD Africa/ FSD network	Rationale for DFID Intervention
Finance for Investment	Capital market development, increasing Capacity of policy makers, regulators, incubators and small businesses and value chain and MSME financing	Bond market development esp. Local currency, and green bonds, value chain finance	With the exception of some efforts by the European Union there is very little support towards rehauling Uganda's capital markets. FSDU in collaboration with FSD Africa is working directly with the capital markets authority in pushing next-generation changes.
Finance for Access	Social protection and refugee programs, affordable housing, financing solutions for education and utilities, micro insurance and pensions, and community based savings.	Reduction in cost of cross-border remittances.	FSDU is the only organization in the market with broad based market systems approach with the poor.
Fintech Innovation	Retail and Payment system architecture, increasing capacity of innovation and Fintech labs, Fintech innovation fund, and shared agent platforms.	Investment in early stage FinTech's (FSDAI)	Creating an ecosystem that supports innovation around shared infrastructure, and increased capacity of local Fintechs.
Financial Stability	Progressive regulation across multiple regulators (including competition, and consumer protection policies and practices), Financial literacy and consumer trust.	N/A	Limited regulatory bandwidth and exposure, leading to stifled or slow growth in innovation. Note: traditional World Bank and IMF support is directed towards existing financial market structures and not towards examining regulatory understanding and bandwidth on emerging technologies.
Financial Integrity	Tiered Know Your Customer, anti-money laundering and reporting standards strengthening.		Critical issue in the National Financial Sector Development Strategy to ensure transparency of payment flows linked to national ID.

F. EXPECTED RESULTS: Assuming £15 MN Funding and Corresponding Results

Indicator	Baseline	2 years	5 years
# jobs (informal/formal employment, livelihoods and micro-enterprise) created or improved/sustained through FSD-supported initiatives, whose average earnings are (I) above the national minimum wage, and (ii) 20% above baseline	0	5,922	42,000
# (million) people facilitated to access basic services	0	18,800	350,000
# Number of people with improved access to financial services	0	56,400	840,000
# Number of businesses (informal micro/small enterprises and formal micro/small enterprises) with improved access to financial services	0	37,600	7,500
Private and public co-investment mobilized (£ million)	0	£0.97m	£5m
Number of policies and regulations developed through FSD support	0		1

G. PROFILE OF ESTIMATED COSTS: Funding will come from PSD central funding

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£ m	£ m	£ m	£ m	£ m	£ m
Finance for investment	0.09	0.82	1.30	1.20	0.99	4.40
Financial access	0.04	0.52	1.12	1.20	0.92	3.80
Financial infrastructure for innovation	0.03	0.31	0.74	0.51	0.39	1.98
Financial stability	0.03	0.31	0.37	0.34	0.18	1.23
Financial integrity	0.01	0.10	0.19	0.17	0.13	0.60
Monitoring & Results Measurement	0.01	0.13	0.23	0.21	0.16	0.74
Programme Management for services retained by Country FSD	0.03	0.35	0.64	0.59	0.45	2.06
Total retained by FSD	**0.24**	**2.54**	**4.59**	**4.22**	**3.22**	**14.81**
Centralised services shared overhead	0.004	0.036	0.056	0.051	0.043	0.19
Grand Total	**0.24**	**2.58**	**4.65**	**4.27**	**3.26**	**15.00**
Programmatic funding split:						
Country core		1.56	3.22	2.92	2.36	10.01
Collaborative working	0.20	0.50	0.50	0.50	0.25	1.95

Annexe 1l. FSD WAEMU

REGION'S FINANCIAL DEVELOPMENT STAGE

The West Africa Economic and Monetary Union (WAEMU) is comprised of eight countries, seven francophone (Benin, Burkina Faso, Côte d'Ivoire, Mali, Niger, Senegal, Togo) and one Lusophone (Guinea Bissau). Cote d'Ivoire and Senegal are the largest economies accounting for over 55% of the regional GDP of US$158bn. They also have the highest per capita incomes, while Togo and Niger have the lowest per capita incomes of only US$858 and US$540 respectively.

2018	Population (Millions)	GDP per capita, (current US$)	GDP (current US$)	Total Revenue (% of GDP)	Money and quasi money (M2) as % of GDP	Current account balance (As % of GDP)	Main Export Products
Benin	13.7	1182	13.6	22.7	72	-12.8	Cotton
Burkina Faso	23.5	900	17.8	27.3	71	-8.5	Cotton
Cote D'Ivoire	29.6	2286	56.9	23.3	33	-3.2	Cocoa
Guinea Bissau	2.3	918	1.8	22.1	66	-3.8	Banana
Mali	22.7	982	18.8	24.6	51	-7.8	Gold
Niger	26.6	539	12.0	23.4	37	-19.0	Uranium
Senegal	19.4	1879	30.6	23.0	58	-8.2	Fish
Togo	9.5	858	6.9	28.6	100	-9.4	Cement
WAEMU	**147.3**	**1279**	**158.3**	**24.0**	**61**	**-7.6**	

Source: African Development Bank, International Monetary Fund

Many of the countries in the WAEMU region can be considered fragile, some with security challenges. Guinea-Bissau is one of the most coup-prone[77] and politically unstable countries in the world. Togo continues to face political tensions with bouts of violence. Presidential elections in Guinea Bissau (November 2019) and Cote d'Ivoire (October 2020) pose a risk to the political stability. There have also been persistent security issues in Burkina Faso, Mali or Niger where recent insurgent attacks have been recorded.

The WAEMU falls in the Sahel region which according to the UN is one of the regions that is most vulnerable to climate change with the largest number of people disproportionately affected by global warming. The Sahel region is experiencing extreme temperatures, fluctuating rainfall, and droughts, all of which have led to land degradation, change of grazing patterns, and reduction in water supply for both animals and people. This jeopardizes food security with a negative impact on security and migration. Cote d'Ivoire had the second largest stock of migrants in Africa in 2017 accounting for about 10% of the population. Cote d'Ivoire and Mali also account for about 14.4% of the total cross Mediterranean migration.

Since 2012, the WAEMU region has experienced strong growth despite the security and political challenges in some member states. According to the IMF, the region's average growth has been above 6% between 2012 and 2018, above the sub-Saharan Africa average. According to the World Bank, financial deepening (increased private sector credit) and infrastructure development have been the main structural determinants of growth. The region has witnessed increased sovereign debt levels over the last several years as budget deficits have widened, but debt levels are considered sustainable except in Togo.

The strong economic growth experienced in the region has led to significant reduction (19.2%) in poverty levels compared to the early 1990s. However, about 42% of the population still lives below the poverty line. Furthermore, the absolute number of people living in poverty has increased because of population growth. About 45m people out of 102m still live in extreme poverty. The average poverty rate in rural areas is almost double that of urban areas. There are also significant disparities among countries. WAEMU countries rank at the bottom of World Bank's human capital index, with Mali and Niger—ranking among the bottom three countries. Education outcomes vary widely across WAEMU countries, suffer from quality issues, while access is very unequal. Health outcomes have improved significantly but major challenges remain, for children with child mortality levels remaining relatively high.

[77] *It has had four successful coups and another 16 attempted coups.*

The financial markets in WAEMU are shallow and are dominated by the banking sector. The regional securities market is a very marginal source of funding, except for governments. The number of listed companies has remained stagnant at about 45 since the launch of the regional exchange (BRVM) in 1998. Despite excess reserves in the banking system, the BCEAO still needs to inject massive amounts of liquidity to many banks that cannot get this liquidity from the market – illustrating a malfunctioning money market.

Despite its dominance, the banking sector is quite weak in the region, a fact that the IMF attributes to regulatory forbearance. According to the IMF, the amount of private credit as a percentage of GDP narrowed in the WAEMU from 2007 to 2017. In Senegal, most of this credit is short term – 68% is in the form of working capital. In addition, the ratios of capital to risk weighted assets (CAR) and non-performing loans (NPLs) to total gross loans stood at less than 10% and about 20% respectively as at 2017.

The insurance industry in the region is also very small. The insurance company assets to GDP ranges from around 3.6% in Cote d'Ivoire to only 0.5% in Mali. The small size of the industry prevents the industry from playing its rightful role in risk management and mitigation and limits the resilience and financial system.

The WAEMU region currency is the CFA franc (XOF). The CFA franc has been pegged to the euro since 1999, with the financial backing of the French treasury. This has largely ensured the general stability of the currency, despite criticism from some quarters on the form of currency arrangement. The integration efforts within the larger West Africa region (ECOWAS) saw the adoption of a single currency "the Eco" in June 2019. The new currency is expected to be launched in 2020 and is set to replace the CFA franc.

The World Bank estimates a housing shortage of 3.5m units in the region, which is increasing due to strong population growth and urbanization. Credit to the housing sector stands at only 2% of total outstanding credit in the region. As is the case for other medium to long-term lending activities, banks mostly rely on term transformation of deposits to fund mortgage lending. As a result of this maturity mismatch the average maturity of housing loans in Côte d'Ivoire is short, averaging 7.4 years – similar to other countries in WAEMU.

According to CGAP and Findex Global Database, the financial Inclusion rate in the WAEMU region remains below 34%. In 2017, ownership of an account at a financial institution in WAEMU varied from 9.5% (Niger) to 34.1% (Togo). Gender gaps are also wide in several countries, with men almost three times as likely to own an account than women in Mali, and almost twice as likely in Côte d'Ivoire and Benin. The BCEAO has developed a regional strategy for financial inclusion which combined with digital opportunities could provide a useful framework for anchoring interventions on financial inclusion.

A Country Diagnostic in Cote d'Ivoire commissioned by FSD Africa alongside GIZ, the African Development Bank and the Centre for Affordable Housing Finance (CAHF) highlights several developmental challenges, which are cross-cutting across the region. Governments in the WAEMU region have been highly dependent on banks in funding their fiscal needs. This was mainly driven by lower interest rate charged by the BCEAO for banks to access liquidity. The BCEAO has since increased its interest rates on liquidity however this has led the economies in the region to increase their reliance on the Eurobond market instead of local capital markets. The governments' fiscal dominance and reliance on domestic borrowing provides relatively more attractive opportunities to local financial institutions when compared to lending to the real economy so that the availability of long-term finance to the private sector is severely constrained.

FSD PROGRAMME, ACHIEVEMENTS AND LESSONS TO DATE

There is currently no FSD programme in any of the WAEMU countries. However, FSD Africa has conducted a number of projects in the region.

FSD Africa has also been an investor in corporate bonds in the region. The African Local Currency Bond Fund, in which FSD Africa has an investment, has invested $30m in 10 corporate bonds in WAEMU.

FSD Africa currently has a project with Agence Umoa-Titres (AUT), a regional agency established to support the development of the bond market and the management of public securities issuance in the Union. The project aims to support AUT's strategic planning, develop a professional certification pathway for the WAEMU in partnership with the Chartered Institute for Securities and Investments (CISI) and implement a sovereign debt monitoring and management database system for the eight treasuries.

FSD Africa is also strengthening regulatory capacity in WAEMU. Through its Africa Regulator Support Programme, FSD Africa has signed a Cooperation Agreement with the Conseil Régional de l'Epargne Publique et des Marchés Financiers (CREPMF), the regional capital markets regulator. This programme will involve an institutional capacity assessment of CREPMF as well as helping CREPMF develop an enabling regulatory framework for Islamic finance. With FSD Africa's support, CREPMF hosted the inaugural West Africa Securities Regulators Association (WASRA) conference in Abidjan at the end of October 2019.

FSD Africa conducted a diagnostic study to support the development of long-term finance in Cote d'Ivoire. This was to identify constraints and potential remedies to the provision of long-term finance from a private sector perspective, with a focus on the infrastructure, housing and SME finance sectors.

FSD Africa has also carried out scoping studies in Senegal and Cote d'Ivoire to identify opportunities for financial sector development. Key findings are highlighted in paragraph 26 below.

WHAT MORE NEEDS TO BE DONE?

Despite ongoing initiatives by the government, development agencies and other stakeholders, there is still a large housing deficit, which mostly affects lower-income groups. Around 800,000 new housing units are needed every year to address the shortage, yet WAEMU banks only issue about 15,000 new mortgages each year. The financial sector can be leveraged to alleviate the funding gap in the housing value chain.

Possibly more than other regions in Sub-Saharan Africa the WAEMU region would benefit greatly from climate finance/mitigating interventions. Potential interventions may include issuance of green bonds to facilitate environmental conservation, agriculture and infrastructure development.

The agricultural industry contributes a significant portion of WAEMU's GDP. Total food production in the region however remains less than the consumption needs. The lack of expansion in the agriculture sector can partially be attributed to inadequate finance to support best practices. A study by FAO and the AfDB notes that limited availability of risk-management instruments, widespread collateral constraints, problems of contract enforcement and a poor loan repayment culture further reduce the appetite of the financial sector to venture into agricultural finance.

Small and Medium Sized Enterprises constitute around 70% of total business units in the WAEMU region and employ about 50% of the employed labour force. Access and cost of finance remains a key challenge for SMEs, which stifles growth in the sector. There is need to support innovation of products and services to SMEs by financial services providers to be able to accommodate the risk profiles of SMEs where traditional approaches have failed.

The WAEMU region can harness the financial sector to address these real sector challenges. However, the financial sector in the region is still small and underdeveloped. The development of the financial sector will therefore be essential in making it a viable source of finance for the real economy. Some the financial sector development interventions would include supporting regulatory and policy reforms, development of appropriate market infrastructure and to support the introduction of new products, services and transactions. This will enable the mobilization of capital for deployment in the real economy. For governments, financial sector development will also reduce reliance on bank financing and foreign debt.

There are activities and engagement by multilateral agencies such as the World Bank Group, including IFC, International Monetary Fund in financial sector development and the Consultative Group to Assist the Poor (CGAP) in financial inclusion. These activities and engagements however do not always seem to translate into funding commitments for specific market building initiatives.

Differing priorities in financial sector development also tends to drag the development of the respective financial markets. Building close policy coherence, collaboration and synchrony for example through a Capital Markets Development Masterplan would ensure uniformity and focus of government efforts towards financial sector development, including climate finance.

Separate scoping exercises with key stakeholders from different parts of the financial services ecosystem in Senegal and Cote D'Ivoire took place in April 2019. The scoping identified potential constraints and opportunities for financial market development. The major constraints that cut across different aspects of financial sector development in WAEMU are as follows:

a) **Weak regulatory capacity –** BCEAO and CREPMF (regional regulatory agencies for the banking and capital markets) have the particularly arduous task of adapting regional regulation to country particularities while at the same time having to move at the speed of all countries in the region.
b) **Low levels of financial literacy and market education.** For both regulators in certain aspects of the markets they serve and investors (specifically institutional) to enable mobilization of capital from such investors.
c) **Lack of adequate facilitative regulation.** The financial market regulators seem not to have in place requisite regulations to adequately harness existing capital be it from retail investors through structured investment products such as collective investment schemes or institutional investors through appropriate regulations. In addition, the regulations need to evolve to accommodate innovations that are coming to the market such as digital financial service platform/crowdfunding etc.
d) **Lack of adequate market infrastructure and processes to facilitate efficient capital markets.** The lack of efficiency of the capital markets in the region has partly contributed to over reliance on a single source of finance – the banking sector.
e) **Lack of product diversification.** As above lack of diversity in products offered by the regional capital markets has partly contributed to reliance in a single source of finance. In addition, a diversified product based facilitates attraction of different groups of investors with different investment needs.

PROPOSED INTERVENTIONS UNDER FSD 2.0

The opportunities and specific proposed interventions from the scoping the activities are summarized below under the five strategic shifts of the DFID Financial Sector Development refresh. The main opportunities cut across the financial sector, from financial inclusion, credit markets, climate finance and improving the availability and access to long term finance and general ecosystem development work. These initiatives are aligned with the national development plans in the region e.g. Plan Senegal Emergent and the Senegal, the National Development Plan in Cote d'Ivoire and with the BCEAO regional financial inclusion strategy.

It is proposed that the FSD WAEMU office be located in Dakar or Abidjan with a satellite office in either city.

Theme	Proposed Activity	Rationale for DFID intervention
Long-term Finance	- Support for the development of the government debt markets. This would build on the work with AUT. Focus of the work would be on the development of the secondary markets, starting with market infrastructure development that would support bond markets and trade reporting for OTC transactions. - Support the creation of a money market trading system to help organise the market and in addition help AUT facilitate excess liquidity management between the treasuries through Repo transactions. This will also promote transparency and price discovery. - Support the retail security issuance. - Support the formation of a treasurers' association to enhance efficiency of bond market operations through networking, capacity building, research, advocacy and regulator engagement. - Support AUT to develop a commercial paper platform for the corporates that can latter be used to grow a pipeline for corporate bond issuance. - Support the development of the Islamic finance.	This would improve access to long-term finance in local currency. This would also support the diversification of the financial sector, reducing reliance on the banking sector.

Theme	Proposed Activity	Rationale for DFID intervention
Inclusion	- Funding innovation pilots in Cote d'Ivoire in key value chains (e.g. cocoa), boosting rural outreach, in collaboration with CGAP and Agency for the Promotion of Financial Inclusion (APIF). - Regional regulatory reform, especially around agency banking, e-signatures, client protection - Regional integration of payment systems (including interoperability) – CGAP-level support - Work with CGAP on merchant payments - Support Agence de Promotion de l'Inclusion Financière de Côte d'Ivoire's (APIF) results measurement unit – collaboration on target-setting and measurement. - Fund a regional FinScope survey in 2020. - Financial support to the Alliance for Financial Inclusion (AFI) capacity building workshops with BCEAO and the WAEMU ministries of finance. - Support the ministries of finance in developing their financial inclusion strategies and SME financing in countries where the strategies are not in place such as Senegal, with a focus on underrepresented groups i.e. women	Improving data and surveys will facilitate identification of gaps and design of potential interventions. Partnership with entities already operating in the market will ensure the FSD's work is additional to what has already been done. Increasing access to finance is expected to lead to improvement in access to basic services and ultimately lead to improvement in livelihoods in alignment with FSD 2.0 strategic focus.
Integrity and stability	- Review effectiveness of implementation of AML/CFT regulation.	Integrity and stability of the financial system is critical to ensure that the impact of the financial sector development programmes being implemented yield the maximum benefit to the economies in the region.
Innovation	- Supporting CREPMF in developing of Islamic Finance regulations. - Islamic governance - BCEAO requires support to put in place regional/national sharia boards. - Knowledge products – including information exchange with the UK Islamic finance industry. - Support peer to peer learning from other regions on a secondment programme. - Assist the governments in the WAEMU region in designing a social housing strategy. - TA support programme to the regional mortgage liquidity facility: CRRH-UEMOA focusing on institutional capacity and support programme for its members banks focusing on mortgage portfolio management. - Support for fintech ecosystem development, especially crowdfunding and, generally, for cross-stakeholder SME financing initiatives (e.g. La Finance S'Engage in Cote d'Ivoire)	Leveraging FSD Africa's experience in Islamic and housing finance, private equity the interventions will facilitate creation of diversity in product range to attract a wide range of investors. These will include locally based institutional investors and will therefore harness domestic capital for deployment in the real economy.
Climate Finance	- Support the development of climate finance and green bond market. This would include demonstration transactions.	Leveraging FSD Africa's experience in the climate finance and green bond, the interventions will facilitate establishment of a robust climate finance market for mobilization of resources targeted at mitigation and adaptation to climate change.

Additionality of FSD WAEMU and opportunities for deeper FSD Network collaboration

FSD WAEMU will plug into the existing FSD Network infrastructure with the benefit of employing and utilizing approaches that have been tried and tested in other jurisdictions under the FSD model. FSD WAEMU is also expected to work closely with FSD Africa who already have an established footprint in the region.

The FSD Network and FSD Africa through already established networks and connections with regulators in various countries will facilitate the sharing of best practice through benchmarking and knowledge sharing engagements. CREPMF has expressed a strong desire for such an engagement with the facilitation of FSD Africa. Should there be opportunities that meet the FSD Africa Investment FSD Africa (I) investment criteria.

Key risks:

Key Risks	Mitigation
- Exogenous/macroeconomic factors that may lead to deterioration of enabling environment for implementation of the programme in a way that enables achievement of the objectives. In addition, partner selection is a key risk as this will determine the extent to which the interventions influence policy at the right level to bring out the intended change.	The identified risks will be mitigated through advocacy and collaboration with the right partners and policy makers to ensure stability in the macroeconomic environment and adequate drive to adopt the intended policy recommendations.
- Lack of enthusiasm by government in driving regulatory reform	
- Government influence, where government may get in the way with non-innovative interventions which may otherwise be well-intentioned. This included influence from external governments that already have deep ties with the region.	
- Political instability occasioned by general elections (Guinea Bissau - November 2019 and Cote d'Ivoire - October 2020) and the threat of insurgent attacks (Mali, Burkina Faso, Niger) in some of the member countries that could make operating in the region difficult.	This is mitigated to the extent that this is a regional initiative with regional and country programming.

IMPLEMENTING PARTNERS

The model will leverage and strengthen existing relationship with regulators and regulatory agency such as AUT, BCEAO, CREMPF through local presence. As per the FSD model, the model will facilitate, when needed, the sourcing of international specialists/experts to provide expert skills in specific interventions.

A deliberate effort to leverage and partner on existing programmes with third party organisations, as so to not to duplicate efforts in the region.

EXPECTED RESULTS

The high-level expected results from the FSD WAEMU programme in line with the FSD 2.0 strategy are;

Indicator definition	Baseline	2 years	5 years
Increase in the number of jobs (informal/formal employment, livelihoods and micro-enterprise) created or improved/sustained through FSD WAEMU supported initiatives.	0	4,948	22,000
Increase in the number of people facilitated to access basic services as a result of FSD WAEMU interventions.	0	52,800	199,000
Increase in the number of people and microenterprises with improved access to financial services in the WAEMU region.	0	158,400	2.7m

Indicator definition	Baseline	2 years	5 years
Increase in the of SMEs with improved access to finance as a result of FSD WAEMU interventions.	0	105,600	55,000
Public and private sector funds (in GBP million) crowded into the financial markets as a result of investments or grant initiatives by FSD WAEMU	0	£3.96m	£80m
Number of Regulations and Policies enacted/changed	0		5

*Please note that the above projections are subject to revision once the programme begins

PROFILE OF ESTIMATED COSTS

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£ m	£ m	£ m	£ m	£ m	£ m
Finance for investment	1.00	1.80	2.20	2.80	3.00	10.80
Financial access	0.60	0.70	0.90	1.00	1.00	4.20
Financial infrastructure for innovation	0.50	0.50	0.70	0.80	0.80	3.30
Financial stability	0.50	0.50	0.50	0.50	0.50	2.50
Financial integrity	0.20	0.30	0.20	0.30	0.30	1.30
Monitoring & Results Measurement	0.14	0.19	0.23	0.27	0.28	1.11
Programme Management for services retained by Country FSD	0.37	0.51	0.61	0.73	0.75	2.97
Total retained by FSD	**3.31**	**4.50**	**5.34**	**6.40**	**6.63**	**26.18**
Centralised services shared overhead	0.051	0.064	0.065	0.078	0.088	0.345
Grand Total	**3.36**	**4.56**	**5.41**	**6.48**	**6.72**	**26.53**
Programmatic funding split:						
Country core	2.43	3.00	3.30	4.30	4.60	17.63
Collaborative working	0.37	0.80	1.20	1.10	1.00	4.47

The total expected expenditure is approximately £26.57m and £13.34m respectively for five and three years of country office funding. This will all be RDEL - if any returnable capital instruments are considered for use during programme implementation these would need to come from the central programme.

RESOURCES

DFID staff resource commitments: Regional Investment Advisor (25% FTE up to September 2020 to support set up, 20% FTE thereafter i.e. 1 day per week on average). B2 Programme Manager (10% FTE – ½ day per week).

Annexe 1m. FSD Zambia

COUNTRY'S FINANCIAL DEVELOPMENT STAGE

As a newly lower middle-income country, **Zambia's macroeconomic developments define the relative circumstances of the financial market, and the circumstances of low-income households**. While growing rapidly from 2009 to 2015, Zambia's development strategy pursued rapid infrastructure development. Unfortunately, lack of sufficiently effective balancing of fiscal revenue and expenditure along with accelerated borrowing has placed Zambia in a very precarious position. It requires immediate action to prevent severe debt distress and stalling of economic growth. The new Finance Minister has introduced an austerity 2020 budget, including allocations to retire outstanding domestic debt but with lower resources available for social services and services to the poor. The IMF is being actively pursued for a programme, and although donors are few, DFID is a key partner and valued advisor.

The financial market is relatively underdeveloped and shallow by comp\arison to other regional and FSD countries. The market is typified by lack of innovation, low depth and participation mainly by the formally employed. The 18 banks, majority foreign-owned, dominate the financial sector, although less than 40% of the population have accounts. The larger foreign banks account for about 70% of the market. Non-bank financial institutions (NBFIs) comprise 129 institutions consisting of eight leasing and finance institutions, three building societies, 80 bureaus de change, one savings and credit institution, 35 microfinance institutions, one development bank, and one credit reference bureau. The insurance industry has 39 licensed insurers and reinsurers, with high concentration but low market penetration. Pensions in Zambia comprise one public mandatory and a number of small private occupational pension schemes. The capital market is very small and narrow, with LuSE listing 23 firms, trading equities and private debt instruments, and handling the secondary market for government bonds.

The main challenges in all segments of the financial sector include delays in improving products and innovating to respond to a broader level of client and real sector needs, low competition, high NPLs (non-performing loans) and cost of credit and banking services to consumers, weak outreach to rural areas and women, and low financial literacy. With its commitments to and understanding of both the real sector and the financial sector, as well as the new DFID country strategy, DFID and its partners are uniquely poised to help the Government and private sector address these challenges.

Financial inclusion is still a challenge in Zambia, although recent developments are quite promising. The last Finscope in 2015 showed about 59% of individuals were financially included, with sizeable growth from 2009 due largely to mobile money expansion and growth of savings groups. Rural households, women, and farmers/fisherfolk are less included (49% excluded). Formal financial inclusion is about 38.2% and informal financial inclusion is 37.9%, with sizeable groups using both types. A quarter of those surveyed have to spend more than they like and are constantly behind in payments, and 32% cannot meet unanticipated costs. 63% save, about one-fifth start businesses, and 40% save to buy assets, showing real options for enterprise growth.

Important recent developments in the formal sector are occurring to expand financial access to the underserved. These include growth of physical and financial infrastructure (National Financial Switch, collateral registry, enhancements of the credit bureau, and movements to increase cell phone towers to expand coverage). Formal financial service providers are increasing innovation in products to move down-market and are bundling services, including mobile money access, for ease of client use. The expansion of both mobile money supply and deepening of products, particularly in the last two years, is helping increase financial inclusion. Public-private partnerships in insurance and digitisation are growing. FSD Zambia has participated in all these changes.

The informal sector, particularly savings groups (SGs), are the point of entry to financial services for low-income households, and SGs are growing and innovating rapidly. FSD Zambia and University of Nottingham research clearly demonstrates that savings groups are a vital entry point for initial financial inclusion in Zambia. This is particularly true for women, who form 86% of the over 600,000 members nationwide. Recent results show that savings groups are even being spontaneously created by individuals and groups who observe them. Members join to save (78%), to borrow (68%) and to have someplace to turn to in time of need (42%). Rural households borrow to smooth cashflow (55%) and to make productive investments (83%), and 86% feel that they are better off due to participation in savings groups. When sharing out savings and profits from loans, 60% invest in enterprises and 33% pay school fees. Recent innovations driven by FSD Zambia under DFID financing include linkages to banks as a graduation strategy for village shop SGs.

Mobile money is at the turning point towards rapid growth, although cell phone coverage is still a challenge. The digital financial services (DFS) market is expanding very rapidly.[78] Since last year there has been an 89% increase in clients to 4.3m, a 104% increase in mobile money agents, and deepening of the types of services beyond cash-in cash-out to merchant payments and a nascent lending market. However, gaps in rural mobile money agents and mobile wallets dormancy is a significant challenge. Cell phone ownership is low at 51% and is concentrated in urban areas with persons less than 40 years old.[79] Although cell service coverage is 87%, well over a third have challenges with quality of signal. About 67% of persons are aware of DFS but only 48% use DFS, and of these only 24% are women. Urban persons dominate in the use of DFS.

The government has made significant commitments and taken action to increase financial inclusion and to improve economic development, particularly for women, youth, and rural households. The Seventh National Development Plan 2017-2021 helps the government guide its policy and actions to both meet the SDGs and increase financial access. In November 2017 the National Financial Sector Development Policy and the associated National Financial Inclusion Strategy 2017-2022 were released, and work is under way through seven Working Groups to improve access. The Bank of Zambia's current (2016-2019) and anticipated (2020-2024) Strategic Plans include financial inclusion and gender equity as strategic pillars. FSD Zambia has a 14-point MOU with BoZ, and is deeply involved in NFIS implementation.

FSD ZAMBIA PROGRAMME: ACHIEVEMENTS AND LESSONS TO DATE

FSD Zambia has built a reputation as a respected facilitator, advisor, and innovation stimulator for the financial market. The organization has a highly qualified and competent governance structure and team, led by the former 2-term Bank of Zambia Governor as Board Chair. FSD Zambia enjoys successful partnerships and relationships with all key financial services providers, regulators, and stakeholders critical for market facilitation. It has invested and built a strong market information and knowledge hub, contributed significantly to policy and regulatory enhancements, and demonstrated a high degree of leadership in anticipating and supporting new market dynamics and change. FSD Zambia is in demand throughout public and private sectors, providing timely and reliable research results, policy advice, market information, and ideas to deepen and broaden financial inclusion.

Since non-profit incorporation in April 2016 with DFID funding of £15.6m through March 2021, FSD Zambia reached 1.33m clients in the country, largely low-income, by 31 March 2019. Of these, 32% were women. Key results include financial policy and regulatory enhancements including revisions in payments legislation and mobile money transaction limits; significant research such as Finscope, social norms, and gender and financial services usage; national weather index insurance; national government digitisation and data for decision-making; notably increased financial service providers collaboration and improved industry engagement to reach down-market; significant savings groups expansion and innovations to expand financial access for women, youth, and rural households; financial literacy by cell phone and Internet; and innovations in client-centric financial products. With FSD Network partner Finmark Trust, FSD Zambia sharing of gender and financial inclusion successes across SADC has been taken up.

Additional significant expected results for the ongoing fiscal year 2019-2020 include review and revision of the Payments Act with industry and regulators; anticipated completion of the financial education materials under the national curriculum for grades 1-12, which when rolled out will affect an estimated 4.1m children and youth; outreach of Zazu, a sponsored financial literacy programme on simple cell phones, reaching 1.1m poor clients so far of which 46% were women; and broad experimentation with digital financial solutions for school fees payment and links of mobile money with savings groups and formal financial institutions.

The FSD Zambia programme strategy is beginning to evolve to explicitly address the expansion and deepening of financial inclusion in tandem with linkage to real sector outcomes. There has been a realisation here -- and across the FSD Network -- that focusing on basic financial access may achieve only limited impact in terms of a contribution to long term economic growth. Thus, FSD Zambia is beginning to more consistently engage with the financial system as a whole, developing pilot interventions to enable the financial sector to evolve to both enable access and service real sector needs for families. With active SRO encouragement, FSD Zambia has begun collaborative work with a range of DFID-financed real sector partners to link engagements in policy, agriculture, tourism and manufacturing, and in other areas.

Potential interventions are more consistently being assessed with a market systems focus, incorporating inclusive financial approaches more broadly into the real sector. Pilots are being undertaken to support and scale up interventions that have the ability to deliver significant systemic change to the financial market system, particularly demonstrating real

[78] *UNCDF State of the Zambian DFS Industry Report 2019.*
[79] *2018 ZICTA ICT Survey.*

sector results. As one example, engagement in the agricultural sector incorporates both a range of insurance options and innovations in financing such as Rent-to-Own, factoring for crop payments to women horticultural farmers, creating blended savings group/bank partnerships to increase village shop working capital, and digitising microfinance credit analysis and loan delivery.

WHAT MORE NEEDS TO BE DONE?

Economic growth and the expansion of financial inclusion in Zambia over the last decade have yet to translate into sufficient impact on poverty reduction. A more inclusive growth path is needed which establishes a virtuous cycle of effective financial systems. These in turn enable investment in growth and human development to produce sustainable impacts on the livelihoods of all Zambians, most particularly the poor. Such an approach includes understanding the persistence of the rural-urban and gender gaps, especially in financial health and economic wellbeing, and addressing of the growing needs and challenges of the expanding youth demographic.

The core target clients particularly important for FSD Zambia to achieve inclusive real sector-empowering finance, create jobs and growth, meet needs, and improve resilience are women, youth, and rural people, particularly the poor. These individuals and families make up the majority of those who are financially, socially, and economically disenfranchised. FSD Zambia's job is to use improvements in the broader financial sector to empower these groups to be active participants in inclusive growth, have regular and strong access to basic services, and enable risk management (particularly for climate change) and savings options for a sustainable future.

The financial system has a crucial role to play in determining how resources are allocated to achieve this growth path. It is not simply the depth or levels of access to the system – conventional indicators of quantity – which will determine the impact. Progress need to be made in improving the quality of finance measured in terms of how households use financial opportunities to engage actively in broad-based growth, development, and resilience, and how their life-cycle financial needs tie in to their real sector interactions.

At a sectoral level, economic and social priorities such as agriculture, tourism, education, and micro-enterprises are not receiving the investment needed, nor are the largely informal segments of these sectors sufficiently well integrated with formal services. The financial system is falling short in its pivotal functions of resource allocation, risk transfer and payments. From the enterprise or household level there are two gaps: overall financial service access; and value for money in economic growth and sustained futures, basic services access, and resilience. Few micro and small-scale enterprises are able to access sufficient liquidity or capital needed to underpin long-term business growth. Savings and microinsurance do not sufficiently serve the purposes of helping secure education and health, building enterprises and jobs, or creating long-term assets.

Deepening participation in more sophisticated financial solutions – such as long-term investment – requires a higher degree of trust. This means work to get policies and rules for the market right. It means integrating clients with the suppliers of financial services, and using digitisation to improve timeliness, information flows, and reliability of financial services to meet social and economic needs. It means sharing information in ways that clients can understand and use and creating streams of financial services which enable clients to bundle and use for changing needs over their lives. Understanding services on offer, being able to afford and trust them, and for the services to be sustainable for financial service providers, clients, and for economic and social sectors is the key to success in moving from financial inclusion to inclusive finance for all.

Greater impact through financial sector development needs to be based on addressing opportunities for growth or welfare gains in the real economy. These opportunities rarely rely on looking simply at the immediate needs of individual low-income households or individual enterprises for existing financial services. End-to-end inclusive financial solutions are needed, such that the necessary investments can be achieved which will drive productivity improvements and simultaneously enable low-income people to participate fully as producers, workers or consumers. A financial system able to support these changes is unlikely to emerge without significant changes across the policy and regulatory environment, industry infrastructure and innovation system.

Practical realisation of the 2.0 conceptual framework above requires coherent developments across multiple interconnected layers. These encompass not only purely financial sector elements – such as improved functioning of the payments system or the interbank market – but economy-wide – such as the rules and mechanisms for data exchange or establishment of identity. From a market development perspective, change is needed at the level of the rules – formal policy and regulation together with the informal business models, rules and norms of finance – and the supporting functions – the infrastructure and business services from linked markets. Shaping developments to deliver value-adding

finance requires broadening the perspective from a pure financial sector supply-side 'push' approach to include a significantly stronger and much broader demand-side 'pull'.

PROPOSED INTERVENTIONS UNDER FSD 2.0

FSD Zambia's renewed strategy targets creating value through inclusive finance. It has considerable synergies with the five strategic shifts of the DFID Financial Sector Development refresh (see italic bullets in first column) and are consistent with the FSD Network vision under FSD2.0 to support the real economy (see italic parentheses in second column). The table below proposes five indicative interventions consistent with DFID Zambia's priorities where there are gaps in the development of the financial sector. While gender is a central and advanced activity in FSD Zambia, support to ensure gender equity is expected to be financed largely by SIDA under a Phase 2 project in design now. These and resources from other financing partners will be integrated to ensure a seamless and reinforced approach to produce the targets with strong gender results.

DFID and the FSD Network are uniquely poised to provide key support in the evolution from financial inclusion to inclusive finance, moving from financial access to blending real and financial sectors for inclusive growth. As the founder and main financier of the FSDs across Africa, DFID has demonstrated the key value of these long-term trusted facilitators of financial inclusion. It has unique understanding and capability to support FSD Zambia and has worked intensively to support its successful inception and growth. The DFID Zambia strategy allows for ongoing engagement among its partners to enable economic growth and job creation in an inclusive manner, and FSD Zambia fills the niche of helping lower-end families and market players to work more closely together to grow. DFID funds will be monitored specifically for their results against the target, and will report impact on women, youth, the disabled, and households based in rural areas.

Interventions	Objective	Sample activities
Climate finance and agricultural value chains - *Investment* - *Inclusion* - *Innovation* - *Stability* - *Integrity*	Mainstreaming climate and environment factors as a financial and strategic objective while also increasing productivity and value addition of agricultural value chains This will directly address climate financing and resilience issues, while resulting in job creation and higher incomes using more sustainable methods. *(Inclusive growth and sustainable futures)*	This work may involve, in close partnership within the FSD Network in the climate change domain and agricultural finance expected collaborative programme: (i) promote the development of financial solutions for reducing negative climate externalities and mitigating risks/increasing resilience due to climate change, particularly weather index and other insurance tools; (ii) enhance digital and other innovations in value chain financing and trade; and (iii) work with regulators and financial institution associations to remove barriers to crop and animal diversification for climate proofing and agricultural investment by smallholders,
Inclusive enterprise platforms - *Investment* - *Innovation* - *Inclusion*	To stimulate the development of financial solutions that can increase market access and investment in productivity /processing for micro and small enterprises, particularly in rural areas, leading to improved profitability, jobs and business ownership, particularly for women and youth. *(Inclusive growth)*	Interventions may include, collaboratively with the FSD Network collaborative programme in enterprise growth and trade: (i) demand-side work to facilitate identification of pain points to be addressed through policy, regulatory, and client-centric financial innovation; (ii) development of informal enterprise client knowledge and use/experience of financial tools and networks for business growth; (iii) engagement with cross-border trade and e-commerce associations to embed financial solutions and de-risking; (iv) work with policymakers and regulators to stimulate business development options at the bottom of the pyramid, linking to angel funders and processors to enable more start-ups; (v) expand insurance and other risk amelioration tools to support enterprise growth; and (vi) support innovation to address the particular needs of women, rural households, and youth in growing successful businesses.

Interventions	Objective	Sample activities
Digital finance and related Policy - *Inclusion* - *Innovation* - *Stability* - *Integrity*	To build the inclusive finance, digital finance and fintech landscape to help financial inclusion translate into positive financial health outcomes. *(Inclusive growth and basic services)*	This intervention would work closely with FSDs in the network with digitisation expertise and interests to expand digital services to meet the needs identified in the FSD 2.0 shift to real economy issues. Activities could include: (i) Support Smart Zambia, the Ministry of Finance, the Bank of Zambia, and other regulators in the execution of the universal biometric identity systems; (ii) advise these and others on how to address integration of the digital IDs and Government e-Payments programme with financial sector organizations to enable clients to benefit; (iii) partner with others to accelerate the development of robust credit market infrastructure, data use and management by financial institutions and regulators; iv) support the design of financial solutions that bolster financial health; and v) Work with regulators to develop and achieve appropriate financial inclusion and sector goals under inter-related Government policies.
Community cohesion in finance - *Investment* - *Inclusion* - *Innovation* - *Stability*	To use effective traditional leadership operations in Zambia to facilitate economic growth through expansion of informal financial service access linked to formal finance, as well as enabling optimal financial services connected to local economic and social service growth options and plans *(Inclusive growth, basic services, and sustainable futures)*	Interventions are expected to include: (i) significant expansion of savings groups, insurance, and linkages to other financial services with the Luapula Provinces chiefs, along with work with the Ministry of Community Development and Social services to expand savings groups in other areas where traditional chiefs, other community leaders, or local social cash transfer programmes wish to move ahead with SGs to expand incomes and social services access; (ii) using local leadership to develop improved opportunities for mobile money in rural areas for better payments access for economic and social services activities, including agent development, merchant and farmer payments, cell phone ownership, (iii) geospatial mapping and research as well as policy work to help define improved options for rural small enterprises and households to collaborate with traditional leaders and each other across regions for better growth options; and (iv) engagement of groups and traditional leaders for expansion of financial literacy blended with access to market/technology information for business growth.
Access to social services: Education, Health, and Social Cash Transfers - *Investment* - *Inclusion* - *Innovation*	To increase planning, financing, and payments arrangements which increase access to education for children and youth, address gaps in health financing for poor households, and enhance effective social cash transfer access and use to strengthen household resilience *Inclusive growth and basic services*	In this area the key challenge is school fees generation and payment but also the addressing of certain health costs and enabling access to Government subsidies for poorer households. Interventions in this area may include: (i) creating and encouraging mechanisms for school fee cost planning, anticipatory savings, digital payments, and tracking by parents, schools (both public and private) and Government Ministries, including potential changing of the school fee payments dates so they do not occur at the same times as Christmas and the annual planting season costs; (ii) expansion, development, and of SG social funds and microinsurance to meet gaps in health costs; (iii) blending savings and financing mechanisms with business options to provide social sector services, potentially including water and sanitation construction and maintenance, private schools and tutoring, child care, ancillary health services, and other social services for expansion; (iv) support improvements in the use of mobile money services for social services access.

OPPORTUNITIES FOR DEEPER FSD NETWORK COLLABORATION

As a founding member of the FSD Network, FSD Zambia will benefit from collaborative working arrangements, especially in the areas of climate finance, MSME growth, and digital finance, all of which have strong synergies with DFID Zambia projects and partners. FSD Zambia is also keen to share its experiences and engage in collaborative experimentation and innovation. FSD Zambia will contribute significant learning from its work in the Zambian market to the broader Network, and could also host the collaborative working expertise for the gender area. FSD Zambia will participate in the shared services under this business case and will clearly benefit from engagement with the eight other member organizations, as well as the new FSDs expected to come online. Due to trade/linkage potential, there is a high possibility for FSD Zambia to collaborate with both DFID Malawi and DRC (with a focus on Katanga Province).

RESOURCES

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£ m	£ m	£ m	£ m	£ m	£ m
Finance for investment	0.54	0.57	0.58	0.57	0.57	2.83
Financial access	1	1.05	1.05	1.06	1.06	5.22
Financial infrastructure for innovation	0.75	0.77	0.78	0.78	0.78	3.86
Financial stability	0.76	0.66	0.64	0.65	0.65	3.36
Financial integrity	0.3	0.3	0.3	0.3	0.3	1.50
Monitoring & Results Measurement	0.32	0.32	0.32	0.32	0.32	1.60
Programme Management for services retained by Country FSD	0.65	0.66	0.67	0.67	0.66	3.31
Total retained by FSD	**4.32**	**4.33**	**4.34**	**4.35**	**4.34**	**21.68**
Centralised services shared overhead	0.07	0.06	0.05	0.05	0.06	0.29
Grand Total	**4.4**	**4.4**	**4.4**	**4.4**	**4.4**	**22**
Programmatic funding split:						
Country core	2.9	2.4	2.4	2.4	2.9	12.8
Collaborative working	0.5	1	1	1	0.5	4.00

DFID Zambia will provide £2m for FY20-21. DFID London through the Network is requested to provide GBP2.4 million that year, and £4.4m for each of the following four years. MRM funding set consistent with historic spend of 7.5% per year. Programme management set with DFID Zambia and other financing partners agreements at 16% per year, net of collaborative programme. In addition, 0.4 FTE advisory capacity will be committed to the programme while programme funded posts under a new investment facility will effectively also provide some capacity.

EXPECTED RESULTS

The table below provides estimated targets for the current indicators as defined by the cross-FSD Network monitoring results and measurement working group. They will be further refined as activities are designed in line with annual business plans and the further development of strategy.

Indicator Definition	2-years	5-years
Number of Direct FTE jobs created /sustained courtesy of FSD support		0
Number of people, who through an FSD's support, are able to access basic services from a private or public provision system that meets human basic needs. **Assumption**: We consider access to basic services facilitated through Savings Groups and Inclusive insurance such as education and health	58,333	1,269,906
Number of adults and microenterprises with an account at a financial institution, payments service provider, or use a remittance channel, or have a loan or credit line, or have an insurance policy that has been supported by an FSD **Assumption**: Based on VfM estimates of average cost per client (ACPC)	175,600	1,763,758
Number of SMEs with an account at a financial institution, payments service provider, or use a remittance channel, or have a loan or credit line, or have an insurance policy that has been supported by an FSD. **Assumption**: Based on the average cost per SME for delivering SME intervention	117,067	103,035
Private and public funds (in GDP m) crowded into investments or grant initiatives originated by an FSD **Assumption**: Based on VfM indicator on partner leverage ratio	£5.44m	£8.68m
Number of policies and regulations developed through FSD support **Assumption**: Currently working with 6 policy and regulatory bodies		6

Annexe 1n. FSD Zimbabwe

A. COUNTRY'S FINANCIAL DEVELOPMENT STAGE

Capital & Credit Markets (Finance for Investment)

Zimbabwe is in desperate need of both domestic and international investment. Prior to the adoption of the RTGS[80] dollar in February 2019, the Zimbabwe Stock Exchange (ZSE) market capitalisation was approximately US$25bn, by June market capitalisation had dropped to RTGS$30bn (US$4.72bn). With real assets undervalued, there remains significant potential for investing in capital markets.

At the same time, only 1% of the population participates in the capital market. Out of those involved, there are only 20,000 active investor accounts.

Insurance penetration is low and limited to wealthier, urban customers. Only 4.7% of the population accesses insurance products, with a downward trend due to currency rebasing. There is a nascent micro-insurance industry.

Financial sector reforms and the *pending* introduction of new Zimbabwe dollar notes are viewed negatively by the country's banking industry. The report on the Zimbabwe banking sector "Navigating a challenging monetary space" (August 2019), argues that the reforms will potentially result in a liquidity crisis.

Financial Access (Focusing on the Marginalised)

The Reserve Bank of Zimbabwe has adopted a developmental approach[81] to drive financial inclusion in Zimbabwe, however much more work is needed. Despite more than 50% of the population having a bank account (parity between men and women), less than 4% of the population is able to access credit from a financial institution, and bank savings remains low with approximately 5%[82] of the population saving.

The number of commercial financial institution branches has reduced significantly from 7.7 to 5.4 branches per 100,000 adults.[83] Traditional branch banking is being replaced by agency banking via retail shops, which then provide a limited range of banking services (such as account opening, deposits, and withdrawals by customers).

Mobile money usage is rising exponentially with rural access doubling to almost 50% in the past few years. 96% of total transactions in 2017 were electronic, and the value of transactions across all electronic platforms accounted for over 90% of the US$97.5bn of total value transactions in the country in the same year, with mobile money constituting 23% of that 90%.

Financial Sector Stability

A Financial Sector Stability Review (FSSR)[84] conducted in November 2018 **found the current legal framework for bank resolution to contain some elements necessary for preparedness, but that gaps remain**. The authorities have agreed to upgrade the banking law to align banking supervision and resolution frameworks with international best practice (end-December 2019 structural benchmark), and to strengthen the Emergency Liquidity Assistance facility.

Financial Innovation (Supporting a safe and secure digital transition)

With inflation soaring and cash in short supply, many Zimbabweans transfer funds using their mobile phones and pay a premium both to access much needed cash and to get foreign currency. The World Bank (WB) notes that increased use of mobile money is a welcome sign of a greater proportion of the population engaged in the banking sector. However, in Zimbabwe it is more a reflection of the difficulty and cost of accessing cash.

The total number of mobile money agents has increased significantly from 40,950 in 2014 to 49,663 in 2018. This alternative to traditional banking models has been a **catalyst in expanding digital financial inclusion and innovation around service offerings.**

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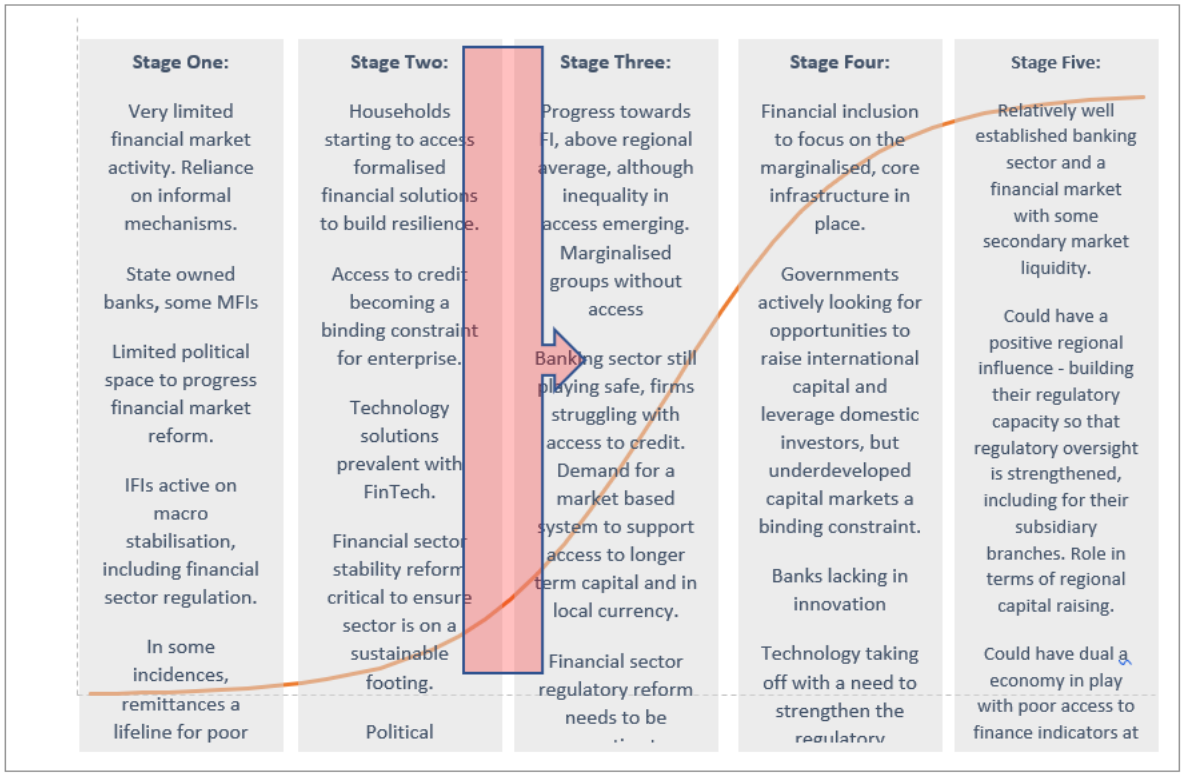
[80] *Real Time Gross Settlement – a term used to describe Zimbabwe's 'electronic' local currency*
[81] *https://www.rbz.co.zw/index.php/financial-stability/financial-inclusion*
[82] *Findex 2017*
[83] *Finscope 2019*
[84] *IMF Staff Report, May 2019*

Financial Integrity (licit and Illicit Financial Flows)

Illicit Financial Flows (IFFs) are a significant issue in Zimbabwe. According to Global Financial Integrity, Zimbabwe could have lost a cumulative US$2.8bn (an annual average loss of US$276m) during the period from 2004 to 2013.

The Reserve Bank of Zimbabwe (RBZ) estimated a loss of US$3bn between 2015 and 2017 and further estimated that US$684m was remitted outside Zimbabwe or externalised under dubious and unwarranted circumstances in 2015. Global Financial Integrity data shows that Zimbabwe lost an estimated US$670m through trade misinvoicing in 2015. **Zimbabwe has an estimated budget deficit of US$672m, a figure that is close to the average annual loss of US$570m through IFFs as estimated by Afrodad.**

Figure 1 below indicates that Zimbabwe is transitioning from Stage 2 to Stage 3 of the financial sector deepening cycle. The extent to which the newly introduced local currency encourages local currency lending will be a key determinant of this transition.



Financial Sector deepening

FSD PROGRAMME, ACHIEVEMENTS AND LESSONS TO DATE

While there is no FSD locally registered entity in Zimbabwe, there has been a considerable amount of work done by FSD Africa's fragile states unit over the last two years to build a presence and portfolio pipeline with the view to transitioning these programs to a fully functional local entity. The portfolio is evolving with the following key activities underway:

- **Alternative Enterprise Credit Competition** (AECC). Business competition to promote innovation and facilitating FSD with a soft landing into the Zimbabwe marketplace.
- **Capacity building program** with the Securities Exchange Commission (SEC) to help identify critical areas to improve the SEC operational effectiveness and efficiency and the design of a capital market master plan.
- **Investment via FSDi:** FSD Africa has approved a US$3m blended finance program to support an invoice discounting business that supports the informal sector. This is pending legal deal closure.
- **Partnerships identification** with key financial institutions to drive innovative financial products for previously excluded market segments.

- **Fintech diagnostic** work to drive innovation in the marketplace and inform opportunities and key areas to improve financial inclusion.

WHAT MORE NEEDS TO BE DONE?

DFID Zimbabwe's country development diagnostic identifies three core opportunities for development in the current country context: i) international political re-engagement and democratic transition, ii) macroeconomic reforms, debt arrears resolution and improved public financial management, and iii) reviving the economy for inclusive growth. **FSD Zimbabwe (FSDZim) will work 'with the grain' in a politically informed way to support economic policies that encourage investment and promote access to adequate savings (and other financial services) and that foster confidence in domestic financial markets.**

The British Mission Zimbabwe's (BMZ) Prosperity Strategy identifies the financial sector as one of three key focus areas. The engagements proposed under this annex will strongly complement the UK Government's existing efforts to promote mutual prosperity through the development of Zimbabwe's financial sector.

Some of the key financial market related failures include:

- **Ease of doing business and financial inclusion rankings are low and behind regional peers**. The impact of financial sector support for the real sector will be dampened by a weak environment for business to operate, coupled with limited credit availability to small businesses and entrepreneurs.
- **Mobile penetration is significantly higher than most countries in Africa**, but mobile data costs are expensive and constrain usage. The high cost is due to the monopolistic environment of one dominant provider with more than 90% of the market share.
- **Capital market players have limited buy-in to the National Financial Inclusion Strategy**[85] due to lack of sector specific financial inclusion goals and objectives and key performance indicators.
- **There is limited collaboration among key stakeholders** to promote the growth of MSMEs (including women- and youth-owned businesses). The absence of viable markets has been noted as a major hindrance to the growth of the MSMEs, women, and youth segments. Rural communities also require special consideration as they have limited collateral to pledge for loans.

There are however several opportunities to promote financial sector development in Zimbabwe:

- **Risk and long-term finance:** Deploying FSDi in high impact sectors (including climate), building liquidity in local capital markets and building the local ecosystem for early stage and risk-bearing capital. This may include innovative market development tools from investment capital (grants to concessional debt and equity) and FSDi advisory offer as well as its market intelligence and convening roles.
- **Rural bank digitisation:** FSDZim can introduce pilots that level the playing field so that rural banks, MFIs, and insurance companies can digitise their operations to improve their operational efficiency and offer new low-cost services to their members. This will improve financial inclusion and provide vital financial services in areas of the country that need it most.
- **Make digital finance work for marginalized groups by** responsibly embracing new technologies and improving data sharing and analytics. Focus on providing demand-side interventions that promote the usage of digital financial services. The overarching objective would be to provide low-income individuals and MSMEs access to a broader range of financial services through formalized financial mechanisms at a reasonable cost.
- **Regulatory support:** Working with the five principal agencies charged with the responsibility of financial regulation and supervision[86] provides FSDZim with the opportunity to help shape policies, for example, on how to improve the governance around how technology impacts the financial sector.

[85] *Source: Zimbabwe Finmark 2019 Financial Inclusion Forum Report*

[86] *Reserve Bank of Zimbabwe (RBZ), The Ministry of Finance, The Deposit Protection Corporation, The Securities Exchange Commission (SEC) and The Insurance and Pensions commission*

Additionality of FSDZim:

FSDZim will continue to play a convening role for the growing group of CMP's with interest in Zimbabwe. This includes PIDG, the CDC group, and Globaleq (a sub of CDC Group) which is at an advance stage of investing in a substantive solar project. AgDevco is considering scoping Zimbabwe in preparation for setting up a country presence.

Other DFID programmes and partners include ZIMREF which is a WB Trust Fund that includes a window on financial sector development (financial sector stability, AML-TF and regulatory support). The IMF has re-engaged the Government of Zimbabwe through a recently agreed Staff Monitored Programme (SMP). FSD Africa through initiatives such as the planned Regulating for Innovation Support will leverage and support the work of the IMF on the SMP.

As an alternative to FSDZim, DFID could put additional funds in ZIMREF (WB) to scale up financial sector work done with the Reserve Bank and Ministry of Finance. The Bank however primarily works with the Government as its client on regulatory issues, with a relatively limited convening role in dialogue and the voice of the private sector, including small business. Concerns and context on the ground may not be raised appropriately and thus not generate an appropriate regulatory response. Working at regulatory, institutional, and firm levels, FSD is likely to deliver change that is of relevance to the market. In doing so, it can deliver lasting solutions to critical constraints and delivering VfM from an enabling environment perspective.

PROPOSED INTERVENTIONS UNDER FSD 2.0

FSDZim program outputs will contribute to access to basic services, inclusive growth, and sustainability by: i) providing new financial services in areas that are underserved; ii) unblocking regulatory barriers that constrain FI risk decisions; iii) supporting the delivery of programs that promote access to finance, through FI strengthening, and enterprise finance; and iv) seeking opportunities to invest in green finance projects.

	FSD 2.0 Thematic Area	FSD Zimbabwe Priority
Demand Side (creating real economy sector/value-chain driven solutions.	**Finance for investment** – building capital markets	Medium
	Financial access – focusing on the marginalised	High
Supply Side: building core financial sector capability.	**Financial stability** – household, corporate and sovereign	Low[87]
	Financial innovation –safe and secure digital transition	High[88]
	Financial integrity – licit and illicit financial flows	Low

FSDZim's strategy, creating value through inclusive finance, has considerable synergies with the five strategic shifts of the DFID Financial Sector Development refresh (see italic bullets in the first column) and consistent with the vision under FSD2.0 to support the real economy (see italic parentheses in second column). The table below proposes indicative interventions consistent with DFID Zimbabwe's priorities where there are gaps in the development of the financial sector:

[87] *Work in the financial stability and integrity thematic areas has been assigned a low priority as other multilaterals such as the World Bank and IMF already have extensive programs of support in these areas. FSDZim will work opportunistically providing focused support to the IFI's where value can be added to existing initiatives*

[88] *Existing FSD activities have identified significant demand for and latent capacity to innovate within the Zimbabwe fintech space – hence high priority*

Interventions	Objective	Sample activities
Enterprise (MSME) banking *- Investment* *- Innovation* *- Inclusion*	Stimulate the development of financial solutions that can increase market access and investment in productivity for small and medium enterprises leading to improved profitability and generating higher-quality jobs. *(Inclusive growth)*	Interventions could include: i) demand-side research that identifies how enterprises currently finance growth and how the needs could best be met through the spectrum of potential financial solutions; and ii) identifying opportunities for alternative risk mitigation products and solutions that meet the needs of smaller and less formal enterprises, in partnership with various financial institutions and the central bank.
Rural banking *- Innovation* *- Inclusion*	Stimulate the development of financial solutions that can increase market access to marginalised and underserved communities. *(Inclusive growth)*	Interventions could include capacity building of existing rural based financial institutions such as SACCOs to develop systems and processes that allow them to better serve the needs of their communities.
Capital markets development *- Innovation* *- Investment*	Stimulate the development of inclusive capital markets that allows for innovation and greater access underserved market segments. *(Inclusive growth)*	Interventions could include: i) working with the Capital Markets regulator to build capacity of local stakeholders to promote innovation and growth in the capital markets; and ii) working with a retail-focused e-commerce investment platform to provide affordable access to investment and savings in capital markets for individuals and entrepreneurs.
Climate finance *- Investment* *- Inclusion* *- Innovation* *- Stability* *- Integrity*	To stimulate interest and action in both "greening finance" - mainstreaming climate and environment factors as a financial and strategic imperative in the financial sector and "financing green" - mobilising private finance for clean and resilient growth. *(Sustainable futures)*	In partnership with FSD Africa and the potential FSD Network climate finance domain, activities could include: i) promoting the development of financial solutions for reducing negative climate externalities within enterprises such as agriculture and energy. In addition a green funding window aimed at entrepreneurs who provide environmentally friendly services such as solar energy for agriculture, biogas, waste energy recycling; ii) supporting financial solutions for mitigating risks and increasing resilience due to climate change[89] and iii) conducting action research on how finance can support rehabilitation in areas such as sustainable forestry and ecotourism.
Digital finance *- Inclusion* *- Innovation* *- Stability* *- Integrity*	To build on the gains in the digital finance and fintech landscape to help financial inclusion translate into positive financial health outcomes, the digital financial infrastructure continues to develop and protect financial service users from inappropriate market conduct *(Inclusive growth and Basic services)*	This intervention would build on and expand existing activity to develop a financial system that delivers real value to low-income people and meets the needs identified in the FSD 2.0 shift to real economy issues including the ones mentioned above. Activities could include: i) Advise Government Digital Payments on how to address emerging challenges; iii) Partner with others to accelerate the development of robust credit market infrastructure and data sharing; iv) Support the design of financial solutions that bolster financial health; and v) Work with regulators to develop appropriate market conduct, integrity, data privacy and open finance policies and regulations.

[89] *To note that DFID Zimbabwe's current humanitarian programme includes a component for enhancing the effectiveness of various sources of early-warning information for triggering forecast-based and early-response finance and assessing the effectiveness of disaster and climate risk insurance and other risk finance instruments that have been implemented in Zimbabwe. This will be delivered by the WB, FSDZ will coordinate with the Bank on work done in this space.*

Proposed new engagements *(indicative*):

- **Enterprise (MSME) and Rural Banking:** capacity building on tactical areas such as alternative risk mitigation strategies in productive credit markets and Savings and Credit Cooperative Societies (SACCOS).
- **Impact fund:** to provide startup capital for innovative projects that promote financial sector development. These funds could focus on the agricultural sector, green investments and sectors that have a high job creation and MSME development impact.
- **Research and development:** on market segments to build the business case for serving marginalized and high-impact sectors. These diagnostics would inform program pipeline.
- **Financial Services Digitisation:** Rural Bank, MFI insurance digitization program with a focus on delivering new products such as insurance and pensions.
- **Capacity Building:** technical support for SEC/ZSE/ IPEC in building capacity of key stakeholders in local capital markets.
- **Advocacy:** for greater sharing of data e.g., through opening up APIs and credit reporting systems.
- **Fintech Sector Development:** follow-on program from the existing FSD Africa initiative to further engage the fintechs with a focus on piloting new models in rural areas.
- **Regulatory Sandbox Design and Launch:** early sandbox scoping and design and sandbox launch and development. A regulatory sandbox is a formal regulatory initiative to live test new products, services, or business models on a time and scope limited basis in order to determine the appropriate regulatory treatment or status to safely operate in the marketplace on a going forward basis.

FSDZim would seek to develop partnerships with country programs with common objectives in order to: i) leverage existing programs to fast-track FSDZim program initiatives; ii) increase delivery capacity through partnerships; and iii) co-fund research and development for market assessments on specific market segments to build the business case for serving marginalised and high-impact sectors. For example:

- FinMark Trust: leverage their research, specifically in the areas of: i) financial innovation, payments and remittances; ii) inclusion policy coordination and advocacy; and iii) formal and informal financial inclusion.
- FSD Africa: Provide on-the-ground program management support for FSD Africa's sector priorities (housing, climate, agriculture, health) from a business development, supervision and relationship management perspective. FSDZim would take into consideration CoPro opportunities. A partnership arrangement would be formalised based on the outcome of the existing strategy process.

EXPECTED RESULTS

The table below outlines FSDZim's indicative results offer against the output metrics provided by the FSD Network:

Indicator Definition	2-years	5-years
Jobs (SDG 8)	1,386	5,280
Access to basic services (SDG 1)	35,000	1,320,000
Financial Sector Development (SDG 8)	105,000	660,000
Financial Sector Development (SDG 9)	70,000	8,250
Financial Sector Development	£2.63m	5
Financial Sector Development		2

THE PROFILE OF ESTIMATED COSTS

A budget of £15m over five years is proposed for FSDZim with funding coming from a central allocation.

Financial Year	2020/21	2021/22	2022/23	2023/24	2024/25	Total
	£ m	£ m	£ m	£ m	£ m	£ m
Finance for investment	0.34	0.45	0.45	0.51	0.51	2.25
Financial access	0.56	0.75	0.75	0.84	0.84	3.75
Financial infrastructure for innovation	0.56	0.75	0.75	0.84	0.84	3.75
Financial stability	0.23	0.30	0.30	0.34	0.34	1.50
Financial integrity	0.11	0.15	0.15	0.17	0.17	0.75
Monitoring & Results Measurement	0.11	0.15	0.15	0.17	0.17	0.75
Programme Management for services retained by Country FSD	0.30	0.41	0.41	0.47	0.46	2.05
Total retained by FSD	**2.22**	**2.96**	**2.96**	**3.33**	**3.33**	**14.80**
Centralised services shared overhead	0.034	0.042	0.036	0.041	0.044	0.196
Grand Total	**2.25**	**3.00**	**3.00**	**3.38**	**3.38**	**15.00**
Programmatic funding split:						
Country core	1.35	1.80	1.80	2.03	2.03	9.00
Collaborative working	0.45	0.60	0.60	0.68	0.68	3.00

RESOURCES

DFID Zimbabwe resource commitments:

- Private Sector Development Adviser (20% FTE)
- B2 Programme Manager (10% FTE)