



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 12-Feb-2018 | Report No: XXXXXXXXX



BASIC INFORMATION

A. Basic Project Data

Country Cooperative Republic of Guyana	Project ID P165425	Project Name Guyana Financial Sector Stability and Development	Parent Project ID (if any)
Region Latin America and the Caribbean	Estimated Board Date 21-Jun-2018	Practice Area (Lead)(s) Finance, Competitiveness and Innovation	Financing Instrument Development Policy Financing
Borrower(s) Cooperative Republic of Guyana	Implementing Agency Ministry of Finance		

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Proposed Development Objective(s)

Strengthen financial stability while supporting financial development and investments

Pillar I: Strengthen financial stability and depositor protection

Pillar II: Develop financial intermediation and support private investments

Financing (in US\$, Millions)

SUMMARY

Total Financing	35.00
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DETAILS

Source: IDA credit	35.00
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Decision



B. Introduction and Context

The proposed Development Policy Credit (DPC) supports Guyana’s reform efforts to reinforce financial sector stability and economic resilience by strengthening financial sector oversight and establishing a deposit insurance mechanism.

It will build on two pillars. The first pillar underpins stronger banking sector supervision and supports creation of deposit insurance to protect depositors. The second pillar supports development of a more efficient and deeper financial system that can help allocate capital domestically. This DPC could be in the amount of US\$35 million. A second DPC planned for FY2019 aims to support both continued financial sector reforms and fiscal policy measures.

Country Context

Guyana has achieved impressive economic growth and debt reduction during the last decade. Guyana suffered from volatile economic growth from the 1960s to the early 2000s when the annual GDP growth rate averaged 1.5 percent. As a result, GDP per capita income fluctuated around US\$2,000 until the 2000s. Economic growth since doubled with an average GDP growth rate of 3.7 percent from 2004 to 2016. The performance was even more impressive after the global financial crises with an average GDP growth rate of 4.8 percent. The sustained high growth rate allowed Guyana to sharply increase its GDP per capita to around US\$4,000 by 2016. Nonetheless, per capita income remains among the lowest in the English-speaking Caribbean.

Newly discovered oil and gas reserves add both wealth and a source of volatility. Off-shore exploration has been successful, with currently discovered estimated gross recoverable resources of around 3.2 billion barrels of oil equivalent in the Stabroek Block. In June 2017, ExxonMobil made the final investment decision (FID) to proceed with development of the first phase of the Liza field, with production of 120,000 barrels per day (bpd) expected to begin in 2020. Government revenue from Liza-1 production is projected to be around 5–6 percent of GDP the first 5 years and grow to 10–12 percent of GDP before and gradually declining after about 8 years. Additional revenues will likely accrue as the Stabroek Block is developed further. Although this new sector represents a diversification from existing exports and will eliminate currently large oil imports (on a net basis), which exposed the country to the risk of higher oil prices, it is also likely to grow to be a source of concentration and thus volatility as revenues start flowing in 2020.

It is a well-known phenomenon that natural resource discoveries do not always lead to economic success, as they may lead to the so-called Resource Curse. A fundamental challenge for the Government of Guyana will be to transform the oil wealth into human capital, physical capital, and financial assets. Only by investing in such assets can the country sustain its wealth over time.

A well-developed and stable financial sector will become a key pillar supporting the non-resource part of the Guyanese economy. A robust and well-functioning financial sector resilient to vulnerabilities imposed by exposure to output and price volatility will be essential for maintaining a growing Guyanese economy. The financial sector has a critical role in intermediating savings into domestic investment and in allocating scarce resources effectively, with positive impact on economic growth. Whereas extractive sectors tend to be financed in international capital markets, the domestic financial sector will be instrumental in financing non-resources sector investments that represent economic diversification. A financial sector that efficiently allocates capital into productive investments will also help abate appreciation pressures from capital inflows.

Financial intermediation to the private sector is below the small state average and banks’ credit portfolios are concentrated. The provision of credit to private sector in Guyana has gradually expanded, reaching 45.4 percent of GDP in 2016 (36.9 percent in 2006), in line with growth patterns in the LAC region (49 percent). However, in recent years,

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credit growth has been subdued due to the economic slowdown and banks seeking to consolidate their balance sheets. In 2016, banks reported a modest 2 percent credit growth (6.2 and 9.1 percent in 2015 and 2014, respectively). Credit risk concentration creates additional challenges to intermediation. The banking system consists of only six banks, with one foreign-owned institution holding one third of banking assets.

Relationship to CPF

The 2016 Country Engagement Note (CEN) emphasizes the Government's strategy of laying the ground for private sector development, including the financial sector. The CEN outlines the Bank's strategy for strengthening the relationship with Guyana for a two-year period. The note highlights the importance of a well-functioning financial sector. It discusses assistance in financial sector strengthening including the legal and regulatory environment for banking, insurance, and credit cooperatives, AML/CFT, and consumer protection in financial services. It also identifies the need to develop the country's payment system and highlights the FSAP as a tool to achieve the needed reforms.

C. Proposed Development Objective(s)

The Program Development Objectives (PDOs) are to strengthen financial stability while supporting financial development and investments. The operation will support several actions that stimulate well-functioning financial intermediation consistent with the Bank's strategy to maximize finance for development. The operation will support confidence in financial institutions and ensure that risks to financial stability are well managed. The actions pertain in part to the Bank of Guyana's ability to manage risks in the financial system and in part by providing for efficient financial transactions that protect the interests of financial services consumers.

Key Results

The first set of expected results will be better crisis management capacity, and thus financial stability, as well as direct depositor protection. The absence of a disorderly bank failure and coverage of depositors are key indicators for success.

The second set of expected results will be a deeper financial sector that provides better financial services. Key indicators for success are: the growth of insurance penetration and insurance companies meeting new solvency requirement, the evolution of retail cashless transactions per capita, and Guyana's status under FATF.

D. Concept Description

The proposed development policy credit is structured in two pillars: (i) strengthening financial stability and depositor protection, and (ii) enabling sound financial inclusion and development. A planned second operation will support further reforms in the financial sector and ensure that deposit insurance is backed up by an adequate initial capitalization. It also ensures that the important reforms to manage the growing fiscal resources are developed and implemented in the next 18 months and thus prior to large new inflows begin.

Despite progress, Guyana still needs to improve financial sector oversight arrangements to reduce the risk and improve the ability to manage financial crises. Guyana does not have deposit insurance, which is not only a protection for depositors and facilitates trust in financial institutions, but it is also an important tool to manage crises by retaining trust and funding for the financial sector in times of stress. The Government intends to establish a deposit insurance scheme (DIS) and is currently contemplating coverage of deposits up to GY\$2 million (~US\$10,000), which would cover about 95 percent of deposit and 33 percent of the value of deposits. The pillar will encompass preconditions for deposit insurance



and guidance on its design and implementation reflecting the principles established by the Basel Committee and the International Association of Deposit Insurers to address the downside risk posed by moral hazard and contingent fiscal liabilities.

Bank resolution and emergency liquidity assistance (ELA) are key elements to have in place when establishing a DIS. Effective bank resolution aims to respond decisively financial distress both to maintain financial stability and to minimize losses for society. ELA ensures that solvent but illiquid financial institutions can continue function during a systemic shock that erodes liquidity. The BoG has legal authority to lend to banks under the BoG Act. The legal foundation for ELA could be strengthened, but procedures for when and how to use ELA could also be established based on the current law.

Trust in the financial system was rattled by the failure of a life insurance company. The failure of CLICO, a leading life insurance provider, in 2009 was relatively well handled, and oversight over the sector was shifted to the Bank of Guyana. The new insurance law represents an important reform to oversight arrangements. The new law greatly upgrades Guyana's observance of the Insurance Core Principles of the International Association of Insurance Supervisors, while being consistent with local market conditions and constraints. The framework enhances the powers of the BoG, including important clarification of powers regarding inspections and corporate governance. The new insurance law was passed in 2016, but has not yet been declared effective. Supporting regulations have been drafted, consulted on with the industry, revised, and submitted by the MOF to the Attorney General (AG) for the final review. The reform of insurance oversight has been supported by two First Initiative grants.

A new national payment act is an important foundation for improving financial services in Guyana. Payment services and mechanisms lag the needs of the Guyanese economy. Most transactions require physical exchange of paper, and within the financial system payments have substantial manual processes. The BoG is working on developing stronger infrastructure to better facilitate electronic payments between financial institutions supported by a World Bank project. The new legal framework will complement the infrastructure being built at BoG to facilitate a shift from cash and checks to electronic payments. It will also facilitate increased efficiency in payments by the MOF and the National Insurance System, which perform a large number of electronic payments. The law has been drafted with technical assistance supported by the First Initiative.

Inadequate implementation of AML/CFT arrangements placed Guyana on the FATF grey list, and only after legislative actions were implemented was the country removed from the list. As a consequence of the country inclusion, trust in the financial system was undermined and banks started losing access to the international payment system. Laws enacted in December 2015 and May 2016 underpinned improvements that led to a more favorable review by the Caribbean Financial Action Task Force (CFATF), which announced in November 2016 that Guyana would be removed from the FATF grey list. A legislative amendment to provide for money laundering as a hybrid offence was approved in August 2017 affording investigative and prosecutorial agencies greater latitude to prosecute cases.

E. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The direct poverty and social impact of the policy measures supported by this development policy credit is expected to be neutral. It should be stressed that in spite of this, the reforms will promote financial stability, which in turn will contribute to the overall favorable developments in the area of poverty. Financial crisis prevention is critical to avoid large downturns in economic activity and drain on fiscal expenditures, which have a significant impact on the poor. Prior



actions under Pillar 1 are not expected to have significant direct impacts on poverty, but adverse distributional effect can potentially be expected from a generous deposit insurance scheme, though the coverage contemplated in Guyana is modest by international comparison. In the same line, Prior actions under Pillar 2 are not expected to have significant direct impacts on poverty. Potential positive effect from a sound financial and insurance system is expected. Increased usage of electronic payment systems, which are much cheaper than the paper-based systems, is expected to benefit poor and rural areas, conditioned on the establishment of an inclusive infrastructure and customer base. While financial inclusion can be a key driver of poverty reduction, the development of an inclusive payments system infrastructure is essentially a prerequisite.

Environment Impacts

The proposed development policy credit measures are not expected to have adverse effects on the environment or natural resources. The policy measures supported by the development policy credit are designed to promote financial stability and financial inclusion with no impact on the environment.

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APPROVAL

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Note to Task Teams: This is the end of the document. No further content should be added. *Please delete this note when finalizing the document.*

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