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Report No: PAD3351

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 25.5 MILLION
(US\$35 MILLION EQUIVALENT)

TO THE

LAO PEOPLE'S DEMOCRATIC REPUBLIC

FOR A

LAO PDR FINANCIAL SECTOR SAFETY NET STRENGTHENING PROJECT

March 9, 2020

Finance, Competitiveness and Innovation Global Practice
East Asia and Pacific Region

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CURRENCY EQUIVALENTS
Exchange Rate Effective January 31, 2020

Currency Unit = Lao Kip (LAK)

LAK 8,884.94 = US\$1

SDR 1 = US\$1.377

US\$1 = SDR 0.7262

FISCAL YEAR

January 1 – December 31

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ABBREVIATIONS AND ACRONYMS

AML/CFT	Anti-Money Laundering and Countering Financing of Terrorism
BOL	Bank of Lao PDR
CPF	Country Partnership Framework
DLI	Disbursement-linked Indicator
DPF	Deposit Protection Fund
DPO	Deposit Protection Office
DTMFI	Deposit-taking Microfinance Institution
ESCP	Environmental and Social Commitment Plan
ESRS	Environmental and Social Review Summary
FM	Financial Management
FSDP	Financial Sector Development Project
FSNP	Financial Safety Net Strengthening Project
GDP	Gross Domestic Product
GOL	Government of Lao PDR
GRS	Grievance Redress Service
IADI	International Association of Deposit Insurers
IFR	Interim Unaudited Financial Report
IMF	International Monetary Fund
IPF	Investment Project Financing
IRR	Implementation Rule and Regulations
IT	Information Technology
MNC	Materially Noncompliant
MOF	Ministry of Finance
MOU	Memorandum of Understanding
NDTMFI	Non-deposit-taking Microfinance Institution
NPL	Non-performing loan
ODA	Official Development Assistance
PBC	Performance-based Condition
PDO	Project Development Objective
PIU	Project Implementation Unit
POM	Project Operations Manual
PPSD	Project Procurement Strategy for Development
PSC	Project Steering Committee
ROA	Return on Assets
SCD	Systematic Country Diagnostic
SCV	Single Deposit View or Single Customer View
SOE	State-Owned Enterprise

SOP	Series of Projects
SORT	Systematic Operations Risk-Rating Tool
STEP	Systematic Tracking of Exchanges in Procurement
TA	Technical Assistance
TTL	Task Team Leader



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DATASHEET

BASIC INFORMATION

Country(ies)	Project Name	
Lao People's Democratic Republic	Lao PDR Financial Sector Safety Net Strengthening	
Project ID	Financing Instrument	Environmental and Social Risk Classification
P169194	Investment Project Financing	Low

Financing & Implementation Modalities

<input type="checkbox"/> Multiphase Programmatic Approach (MPA)	<input type="checkbox"/> Contingent Emergency Response Component (CERC)
<input type="checkbox"/> Series of Projects (SOP)	<input type="checkbox"/> Fragile State(s)
<input checked="" type="checkbox"/> Disbursement-linked Indicators (DLIs)	<input type="checkbox"/> Small State(s)
<input type="checkbox"/> Financial Intermediaries (FI)	<input type="checkbox"/> Fragile within a non-fragile Country
<input type="checkbox"/> Project-Based Guarantee	<input type="checkbox"/> Conflict
<input type="checkbox"/> Deferred Drawdown	<input type="checkbox"/> Responding to Natural or Man-made Disaster
<input type="checkbox"/> Alternate Procurement Arrangements (APA)	

Expected Approval Date	Expected Closing Date
30-Mar-2020	30-Sep-2024

Bank/IFC Collaboration
No

Proposed Development Objective(s)

To strengthen the financial and institutional capacity of the Deposit Protection Office to fulfill its deposit insurance mandate.



Components

Component Name	Cost (US\$, millions)
Component 1: Capitalization of Deposit Protection Office Equity Fund	33.25
Component 2: Institutional Capacity Building for DPO and Project Management	1.75

Organizations

Borrower: Lao People’s Democratic Republic
 Implementing Agency: Deposit Protection Office

PROJECT FINANCING DATA (US\$, Millions)

SUMMARY

Total Project Cost	35.00
Total Financing	35.00
of which IBRD/IDA	35.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Development Association (IDA)	35.00
IDA Credit	35.00

IDA Resources (in US\$, Millions)

	Credit Amount	Grant Amount	Guarantee Amount	Total Amount
Lao People's Democratic Republic	35.00	0.00	0.00	35.00
National PBA	35.00	0.00	0.00	35.00
Total	35.00	0.00	0.00	35.00



Expected Disbursements (in US\$, Millions)

WB Fiscal Year	2020	2021	2022	2023	2024	2025
Annual	0.00	11.00	11.00	9.00	4.00	0.00
Cumulative	0.00	11.00	22.00	31.00	35.00	35.00

INSTITUTIONAL DATA

Practice Area (Lead)

Finance, Competitiveness and Innovation

Contributing Practice Areas

Climate Change and Disaster Screening

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

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	● Substantial
2. Macroeconomic	● High
3. Sector Strategies and Policies	● Moderate
4. Technical Design of Project or Program	● Substantial
5. Institutional Capacity for Implementation and Sustainability	● Substantial
6. Fiduciary	● Substantial
7. Environment and Social	● Low
8. Stakeholders	● Substantial
9. Other	
10. Overall	● Substantial



COMPLIANCE

Policy

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

Yes No

Does the project require any waivers of Bank policies?

Yes No

Environmental and Social Standards Relevance Given its Context at the Time of Appraisal

E & S Standards	Relevance
Assessment and Management of Environmental and Social Risks and Impacts	Relevant
Stakeholder Engagement and Information Disclosure	Relevant
Labor and Working Conditions	Relevant
Resource Efficiency and Pollution Prevention and Management	Not Currently Relevant
Community Health and Safety	Not Currently Relevant
Land Acquisition, Restrictions on Land Use and Involuntary Resettlement	Not Currently Relevant
Biodiversity Conservation and Sustainable Management of Living Natural Resources	Not Currently Relevant
Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities	Relevant
Cultural Heritage	Not Currently Relevant
Financial Intermediaries	Not Currently Relevant

NOTE: For further information regarding the World Bank’s due diligence assessment of the Project’s potential environmental and social risks and impacts, please refer to the Project’s Appraisal Environmental and Social Review Summary (ESRS).

Legal Covenants

Sections and Description



Subsidiary Agreement

Financing Agreement: Schedule 2, Section I.B

Recurrent, Continuous

1. To facilitate the carrying out of the Project, the Recipient shall make the proceeds of the Financing available to the Project Implementing Entity under a subsidiary agreement between the Recipient and the Project Implementing Entity, under terms and conditions acceptable to the Association (the Subsidiary Agreement).
2. The Recipient shall exercise its rights under the Subsidiary Agreement in such manner as to protect the interests of the Recipient, and the Association and to accomplish the purposes of the Financing. Except as the Association shall otherwise agree, the Recipient shall not assign, amend, abrogate or waive the Subsidiary Agreement or any of its provisions.

Sections and Description

Project Operations Manual

Financing Agreement: Schedule 2, Section I.C

Recurrent, Continuous

1. The Recipient shall cause the Project Implementing Entity to ensure that the Project is carried out in accordance with the arrangements and procedures set out in the Project Operations Manual satisfactory to the Association, that includes, inter alia, detailed arrangements and procedures for: (i) institutional coordination and day-to-day execution of the Project; (ii) disbursement, financial management and procurement; (iii) environmental and social safeguards management; (iv) a verification protocol containing the technical standards and arrangements and procedures for the monitoring, reporting and verification of PBCs; (v) monitoring, evaluation, reporting and communication; and (vi) such other administrative, financial, technical and organizational arrangements and procedures as shall be required for the Project.

Sections and Description

PBC Monitoring and Reporting

Financing Agreement: Schedule 2, Section I.E

Recurrent, Continuous

Without limitation on its other reporting obligations under this Agreement, the Recipient shall cause the Project Implementing Entity, not later than November 30 of each year during the Project implementation period, to furnish reports to the Association on the status of achievement of the relevant PBC Targets, in accordance with the Verification Protocols and procedures set out in the Project Operational Manual.

Sections and Description

Environmental and Social Standards

Financing Agreement: Schedule 2, Section I.F

Recurrent, Continuous

The Recipient shall cause the Project Implementing Entity to ensure that the Project is carried out in accordance with the Environmental and Social Standards, in a manner acceptable to the Association.



Sections and Description

Financing under Part 1 of the Project based on PBCs

Financing Agreement: Schedule 2, Section I.G

Recurrent, Continuous

1. The Recipient shall cause the Project Implementing Entity to:
 - (a) implement Part 1 of the Project in accordance with the institutional, environmental and social risk management, financial management and procurement arrangements set out in this Schedule 2 to this Agreement;
 - (b) throughout the period of implementation of said part of the Project as necessary, carry out verification to determine whether the PBCs have been met as detailed in the POM; and
 - (c) furnish said assessment to the Association for its review.
2. (a) The amount of payments which the Recipient may request for PBC- based financing under Part 1 of the Project shall be determined on the basis of the maximum amount allocated by the Association to each PBC, subject to the provisions of Section III of this Schedule 2, provided that such amount shall not exceed the total amount of payment for Eligible Expenditures incurred during the year covered by the PBC-based financing payment requested, excluding any amount of eligible expenditures financed from other sources of financing.
 - (b) Notwithstanding the provision of sub-paragraph (a) of this sub-section 2, all payments under the PBC-based financing shall be subject to the Association’s prior written approval and shall only be eligible for financing out of the proceeds of the Financing if and to the extent approved by the Association in accordance with the provisions of Section III of this Schedule.

Sections and Description

Other Undertakings

Financing Agreement: Schedule 2, Section I.H

1. Not later than eighteen (18) months from the Effective Date of this Agreement, the Recipient shall:
 - (a) cause the Project Implementing Entity to enter into an agreement with MOF acceptable to the Association for back-up funding support;
 - (b) cause the Project Implementing Entity’s Board to approve regulations acceptable to the Association on procedures for claiming deposit insurance in the event of payout; and
 - (c) cause the Governor of the Bank of the Lao PDR to approve regulations acceptable to the Association governing: (i) problem bank resolution process framework and (ii) prompt corrective actions and early intervention measures.

Conditions

Type	Description
Effectiveness	The Project Implementing Entity has adopted the Project Operations Manual acceptable to the Association.
Type	Description
Effectiveness	The Subsidiary Agreement has been executed on behalf of the Recipient and the Project



	Implementing Entity.
Type Disbursement	Description No withdrawal shall be made for Eligible Expenditure Programs under Category (1), unless and until the Recipient has: (i) furnished evidence satisfactory to the Association in accordance with the Verification Protocol set forth in the Project Operational Manual that the Recipient has achieved the respective PBC Targets set forth in Schedule 4 to this Agreement against which withdrawal is requested; and (ii) complied with the additional instructions referred to in Section III of this Schedule, including furnished to the Association the applicable interim unaudited financial reports documenting the Eligible Expenditure Programs during the respective Fiscal Year up to the date against which withdrawal is requested.



I. STRATEGIC CONTEXT

A. Country Context

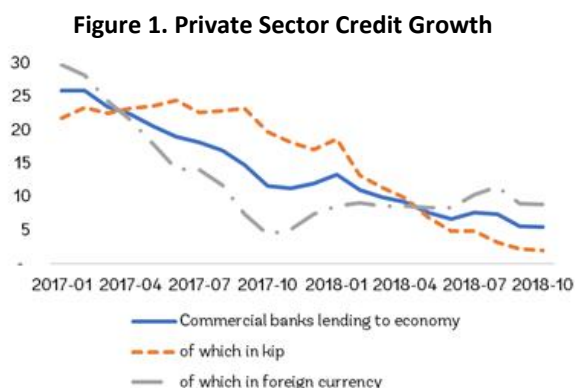
- Lao PDR faces some headwinds on the macroeconomic front.** Growth has moderated in recent years, declining from 6.3 percent in 2018 to an historical low of 5.2 percent in 2019, owing mainly to natural disasters (floods, droughts, and a caterpillar infestation) which affected the agricultural sector. The fiscal deficit increased to nearly 5 percent of gross domestic product (GDP) in 2019, up from 4.7 percent of GDP in 2018. Revenue mobilization remains a challenge due to partial policy implementation and poor tax administration. The revenue-to-GDP ratio has declined from 16.2 percent in 2018 to 14.8 percent in 2019. The rising fiscal deficit has resulted in growing public debt, estimated at almost 60 percent of GDP in 2019, up from 57.2 percent of GDP in 2018. The risk of debt distress remains high.
- The economic outlook is subject to downside risks.** Growth is expected to rebound to 5.8 percent on average during 2020–2021. Revenue mobilization is expected to bring down the fiscal deficit to 4.5 percent of GDP by 2021, with a debt-to-GDP ratio of 58.3 percent in the same year. Trade tensions could dampen growth in Lao PDR’s major trading partners, spilling over to the domestic economy through lower trade and investment and lower prices for export commodities. Domestic risks also include low levels of foreign reserves and limited fiscal space—which increase the vulnerability to adverse shocks—more frequent weather-related shocks and limited progress on building buffers, reducing debt, and addressing financial sector stability.
- Progress toward reducing poverty has continued, albeit at a slower pace than in the past.** The incidence of poverty fell from 46 percent to 23 percent between 1992 and 2012. The official estimates of poverty and inequality in 2018–2019 are expected to be available in mid-2020. Meanwhile, the incidence of poverty (using the international poverty line) is projected to have declined to 18.4 percent in 2019 and is expected to fall below 18 percent in 2020–2021. The incidence of poverty remains much higher in rural areas (23 percent) than in urban areas (7 percent). Poverty is particularly entrenched among remote and highland communities that are isolated during the rainy season, and gender disparities remain significant.
- The political and social environment has remained stable, but challenges persist in the implementation of key reforms.** Implementation of key reforms remains a challenge owing to limited capacity and a complex political economy. Top priorities of the Government of Lao PDR (GOL) include maintaining macroeconomic stability, advancing the green growth agenda, further reducing poverty, improving the investment climate, protecting the environment, and strengthening disaster response and preparedness. In 2019, the National Assembly adopted several resolutions to provide legal backup for and enhance the performance of the GOL and judiciary bodies. The National Assembly is asking for more accountability and the curbing of corruption.

B. Sectoral and Institutional Context

- Recent Developments in the Financial Sector*



5. **The Lao PDR financial sector is bank dominated with significant state ownership.** The number of banks has grown from 12 in 2006 to 42 in 2018, driven by the partial liberalization of the sector beginning in 2007. Three state-owned banks (SOBs) *Banque pour le Commerce Exterieur Lao*, Lao Development Bank, and Agricultural Promotion Bank, account for approximately 43 percent of total assets, foreign-owned banks (28 percent), domestic private banks (19 percent), and joint-venture banks the remainder (10 percent).



6. **Private sector credit growth (see figure 1 and table 1) has fallen significantly after a sustained period of high growth.** Private sector credit growth averaged more than 35 percent for a decade (through 2014) amid a booming economy and strong growth in domestic deposits before slowing to 22 percent in 2016 and 14 percent in 2017. In 2018, credit growth continued on a downward trend due to economic slowdown and fiscal tightening, declining further to 4.5 percent, representing 41.5 percent of GDP in 2018. Interest rate caps, which have been in effect since 2015, contributed to the slowdown in credit growth, and an increase in dollar lending. In early 2019, interest rate caps were removed, which could support growth in private sector credit.

Table 1. Key Financial Sector Indicators (%)

		2015	2016	2017	2018	Q3 2019
Credit to the private sector	Year-on-year growth	19.3	22.0	14.2	4.4	6.2
	% of GDP	37.1	41.0	43.0	41.5	
Assets	Year-on-year growth	20.4	15.8	8.2	6.6	8.0
	% of GDP	83.3	87.5	87.0	86.0	
Deposits	Year-on-year growth	17.6	12.7	11.6	8.3	14.1
	% of GDP	53.9	47.2	48.4	48.4	
Loan-to-deposit ratio (%)		89.2	98.0	98.4	93.7	87.0

Source: Bank of Lao PDR (BOL) website.

7. **Overall, capital levels might be overstated, and state-owned banks and some smaller banks face capital shortages.** Regulatory capital to risk-weighted assets (Capital Adequacy Ratio) increased to 18 percent in September 2018 from 16 percent at the end of 2017 (see table 2) but declined significantly in 2019 to 13 percent in Q3 2019. Though this is still above the regulatory 8 percent, there is wide variation among banks, particularly for state-owned commercial banks. As a result, the profitability (return on



assets [ROA]) remains low. Asset quality might not be accurately reflected in these numbers due to weak accounting standards and a regulatory cap on nonperforming loans (NPLs); thus, actual regulatory capital may be lower than reported. Capital adequacy positions differ significantly among banks. The three state-owned banks are reportedly undercapitalized; the Government recapitalized the third state-owned bank in 2017. The Government is seeking strategic investors, but its efforts have thus far been unsuccessful.

Table 2. Financial Soundness Indicators

Financial Soundness indicators	2017-Q4	2018-Q1	2018-Q2	2018-Q3	2018-Q4	2019-Q1	2019-Q2	2019-Q3
Regulatory capital to risk-weighted assets (CAR)	15.83%	15.86%	16.33%	17.84%	18.32%	16.13%	14.31%	13.17%
Regulatory Tier 1 capital to risk-weighted assets	12.53%	12.13%	12.53%	13.88%	13.59%	11.40%	10.29%	9.85%
Nonperforming loans net of provisions to capital	9.33%	9.07%	8.20%	7.54%	10.24%	9.35%	10.80%	12.22%
Nonperforming loans to total gross loans (NPL)	3.07%	3.08%	3.09%	3.10%	3.12%	3.13%	3.11%	3.07%
Return on assets	0.54%	0.46%	0.60%	0.68%	0.80%	0.73%	0.98%	1.51%
Return on equity	7.77%	6.53%	8.48%	9.38%	10.89%	10.05%	13.88%	21.49%
source: Bank of Lao PDR								

8. **Overall profitability in the sector has moderately improved, driven by higher loan-to-deposit ratios, but performance among banks varies significantly.** The ROA gradually increased from 0.5 percent at the end of 2017 to 0.7 percent in Q3 2018 and to 1.51 percent in Q3 2019. Return on equity rose from 7.7 percent at the end of 2017 to 10.9 percent in Q4 2018 and to 21.5 percent in Q3 2019. However, performance among banks varied significantly. For example, among 23 commercial banks with publicly available data, three experienced negative ROA in 2018 and only three recorded ROA above 2 percent.

9. **Though the level of NPLs is reportedly low, market participants believe they are understated and rising.** The level of NPLs is reported at 3.07 percent in Q3 2019. However, there has been a substantial increase in the level of NPLs net of provisions to capital, increasing from 7.5 percent in Q3 2018 to 12.2 percent in Q3 2020, which could indicate additional provisions that may be needed relative to capital. The Central Bank (BOL) sets a 3 percent maximum threshold for the ratio of NPLs to total loans, which has led to the practice of rolling over delinquent loans.

10. Lao PDR also has low levels of financial inclusion. According to FINDEX 2017, only 29.1 percent of adults age 15 years and above have a bank account, compared to 70.6 percent and 57.8 percent for East Asia and Pacific and lower middle-income countries, respectively. Disaggregated by gender, women have a slightly higher access at 31.9 percent. Only 8.6 percent age 15 years and above borrowed from a financial institution or used a credit card in the past year, which is well below the East Asia and Pacific average of 21.5 percent and slightly below average for lower-middle-income countries. Only 8 percent of women borrow from a financial institution compared to 10 percent of men, which could be due to the larger share of women working in the informal sector.

11. **The microfinance sector is small and underdeveloped.** The sector comprises 18 deposit-taking microfinance institutions (DTMFIs) and 79 non-deposit-taking institutions (NDTMFIs), as well as leasing pawn shops and credit unions, with assets of US\$450 million. The sector experienced rapid growth between 2015 and 2017, especially NDTMFIs, but growth has moderated in 2018 in line with overall economic slowdown. The sector is regulated by the Financial Institutions Department of the BOL, and a microfinance association provides capacity building. Microfinance institutions report monthly to the BOL, but data quality is poor, limiting quality of supervision. Two DTMFIs were closed in 2016, prompting BOL decision to suspend issuance of new licenses. The BOL and the Deposit Protection Office (DPO) indicated



the need to address weaknesses in the sector to enable DTMFIs to qualify for registration and inclusion under deposit insurance coverage, as mandated by Article 33 of the Deposit Insurance Decree (No. 329/GOL, October 25, 2017).¹ This will delay deposit insurance coverage to depositors of DTMFIs to a later stage.

12. The banking sector’s rapid growth from a low base has raised concerns over financial stability. Banking supervision capacity, which relies on a compliance-based framework, while working toward a more risk-based approach, has been burdened by the rapid increase in the number of banks and credit growth. The BOL does not have an early warning system in place, relying on regular off-site monitoring (mostly based on manual process and analysis), in addition to on-site inspections. There is no framework for prompt corrective or early supervisory action in place nor is there an institutional arrangement for bank resolution—such as a dedicated resolution unit or a crisis management framework. The reported financial soundness indicators are presented on an aggregate basis,² which masks vulnerabilities in state-owned banks. Around 50 percent of loans and deposits in the banking sector are denominated in foreign currency, exposing the sector to significant exchange rate risk. Mechanisms and authorities to deal with bank failures and exercise of lender of last resort functions are lacking or inadequate. The legal framework for the financial sector has improved significantly with passage of the Commercial Banking Law (see Sec. ii below), the Bank of Lao PDR Law, and Decree on Deposit Protection. However, secondary regulations to pave the way for proper implementation must be prepared.

ii. Measures to strengthen financial sector safety net

13. Lao authorities have begun to address financial sector vulnerabilities with support from the World Bank and the International Monetary Fund (IMF). The largest state-owned bank has been partially re-capitalized (in September 2017) while restructuring plans are being developed for the two other state-owned banks. In the last three years, the World Bank with funding from the Korean Trust Fund, has been supporting the improvement of the legal and regulatory framework, resulting in the issuance of implementing regulations on prudential, supervisory and regulatory requirements. The legal and regulatory framework has been further enhanced with the passage of the BOL Law (July 2018) and Commercial Banking Law (January 2019). Supported by the Lao PDR Green Resilient Growth DPO 2 (P166839), the BOL has produced and published a set of core financial soundness indicators and has amended the BOL Law to enhance the role and operation of the BOL in line with good practice. Authorities are implementing a plan to transition to Basel II and are currently in the process of adopting risk-based supervision with the support of the IMF. With support from the World Bank, the country conducted a National Risk Assessment for Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) and is currently developing and implementing a risk-based AML/CFT supervision approach framework in preparation for Lao PDR’s AML/CFT evaluation in 2020. A sustained effort is needed to secure a stable financial sector that contributes to economic growth.

14. The amendments to the Commercial Banking Law are expected to bring Lao PDR closer to compliance with the Basel Core Principles for Effective Supervision. The National Assembly passed a new banking law on January 21, 2019, to replace the 2006 Banking Law. The World Bank provided comments

¹ See <http://www.laoservicesportal.gov.la/index.php?r=site%2Fdisplaylegal&id=458>.

² Publication of financial soundness indicators disaggregated by types of banks is an indicative trigger for Green Growth Development Policy Operation (DPO) 3.



on various drafts, along with country examples and policy guidance. While gaps remain, which will need to be addressed through secondary regulations, the new banking law provides the BOL with powers to put in place a more effective—supervisory, corrective, and resolution—regime. With carefully drafted secondary legislation and capacity building, the BOL would be able to carry out risk-based supervision, institute an early warning system and prompt a corrective action framework, and put in place an effective resolution structure. The amended BOL Law which was passed in 2018 is also an improvement over its predecessor in terms of distinguishing Emergency Lending Arrangement, Lender of Last Resort, and funding for systemically important banks. The BOL Law also limits BOL lending by providing conditions under which lending by the BOL to the financial sector may be undertaken.

15. **The legal framework supporting deposit insurance has been strengthened with the adoption of a Decree on Deposit Protection in October 2017, but challenges remain.** The DPO, with World Bank support, conducted a self-assessment against International Association of Deposit Insurers (IADI) Core Principles for Effective Deposit Protection³ in 2017, which identified several areas of non-conformity with international best practice (IADI Core Principles), creating a risk of contagion in the event of bank closure with the DPO not ready to promptly execute payouts. The self-assessment raised awareness among authorities of the significant gaps and work required for the DPO to carry out its mandate and align the organization and its operations to international best practice. The main areas of noncompliance include governance; legal protection for DPO board, management, and staff; inadequate capability to implement deposit insurance mandate; lack of crisis management plan; lack of a public awareness program; and lack of early detection and timely intervention framework. Following the IADI self-assessment, and with World Bank assistance, the DPO prepared a prioritized and sequenced action plan to move toward compliance. The Government issued a Decree on Deposit Protection (No. 329/GOL, October 25, 2017), which is an improvement over the previous system and strengthens the DPO’s legal mandate to undertake many of the reforms necessary to comply with IADI principles. The proposed project will help the DPO implement the new decree and address the gaps to comply with international standards. See Box 1 for further details on deposit protection in Lao PDR.

Box 1. Deposit Protection in Lao PDR

The DPO was established on September 23, 1999, tasked with protecting the rights and interests of depositors.⁴ Since its establishment up to 2006, the DPO was a 100 percent state-owned enterprise (SOE) under the supervision of the BOL and received budget from the BOL. Based on the Decision on Commercialization of DPO No. 235/BOL, dated November 15, 2007, the DPO became financially independent and operated as an SOE under the supervision of the BOL, with its own office. All expenses of the DPO are charged against its own funds, sourced primarily from income from investments. The 2017 decree provided the DPO further autonomy, but the DPO is still not operationally independent. The DPO is currently a state-owned financial institution (equivalent to a department, a non-profit legal entity, having financial autonomy and under the supervision of the BOL).

The DPO has a paybox mandate in which the deposit insurer is only responsible for the reimbursement of insured deposits (the BOL is the resolution authority). Effective 2013, depositors of member banks declared bankrupt by the BOL are entitled to file a claim with the Deposit Protection Fund (DPF) according to balances in their deposits, for principal and accrued interest based on the maximum amount of LAK 28,000,000, THB 36,000, and US\$1,200

³ IADI Core Principles for Effective Deposit Insurance Systems (2014).

⁴ Agreement of the Minister of Finance on the Establishment of Depositor Protection Fund No. 1285/MOF, dated September 23, 1999.



for each depositor and for each currency.⁵ Following issuance of the decree, the DPO Board approved, in 2019, a consolidation of coverage level to equivalent LAK 50 million or US\$5,600. The coverage level (coverage per capita GDP), at more than double per capita GDP (US\$2,457 in 2017), is relatively low compared to lower-middle-income countries (11.3) and low-income countries (5.0).⁶ About 13 percent of total deposits are insured under the coverage limit.

Since its establishment, there has never been a bank failure that would have required payout of insured deposits by the DPO. On December 24, 2019, the BOL announced the closure of the Lao Construction Bank, a small private bank, with deposits equivalent to 0.1 percent of total deposits. The Lao Construction Bank was noncompliant with prudential requirements and also in violation of the requirement to become a member of the DPO. In the past, the BOL was unable to resolve the bank as it lacked such powers under the old Commercial Banking Law. However, with the amended Commercial Banking Law (in 2019), which benefited from World Bank technical assistance (TA), the BOL now has resolution powers, which allowed it to take the action to resolve the bank.

16. **The proposed investment project is part of a wider World Bank engagement, coordinated with the IMF, to support the Government’s coordinated efforts to strengthen the financial sector safety net⁷ comprising policy-based lending (Green Resilient Growth DPOs 2 and 3) and programmatic technical assistance (Lao PDR Financial Sector Development ASA Program, FSDP, P171539).** The FSDP is a World Bank-executed Trust Fund in the amount of US\$1,000,000 financed by the Ministry of Economy and Finance of Republic of Korea in partnership with the World Bank’s ‘Seoul Center for Financial Sector Development’. Authorities recognize that strengthening financial sector stability will require a sustained effort with strong support from development partners. Further progress is necessary in the following areas:

- **Prudential regulation and supervision.** The IMF is supporting the adoption of risk-based supervision. The World Bank, through a Bank-executed Trust Fund, is supporting drafting of regulations to bolster the regulatory and supervisory framework including the development of an early warning system and an early intervention and prompt corrective action framework.
- **Resolution authority.** The World Bank is assisting the BOL with the development of a resolution framework consistent with international good practice (also financed through the Bank-executed Trust Fund). The framework will include the new implementing rules on problem-bank resolution, as well as the formation of the dedicated resolution unit and TA to ensure proper implementation. The project will also support the establishment of a Financial Stability Committee, tasked with monitoring and reacting to financial sector risks, and developing a crisis management protocol.

C. Relevance to Higher Level Objectives

⁵ The maximum deposit insurance coverage has been amended three times. In 1999, coverage was LAK 15,000,000. Starting 2008, the limits were amended to LAK 20,000,000, THB 30,000, and US\$1,000.

⁶ <https://www.imf.org/external/pubs/ft/wp/2014/wp14118.pdf>.

⁷ The ‘financial system safety net’ is defined to include the functions of prudential regulation and supervision, resolution authority, a lender of last resort and deposit insurance.



17. The project is fully aligned with the Country Partnership Framework (CPF) for the Lao People’s Democratic Republic, 2017–2021 (Report No. 110813-LA) and the Systematic Country Diagnostic (SCD) (SCD 112241-LA). The SCD identifies strengthening financial sector stability as a top priority, which is necessary to achieve inclusive and sustainable growth. Strengthening the legal and regulatory framework in the financial sector is a key imperative under the CPF’s overarching priority to enhance institutional quality and creating a rules-based environment. In addition, the proposed project contributes to CPF Objective 1.1 ‘supporting financial sector stability’. In alignment with the WBG’s twin goals of ending extreme poverty and promoting shared prosperity, the proposed project aims to help increased financial sector stability through strengthening DPO’s capacity.

18. **Gender.** The project will closely monitor gender aspects of financial inclusion as it relates to deposit insurance. As noted, women have more access to a financial transaction account (32 percent) versus men (26 percent). However, only 8 percent of women borrow from a financial institution compared to 10 percent of men, which could be due to the larger share of women working in the informal sector (Global Findex Database 2017). As no gender-disaggregated data on depositors exists, the project will carry out a baseline deposit insurance public awareness survey, which will help identify potential gender-related deficiencies which may be addressed through the public awareness strategy (also supported by the project - see performance-based condition [PBC]#12).

II. PROJECT DESCRIPTION

A. Project Development Objective

PDO Statement

19. The Project Development Objective (PDO) is to strengthen the financial and institutional capacity of the Deposit Protection Office to fulfill its deposit insurance mandate.

20. The DPO in Lao PDR has a ‘paybox’ mandate, where the deposit insurer is only responsible for the reimbursement of insured deposits. Project beneficiaries include the DPO, as well as households and small and medium enterprises that have deposits in the banking system. The economy, as a whole, will also benefit from increased financial sector stability due to a strengthened financial safety net.

PDO Level Indicators

Capitalization of Deposit Protection Equity Fund

- Adequate financial inflows into the DPO during the course of the project, in order to achieve a funding ratio of at least 1.10 percent (eligible deposits) (Percentage)
- Arrangement on backup funding support in place (Yes/No)



Strengthened institutional capacity

- DPO empowered to perform its legally-mandated function (deposit payout), as evidenced by progress towards compliance with IADI Core Principles⁸
- Simulation exercise on deposit insurance claims processing and payment conducted (Yes/No)

21. The operation aims to increase the DPO's capitalization and strengthen its institutional capacity. The project is part of a broader strategy to strengthen the overall financial safety net, through strengthening the supervision and resolution of deposit-taking financial institutions, as well as the mechanism for timely payouts of depositors in the case of bank failures. In light of the existing vulnerabilities in the banking sector, it is imperative to bolster the DPO's financial and institutional capacity with World Bank support. As demonstrated by the lessons from the global financial crisis, the establishment of a credible deposit insurance system is critical for financial sector stability, including maintaining public confidence and protecting less sophisticated and small depositors.

22. The proposed instrument is Investment Project Financing (IPF) with PBCs,⁹ drawing on experience from recent successful World Bank projects supporting deposit insurance schemes. In particular, the recent World Bank projects in Bulgaria (Deposit Insurance Strengthening Project [P154219]), Serbia (Deposit Insurance Strengthening Project [P146248]), and Mozambique (Mozambique: Financial Inclusion and Stability Project [P166107]) financed the bolstering of reserves of respective deposit insurance funds, with disbursements linked to the tangible measures aimed at strengthening their institutional and financial capacity. In contrast to these other World Bank operations, Lao PDR has never faced a payout event, which is a fundamental yet complex task requiring strong technical expertise, capacity building, access to information, systems development and cooperation, adequate financial and human resources, and coordination with member institutions and authorities. As such, the project has the opportunity to implement and test an effective payout system and bolster the overall deposit protection system. The World Bank team and authorities also agreed that the DPO and BOL would require substantial TA, given the large capacity-building agenda demonstrated in the recent IADI self-assessment. In parallel to the IPF, the World Bank will deliver TA to both the BOL and DPO, financed by the Ministry of Economy and Finance of Korea in partnership with the World Bank's 'Seoul Center for Financial Sector Development'.

23. The project comprises two components that are discussed in the following paragraphs.

B. Project Components

Component 1: Capitalization of Deposit Protection Office Equity Fund (US\$33.25 million)

24. **The first component will capitalize the DPO's Equity fund (DPF).** The eligible expenditure will be represented by the IDA funds transferred to capitalize the Deposit Protection Office Equity Fund. It will

⁸ This indicator will use as a baseline, the World Bank assessment against IADI principles, conducted during project preparation. For consistency, the World Bank will conduct periodic assessments as part of project supervision to track progress and a final assessment. Further details on methodology are including in section VII.

⁹ Formerly referred to as IPF with Disbursement-Linked Indicators.



use PBCs, whereby the World Bank funds are disbursed in tranches based upon verification of achievement of the pre-agreed PBCs. The PBCs, in turn, have been formulated based on the World Bank's assessment of critical actions necessary to strengthen the DPO and move toward compliance with IADI Core Principles. The preliminary list of PBCs, is presented in the following paragraphs.

25. **The World Bank financing is needed to support the DPO in achieving a more prudent funding ratio**, reflective of the current risks in the banking system. The fund ratio is the ratio of the DPF¹⁰ to the total insured (covered) deposits or eligible deposits in member financial institutions. According to the IADI, deposit fund reserves 'should be sufficient for serious difficulties in the banking sector but not for systemic crisis'. DPO reserves can be increased through equity, premiums collected from member banks, investment income, and borrowings and recoveries from failed banks. Premium collection will constitute a major contribution to the fund over the long term, but fund buildup through premium collection takes some time. Given low profitability of banks, increasing premiums significantly is not considered a viable strategy to achieve a more prudent fund ratio in the near to medium term. Hence, the DPO requires funding support from the World Bank.

26. **The World Bank estimates demonstrate that the proposed IDA investment will strengthen the DPF, while measures supported by the project such as mobilizing backup funding facility will bolster the sustainability of the fund in the event of a crisis.** Preliminary analysis based on published audited statements of most banks, suggests that the current fund size is insufficient to cover eligible deposits of banks experiencing losses. With BOL initiatives to adopt risk-based supervision and international standards on banking supervision, regulation, and reporting, the number of banks that could eventually need recapitalization and resolution may increase. The buildup of reserves in the near term is essential to prepare the DPO to deal with potential bank failures and system vulnerabilities, while the establishment of a backup funding facility that can be mobilized in a timely manner will further enhance the credibility and sustainability of the deposit protection system. The Target Fund Ratio, which is defined as the ratio of total DPO reserves to the total insured deposits or total eligible deposits in member financial institutions, with World Bank financing is projected to increase from 0.51 percent of eligible deposits in 2018 to 1.1 percent in 2024 or from 3.7 percent of insured deposits to 8.2 percent during the same period.¹¹ The DPF, which amounted to LAK 361 billion or about US\$41 million at end 2018, is currently enough to cover the payout of one medium-sized bank or most small banks. The IDA loan would substantially increase the size of the DPF and support the strengthening of the methodology for determining the Target Fund Ratio.

¹⁰ DPF refers to two funds on the DPO's balance sheet. The 'Deposit Protection Office Equity Fund, as stipulated in the Deposit Protection Decree (2017), is a special account set up for government contributions to the DPO. The Deposit Protection Reserve is a fund for accumulation and use of deposit premiums for payout of protected amounts when a member falls into bankruptcy. IDA funds for Component 1 will capitalize the Deposit Protection Office Equity Fund, but will be made available for a payout of insured deposits if the Deposit Protection Reserve Fund is depleted.

¹¹ International experience on size of target fund varies significantly, Bulgaria (1 percent insured), Kosovo 8–9 percent (insured), South Korea 0.825 percent to 1.1 percent (eligible), Philippines (5.5 percent to 8 percent); Jamaica 8 percent to 10 percent (insured); Indonesia (2.5 percent eligible). Source: IADI (July 2018). Deposit Insurance Fund Target Ratio. Research Paper.



27. The PBCs aim to help achieve the PDO and are divided into the two aspects of the PDO: (a) strengthening financial capacity and (b) strengthening institutional capacity. Table 3 lists the PBCs by results areas, expected completion date, which are indicative, and current status.

Table 3. Performance-based Conditions

No.	Performance-based Conditions
PBC A: Strengthen financial capacity of DPO	
A.1.	DPO’s Board has approved a Target Fund Ratio methodology and strategy
A.2.	BOL Governor has approved regulations on adjusted deposit premiums
A.3.	DPO has entered into an agreement with MOF acceptable to the Association for back-up funding support
A.4.	DPO has withdrawn all investments and deposits in commercial banks and invested them in government securities and central bank bonds
PBC B: Enhance coordination between DPO and other financial safety net institutions	
B.1.	DPO and Bank of Lao PDR have signed a memorandum of understanding acceptable to the Association regulating the flow of information between the two entities
B.2-B.3.	B.2. Bank of Lao PDR has issued an order to constitute a technical committee to prepare groundwork for establishing the Financial Sector Stability Committee B.3. Bank of Lao PDR has issued an order to constitute Financial Sector Stability Committee
PBC C: Improve governance of DPO	
C.1 – C.2	C.1. BOL Governor has approved its Corporate Governance Charter C.2. DPO Board has approved its Code of Ethics
C.3 – C.5	C.3. DPO has implemented an improved accounting and reporting system that includes a chart of accounts C.4. DPO has implemented an improved accounting and reporting system that includes reporting system C.5. DPO has implemented an improved accounting and reporting system that includes IT system
PBC D: Enhance DPO’s readiness and capability to perform its deposit insurance mandate	
D.1	DPO Board has approved and issued to its members regulations acceptable to the Association on record keeping of deposits including requirement to prepare deposit data in Single Deposit View (SCV) format
D.2	DPO Board has approved regulations acceptable to the Association on procedures for claiming deposit insurance in the event of payout
D.3	DPO has conducted a simulation exercise on deposit insurance claims processing and payment.
PBC E: Promote public awareness and literacy on deposit insurance	
E.1 – E.3	E.1. BOL and DPO have each issued regulations acceptable to the Association requiring their respective member institutions to provide standard information on deposit insurance coverage to their clients E.2. DPO Board has approved a Public Awareness Strategy on deposit insurance E.3. DPO Board has approved the public awareness strategy revised based on survey conducted to the public.
F.1 – F.2	F.1. BOL Governor has approved regulations acceptable to the Association governing problem bank resolution process framework F.2. BOL Governor has approved regulations acceptable to the Association governing prompt corrective actions and early intervention measures
F.3.	DPO has completed a self assessment on the extent of compliance with IADI Core Principles on Deposit Insurance and identified gaps and actions for achieving full compliance



28. The first four PBCs listed above aim to strengthen the financial capacity of the DPO by adopting a long-term, coordinated, and responsive funding strategy that will involve the following:

PBC A.1: DPO's Board has approved a Target Fund Ratio methodology and strategy.

29. Target Fund Ratio is defined as the ratio of total DPO reserves to the total insured deposits or total eligible deposits in member financial institutions. Adopting a Target Fund Ratio and strategy will enable the DPO to assess the adequacy of its reserves and focus on achieving a stronger financial position to cover risks and eventualities from covered institutions. Achieving target ratio gives comfort of financial adequacy under normal circumstances and will boost confidence of depositors on the strength of the financial safety net. Setting a target ratio will also help establish financial discipline which is necessary to promote sustainability. The DPO should regularly review the reasonableness of its target ratio, by ensuring that its reserves can meet potential claims from depositors of banks that may be closed. Regular assessment of funding requirements to cover risks goes hand in hand with mapping out a strategy on how to achieve the target and plan ahead of time on the appropriate funding strategy, that is, whether to increase premiums, request additional equity from the Government, or borrow funds to bridge the gaps. It should also involve arrangements on how to complement reserves with backup funding facility to cover any unforeseen event/s that will require liquidity beyond its available funds for temporary or permanent liquidity needs.

PBC A.2: BOL Governor has approved regulations on adjusted deposit premiums.

30. The DPO relies on premium collection to build up its reserves. Premium collections lend sustainability to the deposit insurance fund buildup process. The DPO is reviewing premium rates to adopt a uniform flat rate irrespective of currency of deposit, consistent with the recent consolidation of maximum amount of deposit insurance coverage to LAK 50 million. The DPO has adjusted premium rates in the past and is able to collect premiums from members promptly. It is moving to further enhance the premium collection process to minimize delays in the payment of premium and optimize investment income. The DPO recognizes that the premium rate should be reasonable and reflective of risks in the system. It is interested in shifting to a risk-based system once risk-based supervision is in place and information on risks of banks becomes available. The DPO recognizes that adjustments in premium may be necessary to build the fund and achieve the target ratio. It is also aware of the need to inform members of the importance of premium collection and why adjustments in rates are necessary.

PBC A.3: DPO has entered into an agreement with MOF acceptable to the Association for back-up funding support.

31. PBC A.3 seeks to enhance collaboration between the DPO and other members of the financial sector safety net (BOL and Ministry of Finance [MOF]), including setting up backup funding arrangements in the event of a crisis. The backup funding arrangement should be clear in terms of procedures and requirements and rapidly disbursing to ensure prompt payment to depositors and prevent undue repercussions to the system due to any delays in the ability of the DPO to reimburse claims of depositors. Together with the establishment of a Financial Stability Committee and crisis management plan, these would constitute important reforms in Lao PDR, and pave the way for members of the financial safety net to more effectively perform their respective roles in strengthening and maintaining stability in the financial system.



PBC A.4: DPO has withdrawn all investments and deposits in commercial banks and invested them in government securities and central bank bonds.

32. The DPO should end its current practice of depositing in commercial banks, consistent with the provisions of the Decree and IADI Core Principles. This represents an important reform to safeguard the DPF. A prudential investment strategy is key to ensure that investment income is optimized by investing in risk-free (government) investment instruments, losses are avoided, and a comfortable liquidity position is maintained that is adequate to cover operational requirements and payout of deposit insurance. Given the amount of funds under the management of the DPO, there should be a formal asset and liability committee to oversee the management of funds and the formulation and implementation of an investment strategy. The DPO Board is constituting a Board Committee to oversee the formulation and implementation of an investment strategy, ensure that adequate controls are in place, and ensure that there is transparency and full disclosure on the financial position of the DPO.

33. Indicators for enhancing coordination between the DPO and other financial safety net institutions include the following:

PBC B.1: DPO and Bank of Lao PDR have signed a memorandum of understanding acceptable to the Association regulating the flow of information between the two entities.

34. The memorandum of understanding (MOU) is intended to formalize the arrangements on information sharing (data to be shared, timing, and process of accessing the data), and coordination between the BOL and DPO, which is critical for the DPO to perform its mandate. The MOU has been drafted, with inputs from the World Bank. Finalization of this MOU will put in place the structure and flow of information between the two agencies. It will also allow the DPO to evaluate risks in the system and anticipate possible bank failures.

PBC B.2 – B.3: B.2. Bank of Lao PDR has issued an order to constitute a technical committee to prepare groundwork for establishing the Financial Sector Stability Committee; B.3. Bank of Lao PDR has issued an order to constitute Financial Sector Stability Committee.

35. This will involve two stages: setting up of a technical committee to prepare the groundwork for the Financial Stability Committee, which will happen at a later stage. This is an important structure to boost preparedness of Lao PDR to handle a financial crisis and to strengthen coordination among financial safety net players. With technical support financed by the Bank-executed Trust Fund, the technical committee will prepare the terms of reference and monitoring framework of key economic and financial variables and how to determine impact of significant movements in variables on the financial system. It will also prepare a crisis management and contingency plan to prepare for any eventuality.

36. Indicators to improve governance of the DPO include the following:

PBC C.1 – C.2: C.1. BOL Governor has approved its Corporate Governance Charter; C.2. DPO Board has approved its Code of Ethics.

37. Adherence to good corporate governance principles is critical for the proper and effective functioning of the DPO. The newly appointed board members should set the tone for good governance



by prescribing rules that will govern how to handle DPO operations, frequency of meetings, ethical standards, how to address conflict of interests, fit and proper rules for engagement of staff and board members, and audit processes. At a minimum, governance rules prescribed to maintain safety and soundness of commercial banks under the Commercial Banking Law should be adopted by the DPO. These should be documented in a Charter which should be posted on the DPO website to strengthen confidence of member institutions and depositing public on the integrity and ability of the DPO to perform its mandate and serve as a financial safety net. A Code of Ethics shall also be prepared to govern decisions and behavior on professional conduct and principles to be observed by the Board, Management, and staff.

PBC C.3 -C.5: C.3. DPO has implemented an improved accounting and reporting system that includes . chart of accounts, C.4. reporting system, and C.5. IT system.

38. Consistent with good governance principles, the DPO needs to put in place an accounting system that is responsive to its needs and with built-in internal control and audit trail process. The DPO has commenced review of its Chart of Accounts, supported by ongoing World Bank TA. It has also started to modify presentation of its financial statements to properly reflect the accounting of its Deposit Insurance Reserve Fund. The existing accounting system should be enhanced and a new computerized system with internal control and audit trail features should be put in place to support monitoring of financial condition, tracking of accountability and management of funds. This PBC will involve three phases: (1) Revision of accounting system-chart of accounts, (2) design of the reporting system, and (3) revision of the information technology (IT) system.

39. Indicators for enhancing the DPO's readiness and capability to perform its deposit insurance mandate include the following:

PBC D.1: DPO Board has approved and issued to its members regulations acceptable to the Association on record keeping of deposits including requirement to prepare deposit data in Single Deposit View (SCV) format.

40. **The DPO should have an information and reporting system to process depositor information in a systematic and accurate manner.** Currently, members are merely required to report deposit data on a consolidated basis. The DPO should issue regulations on proper record keeping of deposit records (signature cards, account opening, and evidence of deposit transactions) to protect depositors and expedite the payment process if the bank is closed. The regulations should be complemented by requiring banks to maintain a computerized record of their deposits in the format (SCV) to be prescribed by the DPO. This will expedite identification of covered deposits and consolidation of deposit insurance entitlements of depositors when a bank is closed.

PBC D.2: DPO Board has approved regulations acceptable to the Association on procedures for claiming deposit insurance in the event of payout.

41. The DPO should issue regulations on the procedures to be followed by depositors in claiming deposit insurance. These regulations which should include documents required to be submitted to substantiate claims for reimbursement of deposits, timing, and procedures for filing. The regulations should be properly and promptly communicated to the depositing public and member institutions. This will give credence to the DPO's preparedness in handling the reimbursement process.



PBC D.3: DPO has conducted a simulation exercise on deposit insurance claims processing and payment.

42. It is important for the DPO to simulate the procedures and guidelines it has developed to handle the reimbursement of claims to ensure preparedness in handling their core mandate and to address any gaps and problems that may be encountered during implementation. This will involve use of actual deposit data of selected bank/banks. It will also enable the DPO to assess resource requirements, including capability and adequacy of its staff in handling reimbursement process. It is considered good practice to do a simulation exercise regularly if there are no bank closures. This will also give an opportunity for the deposit insurer to check compliance by banks with its regulations on record keeping.

43. Indicators for promoting public awareness and literacy on deposit insurance include the following:

PBC E.1: BOL and DPO have each issued regulations acceptable to the Association requiring their respective member institutions to provide standard information on deposit insurance coverage to their clients.

44. It is the responsibility of the DPO to require banks to inform depositors about deposit insurance and the DPO should prescribe the format, content, language, and medium for the proper dissemination of this information. Currently, there are no signages or announcements in bank premises and ATMs on the membership of the banks and the amount of deposit insurance coverage. The DPO is preparing to comply with this requirement. It has drafted a revised logo and is working on format of announcements to enhance its visibility, presence, and role in the financial system.

PBC E.2: DPO Board has approved a Public Awareness Strategy on deposit insurance.

45. The DPO has commenced preparations of a public information campaign on deposit insurance. This covers basic information that the public should be made aware of and which have not been communicated to members and the depositing public, such as membership of the bank with the DPO, amount of deposits insured, and excluded and included deposits. The DPO is taking advantage of the issuance of the new decree on deposit protection and the occasion of its 20th anniversary to commence some of its public information initiatives. It is preparing a more comprehensive public awareness strategy framework, with assistance from the World Bank.

PBC E.3: DPO Board has approved an updated public awareness strategy based on survey conducted to the public.

46. The DPO will conduct a public awareness survey to enable it to revise its public awareness strategy, to make it more targeted and expand its reach to more depositors. It will also allow the DPO to craft a more responsive and cost-effective campaign, prepare a budget for its information campaign, and measure the effectiveness of the campaigns.

PBC F.1 – F.2: F.1. BOL Governor has approved regulations acceptable to the Association governing problem bank resolution process framework; F.2. BOL Governor has approved regulations acceptable to the Association governing prompt corrective actions and early intervention measures.



47. The new Commercial Banking Law provides for early intervention and resolution of commercial banks in crisis. Implementing regulations need to be issued to define the specific processes involved and the structure that will be responsible for dealing with banks in crisis. To be able to craft the implementing rules, the BOL and DPO should be familiar with issues and problem areas likely to emerge in dealing with banks in crisis and possible legal issues that could arise or deter/delay the exercise by the BOL of its authorities under the law. This will support initiatives to move toward risk-based supervision and examination and comply with international standards on banking supervision and regulation.

PBC F.3: DPO has completed a self assessment on the extent of compliance with IADI Core Principles on Deposit Insurance and identified gaps and actions for achieving full compliance.

48. Gaps identified during the self-assessment conducted by the DPO with the support of the World Bank should be addressed by the DPO. The measures needed to address the gaps have been identified, some of which have been included in the PBCs. The DPO will conduct the updated self-assessment, with World Bank TA, during the second half of project implementation and update the action plan.

Component 2: Institutional capacity building for DPO and project management (US\$1.75 million)

49. **The project will finance select TA to strengthen the DPO's institutional capacity and to complement parallel and ongoing TA financed by the World Bank.** The World Bank has been providing TA (financed by Bank-executed Trust Funds) to the DPO and BOL since 2016. Substantial TA is needed to support the DPO's institutional development, and the project will continue to rely on externally funded TA provided by the World Bank with limited TA financed under the project. The World Bank TA program, Financial Sector Development Program (P171539), is financed by the Ministry of Economy and Finance of Korea in partnership with the World Bank 'Seoul Center for Financial Sector Development'. The TA will include a consultancy to undertake a public awareness survey (PBC E.2-E.3), and general deposit insurance consultancies to help the DPO achieve institutional capacity-related PBCs and other PBCs as necessary. This component will also finance consultants to support project implementation, including the following functions: project coordinator, communications, financial management (FM) and procurement. This component will also include contingent funding, which could be mobilized to finance additional TA should outside resources prove to be insufficient.

C. Project Beneficiaries

50. The direct beneficiary of the project is the DPO. The project aims at strengthening the financial and institutional capacity of the DPO to allow it to meet its deposit insurance obligations according to the Decree on Deposit Protection.

51. Households and small and medium enterprises that have deposits in the banking system will also benefit from the project. The DPO protects depositors up to an insured limit of LAK 50,000,000. Based on deposit data, 13 percent of deposits are covered by the DPO. Enhancing the financial and institutional capacity of the DPO will ensure that these banking customers are protected in the case of a bank failure. A strengthened deposit insurance system will contribute to increased financial inclusion by increasing confidence in saving in financial institutions. According to Findex, 60 percent of Lao saved in the last year



but only 18 percent saved at a financial institution. A bank failure without deposit protection would hamper the country's efforts to increase financial inclusion.

52. The broader public will also benefit from availability of information to keep them informed on an ongoing basis about deposit insurance. This is one of the DPO's mandate as identified in PBCs E.2 and E.3 on the promotion of public awareness and literacy on deposit insurance.

53. In the long run, the banking system and economy will benefit from the project. Deposit insurance schemes are a core part of the financial safety net that aim to improve confidence in the financial system. Strengthening capacity of the DPO will thus have a positive impact on strengthening confidence in the banking system. This can lead to an increase in the amount of domestic savings that can be mobilized for more productive uses, which would enable increased growth and job creation.

54. Banks that operate in Lao PDR will also benefit from the ability of the DPO to meet its deposit insurance obligations. Putting in place an effective safety net will help prevent the impact of contagion due to bank failure, as depositors become aware that their deposits are protected. Thus, the project will minimize the possibility that a small bank failure becomes a systemwide issue that would have a negative impact on the operations of other banks. A poorly handled bank failure and lack of protection of small depositors could cause panic and contagion, thereby affecting the stability of the banking system.

D. Results Chain

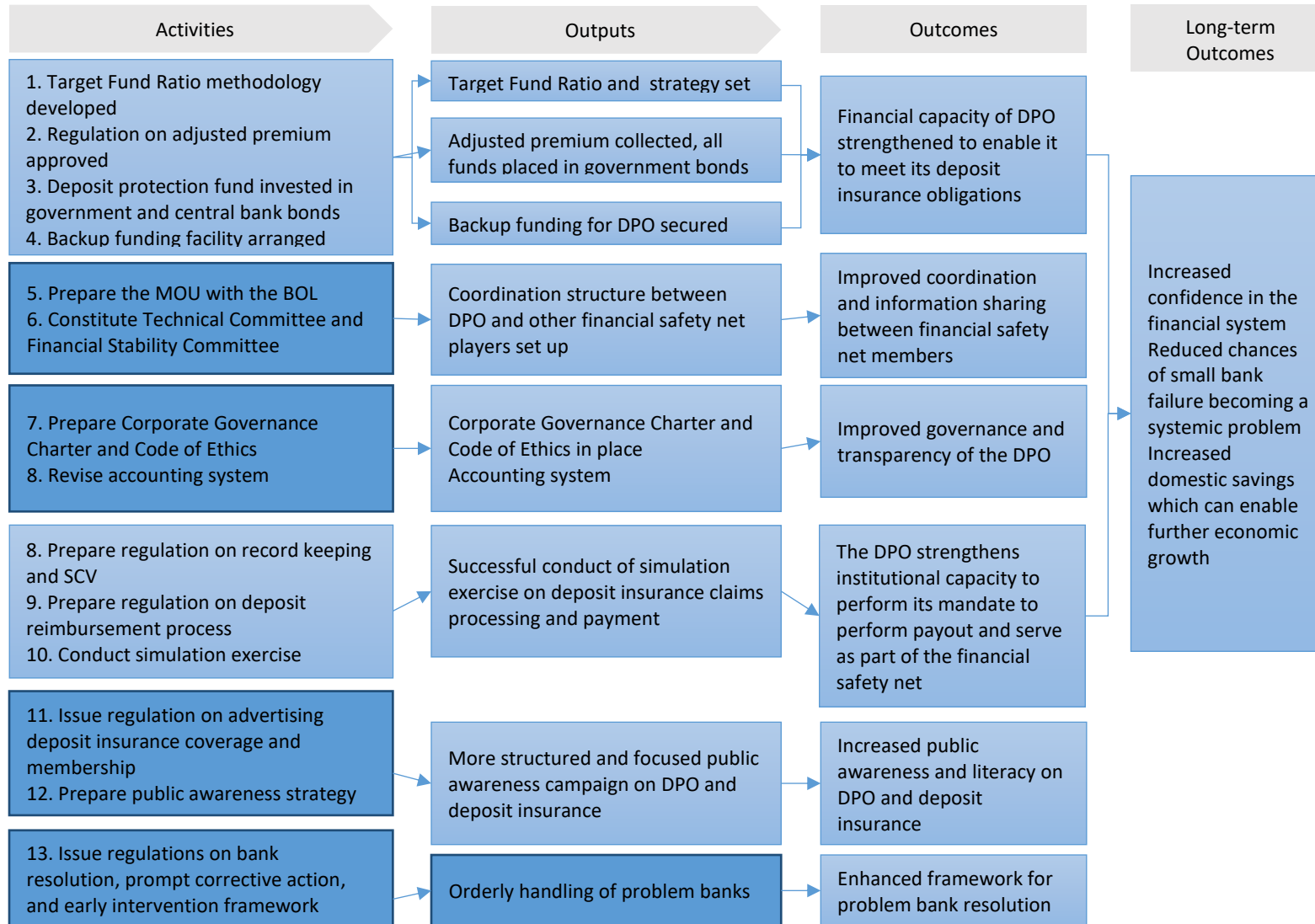
55. The Theory of Change for the project identifies the main activities, corresponding outputs, and expected outcome as reflected in figure 2. One of the main activities is to strengthen the financial capacity of the DPO through capitalization of the DPO's DPF with sufficient resources to allow the DPO to meet its deposit insurance obligations. Another activity is to strengthen the institutional capacity of the DPO.

56. The PBCs are the outputs of the project. While most of the project funds will be allocated toward strengthening the financial capacity of the DPO, the project supports several important outputs related to institutional strengthening of the DPO, as the main beneficiary of the TA. The PBC outputs not only enhance the capacity of the DPO, but they also pave the way and ensure that the BOL installs a more robust, systematic process to handle troubled and failed banks. The PBC provides the basis for important reforms of the whole regulatory, supervisory, and resolution framework for the banking system.

57. Longer-term outcomes expected from the project are reflected in its contribution to strengthened public confidence in the financial system, reduced chances of small bank failures becoming a systemic problem, and increased domestic savings which can enable further economic growth.



Figure 2. Theory of Change





E. Rationale for Bank Involvement and Role of Partners

58. The World Bank has been providing comprehensive TA to the BOL and DPO since 2016. The project offers an opportunity to deepen this engagement and deliver meaningful reforms to strengthen the financial safety net. The DPO requires a combination of financial and institutional support and policy advice to enable it to carry out its functions. The project will support the DPO in complying/moving toward compliance with IADI Core Principles for effective deposit protection, including strengthening the bank resolution framework. Project design includes TA to increase the DPO's institutional capacity and will draw on the World Bank's extensive global experience in strengthening deposit protection institutions, both through TA and lending operations. As discussed earlier, the project is part of a wider World Bank engagement, coordinated with the IMF, consisting of policy-based lending (Green Growth DPO series with a financial stability sub-pillar) and programmatic TA.

F. Lessons Learned and Reflected in the Project Design

59. The design of the project is informed by several World Bank projects in the Europe and Central Asia regions, and most recently, the Africa region. At least five other World Bank IPF operations have combined results-based financing and TA to enhance financial stability. Two projects (in Bulgaria and in Serbia) focused on deposit insurance, two other projects (in Bosnia and Herzegovina and in Serbia) focus on broader financial sector operations, and one project in Mozambique focuses on increasing financial inclusion and stability.¹² The Serbia Deposit Insurance Strengthening Project was the first World Bank operation to (re)capitalize a deposit insurance fund, demonstrating a different way of engaging in the financial sector and responding to crises. To achieve that, the project extended requirements of OP 10.00 (Investment Project Financing) on productive use to include an expenditure into a 'fund' as an eligible expenditure. This novel feature has since been used as a model for several other operations. These and other projects have shown that a combination of Results-based Financing and TA can be an effective instrument for achieving change in a sustainable manner. While the PBCs offer a financial incentive for reform, the TA can support the implementing agency to achieve the PBCs and build long-term capacity. The World Bank Group has also developed knowledge products to assist in the challenges of implementing credible deposit insurance systems.¹³

60. **Combining Results-based Financing and TA can be effective for implementing reforms and building capacity in a sustainable manner.** In this project, the PBCs provide the impetus and financial incentive to implement reforms, while the specifically tailored TA activities will be useful in supporting the implementing agency, the Deposit Insurance Agency, in achieving the targets of each of the PBCs. The Lao PDR project benefits from the availability of TA funding outside of the project, which will ensure a high degree of technical support to help the DPO achieve the PBCs and allow for increased allocation of the IDA credit toward fund capitalization as opposed to TA. Under the ongoing Financial Sector Development technical assistance program (FSDP, financed by the Ministry of Economy and Finance of Korea in partnership with the World Bank 'Seoul Center for Financial

¹² Bulgaria Deposit Insurance Strengthening Project (P154219), Serbia Deposit Insurance Strengthening Project (P146248), Bosnia and Herzegovina Banking Sector Strengthening Project (P158387), Serbia State-Owned Financial Institutions Strengthening Project (P156837), and Mozambique Financial Inclusion and Stability Project (P166107).

¹³ World Bank. 2017. *Deposit Insurance Systems: Addressing Emerging Challenges in Funding, Investment, Risk-based Contributions & Stress Testing*. Washington, DC: World Bank



Sector Development) the World Bank is already supporting the DPO on actions related to several PBCs included under the project.

61. **Based on extensive experiences across the globe, the World Bank and the Financial Sector Reform and Strengthening Initiative (FIRST) Initiative have developed key lessons from deposit insurance systems in developing countries**, including, among others, that (a) deposit insurance is not a ‘cure’ for weak banks, (b) a deposit insurance system is only as strong as the safety net in which it operates, (c) preparing for payout is no small task, (d) the framework should not be static and should be subject to regular reviews, and (e) an effective deposit insurance system is not free and a deposit insurance system without backup funding is ‘not an option’.¹⁴ The project, and parallel TA in coordination with the IMF, will incorporate these lessons through support for commensurate strengthening of other aspects of the financial safety net and a strong focus on helping the DPO improve its operational capacity to handle payouts. Further, the project supports improvement in Target Fund Ratio methodology to ensure that fund reserve is adequate and also will mobilize ex ante backup funding to cover any shortfalls. Because the DPO has never experienced a deposit payout, the project will focus on preparing to undertake an effective payout.

III. IMPLEMENTATION ARRANGEMENTS

A. Institutional and Implementation Arrangements

62. The DPO will serve as the implementing agency. The DPO does not have prior experience with implementing World Bank projects and will need to establish a small technical group to ensure the project is implemented in accordance with the World Bank’s fiduciary rules. The implementation arrangements strive to build upon the DPO’s normal operations to the extent possible. There will be a TA component, which will be closely coordinated with the externally funded FSDP. Based on procurement and FM assessments of institutional capacity, consultancy support will be necessary to learn about World Bank fiduciary procedures and maintain adequate governance and FM arrangements as well as to prepare disbursements against PBCs. Support will be provided as necessary by the World Bank fiduciary team.

63. **Buy-in from other members of financial safety net.** While the project focus is on deposit protection, success of the project requires addressing important gaps in the financial safety net, beyond deposit insurance. Therefore, the project design and implementation will require buy-in from the Central Bank and MOF to ensure that the PDO is achieved. The BOL and MOF will be important stakeholders, with responsibilities for achieving PBCs (#A.4, B.1, B.2, B.3, E.1, F.1, and F.2). Both of these entities, in addition to the DPO, play a critical role in the financial safety net and are represented on the DPO’s management board, which is co-chaired by the BOL and MOF. For instance, in the case of the Deposit Insurance Decree, the MOF will need to issue a ministerial level resolution to ensure proper guidelines on the transfer of funds in the event of a crisis (as the DPO holds two funds—reserve and equity funds). Under the project, the MOF is responsible for a critical PBC, providing backup funding for the DPO which will bolster the sustainability of the fund in the event of a crisis. The BOL is responsible for implementing a PBC which involves approving regulations governing the problem-bank resolution process

¹⁴ World Bank. 2017. *Challenges in Building Effective Deposit Insurance Systems in Developing Countries*. Washington, DC: World Bank.



framework and prompt corrective action and early intervention. Finally, the project supports the establishment of a Financial Stability Committee, which will include the MOF and BOL.

B. Results Monitoring and Evaluation Arrangements

64. Section VII lists the main outcome indicators for the project and the principal results and the PBCs. These will serve as the basis for results monitoring and evaluation. The DPO will have the primary responsibility for collecting the data required for monitoring and evaluation and for verification of the PBCs based on protocols outlined in section VII. Indicators will be measured against agreed targets and compared to defined baselines. The DPO will report relevant data to the World Bank through biannual project progress reports.

65. The project will promote citizen engagement and gender equality and analyze beneficiary feedback in several ways. While no gender issues which could be addressed by the project were identified,¹⁵ gender actions will be built into the PBC system and included in the verification protocol, to ensure that the deposit insurance scheme provides equal access and equal opportunities and is equally effective for women and men. First, the DPO will conduct periodic consultations with member commercial banks to monitor the implementation of PBC E.1 (BOL and DPO have each issued regulations acceptable to the Association requiring their respective member institutions to provide standard information on deposit insurance coverage to their clients). Second, following the implementation of PBC E.1, the DPO will administer periodic surveys through commercial bank branches to ascertain depositor awareness and literacy, and analyze results to identify any gender gaps. Third, the DPO will conduct a public awareness survey to inform public awareness strategy (PBC E.3). Feedback from consultations with member banks and depositors will also inform public awareness strategy, which is intended to be a living document. Results will be disaggregated by gender when possible. The Results Framework will include two indicators to capture citizen engagement: (a) Beneficiary satisfaction with public awareness and literacy program about the deposit insurance (disaggregated by number/percent of women) and (b) Percentage of complaints handled from Grievance Redress Mechanism in place (disaggregated by number/percent of women). Finally, to close the feedback loop, the DPO will establish a dedicated grievance system to monitor feedback, and will periodically update the frequently asked questions section on the website to report on common problems/inquiries, including feedback from commercial banks and surveys of depositors.

C. Sustainability

66. The project will contribute to the sustainability of the DPF. The sustainability of the fund depends on the DPO's ability to raise funds, both before and during a financial crisis, to achieve an adequate Target Fund Ratio. The DPO can raise funding through premium collection, proceeds from investment of its capital, and borrowings (Government or capital markets). The DPO's main source of funding is deposit premiums from commercial banks. The project will support the DPO to implement an enhanced Target Fund Ratio (PBC A.1) which will better enable the DPO to assess the adequacy of its reserves and adopt strategies to achieve an adequate financial position, which could include adjustments in the premium rates that the DPO charges to its member banks, to cover risks from covered institutions. Other PBCs that would contribute to the DPO's sustainability include PBC A.4 (DPO has withdrawn all investments and deposits in commercial banks and invested them in government securities and

¹⁵ The project could address gender gaps in access to deposit insurance. However, data on gender of insured depositors is not available.



central bank bonds) and PBC A.3 (DPO has entered into an agreement with MOF acceptable to the Association for back-up funding support. PBC A.3 would reduce the risk of DPOs' investments of reserve funds and thereby ensure that they are available in the event of a crisis.

IV. PROJECT APPRAISAL SUMMARY

A. Technical, Economic and Financial Analysis (if applicable)

67. The project is expected to strengthen financial sector stability. Ensuring that the DPO has the financial and institutional capacity to function as part of the financial safety, together with commensurate strengthening of banking supervision and the resolution framework, which is being supported by the IMF and World Bank TA, will help increase confidence in the banking system. This confidence will stimulate higher domestic savings channeled through the banking system that can then be allocated to productive purposes. These resources can then be used for investments that, among other things, lead to job creation and shared prosperity. In the event of a bank failure, the project will help ensure that insured depositors, the majority of whom are households, will not lose their savings. The project can also be expected to promote increased financial inclusion. The project will support increasing public awareness and financial literacy to ensure that depositors are informed about the benefits of deposit insurance as a means to safely store money.

Technical

68. The project design is based on the DPO's self-assessment, with World Bank support, against IADI Core Principles for Effective Deposit Protection, and the prioritized and sequenced action plan to move toward compliance. The assessment revealed a number of gaps that the project will address. It is important to note that the DPO cannot be expected to achieve full compliance under this project. It strives to take a phased approach tailored to the Lao context, including the capacity of the DPO and other financial safety net members, and recognizes the political economy and legislative environment. The project addresses actions mostly under the DPO's control but does include essential elements of an effective deposit insurance outside DPO control, including the need for bank resolution, backup funding, and legal protection. As noted, the DPO has an adequate legal and institutional framework for deposit insurance, but the self-assessment revealed a number of gaps that the project aims to address.

69. **Core Principle 9: Sources and Uses of Funds.** "The deposit insurer should have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors' claims, including assured liquidity funding arrangements. Responsibility for paying the cost of deposit insurance should be borne by banks. The deposit insurer has responsibility for the sound investment and management of its funds. Emergency funding arrangements for the deposit insurance system, including prearranged and assured sources of liquidity funding, are explicitly set out (or permitted) in law or regulation. Sources may include a funding agreement with the government, the central bank or market borrowing. If market borrowing is used, it is not the sole source of funding. The arrangement for emergency liquidity funding is set up in advance, to ensure effective and timely access when required."¹⁶

¹⁶ International Association of Deposit Insurers. 2014. *IADI Core Principles for Effective Deposit Insurance Systems*.



- **Result of the assessment.** Currently, the DPO has built a reserve fund amounting to LAK 361 billion, which represents 0.51 percent of total eligible deposits as of end 2018. The DPO set its Target Fund Ratio at 2 percent of total eligible deposits by 2044. This methodology is not prudent considering that it sets an extended period for reserve accumulation (more than 25 years), and it does not consider immediate risks in the banking system. The DPO's current approach to determine the Target Fund Ratio is based on projected growth in deposits, premium collections, and investment income. No assumptions were made on possible claims against the DPF. The amount of premium collections depends on the growth of deposits and premium rate. The current premium rate of 0.1 percent and deposit protection coverage of LAK 50 million was applied throughout the projection period (2020–2044), while deposits were assumed to grow at a fixed amount of LAK 6.2 trillion per year. This methodology, based on supply-side analysis, falls short of the requirements under IADI Core Principle 9 as it does not incorporate assessment of risks in the banking system and deposit levels of banks at risk. The DPO's current investment practice includes depositing in commercial banks. As of end 2018, DPO outstanding deposits with member commercial banks amounted to LAK 226 billion representing 62 percent of the Deposit Protection Reserves Fund. This is counter to IADI Core Principles. The Decree on Deposit Protection provides that the DPO should invest in low-risk instruments namely government bonds, central bank bonds, and deposits in the BOL. Hence, depositing in commercial banks should be discontinued.
- **Impact on the design of the project.** To move toward compliance, the DPO needs to consider risk assessments of member banks to develop a more robust Target Fund Ratio. Incorporating risks will provide a fuller picture of possible outflows and allow for more informed assessment of the adequacy of the fund. However, these data are not readily available. The risk monitoring and evaluation framework is still being worked on. In the absence of these data, determination of the target ratio may take a simpler approach of determining how many small or medium-size banks the DPO targets to service. The DPO may eventually re-estimate and review its target periodically based on deposits at risk and likelihood of failure of members, as soon as these data become available. The project will support the DPO to move toward a more robust methodology to determine the Target Fund Ratio (PBC A.1), which tests the adequacy and sustainability of the fund against potential claims over the medium and long term. The project will develop a framework to ensure the sustainability of the fund which incorporates triggers for increases in premiums, requests for equity, and triggers to borrow funds or tap into backup funding (PBC A.3) while at the same time determining appropriate premium rates and other fund inflows necessary to achieve that target. Premium collections are the most significant contributor to the DPRF. Backup funding arrangements (PBC A.3) can take the form of a special line of credit from the MOF or a guaranteed line of credit from the central bank. The World Bank will provide TA to support the DPO to achieve PBC A.3, with regard to the backup funding arrangements for the DPO in the event of crisis.

70. **Core Principle 4: Relationship with Other Safety Net Participants.** “In order to protect depositors and contribute to financial stability, there should be a formal and comprehensive framework in place for the close coordination of activities and information sharing, on an ongoing basis, between the deposit insurer and other financial safety-net participants. For full compliance, information sharing and coordination between the DI and relevant safety net participants must be timely and occur both on an ongoing basis and whenever material supervisory actions are to be taken regarding member banks.”¹⁷

¹⁷ IADI 2014.



- **Result of the assessment.** At the time of the self-assessment against IADI Core Principles, the DPO was found to be compliant with this core principle, as it has an existing MOU with the BOL. However, the MOU needs to be updated following the adoption of the Decree on Deposit Protection to ensure adequacy of information shared and timeliness of access to and availability of information. Specific guidelines should be adopted by BOL on the notification process and timing for decisions to place banks under resolution, withdrawal of license, and decision to liquidate, to enable the DPO to prepare for these eventualities.
- **Impact on the design of the project.** A revised MOU has been drafted based on World Bank review and recommendations between the DPO and BOL and was signed and finalized in June 2019. The World Bank will monitor implementation of the MOU to enable the DPO to analyze deposits and financial data on the banking system and adequately and promptly carry out its mandate.

71. **Core Principle 3: Governance.** “The deposit insurer should be operationally independent, well-governed, transparent, accountable, and insulated from external interference.”

- **Result of the assessment.** The DPO was found to be materially noncompliant (MNC). Under the new decree, the governance arrangements fall short of compliance in terms of board structure with (the BOL as chair and no independent board members). While the DPO remains under the supervision and management of the BOL, certain enhancements to the governance structure have been introduced in the decree to improve its governance framework:
 - Reporting of the DPO directly to its board, chaired by the BOL, instead of the BOL Supervision Department
 - Internal and external audit of the operations and financials of the DPO
 - Prohibition on purchase of assets from distressed banks and DTMFIs
 - Explicit declaration of responsibility of the DPO to prepare and disclose annual report and financial statements to BOL
 - Inclusion of provision on depositors’ right to ask for information to enable them to make informed decisions
 - Inclusion of government equity commitment
 - Prohibition for DPO management to buy assets of bankrupt members.
- **Impact on the design of the project.** Since a new DPO board, chaired by the BOL and with no independent directors, was recently appointed (December 2018) for a five-year period, the project will endeavor to strengthen governance by ensuring continued compliance with the qualifications during board members’ incumbency while guidelines on disqualifications are clearly defined, for example, conflict of interest and violation of government rules and regulations. The integration of these guidelines together with rules on handling business operations and practices shall be incorporated in the Code of Corporate Governance. This will be supported by the project under PBC C.1.



72. **Core Principle 10: Public Awareness.** “In order to protect depositors and contribute to financial stability, it is essential that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.”

- **Result of the assessment.** The self-assessment found the DPO to be noncompliant on this core principle, as it does not have guidelines on how to inform the depositing public in the event of a bank closure. The DPO has to develop a public awareness program to inform the public about the concept of deposit insurance, the DPO’s role in protecting depositors, and the guidelines for paying insured deposits. The DPO should ask members to play a major role in helping promote public awareness.
- **Impact on the design of the project.** PBC E.2 aims to address the gaps in public awareness efforts of the DPO. The PBCs cover issuance of a regulation requiring members to advertise maximum deposit insurance coverage and membership with the DPO, and dissemination of guidelines on the reimbursement process, both of which are very basic to help promote confidence of depositors on the preparedness of the DPO to pay out insurance on deposits. A public awareness strategy framework will be formulated to define the process of educating the public on the deposit insurance system and enhance the visibility and awareness on the DPO. The World Bank is supporting the preparation of the reimbursement guidelines and development of the public awareness strategy framework, including the conduct of a survey that will allow the DPO to fine-tune its strategy to be more focused and cost-effective, and to allow it to measure the results of its public awareness initiatives.

73. **Core Principle 14: Failure Resolution.** “An effective failure resolution regime should enable the deposit insurer to provide for protection of depositors and contribute to financial stability. The legal framework should include a special resolution regime.”

- **Result of the assessment.** According to the self-assessment, the DPO is noncompliant. The BOL is the resolution authority and is authorized to rehabilitate banks but lacks comprehensive resolution powers. The Commercial Banking Law, which was recently signed, provides for early intervention measures and resolution of commercial banks in crisis, including the designation of a committee to handle the resolution process. The law also provides for the authority of the BOL to take control of the bank subject of resolution or rehabilitation. There is a need to prepare the implementing guidelines to ensure an orderly resolution and rehabilitation process and avoid any legal complications. The banks should be informed of these provisions and guidelines so that they are aware of what will happen should the bank have problems.
- **Impact on the design of the project.** The project and World Bank-executed TA will support PBCs F.1–F.2, which involve the preparation of the guidelines on resolution and setting up of a committee or group who will handle preparation of the guidelines and implementation. The guidelines on prompt corrective actions and bank resolution should be prepared based on the recently signed Commercial Banking Law. The authorities also need to consider a structure that will support the development of expertise required to handle resolution and rehabilitation of banks, because these require specific skill sets, to ensure proper implementation of the regulations.

74. **Core Principle 6: Deposit Insurer’s Role in Contingency Planning and Crisis Management.** “The deposit insurer should have in place effective contingency planning and crisis management policies and procedures, to ensure that it is able to effectively respond to the risk of, and actual, bank failures and other events. The



development of system-wide crisis preparedness strategies and management policies should be the joint responsibility of all safety-net participants. The deposit insurer should be a member of any institutional framework for ongoing communication and coordination involving financial safety-net participants related to system-wide crisis preparedness and management.”

- **Result of the assessment.** The DPO is noncompliant. It has only recently started to analyze different crisis scenarios and how it would respond. A clear contingency planning process is missing on the institutional as well as national level between safety net participants. Lao PDR has no coordination body such as a Financial Stability Committee or Crisis Committee and has never conducted a crisis simulation exercise.
- **Impact on the design of the project.** Although the PBCs do not specifically include crisis management and contingency planning, the requirement for setting up a Financial Stability Committee will have to consider these as part of its terms of reference. Also, from a good governance standpoint, the BOL and DPO should initiate contingency planning and risk management measures for their own purposes. The safety net, which includes the BOL, DPO, and MOF (and potentially other financial actors) should engage in contingency planning and conduct a crisis simulation. The World Bank can support initiatives in this area through its parallel TA program. If the DPO targets compliance with core principles, it needs to prepare policy guidelines on crisis management as a deposit insurer.

75. **Core Principle 15: Reimbursing Depositors.** “The Deposit Insurance System (DIS) should reimburse depositors’ insured funds promptly, in order to contribute to financial stability. There should be a clear and unequivocal trigger for insured depositor reimbursement.”

- **Result of the assessment.** According to the self-assessment (the rating is MNC), there are no guidelines on reimbursement nor is there an adequate infrastructure to allow an expeditious payout. The time line contemplated under the decree before a depositor may be paid is within 90 days from the date the depositors are notified. This can be extended two times but no more than 90 days each time. This is long compared to the 7-day international benchmark. Achieving the 7 days payout time frame will be impossible given the absence of sufficient infrastructure, guidelines, and trained staff to handle reimbursement operations. The DPO still has to prepare the reimbursement guidelines, gear up, and prepare for handling the reimbursement processes, including set-off procedures. The guidelines should specify how to handle exceptional circumstances when the DPO may make advance payments to depositors or make interim and emergency partial payments.
- **Impact on the design of the project.** PBCs D.1 and D.2 require the DPO to put in place the necessary infrastructure to allow expeditious payout process: (a) prepare reimbursement guidelines; (b) establish requirement for banks to properly maintain record of deposits using SCV format; (c) develop system for processing data from SCV; (d) develop training manual for handling reimbursement process; and (e) conduct training and simulation exercises, including handling of crisis situations during payout operations (PBC D.3). As part of its ongoing TA program, the World Bank is providing TA to the DPO in these areas.

76. **Core Principle 14: Failure Resolution.** “An effective failure resolution regime should enable the deposit insurer to provide for protection of depositors and contribute to financial stability. The legal framework should include a special resolution regime.”



- **Result of the assessment.** The BOL is the resolution authority. Assessment for this core principle was noncompliant since at that time, the BOL does not have guidelines nor is its authority sufficient to undertake resolution and rehabilitation of banks in crisis. Since then, the BOL Law and the Commercial Banking Law have been amended, which provides for enhanced authority of the BOL and provisions on early detection and timely intervention, resolution, and rehabilitation of banks.
- **Impact on the design of the project.** PBCs F.1 – F.2 specifically require that regulations governing problem-bank resolution process including framework for early intervention and prompt corrective action are put in place. This should pave the way for orderly resolution and rehabilitation of banks in crisis, critical to helping maintain financial stability and boosting confidence in the financial system.

B. Fiduciary

(i) Financial Management

77. The World Bank FM specialist conducted an assessment of the DPO's FM capacity through questionnaire and direct interview of staff of the Accounting Division. Main FM risks identified which could affect the achievement of the project's objective are limited personnel and lack of experience in implementing official development assistance (ODA) projects. English language skills are also limited and the DPO lacks consolidated and adequate FM policies and procedures. Limited capacity and lack of experience and guidance to follow is likely to increase risks of noncompliance, delays in submitting consolidated financial and audit reports, unsatisfactory accounting records, and misuse of funds. Hence, FM risk is considered Substantial. Risk mitigation measures include (a) providing consultant support to the Accounting and Fund Management Division to enable them to implement and maintain satisfactory FM arrangements for the project; DPO staff shall also be assigned to oversee FM work of the consultant to gain experience and sustain capacity within the DPO; (b) having an acceptable FM Manual in place; and (c) paving the way for an annual audit by independent and qualified auditors to provide assurances that FM policies, procedures, and requirement for use of funds, including PBC payments, are complied with. Audit terms of reference will be approved by the World Bank. The World Bank team will carry out implementation support missions twice a year.

(ii) Procurement

78. Procurement under the project will be carried out in accordance with the World Bank Procurement Regulations for IPF Borrowers, dated July 1, 2016, revised November 2017 and August 2018, and provisions stipulated in the Financing Agreement. Procurement that involves approaching the national market will be carried out in accordance with national regulations including Law on State Budget Procurement No. 30/NA, dated November 2, 2017; Guidelines on the Implementation of the Law on State Budget Procurement No. 0477/MOF, dated February 13, 2019, and harmonized bidding documents and request for quotations for procurement of works, goods, and non-consulting services agreed with the World Bank. The DPO is the implementing agency and will be responsible for all the procurement activities for the project.

79. The DPO has prepared a Project Procurement Strategy for Development (PPSD) with the support from the World Bank team, and the document has been approved by the procurement hub leader. The PPSD presents how major procurement activities under the project will support the PDO and deliver the best value for money under a risk-based approach. In addition, the PPSD includes the rationale for procurement decisions including the



selection of the approach to market and procurement methods. The PPSD shall be regularly updated as appropriate during project implementation.

80. The procurement of consultant services under the project is small and simple. An estimated budget of US\$0.75 million would be spent for all procurement activities under this project following the World Bank Procurement Regulations for IPF Borrowers. However, two key consulting services for the project, including a local firm to carry out public awareness survey and an international deposit insurance consultant, have been identified as strategically important to project implementation. These assignments therefore require heightened attention of the project.

81. **Procurement capacity and risk assessment.** The DPO does not have prior experience in implementing World Bank-financed projects and other development partner-funded projects. The DPO has limited procurement capacity and the World Bank Procurement Regulations for IPF Borrowers is new to the assigned procurement staff of the DPO.

82. **Procurement risks and mitigation measures.** Overall residual procurement risk of this project is Moderate. The identified risks and mitigation measures are as follows:

- **Risks.** (a) Limited knowledge and experience of the DPO with the World Bank Procurement Regulations for IPF Borrowers and Systematic Tracking of Exchanges in Procurement (STEP) that may cause delays in project implementation and noncompliance; (b) possible delays in procurement process during the project start-up phase due to slow technical inputs from concerned departments; and (c) governance risks associated with conflict of interest, fraud, and corruption, which may adversely affect the efficiency and effectiveness of project implementation.
- **Mitigation measures.**
 - (a) Provision of procurement training for the DPO's staff, including initial training during project preparation and in-depth procurement trainings during project implementation and hiring of national procurement consultant to assist the project in carrying out procurement activities, and the DPO will assign one focal person for implementation of STEP and monitoring the procurement tracking form. The World Bank will provide guidance to support the DPO with initial procurements and drafting of the Project Operations Manual (POM).
 - (b) Careful procurement planning and scheduling, procurement advanced as much as possible; procurement monitoring using STEP; and closer coordination between implementing departments and follow-up to get technical inputs and terms of reference on time.
 - (c) Enhanced disclosure of procurement information, including publication of the annual Procurement Plan and a quarterly summary of the contract award information for all procurement packages on the project website and in newspapers and establishment of a procurement complaint handling mechanism consistent with the Government Procurement Rules and Regulations and the World Bank

83. A detailed procurement capacity and risk assessment, including mitigation measures is included in the PPSD.



C. Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

D. Environmental and Social

84. The screening of social risks and impacts of project activities was based on discussions with the task team and desk research on previous experience of projects of this nature. The project has the potential for positive impact specifically for those insured depositors who will not lose their savings and will get a timely payout, in the case of a bank failure. Surveys are planned to assess understanding and awareness on deposit insurance and further information needed for inclusivity will be incorporated into the survey design.

85. An Environmental and Social Commitment Plan was prepared and disclosed on the BOL website on January 23, 2020, as well as the World Bank external site on January 31, 2020. During project implementation, engagement with the implementing agency will focus on understanding better its strategy for promoting awareness and literacy about the deposit insurance system and its feedback and complaints mechanism. The Stakeholder Engagement Plan will be updated periodically in line with implementation of the strategy and survey results findings.

86. The environmental screening was carried out by discussing the nature of project activities with the task team and DPO; it is confirmed that the World Bank funds will only be invested in government bond markets, which will not pose any physical footprint. The project will not finance any infrastructure and/or TA that could conceivably result in any adverse environmental impacts.

V. GRIEVANCE REDRESS SERVICES

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



VI. KEY RISKS

88. The proposed overall risk rating is **Substantial**.

89. **Political and governance (Substantial)**. There is a high level of political commitment to strengthen the deposit insurer's institutional and financial capacity and to develop a 'problem-bank' resolution framework. However, there has been less progress in addressing financial sector vulnerabilities stemming from two financially distressed state-owned banks. Authorities are implementing a restructuring plan aimed at improving business performance, but progress has been slow and a long-term solution remains uncertain. These risks could be mitigated by taking more decisive measures to address vulnerabilities stemming from the two state-owned banks, including exploring resolution options. The project, through PBC 19, will support the development of a problem-bank resolution framework.

90. **Macroeconomic risk (High)**. The macroeconomic environment in Lao PDR has deteriorated in 2019. The GOL is putting together a fiscal consolidation plan to reduce the budget deficit and contain rising public debt, but implementation may be challenging. The uncertainty in the global economy, especially ongoing trade tension between the United States and China, expected tightening of interest rates in the United States, and related enhanced volatility in commodity prices could negatively affect global trade and the Lao economy by reducing demand for investment and its exports and put further pressure on the fiscal space and already low reserves. Further, macroeconomic deterioration could have knock-on effects in the financial sector, resulting in an increase in NPLs which could result in bank failures. This could threaten to deplete DPO reserves and require government emergency funding support at a time when fiscal space is already under pressure. The project partially mitigates this risk by strengthening the DPO's financial capacity to manage a crisis. An effective deposit insurance scheme can help prevent bank failures from turning into a full-blown banking crisis, which can be extremely costly.

91. **Technical design and stakeholders (Substantial)**. The main risks here relate to the Government's ability to deliver on PBCs that require actions from agencies (stakeholders) outside the scope of the DPO, including the BOL and MOF. Authorities need to establish early warning systems and strengthen risk-based banking supervision. Furthermore, if the 'problem-bank' resolution framework is not sufficiently established and operational, all losses of a bank failure might be imposed on the DPO. In general, significant progress has been made in updating the primary legal framework, but secondary regulations still need to be issued and made effective. Arrangements for backup funding with the MOF need to be put in place. Risk is mitigated by the BOL's commitment to make progress in these areas, with both the IMF (implementation of risk-based supervision) and World Bank support. For example, with respect to PBC 19 (bank resolution), the BOL has been working closely with the World Bank on updating legal and regulatory framework for the financial sector and World Bank TA related to international best practices on regulations on resolution and prompt corrective actions commenced in late 2019. The DPO's Board of Directors, chaired by the Deputy Governor of the BOL, and including high-level representatives from the Banking Supervision Department, MOF, provides the ideal mechanism to coordinate actions necessary to achieve PBCs, as it includes high-level representatives from each department with responsibilities under the project. Furthermore, the actions required to meet PBCs are consistent with government policy directions and will be supported by World Bank TA (financed by the World Bank).

92. **Institutional capacity for implementation and Fiduciary (Substantial)**. The main operational (implementation) risk is the DPO's lack of experience in implementing World Bank projects and also its absorptive capacity to benefit from TA. This risk is mitigated by the mobilization of consultants to provide project management support and deposit insurance experts to support implementation of actions necessary to achieve



PBCs financed by the project and supported by parallel TA financed by the World Bank. Another mitigating factor is the proposed long implementation period of this project to allow gradual change. Fiduciary risks are also Substantial due to the DPO's lack of experience in implementing World Bank projects and project design has sought to mitigate these risks by providing technical and consultancy support to bolster the DPO's FM and procurement functions.



VII. RESULTS FRAMEWORK AND MONITORING

Results Framework

COUNTRY: Lao People's Democratic Republic
Lao PDR Financial Sector Safety Net Strengthening

Project Development Objectives(s)

To strengthen the financial and institutional capacity of the Deposit Protection Office to fulfill its deposit insurance mandate.

Project Development Objective Indicators

Indicator Name	DLI	Baseline	End Target
Capitalization of Deposit Protection Office Equity Fund			
Adequate financial inflows into the DPO during the course of the project, in order to achieve a funding ratio of at least 1.10% (eligible deposits) (Percentage)	DLI 1	0.51	1.10
Arrangement on back-up funding support in place (Yes/No)	DLI 3	No	Yes
Strengthened Institutional capacity			
DPO empowered to perform its legally-mandated function (deposit payout), as evidenced by progress towards compliance with IADI Core Principles (Text)		Materially Non-Compliant	Partially Compliant
Simulation exercise on deposit insurance claims processing and payment conducted (Yes/No)	DLI 15	No	Yes



Intermediate Results Indicators by Components

Indicator Name	DLI	Baseline	End Target
Capitalization of Deposit Protection Fund			
Regulation on adjusted premium passed (Yes/No)	DLI 2	No	Yes
DPO reserves invested in instruments other than deposits at member institutions (Percentage)	DLI 4	38.00	100.00
Strengthened Institutional capacity			
Sharing of BOL risk information on problematic banks with DPO (Yes/No)	DLI 5	No	Yes
Technical committee constituted to prepare groundwork for Financial Sector Stability Committee (Yes/No)	DLI 6	No	Yes
DPO Corporate Governance Charter and Code of Ethics approved (Yes/No)	DLI 8	No	Yes
Audited financial statements generated from the new accounting system (Yes/No)	DLI 10	No	Yes
Regulation on record keeping of deposits approved and issued (Yes/No)	DLI 13	No	Yes
Regulation on procedures for claiming deposit insurance approved (Yes/No)	DLI 14	No	Yes
Regulation requiring member Institutions to provide standard information on deposit insurance coverage to their clients issued (Yes/No)	DLI 16	No	Yes
Public awareness strategy revised based on survey conducted (Yes/No)	DLI 18	No	Yes
Percentage of complaints handled from Grievance Redress mechanism in place (disaggregated by number/percent of women) (Percentage)		0.00	75.00
Beneficiary satisfaction with public awareness and literacy program about the deposit insurance (disaggregated by number/percent of women) (Percentage)		0.00	75.00



Indicator Name	DLI	Baseline	End Target
Regulations governing problem bank resolution process in place (Yes/No)	DLI 19	No	Yes
Regulations on prompt corrective action and early intervention in place (Yes/No)	DLI 20	No	Yes
Assessment on Compliance with IADI Core Principles on Deposit Insurance completed (Yes/No)	DLI 21	No	Yes
Timely payout of insured deposits in the event of a bank failure (Yes/No)		No	Yes

Monitoring & Evaluation Plan: PDO Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Adequate financial inflows into the DPO during the course of the project, in order to achieve a funding ratio of at least 1.10% (eligible deposits)	This indicator is defined as the ratio of total DPO reserves to the total eligible deposits in member financial institutions. The current target is based on the team’s assumption and analysis in the PAD. During project implementation, to achieve DLI#1, the project will update the methodology for determining the TFR, and	Annual	Reports from DPO	Reports from DPO	DPO



	<p>strategy for achieving it, supported by World Bank technical assistance. As such, the TFR target is expected to be fine-tuned during the course of the project. Any revisions to the target will be documented in Project Operations Manual.</p>				
<p>DPO empowered to perform its legally-mandated function (deposit payout), as evidenced by progress towards compliance with IADI Core Principles</p>	<p>Indicator will measure DPO progress towards complying with IADI core principles. According to the baseline assessment conducted by WB in September 2019, and a scoring system developed by the WB, DPO is materially non-compliant. The scoring system is based on the 16 core principles (and each CP has sub-criteria), in which each CP is assigned a percentage as follows: NA=0% (not applicable), NC=Non-compliant (25%); MNC=50% (materially non-compliant); LC=75%, Largely compliant, C=100%, Compliant. The baseline is 57%, which corresponds to materially Non-Compliant.</p>	<p>Annual</p>	<p>IADI core principle assessment</p>	<p>IADI core principle assessment</p>	<p>DPO</p>



	<p>The target is based on the assumption that DPO achieves all the DLIs, which would correspond to an overall rating of 74%, or Partially Compliant. The World Bank will periodically update the assessment during project implementation.</p>				
<p>Arrangement on back-up funding support in place</p>	<p>This indicator is aligned with DLI 4. Back-up funding facility is critical as a good international practice under IADI Core Principle to ensure liquidity in the event of a crisis. The backup funding arrangement should be clear in terms of procedures and requirements and rapidly disbursing to ensure prompt payment to depositors and prevent undue repercussions to the system of any delays in the ability of DPO to reimburse claims of depositors. Note that estimated amount of the backup facility is not included, as the WB will provide assistance on the methodology to determine</p>	<p>Annual</p>	<p>Annual verification Protocol for DLI</p>	<p>Verification Protocol for DL4</p>	<p>DPO</p>



	appropriate level and size of the back-up fund.				
Simulation exercise on deposit insurance claims processing and payment conducted	DPO will conduct an exercise to simulate the procedures and guidelines it has developed to handle the reimbursement of claims to ensure preparedness in handling their core mandate and to address any gaps and problems that may be encountered during implementation. This shall involve use of actual deposit data of selected bank/banks. The output of the exercise will be a report documenting the results of the exercise, successes and failures, lessons learned, that will inform further enhancements to bolster DPOs capacity to fulfill its deposit insurance mandate.	Annual	Verification Protocol for DLI	Verification Protocol for DLI 15	DPO

Monitoring & Evaluation Plan: Intermediate Results Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Regulation on adjusted premium passed	DPO is reviewing premium rates to adopt a uniform flat	Annual	Annual verification	Verification Protocol for DLI 2	DPO



	rate irrespective of currency of deposit, consistent with the recent consolidation of maximum amount of deposit insurance coverage to 50 Million Kip. DPO has adjusted premium rates in the past and is able to collect premium from members promptly. It is moving to further enhance the premium collection process to minimize delays in the payment of premium and optimize investment income.		Protocol for DLI		
DPO reserves invested in instruments other than deposits at member institutions	This indicator is aligned with DLI 3 which requires that all of the DPO reserves be invested in instruments other than deposits at member institutions. As of end 2018, 38% of DPO reserves have been invested in low risk instruments namely government bonds, central bank bonds and deposits in Bank of Lao	Annual	Annual verification Protocol for DLI	Verification Protocol for DLI 3	DPO
Sharing of BOL risk information on problematic banks with DPO	This indicator is aligned with DLI 5. MOU between BOL and DPO will enable DPO to receive sufficient	Annual	Annual verification Protocol for DLI	Verification Protocol for DLI 5	DPO



	information about risks in the banking system to inform its funding strategy.				
Technical committee constituted to prepare groundwork for Financial Sector Stability Committee	This indicator is aligned with DLI 6. Technical committee on financial stability shall be constituted supported by terms of reference and members from relevant agencies. This committee will prepare groundwork for Financial Sector Stability Committee.	Annual	Annual verification Protocol for DLI	Verification Protocol for DLI 6	DPO
DPO Corporate Governance Charter and Code of Ethics approved	This indicator is aligned with DLI 8-9 which requires a Corporate Governance Charter to be approved by BOL Governor, and a Code of Ethics to be approved by DPO Board.	Annual	Verification Protocol for DLI	Verification Protocol for DLI 8-9	DPO
Audited financial statements generated from the new accounting system	This indicator is aligned with DLIs 10-12. This is to improve DPO accounting and reporting system with an aim to generate financial statements and report from the new accounting system and approved by DPO Board	Annual	Annual verification Protocol for DLI	Verification Protocol for DLI 10-12	DPO
Regulation on record keeping of deposits approved and issued	This indicator is consistent with DLI 13 which requires that Regulation on record keeping of deposits include	Annual	Verification Protocol for DLI	Verification Protocol for DLI 13	DPO



	requirement to prepare deposit data in Single Deposit View (SCV) format be approved by the DPO Board and issued to members				
Regulation on procedures for claiming deposit insurance approved	This indicator is consistent with DLI 14 which requires Regulation that guide the procedure for claiming deposit insurance in the event of payout be approved by the DPO Board	Annual	Verification Protocol for DLI	Verification Protocol	DPO
Regulation requiring member Institutions to provide standard information on deposit insurance coverage to their clients issued	This indicator is aligned with DLI 16 which requires that Regulation requiring member Institutions to provide standard information on deposit insurance coverage to their clients issued by BOL/DPO	Annual	Annual verification Protocol for DLI	Verification Protocol for DLI 16	DPO
Public awareness strategy revised based on survey conducted	This indicator is aligned with DLI 12. Based on survey conducted, DPO Board approves the revised public awareness strategy, acceptable to the WB	Annual	Annual verification Protocol for DLI	Verification Protocol for DLI 12	DPO
Percentage of complaints handled from Grievance Redress mechanism in place (disaggregated by number/percent of women)	Draft Public awareness strategy contains plans for grievance mechanism, including via website and other facilities for grievance	Annual	Report from DPO	monitoring via website and other facilities for grievance and complaints by depositors	DPO



	and complaints by depositors. Indicator will track percentage of registered grievances that are addressed according to agreed procedures. This is the total number of grievance messages received by [website and other facilities], which have been satisfactorily addressed and recorded.				
Beneficiary satisfaction with public awareness and literacy program about the deposit insurance (disaggregated by number/percent of women)	Draft Public awareness strategy envisions conducting evaluations and developing feedback mechanisms to determine if objectives were met and how many depositors and /or members were reached	Annual	Report from DPO	evaluations and feedback mechanisms	DPO
Regulations governing problem bank resolution process in place	This indicator is aligned with DLI 19 which requires Regulations governing problem bank resolution process (incl. on how to resolve banks, early warning system, and prompt corrective action framework) be adopted by the BOL	Annual	Annual verification Protocol for DLI	Verification Protocol for DLI 19	DPO
Regulations on prompt corrective action and early intervention in place	This indicator is aligned with DLI 20 which requires the	Annual	Annual verification	Verification Protocol for DLI 20	DPO



	finalization of regulations on prompt corrective action and early intervention		Protocol for DLI		
Assessment on Compliance with IADI Core Principles on Deposit Insurance completed	This indicator is aligned with DLI 21 which requires the assessment to be conducted by DPO with WB technical assistance during the latter years of the project, and the development of an action plan to address identified gaps.	Annual	Annual verification Protocol for DLI	Verification Protocol for DLI 21	DPO
Timely payout of insured deposits in the event of a bank failure	Indicator will measure DPOs adherence to it's legal obligations to payout out depositors in the event of a bank failure. The timelines are defined by Decree on Deposit Insurance: 1. within 15 days from certification of bankruptcy for bankrupt bank to file proposal to DPO; 2. within 60 days from receipt of proposal by DPO to announce claims process and timeline; 3. within 90 days from announcement for depositors to file claims, may be extended twice, each extension not to exceed 90 days. The indicator will be measured	tbd	Reports from DPO	Reports from DPO	DPO



by DPO and WB.

Disbursement Linked Indicators Matrix

DLI 1	DPO’s Board has approved a Target Fund Ratio methodology and strategy (PBC A.1)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	2.38	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	Yes		2.38	
July 2021 - June 2022	Yes		0.00	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	
DLI 2	BOL Governor has approved regulations on adjusted deposit premiums (PBC A.2)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Intermediate Outcome	No	Yes/No	2.38	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	Yes		2.38	



July 2021 - June 2022	Yes		0.00	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	
DLI 3	DPO has entered into an agreement with MOF acceptable to the Association for back-up funding support (PBC A.3)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Outcome	No	Yes/No	2.38	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	No		0.00	
July 2021 - June 2022	Yes		2.38	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	
DLI 4	DPO has withdrawn all investments and deposits in commercial banks and invested them in government securities and central bank bonds (PBC A.4)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Intermediate Outcome	No	Percentage	2.38	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	38.00			



July 2020 - June 2021	38.00	0.00
July 2021 - June 2022	38.00	0.00
July 2022 - June 2023	100.00	2.38
July 2023 - June 2024	100.00	0.00

DLI 5 DPO and Bank of Lao PDR have signed a memorandum of understanding acceptable to the Association regulating the flow of information between the two entities (PBC B.1)

Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Intermediate Outcome	No	Yes/No	2.38	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	Yes		2.38	
July 2021 - June 2022	Yes		0.00	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	

DLI 6 Bank of Lao PDR has issued an order to constitute a technical committee to prepare groundwork for establishing the Financial Sector Stability Committee (PBC B.2)

Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Intermediate Outcome	No	Yes/No	1.80	0.00
Period	Value		Allocated Amount (USD)	Formula



Baseline	No		
July 2020 - June 2021	No		0.00
July 2021 - June 2022	Yes		1.80
July 2022 - June 2023	Yes		0.00
July 2023 - June 2024	Yes		0.00

DLI 7	Bank of Lao PDR has issued an order to constitute Financial Sector Stability Committee (PBC B.3)		
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Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	0.58	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	No		0.00	
July 2021 - June 2022	No		0.00	
July 2022 - June 2023	No		0.00	
July 2023 - June 2024	Yes		0.58	

DLI 8	BOL Governor has approved its Corporate Governance Charter (PBC C.1)		
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Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Intermediate Outcome	No	Yes/No	1.19	0.00
Period	Value		Allocated Amount (USD)	Formula



Baseline	No		
July 2020 - June 2021	Yes		1.19
July 2021 - June 2022	Yes		0.00
July 2022 - June 2023	Yes		0.00
July 2023 - June 2024	Yes		0.00

DLI 9		BOL Governor has approved its Code of Ethics (PBC C.2)		
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Intermediate Outcome	No	Yes/No	1.19	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	Yes		1.19	
July 2021 - June 2022	Yes		0.00	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	

DLI 10		DPO has implemented an improved accounting and reporting system that includes a chart of accounts (PBC C.3)		
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	0.79	0.00
Period	Value		Allocated Amount (USD)	Formula



Baseline	No		
July 2020 - June 2021	Yes		0.79
July 2021 - June 2022	Yes		0.00
July 2022 - June 2023	Yes		0.00
July 2023 - June 2024	Yes		0.00

DLI 11		DPO has implemented an improved accounting and reporting system that includes the reporting system (PBC C.4)		
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	0.79	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	Yes		0.79	
July 2021 - June 2022	Yes		0.00	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	

DLI 12		DPO has implemented an improved accounting and reporting system that includes IT system (PBC C.5)		
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	0.79	0.00
Period	Value		Allocated Amount (USD)	Formula



Baseline	No			
July 2020 - June 2021	No		0.00	
July 2021 - June 2022	Yes		0.79	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	
DLI 13	DPO Board has approved and issued to its members regulations acceptable to the Association on record keeping of deposits including requirement to prepare deposit data in SCV format (PBC D.1)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	2.38	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	No		0.00	
July 2021 - June 2022	Yes		2.38	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	



DLI 14	DPO Board has approved regulations acceptable to the Association on procedures for claiming deposit insurance in the event of payout (PBC D.2)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	2.38	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	Yes		2.38	
July 2021 - June 2022	Yes		0.00	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	
DLI 15	DPO has conducted a simulation exercise on deposit insurance claims processing and payment (PBC D.3)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Outcome	No	Yes/No	2.38	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	No		0.00	
July 2021 - June 2022	Yes		2.38	
July 2022 - June 2023	Yes		0.00	



July 2023 - June 2024	Yes		0.00	
DLI 16	BOL&DPO have each issued regulations acceptable to the Assoc. requiring their respective member institutions to provide standard information on deposit insurance coverage to their clients (PBC E.1)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	0.79	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	Yes		0.79	
July 2021 - June 2022	Yes		0.00	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	
DLI 17	DPO Board has approved a Public Awareness Strategy on deposit insurance (PBC E.2)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	0.79	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	No		0.00	
July 2021 - June 2022	Yes		0.79	



July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	
DLI 18	DPO Board has approved the public awareness strategy revised based on survey conducted to the public (PBC E.3)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	0.79	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	No		0.00	
July 2021 - June 2022	No		0.00	
July 2022 - June 2023	Yes		0.79	
July 2023 - June 2024	Yes		0.00	
DLI 19	BOL Governor has approved regulations acceptable to the Association governing problem bank resolution process framework (PBC F.1)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	1.19	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	Yes		1.19	



July 2021 - June 2022	Yes		0.00	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	
DLI 20	BOL Governor has approved regulations acceptable to the Association on prompt corrective action and early intervention in place (PBC F.2)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Output	No	Yes/No	1.19	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			
July 2020 - June 2021	No		0.00	
July 2021 - June 2022	Yes		1.19	
July 2022 - June 2023	Yes		0.00	
July 2023 - June 2024	Yes		0.00	
DLI 21	DPO has completed a self assessment on the extent of compliance with IADI Core Principles on Deposit Insurance and identified gaps and actions for achieving full compliance (PBC F.3)			
Type of DLI	Scalability	Unit of Measure	Total Allocated Amount (USD)	As % of Total Financing Amount
Outcome	No	Yes/No	2.38	0.00
Period	Value		Allocated Amount (USD)	Formula
Baseline	No			



July 2020 - June 2021	No	0.00
July 2021 - June 2022	No	0.00
July 2022 - June 2023	No	0.00
July 2023 - June 2024	Yes	2.38

Verification Protocol Table: Disbursement Linked Indicators

DLI 1	DPO’s Board has approved a Target Fund Ratio methodology and strategy (PBC A.1)
Description	Target fund ratio is defined as the ratio of total DPO reserves to the total insured deposits in member financial institutions. The project will support DPO to move towards a more robust methodology to determine the TFR, which tests the adequacy and sustainability of the fund against potential claims over the medium and long term. The project will develop a framework to ensure the sustainability of the fund which incorporates triggers for increases in premiums, requests for equity and triggers to borrow funds or tap into back-up funding, while at the same time determining appropriate premium rates, and other fund inflows necessary to achieve that target.
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from the Deposit Protection Office confirming that Target Fund Ratio Strategy has been approved by DPO Board, with a copy of the relevant decision and strategy attached.
DLI 2	BOL Governor has approved regulations on adjusted deposit premiums (PBC A.2)
Description	DPO is reviewing premium rates to adopt a uniform flat rate irrespective of currency of deposit, consistent with the recent consolidation of maximum amount of deposit insurance coverage to 50 Million Kip. DPO has adjusted premium rates in the past and is able to collect premium from members promptly. It is moving to further enhance the premium collection



	process to minimize delays in the payment of premium and optimize investment income.
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from the Deposit Protection Office confirming BOL Governor approval of adjusted premium, with a copy of the relevant decision attached.
DLI 3	DPO has entered into an agreement with MOF acceptable to the Association for back-up funding support (PBC A.3)
Description	Back-up funding facility is critical as a good international practice under IADI Core Principle to ensure liquidity in the event of a crisis. The backup funding arrangement should be clear in terms of procedures and requirements and rapidly disbursing to ensure prompt payment to depositors and prevent undue repercussions to the system of any delays in the ability of DPO to reimburse claims of depositors. Note that estimated amount of is not included as the WB will provide assistance on the methodology to determine appropriate level and size of the back-up fund.
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from DPO on its back up funding facility to be provided by MOF, approved by the Board and supported by letter of commitment from MOF - /funding sources.
DLI 4	DPO has withdrawn all investments and deposits in commercial banks and invested them in government securities and central bank bonds (PBC A.4)
Description	DPO is gradually withdrawing investments in commercial banks, consistent with the provisions of the Decree and IADI Core principles, and investing in risk-free (government) investment instruments. DPO Board is constituting a Board Committee to oversee the formulation and implementation of an investment strategy, ensure that adequate controls are in place, and that there is transparency and full disclosure on the financial position of DPO.
Data source/ Agency	BOL/DPO
Verification Entity	WB



Procedure	Official letter from DPO certifying that all investments and deposits in commercial banks have been withdrawn and invested in government securities and central bank bonds, supported by letter from BOL Governor confirming the status of investments of DPO. (to be verified by WB External auditor)
DLI 5	DPO and Bank of Lao PDR have signed a memorandum of understanding acceptable to the Association regulating the flow of information between the two entities (PBC B.1)
Description	The MOU is intended to formalize the arrangements on information sharing (data to be shared, timing and process of accessing the data), and coordination between BoL and DPO, which are very critical in the ability of DPO to perform its mandate.
Data source/ Agency	DPO/BOL
Verification Entity	WB
Procedure	Copy of signed MOU between DPO and BOL, acceptable to the WB.
DLI 6	Bank of Lao PDR has issued an order to constitute a technical committee to prepare groundwork for establishing the Financial Sector Stability Committee (PBC B.2)
Description	The DLI involves establishing a technical committee to prepare the groundwork for the Financial Stability Committee which will happen at a later stage. With technical support from the WB, technical committee will prepare the terms of reference and monitoring framework of key economic and financial variables and how to determine impact of significant movements in variables on the financial system. They will also prepare crisis management and contingency plan to prepare for any eventuality.
Data source/ Agency	DPO/BOL
Verification Entity	WB
Procedure	DPO letter furnishing WB of the BOL order or directive constituting Technical Committee supported by terms of reference and members



DLI 7	Bank of Lao PDR has issued an order to constitute Financial Sector Stability Committee (PBC B.3)
Description	Establishment of Financial Sector Stability Committee
Data source/ Agency	BOL/DPO
Verification Entity	WB
Procedure	DPO letter furnishing WB of the BOL order or directive constituting Financial Sector Stability Committee supported by terms of reference and members.
DLI 8	BOL Governor has approved its Corporate Governance Charter (PBC C.1)
Description	DPO corporate governance charter will stipulate rules to govern how to handle DPO operations, frequency of meetings, ethical standards, how to address conflict of interests, fit and proper rules for engagement of staff and board members, and audit processes.
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from the Deposit Protection Office on BOL Governor approval of Corporate Governance Charter, together with copies of relevant documents, acceptable to the WB
DLI 9	BOL Governor has approved its Code of Ethics (PBC C.2)
Description	The Code of Ethics will govern decisions and behavior on professional conduct and principles to be observed by the DPO Board, Management and staff.
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from the Deposit Protection Office on BOL Board approved Code of Ethics, together with copies of relevant documents, acceptable to the WB.



DLI 10	DPO has implemented an improved accounting and reporting system that includes a chart of accounts (PBC C.3)
Description	This is to improve DPO accounting system with an aim to generate financial statements and report from the new accounting system and approved by DPO Board
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Letter from BOL Governor that new accounting system has been implemented and that Audited financial statements have been generated from the new accounting system.
DLI 11	DPO has implemented an improved accounting and reporting system that includes the reporting system (PBC C.4)
Description	This is to improve DPO accounting and reporting system with an aim to generate financial statements and report from the new accounting system and approved by DPO Board
Data source/ Agency	BOL/DPO
Verification Entity	WB
Procedure	Letter from BOL Governor that new accounting system has been implemented and that Audited financial statements have been generated from the new accounting system.
DLI 12	DPO has implemented an improved accounting and reporting system that includes IT system (PBC C.5)
Description	This is to improve DPO accounting and reporting system with an aim to generate financial statements and report from the new accounting system and approved by DPO Board
Data source/ Agency	BOL/DPO
Verification Entity	WB
Procedure	Letter from BOL Governor that new accounting system has been implemented and that Audited financial statements have been generated from the new accounting system.



DLI 13	DPO Board has approved and issued to its members regulations acceptable to the Association on record keeping of deposits including requirement to prepare deposit data in SCV format (PBC D.1)
Description	Regulation on record keeping of deposits approved and issued
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from DPO furnishing WB a copy of the Board approved regulation and notification to members
DLI 14	DPO Board has approved regulations acceptable to the Association on procedures for claiming deposit insurance in the event of payout (PBC D.2)
Description	Regulation on procedures for claiming deposit insurance approved
Data source/ Agency	BOL/DPO
Verification Entity	WB
Procedure	Regulation on procedures for claiming deposit insurance in the event of payout has been signed by the DPO Board.
DLI 15	DPO has conducted a simulation exercise on deposit insurance claims processing and payment (PBC D.3)
Description	The Implementing Agency has conducted a simulation exercise on deposit insurance claims processing and payment.
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from DPO reporting conduct of simulation exercise and results.
DLI 16	BOL&DPO have each issued regulations acceptable to the Assoc. requiring their respective member institutions to provide standard information on deposit insurance coverage to their clients (PBC E.1)
Description	BOL/DPO have issued regulations requiring member Institutions to provide standard information on deposit insurance coverage to their clients. The regulations will require member institutions to incorporate information necessary to address



	gender specific needs as determined by DPO.
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from DPO furnishing WB of copy of regulation and report on compliance by members.
DLI 17	DPO Board has approved a Public Awareness Strategy on deposit insurance (PBC E.2)
Description	The public awareness strategy describes the public information campaign on deposit insurance. This covers basic information that the public should be made aware of and which have not been communicated to members and the depositing public, such as membership of the bank with DPO, amount of deposits insured, excluded and included deposits. The public awareness strategy shall take into account needs of different groups such gender, literacy, language and others.
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from DPO on Board approval of Public Awareness Strategy, acceptable to WB. The approved public awareness strategy shall take into account needs of different groups such as gender, literacy, language and others.
DLI 18	DPO Board has approved the public awareness strategy revised based on survey conducted to the public (PBC E.3)
Description	DPO will conduct a public awareness survey to enable it to revise its Public Awareness Strategy, to make it more targeted and expand its reach to more depositors. It will also allow DPO to craft a more responsive and cost-effective campaign, prepare budget for its information campaign and measure how effective the campaigns are.
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from DPO informing WB of the Board approval of Revised Public Awareness Strategy based on survey conducted,supported by copy of the approved strategy, acceptable to the WB. The baseline public awareness survey should include qualitative and quantitative data on female and male depositor’s knowledge, norms and practices with particular focus on poor and ethnic women (with low literacy) across a variety of urban/rural geographical locations.



DLI 19	BOL Governor has approved regulations acceptable to the Association governing problem bank resolution process framework (PBC F.1)
Description	The law on Commercial Banking, which was recently signed, provides for early intervention measures and resolution of commercial banks in crisis, including the designation of a Committee to handle the resolution process. The law also provides for the authority of the BOL to take control of the bank subject of resolution or rehabilitation. This PBC supports the preparation of the implementing guidelines to ensure an orderly resolution and rehabilitation process and avoid any legal complications.
Data source/ Agency	BOL
Verification Entity	WB
Procedure	Official letter from DPO informing the WB of BOL Governor approval of the Regulations governing problem bank resolution process framework, acceptable to the WB.
DLI 20	BOL Governor has approved regulations acceptable to the Association on prompt corrective action and early intervention in place (PBC F.2)
Description	The law on Commercial Banking, which was recently signed, provides BOL authority to enforce early intervention measures (prompt corrective actions) and resolution of commercial banks in crisis, including the designation of a Committee to handle the resolution process. There is a need to prepare the implementing guidelines to ensure an orderly resolution and rehabilitation process and avoid any legal complications.
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from DPO informing the WB of BOL Governor approval of the Regulations governing prompt corrective action and early intervention, acceptable to the WB.



DLI 21	DPO has completed a self assessment on the extent of compliance with IADI Core Principles on Deposit Insurance and identified gaps and actions for achieving full compliance (PBC F.3)
Description	This is an assessment on Compliance with IADI Core Principles on Deposit Insurance to be carried out by DPO, with World Bank technical assistance, toward to latter years of the project.
Data source/ Agency	DPO
Verification Entity	WB
Procedure	Official letter from DPO of completion of assessment and results of assessment, and action plan to identify gaps.



ANNEX 1: Implementation Arrangements and Support Plan

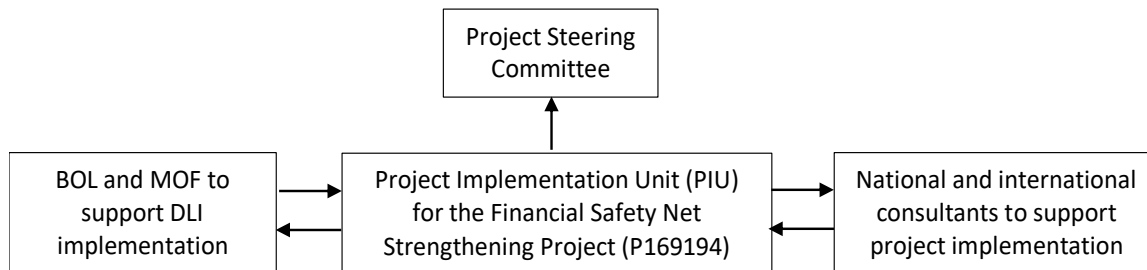
COUNTRY: Lao People's Democratic Republic
Lao PDR Financial Sector Safety Net Strengthening

Project Institutional and Implementation Arrangements

- 1. The DPO will serve as the project implementing entity for both Components 1 and 2.** The Project Steering Committee (PSC), chaired by the Deputy Governor of the BOL (or designee), will guide and oversee the overall implementation of the Financial Sector Safety Net Strengthening Project (FSNP). Membership of the PSC consists of representatives from all line departments involved in projects overseen by the PSC. The committee will meet every 12 months but will review and endorse work plans for implementation of this project every 6 months following recommendation by the Project Implementation Unit (PIU) for this project.
- 2. Project implementation is delegated to the PIU in the DPO under the oversight of the PSC.** The PIU will be the central agency responsible for overall project implementation monitoring, fiduciary oversight, and working closely with the BOL and MOF on the implementation of the PBCs. Component 1 has disbursements against number of PBCs, and Component 2 involves a small number of consulting contracts. Thus, the principal activities for the PIU will comprise (a) verifying PBCs achievement for disbursement, (b) reporting on the World Bank advances that result in the financing of the Deposit Protection Office Equity Fund, (c) managing TA procurement, and (d) liaising with and reporting to the Government and with the World Bank on project progress. The PIU will also be responsible for preparing the work plans for PSC review and endorsement.
- 3. The PIU will consist of a team of government staff, local consultants, and international advisers.** The DPO does not have any prior experience with implementing World Bank projects, and will need to designate a small team of relevant staff (among others, a program coordinator, procurement specialist, FM specialist, communication consultant, and a deposit insurance adviser), led by a project coordinator, to ensure the project is properly implemented in accordance with the World Bank's fiduciary rules.
- 4. The BOL and the MOF will be important stakeholders.** Both of these entities, in addition to the DPO, play a critical role in the financial safety net. Therefore, the project design and implementation will require buy-in and close cooperation from both the BOL and MOF to ensure that the PDO is achieved.



Figure 1.1. Overview Implementation Arrangements



Financial Management

5. Main FM risks identified which could have an impact on the achievement of the PDO are limited personnel and lack of experience in implementing ODA projects. English language skill is also limited and there is a lack of consolidated and adequate FM policies and procedures. Limited capacity and lack of experience and guidance is likely to increase risks of noncompliance and lead to delays in submitting consolidated financial and audit reports, unsatisfactory accounting records, and misuse of funds. Hence, FM risk at this stage is considered Substantial. Risk mitigation measures include (a) providing technical and consultant support to the Accounting and Fund Management Division to enable them to implement and maintain satisfactory FM arrangements for the project; DPO staff shall also be assigned to work with the consultant to gain experience and sustain capacity within the DPO; (b) having an acceptable FM Manual in place; and (c) paving the way for an annual audit by independent and qualified auditors to provide assurances that FM policies, procedures, and requirement for use of funds, including PBC payments, are complied with. Audit terms of reference will be approved by the World Bank. The World Bank team will carry out implementation support missions twice a year.

6. **Staffing.** There are only two technical staff in the accounting subsection of the Accounting and Fund Management Division. Due to limited staff capacity at the Accounting and Fund Management Division and lack of experience in managing ODA projects, FM and disbursement work of the project will be supported by a local qualified and experienced consultant. Consultant terms of reference will be agreed with the World Bank. There is no consolidated FM policy and procedure in place. Hence, a full FM Manual describing applicable policies, procedures and arrangement for project FM and disbursement aspects will be needed to guide staff and consultant involved in the implementation of the project. The FM Manual will require ‘no-objection’ from the World Bank. Assigned DPO staff and consultant will be trained in the World Bank’s disbursement procedures and other FM requirements before the first disbursement.

7. **Planning and budgeting.** For project purposes, the annual project budget will be prepared according to the annual work plan for Component 2. Both the annual work plan and budget will be submitted for ‘no-objection’ by the World Bank. Details of budgeting processes and the time line for processing and revision will be agreed and documented in the FM Manual.

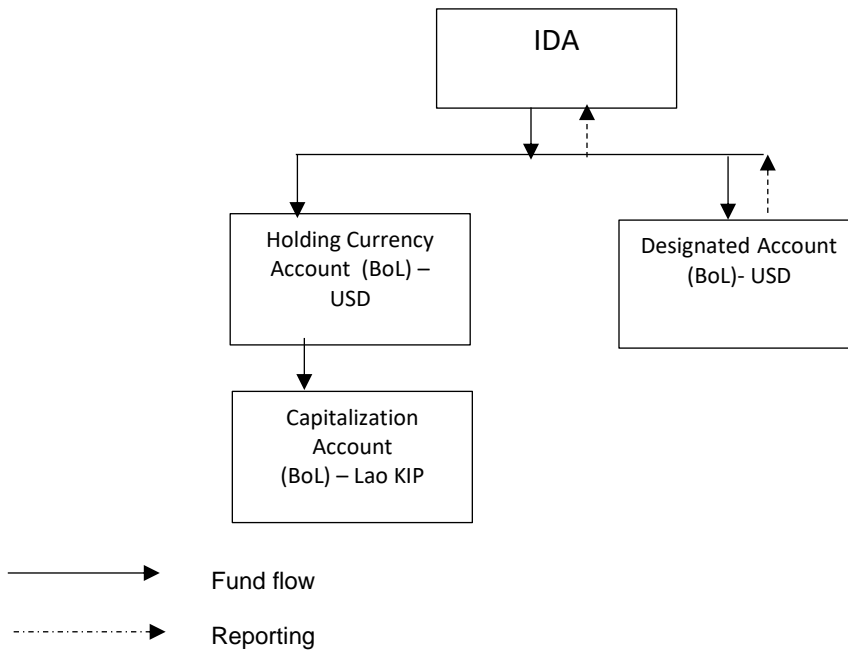
8. **Funds flow.** PBC payments (under Component 1) will flow from the Credit account to a Holding Currency Account opened at the Bank of Lao, denominated in USD. Upon receipt, the fund will be converted to KIP Lao and transferred immediately to the Capitalization Account opened at the Bank of Lao, denominated in Lao Kip. Funds for implementation of Component 2 will flow from IDA to a designated account denominated in USD opened at



the Bank of Lao PDR. DPO may open an Operating Account denominated in USD at a commercial bank to facilitate small day to day payments.

9. Figure 1.2 depicts the funds flow.

Figure 1.2. Funds Flow



10. **Accounting.** Cash basis of accounting will be used. The project will use accounting policy generally accepted for donor-financed projects. The project’s accounting policies and procedures will be detailed in the FM Manual. The project will use the current accounting software (Bank 2000) used by the DPO to record project transactions.

11. **Financial reporting.** For financial reporting purposes, the project will report on receipts, expenditure, and fund balances. The project will follow the Government’s fiscal year—January to December. The interim unaudited financial report (IFR) will be prepared every six months and submitted to the World Bank no later than 45 days after the semester ends. The form and contents of the IFR will be agreed with the World Bank.

12. **Audit.** The project financial statements will be audited annually by independent qualified auditors with terms of reference acceptable to the World Bank. An entity audit report will also be required. The auditors will confirm if PBC payments were only used for the purpose allowed. Both audit reports and Management Letters are to be submitted to the World Bank no later than six months after the end of each fiscal year. The project audit report will be subject to public disclosure as per the World Bank’s Policy on Access to Information. The DPO shall disclose the audit report on its website.



Disbursement Arrangements

Component 1.

13. PBC Payments will only be made upon submission of supporting documentation satisfactory to the Bank confirming the achievement of respective PBC or PBCs. PBC payment is valued in SDR, disbursed in USD into a Holding Currency Account, and immediately transferred to the Capitalization account in Lao Kip.

14. The PIU will be responsible for preparation and submission of customized eligible expenditure tables (the format will be attached to the Disbursement and Financial Information Letter - DFIL), together with the evidence of achievement of the PBCs. The eligible expenditure will be represented by the IDA funds transferred to capitalize the Deposit Protection Office Equity Fund. Verification of achievement of all PBCs will be done by the Bank.

15. **Component 2 - input based.** A Designated Account denominated in U.S. dollars will be opened at the BOL. Advance to the Designated Account will be based on approved 6 months expenditure forecast. Direct Payment and Reimbursement will also be used. Reporting of expenditure paid from the Designated Account will be done quarterly based on the Statement of Expenditure. Minimum application value for Direct Payment and Special Commitment will be US\$100,000 or equivalent. **An amount not exceeding US\$100,000 may be made for payments that incurred on or after February 25, 2020.**

16. Disbursement will be made against the following categories as in table 1.1.

Table 1.1. Disbursement Categories

Category	Amount of Credit Allocated (SDR)	Percentage of Expenditures to Be Financed (inclusive of Taxes)
(1) Eligible expenditure programs under Component 1	24,200,000	100
(2) Goods, non-consulting services, consulting services, and training and operating costs under Component 2	1,300,000	100
TOTAL AMOUNT	25,500,000	

17. Operating cost means reasonable costs required for the day-to-day coordination, administration, operation, and supervision of project activities, including leasing and/or routine repair and maintenance of equipment; facilities and office premises; fuel, office supplies, and consumables; communication expenses (including postage, telephone and Internet costs); translation, printing, and photocopying expenses; bank charges, publications, and advertising expenses; travel insurance; project-related meeting expenses; project-related travel, subsistence, and lodging expenses; and other administrative costs directly related to the project but excluding consulting fees and salaries, bonuses, fees, and honoraria or equivalent payments of members of the recipient’s civil service.

18. The project will have a disbursement deadline date (final date on which IDA will accept applications for withdrawal from the recipient or documentation on the use of credit proceeds already advanced by IDA) of four months after the closing date of the project. Expenditures incurred between the closing date and the



disbursement deadline date are not eligible for disbursement. All documentation for expenditure forwarded to IDA for disbursements will be retained and be made available to the external auditors for their annual audit and to IDA and its representatives if requested. If the auditors or the IDA implementation support missions find that disbursements made were not justified by the supporting documentation or are ineligible, IDA may, at its discretion, require the borrower to (a) refund an equivalent amount to IDA or (b) exceptionally, provide substitute documentation evidencing other eligible expenditures.

Procurement

19. **Institutional arrangements for procurement.** The procurement activities for the project will be carried out by the procurement unit of the DPO with the support of an individual procurement consultant.

20. Procurement under national procurement procedures as agreed with the World Bank will be carried out in accordance with national regulations including Law on State Budget Procurement No. 30/NA, dated November 2, 2017; Guidelines on the Implementation of the Law on State Budget Procurement No. 0477/MOF, dated February 13, 2019; harmonized bidding documents and request for quotations for procurement of works, goods, and non-consulting services agreed with the World Bank. For the international market approach, the World Bank's Standard Procurement Documents shall be used, and for national market approach, the Harmonized Bidding Documents and Request for Quotations will be used.

21. The POM will elaborate the details of procurement arrangements, including responsibility of DPO, and procurement risk mitigation action plan. It refers to (a) the World Bank Procurement Regulations for IPF Borrowers (July 2016 and revised November 2017 and revised August 2018) applicable to this project, (b) the PPSD and Procurement Plan, and (c) national regulation.

22. **Procurement Plan.** Based on the PPSD, the first 18 months Procurement Plan for the project have been jointly prepared by the DPO, and agreed with the World Bank, and is attached as an annex to this Project Appraisal Document.

23. **Use of STEP.** STEP, which is a web-based tool for procurement planning and tracking, streamlining and automation, and monitoring and reporting, is applicable to this project.

24. **World Bank's review and implementation support.** The procurement supervision will be part of the semiannual project implementation support mission and procurement clinics/consultation will be provided based on need. In addition to the prior review by the World Bank based on the prior thresholds, which are subject to change according to the result of risk assessment carried out during the project implementation, the World Bank will carry out the annual procurement ex post review on a sample of at least 20 percent of all post review contracts financed by the project. STEP will help the World Bank to monitor the procurement progress and to take appropriate supportive actions in due course.

Environmental and Social (including safeguards)

Monitoring and Evaluation

25. **Section VII lists the main outcome indicators for the project and the principal results, and table 3 lists the PBCs and the verification protocols.** The PBCs are not scalable. These will serve as the basis for the results



monitoring and evaluation framework. The DPO will be responsible for collecting the data required for monitoring and evaluation and for verification of the PBCs based on protocols outlined in section VII. The World Bank supervision team will be responsible for verifying achievement of PBCs, as opposed to an external auditor, owing to the technical nature of the PBCs. Indicators will be measured against agreed targets and compared to defined baselines. Project progress reports will be prepared by the DPO on a quarterly basis and submitted for World Bank review. These reports will include interim unaudited financial statements.

Strategy and Approach for Implementation Support

26. The Implementation support strategy addresses the design and implementation requirements of the project, including the implementation of the risk mitigation measures and lessons learned from similar projects in the region/across the world. Key risks identified for this project include the operational risk stemming from institutional capacity to implement the project, fiduciary risks, and from the fact that a number of PBCs depend fully or partially on the actions by parties other than the DPO, stakeholder coordination, and technical design. The implementation support strategy for mitigating the risks is addressed in the following paragraphs.

27. The operational risks relate to the DPO's ability to achieve the proposed PBCs. This risk is mitigated by the fact that the PBCs are fully consistent with the current plan and policy intentions of the DPO and supported by the BOL and MOF. Besides Component 2 Institutional Capacity Building for DPO and Project Management, the World Bank team will provide technical support to DPO through the Bank-executed Trust Fund, financed by the Government of Republic of Korea. The support includes the PBCs #19–20 related to the BOL on bank resolution and prompt corrective actions.

28. As the PIU has no experience in implementing World Bank projects, increased World Bank support will be required. During the initial phase, the DPO will be supported by a project coordinator consultant, in addition to the procurement specialist to support the DPO on the recruitment of key staff for the PIU setup. The project foresees implementation support through the employment of national consultants and an advisor. Review of the performance of the experts hired under the project will be part of the implementation support missions and midterm review. Similarly, FM training and support will be provided to the PIU to support the setup of the required FM functions.

29. The task team leader (TTL) will also continually validate that the project objectives, project design, economic justification, and key performance indicators for the project are still relevant to the higher objectives to which the project contributes, primarily through the implementation support arrangements. Semiannual implementation support missions per year are expected to take place, in addition to technical support missions and continuous support provided by the Vientiane-based task team.

Implementation Support Plan and Resource Requirements

30. **Procurement.** Implementation support will include (a) prior review of select procurement documents, (b) at least twice a year conduct of ex post reviews, (c) training procurement staff and providing detailed guidance on the World Bank's Procurement Guidelines, and (d) monitoring of procurement progress in relation to the detailed Procurement Plan.

31. **FM.** For Component 1, FM supervision will be conducted through (a) verification of financing after each advance and (b) review of annual audits of the Designated Account. For Component 2, the supervision will be



conducted through (a) review of audited project financial statements and auditor’s Management Letter, (b) on-site supervision with the frequency based on the assessed project’s risk and performance, and (c) review of the project’s FM and disbursement arrangements to ensure compliance with the World Bank’s minimum requirements. Implementation support and supervision will be performed by the World Bank’s accredited FM specialist.

32. **Technical advice.** TA will be provided to the DPO, BOL, and MOF on the PBCs using the Bank-executed Trust Fund, financed by the Government of Republic of Korea.

33. **Project management.** Advice on the overall management and supervision of the project will be provided to ensure technical soundness and consistency, transparency and good governance, inclusiveness, and compliance with relevant guidelines and procedures.

34. The core task team supporting the project will be sourced from World Bank offices in Washington DC, Lao PDR, and other countries in East Asia and Pacific. The team will be supported by experts and consultants. The number of staff weeks envisioned is as provided in table 1.2.

Table 1.2. Implementation Support Plan

Time	Focus	Skills Needed	Resource Estimate/Year
First 12 months	Project Implementation Support	Financial sector specialist (TTL)	12 weeks (US\$50,000)
		FM specialist	2 weeks (US\$5,000)
		Procurement specialist,	2 weeks (US\$5,000)
		Environmental and social safeguard specialist	2 weeks (US\$5,000)
		Deposit insurance expert	12 weeks (US\$60,000)
		Financial sector legal and regulatory experts	5 weeks (US\$32,000)
12–54 months	Project Implementation Support	Financial sector specialist (TTL)	36 weeks (US\$125,000)
		FM specialist	6 weeks (US\$30,000)
		Procurement specialist	4 weeks (US\$20,000)
		Environmental and social safeguard specialist	4 weeks (US\$5,000)
		Deposit insurance expert	40 weeks (US\$200,000)
		Financial sector legal and regulatory experts	15 weeks (US\$66,000)

ANNEX 2: PROCUREMENT PLAN

COUNTRY: Lao People's Democratic Republic
Lao PDR Financial Sector Safety Net Strengthening

Country: Lao People’s Democratic Republic

Full Project Name: Financial Sector Safety Net Strengthening (FSNP)



Project Number: P169194

Project Implementation agency: Deposit Office Protection (DPO)

Date of the Procurement Plan: 15 November 2019

Period covered by this Procurement Plan: 15 November 2019 to 15 May 2021

Preamble

In accordance with paragraph 5.9 of the “World Bank Procurement Regulations for IPF Borrowers” (July 2016) (“Procurement Regulations”) the Bank’s Systematic Tracking and Exchanges in Procurement (STEP) system will be used to prepare, clear and update Procurement Plans and conduct all procurement transactions for the Project.

This textual part along with the Procurement Plan tables in STEP constitute the Procurement Plan for the Project. The following conditions apply to all procurement activities in the Procurement Plan. The other elements of the Procurement Plan as required under paragraph 4.4 of the Procurement Regulations are set forth in STEP.

The Bank’s Standard Procurement Documents: shall be used for all contracts subject to international competitive procurement and those contracts as specified in the Procurement Plan tables in STEP.

National Procurement Arrangements: In accordance with paragraph 5.3 of the Procurement Regulations, when approaching the national market (as specified in the Procurement Plan tables in STEP), the country’s own procurement procedures may be used.

When the Borrower uses its own national open competitive procurement arrangements as set forth in Procurement Decree No. 03, dated January 9, 2004; Implementation Rule and Regulations (IRR) No. 0063 issued by the MOF on March 12, 2004, and No. 0861/MOF, dated May 5, 2009 (amended version); and the Procurement Manual dated May 2009, such arrangements shall be subject to paragraph 5.4 of the Procurement Regulations and the following conditions.

1. The request for bids/request for proposals document shall require that bidders/proposers submitting bids/proposals present a signed acceptance at the time of bidding, to be incorporated in any resulting contracts, confirming application of, and compliance with, Bank Anti-Corruption Guidelines, including without limitation the Bank’s right to sanction and the Bank’s inspection and audit rights;
2. Information related to award of contract including reasons for rejection of unsuccessful bidders shall be published on the implementing agency websites and/or newspaper of wide circulation.
3. All complaints on procurement related matters including complaints arising from procurement under Bank financed Projects whilst using National Procurement Procedures shall be dealt with in accordance with Article 33 of the Procurement Decree. Borrower shall put in place an effective complaint review mechanism for dealing with procurement related complaints and shall disclose the details in all the bidding documents. All complaints shall be recorded by the Borrower in the appropriate tracking and monitoring system, as agreed between the Bank and the Borrower.



4. When other national procurement arrangements other than national open competitive procurement arrangements are applied by the Borrower, such arrangements shall be subject to paragraph 5.5 of the Procurement Regulations.
5. Leased Assets as specified under paragraph 5.10 of the Procurement Regulations: Leasing may be used for those contracts identified in the Procurement Plan tables. “Not Applicable”
6. Procurement of Second-Hand Goods as specified under paragraph 5.11 of the Procurement Regulations – is allowed for those contracts identified in the Procurement Plan tables “Not Applicable”
7. Domestic preference as specified under paragraph 5.51 of the Procurement Regulations (Goods and Works). “Not Applicable”

Other Relevant Procurement Information

It is important to note that the IA for this project has no procurement capacity and in the implementation of procurement activities under donor-financed project. The IA will need the support of one national procurement consultant to assist the procurement work. IA will carry out procurement activities financed under the project themselves with the support of a national procurement consultant



The procurement approach and methods of each package is shown in this table.

Reference No.	Contract Title, Description, and Category	Estimated Cost (US\$)	Packages	Prior Bank Oversight	Procurement Approach/ Competition	Selection Methods	Evaluation Method	Planned Contract Start Date	Comment
Component 2. Institutional strengthening and Project management		750,000							
Activity A: Institutional strengthening		450,000							
Consultant Services		450,000							
DPO-CS-1	Public awareness surveys	150,000	1	Post	Open National	CQS	Lowest Evaluated	August 2020	Lump Sum
DPO-CS-2	Communication specialist	50,000	1	Post	Open National	IC	Individual	June 2020	24 months contract over 4 years
DPO-CS-03	International Deposit Insurance advisor	250,000	1	Prior	Open International	IC	Individual	June 2020	12 months contract over 2.5 years
Activity B: Project management		300,000							
Consultant Services		300,000							
DPO-CS-04	National Procurement consultant	30,000	1	Post	Open National	IC	Individual	April 2020	1 year contract
DPO-CS-05	National Financial Management consultant	125,000	1	Post	Open National	IC	Individual	April 2020	4 years contract
DPO-CS-06	National Project Coordinator Consultant	100,000	1	Post	Open National	IC	Individual	August 2020	4 years contract
DPO-CS-07	Audit Firm	45,000	1	Post	Open National	LCS	Lowest Evaluated	December 2020	5 years contract

Note: CQS = Selection Based on Consultants' Qualification; IC = Individual Consultant; LCS = Least-Cost Selection;



ANNEX 3: PERFORMANCE-BASED CONDITIONS UNDER THE PROJECT

COUNTRY: Lao People's Democratic Republic
Lao PDR Financial Sector Safety Net Strengthening

PBCs	Year 1	Year 2	Year 3	Year 4
PBC A: Strengthen financial capacity of DPO	<p>PBC #A.1 DPO’s Board has approved a Target Fund Ratio methodology and strategy</p> <p>PBC Value SDR 1.730 million (mn)</p> <p>PBC #A.2 BOL Governor has approved regulations on adjusted deposit premiums</p> <p>PBC Value: SDR 1.730 mn</p>	<p>PBC #A.3 DPO has entered into an agreement with MOF acceptable to the Association for back-up funding support</p> <p>PBC Value: SDR 1.730 mn</p>	<p>PBC# A.4 DPO has withdrawn all investments and deposits in commercial banks and invested them in government securities and central bank bonds</p> <p>PBC Value: SDR 1.730 mn</p>	
	PBC Value: SDR 3.46 mn	PBC Value: SDR 1.730 mn	PBC Value: SDR 1.730 mn	
PBC B. Enhance coordination between DPO and other financial safety net institutions	<p>PBC #B.1 DPO and Bank of Lao PDR have signed a memorandum of understanding acceptable to the Association regulating the flow of information between the two entities</p> <p>PBC Value SDR 1.730 mn</p>	<p>PBC #B.2 Bank of Lao PDR has issued an order to constitute a technical committee to prepare groundwork for establishing the Financial Sector Stability Committee</p> <p>PBC Value: SDR 1.31 mn</p>		<p>PBC #B.3 Bank of Lao PDR has issued an order to constitute Financial Sector Stability Committee</p> <p>PBC Value: SDR 0.42 mn</p>



	PBC Value: SDR1.730 mn	PBC Value: SDR 1.310 mn		PBC Value: SDR 0.42 mn
PBC C. Improve governance of DPO	<p>PBC #C.1 BOL Governor has approved its corporate governance charter</p> <p>PBC Value: SDR 0.87 mn</p> <p>PBC #C. 2 DPO Board has approved its corporate code of ethics</p> <p>PBC Value: SDR 0.87 mn</p> <p>PBC #C.3 DPO has implemented an improved accounting and reporting system that includes chart of accounts</p> <p>PBC Value: SDR 0.58 mn</p> <p>PBC #C.4 DPO has implemented an improved accounting and reporting system that includes a reporting system</p> <p>PBC Value: SDR 0.574 mn</p>	<p>PBC #C.5 DPO has implemented an improved accounting and reporting system that includes an IT system</p> <p>PBC Value: SDR 0.574 mn</p>		
	PBC Value: SDR 2.894 mn	PBC Value: SDR 0.574 mn		
PBC D. Enhance DPO's readiness and		PBC # D.1 DPO Board has		



<p>capability to perform its deposit insurance mandate</p>		<p>approved and issued to its members regulations acceptable to the Association on record keeping of deposits including requirement to prepare deposit data in Single Deposit View (SCV) format</p> <p>PBC Value: SDR 1.725 mn</p> <p>PBC #D.2 DPO Board has approved regulations acceptable to the Association on procedures for claiming deposit insurance in the event of payout.</p> <p>PBC Value: SDR 1.725 mn</p> <p>PBC #D.3 DPO has conducted a simulation exercise on deposit insurance claims processing and payment.</p> <p>PBC Value: SDR 1.725 mn</p>		
		<p>PBC Value: SDR 5.175 mn</p>		
<p>PBC E. Promote public awareness and literacy on deposit insurance</p>	<p>PBC #E.1 BOL and DPO have each issued regulations acceptable to the Association requiring their respective member institutions to</p>	<p>PBC #E.2 DPO Board has approved a public awareness strategy on deposit insurance</p>	<p>PBC# E.3 DPO Board has approved an updated public awareness strategy based on survey</p>	



	provide standard information on deposit insurance coverage to their clients. PBC Value: SDR 0.574 mn	PBC Value: SDR 0.574 mn	conducted to the public. PBC Value: SDR 0.574 mn	
	PBC Value: SDR 0.574 mn	PBC Value: SDR 0.574 mn	PBC Value: SDR 0.574mn	
PBC F. Other		PBC #F.1 BOL Governor has approved regulations acceptable to the Association governing problem bank resolution process framework PBC Value: SDR 0.865 million PBC #F.2 The BOL Governor has approved regulations acceptable to the Association governing prompt corrective actions and early intervention PBC Value: SDR 0.865mn		PBC #F.3 DPO has completed a self assessment on the extent of compliance with IADI Core Principles on Deposit Insurance and identified gaps and actions for achieving full compliance PBC Value: SDR 1.725 mn
		PBC Value SDR 1.73 mn		PBC Value: SDR 1.725 mn