

**PROJECT INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

Report No.: PIDA237

<b>Project Name</b>	Financial Market Development and Stability Enhancement Project (P125305)
<b>Region</b>	EUROPE AND CENTRAL ASIA
<b>Country</b>	Russian Federation
<b>Sector(s)</b>	Capital markets (70%), Banking (15%), Non-compulsory pensions and insurance (10%), Payments, settlements, and remittance systems (5% )
<b>Lending Instrument</b>	Technical Assistance Loan
<b>Project ID</b>	P125305
<b>Borrower(s)</b>	Ministry of Finance
<b>Implementing Agency</b>	Ministry of Finance, FFMS
<b>Environmental Category</b>	C-Not Required
<b>Date PID Prepared</b>	29-Sep-2012
<b>Estimated Date of Appraisal Completion</b>	26-Sep-2012
<b>Estimated Date of Board Approval</b>	25-Feb-2013
<b>Decision</b>	

**I. Project Context**

**Country Context**

The Russian economy was hit hard by the global crisis, but the pre-crisis macroeconomic fundamentals were strong and the Government's policy response adequate. Hit by a triple shock—oil prices, capital outflows, and sharply deteriorating external borrowing conditions—the economy's real GDP dropped by 7.9 percent in 2009. The fiscal surplus turned into a deficit for the first time in a decade due to a collapse of the revenue base and crisis-related expenditures. The banking sector, which had relied heavily on non-deposit sources of financing, faced severe liquidity constraints. A deposit run at the end of 2008 exacerbated the liquidity crunch, but the authorities were able to mitigate its secondary effects. The authorities mounted an anti-crisis package of measures (using fiscal reserves) to support the financial sector and the real economy. While the global recovery weakened in 2011, Russia's economy strengthened in the second half of 2011. Output returned to pre-crisis levels at the end of 2011 as high oil prices, strong consumption, and wage growth supported domestic demand.

The financial sector is improving, but stronger supervision is needed for sound and stable financial intermediation. In 2011, credit to the private sector increased by about 26 percent year-on-year (yoy). The share of credit to GDP remains relatively low, at about 46 percent at end-2011. Deposits amount to 48 percent of GDP, and increased by 21 percent yoy at end-2011. Asset quality remains a concern. The capital markets still have the potential for further growth and to provide more diversified sources of funding in the economy.

Undertaking structural reforms will contribute to Russia's sustained long term growth. The state's strong role in the economy, a weak business and investment climate, corruption, and weak domestic competition are significant impediments that constrain investment, diversification, and growth. Reforms in these areas are important priorities.

**II. Sectoral and Institutional Context**

Further progress in the legal, regulatory, and supervisory framework for the financial sector is needed to meet G20 recommendations, and in light of more recent economic developments. Russia has committed as part of its G20 involvement to implement measures to further strengthen the financial sector legal, regulatory and supervisory architecture in line with the G20 regulatory reform agenda. The Government's Banking Sector Development Strategy through 2015 and the Financial Market Development Strategy until 2020 outline the reform agenda for the further development of the banking sector and the financial/capital market. A comprehensive cross-sectoral modernized supervisory structure is needed, while the requisite regulatory norms, supervisory powers, and market oversight mechanisms need to be strengthened.

Despite the expansion of Russia's capital market in recent years, it lags behind other major developed and emerging economies. The breadth and depth of the equity, bond and investment fund markets remain well below capacity, given comparable economies and the ongoing enterprise financing needs and business expansion possibilities. The institutional investor base needs to expand as it is essential to provide sources of long-term capital to the Russian financial market. Developing the capital market is important in an environment of moderate credit growth in the banking sector, especially in the context of the Eurozone crisis.

In this context, developing the capital market and investment funding instruments would provide useful alternative funding instruments. This would benefit underserved segments of the corporate and business sectors and individuals at the retail investor level. While Russia aims to expand its capital market reach more globally, further breadth in the domestic market will also help provide greater market depth and thus, allow further expansion into global markets and attraction of foreign investors. Given the regional and global influence of Russia's economy, the deepening of its financial markets and strengthened regulation serve its objective of aiming to become an international financial center.

The project would thus support the following activities:

Component 1. Enhance the institutional capacity of the Federal Financial Market Service (FFMS) to monitor and supervise the financial market and strengthen its stability. Under this component, reforms will be undertaken and information technology systems developed, to: (i) strengthen

micro-prudential supervision of non-bank financial market participants including investment firms, brokers, dealers, pension funds, insurance companies, and others; (ii) develop a comprehensive financial market monitoring system and creation of an early warning system for crisis detection; (iii) enhance institutional capacity of FFMS, (iv) improve reliability and security of information collection, sharing, storage and delivery, and efficiency of information processing; and (iv) enhance the attractiveness of the Russian financial market to internal retail investors and international institutional investors. These reforms will enhance the capacity of FFMS to oversee and address risks more effectively, while ensuring market development.

Component 2. Support financial market development. This component aims to encourage further development of the securities market and nonbank intermediaries by: (i) setting out proposals and measures aimed at improving the control, supervision, and the legal and regulatory framework of the financial market to, inter alia, ensure its stability and efficiency, (ii) to improve the operation of the financial market infrastructure (including the organized market, regulated and unregulated market for derivative financial instruments, registration of rights aiming the setting up of a central depository, insurance, and other areas); (iii) development of, and regulation of financial instruments and collective investment schemes; (iv) improving corporate governance and mechanisms of protecting shareholder rights; and (v) strengthening regulation of financial intermediaries in line with G20 recommendations.

Component 3. Set out measures to improve Government policy and regulatory framework of the financial market. This component will support the Ministry of Finance in the development and implementation of the Government's policy in the financial sector. Activities include: (i) developing proposals for implementing international recommendations and implementation of Government policy in the financial sector, including treatment of systemically important financial institutions; (ii) formulating the strategy for the development of financial markets and establishment of an international financial center in Moscow; (iii) developing proposals for the improvement in the Government's policy on securities market development and financial market instruments; (iv) setting forth proposals and measures for improving Government policy and regulation in the banking sector, insurance sector, securities markets, pension funds, and credit rating agencies.

Component 4. Project management. This component will finance the project management function, as well as periodic monitoring and evaluation. This function will be undertaken by the FER Project Implementation Unit (PIU) which was selected according to a competitive public bid. The PIU will provide support to the project implementing agencies for project implementation and management, preparation of bidding documents, implementation of selection procedures, preparation of contracts in line with IBRD practices, payments processing, disbursement monitoring, preparation of financial reports, and other functions. The PIU will undertake responsibilities mentioned above in accordance with an agency agreement to be concluded with the implementing agency.

### III. Project Development Objectives

The Project Development Objectives are: (i) strengthen Russia's legal and regulatory framework for the financial markets in line with global G20 regulatory reform standards; (ii) enhance supervision of the securities sector and non-banks to oversee and enforce regulations and management of risks within and across financial sub-sectors; and (iii) increase the depth of financial services and instruments in Russia's financial markets, both domestically and internationally, and attract new institutional and retail investors.

### IV. Project Description

#### Component Name

Enhance the institutional capacity of the Federal Financial Market Service (FFMS) to monitor and supervise the financial market and strengthen its stability

Support financial market development

Set out measures to improve Government policy and the regulatory framework in the financial market

Project management

### V. Financing (in USD Million)

#### For Loans/Credits/Others

	Amount
Borrower	100.00
International Bank for Reconstruction and Development	50.00
Total	150.00

### VI. Implementation

The implementing agencies will be the FFMS and the Ministry of Finance (MoF). They and the PIU (the Foundation for Enterprise Restructuring - FER) have already had extensive experience in the predecessor Capital Market Development Project (CMDP). FER demonstrated their expertise in project management, administration, financial recordkeeping, procurement and contracting. The agencies are thus fully capable of successfully implementing this project, which will essentially operate as a second phase of the predecessor project. Both MoF and FFMS will outsource fiduciary functions to the PIU while focusing on the overall technical, policy and management aspects of the project. The technical agencies (FFMS and MoF) will be responsible for defining the sub-tasks under each component and preparing technical Terms of Reference (ToRs) for contracting needs. The ToRs will be reviewed for quality and formatting by FER, which, if it considers acceptable, will then proceed with competitive contracting and selection ranking procedures, using a panel of appointed experts coming from the technical agencies, FER and outside.

The PIU will have the primary responsibility for project reporting and monitoring of activities, expenditures and results. The Bank team has agreed with the Government's technical executing agencies on key monitorable indicators to track during key phases of the project and to establish the sources of such data baselines. On an annual basis, the outcome/results indicators will be compiled against the baseline and reported along with the applicable project components and expenditures to date. The interim results indicators will be used to evaluate whether the project activities are performing the relevant interventions.

The sustainability of the activities and reforms implemented under the project will rely on the continuity of the regulatory institutions and relevance

of the reforms to the market. The FFMS has strong and proven capacity and has worked with the Financial Policy Department of the MoF to upgrade financial market regulations in the past decade. Sustainability of reforms will be based on their effectiveness and relevance to the market, as well as a market infrastructure that is sufficiently robust to attract a larger mass of international investors. In this regard, while the components regarding the regulatory and supervisory reform are important to form the legal basis of the market, the financial infrastructure elements will be key implementation milestones that will ensure sustainability of the project and its reforms.

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**VII. Safeguard Policies (including public consultation)**

<b>Safeguard Policies Triggered by the Project</b>	<b>Yes</b>	<b>No</b>
Environmental Assessment OP/BP 4.01		<b>X</b>
Natural Habitats OP/BP 4.04		<b>X</b>
Forests OP/BP 4.36		<b>X</b>
Pest Management OP 4.09		<b>X</b>
Physical Cultural Resources OP/BP 4.11		<b>X</b>
Indigenous Peoples OP/BP 4.10		<b>X</b>
Involuntary Resettlement OP/BP 4.12		<b>X</b>
Safety of Dams OP/BP 4.37		<b>X</b>
Projects on International Waterways OP/BP 7.50		<b>X</b>
Projects in Disputed Areas OP/BP 7.60		<b>X</b>

**VIII. Contact point**

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