Project Information Document (PID)
## BASIC INFORMATION

### A. Basic Project Data

<table>
<thead>
<tr>
<th>Country</th>
<th>Project ID</th>
<th>Project Name</th>
<th>Parent Project ID (if any)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lao People’s Democratic Republic</td>
<td>P169194</td>
<td>Lao PDR Financial Sector Safety Net Strengthening</td>
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<table>
<thead>
<tr>
<th>Region</th>
<th>Estimated Appraisal Date</th>
<th>Estimated Board Date</th>
<th>Practice Area (Lead)</th>
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<tbody>
<tr>
<td>EAST ASIA AND PACIFIC</td>
<td>14-Feb-2020</td>
<td>31-Mar-2020</td>
<td>Finance, Competitiveness and Innovation</td>
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<table>
<thead>
<tr>
<th>Financing Instrument</th>
<th>Borrower(s)</th>
<th>Implementing Agency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Project Financing</td>
<td>Lao People’s Democratic Republic</td>
<td>Deposit Protection Office</td>
</tr>
</tbody>
</table>

### Proposed Development Objective(s)

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

### Components

- Institutional capacity building for DPO and project management
- Capitalization of the Deposit Protection Fund

## PROJECT FINANCING DATA (US$, Millions)

### SUMMARY

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Total Project Cost</td>
<td>35.00</td>
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<tr>
<td>Total Financing</td>
<td>35.00</td>
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<tr>
<td>of which IBRD/IDA</td>
<td>35.00</td>
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<tr>
<td>Financing Gap</td>
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</table>

### DETAILS

**World Bank Group Financing**

<p>| | |</p>
<table>
<thead>
<tr>
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<tbody>
<tr>
<td>International Development Association (IDA)</td>
<td>35.00</td>
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<tr>
<td>IDA Credit</td>
<td>35.00</td>
</tr>
</tbody>
</table>
Environmental and Social Risk Classification
Low

Decision
The review did authorize the team to appraise and negotiate

Other Decision (as needed)

B. Introduction and Context

Country Context

1. **Lao PDR faces some headwinds on the macroeconomic front.** Growth has moderated in recent years, declining from 6.3 percent in 2013 to an historical low of 5.2 percent in 2019, owing mainly to natural disasters (floods, droughts, a caterpillar infestation) which affected the agricultural sector. The fiscal deficit increased to nearly 5 percent of GDP in 2019, up from 4.7 percent of GDP in 2018. Revenue mobilization remains a challenge due to partial policy implementation and weak tax administration. The revenue to GPD 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.

2. **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.

3. **Progress towards reducing poverty has continued, albeit at a slower pace than in the past.** The incidence of poverty fell from 46 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 (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.
4. **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. GoL’s top priorities 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 (NA) adopted several resolutions to provide legal back-up for and enhance the performance of the GoL and judiciary bodies. The NA is asking for more accountability and the curbing of corruption.

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**Sectoral and Institutional Context**

5. **The Laotian 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 (BCEL), Lao Development Bank (LDB), 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).

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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.
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-CAR) 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 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) remains low. Asset quality might not be accurately reflected in these numbers due to weak accounting standards and a regulatory cap on non-performing loans, thus actual regulatory capital may be lower than reported. Capital adequacy positions differ significantly among banks. The three state-owned banks are reportedly undercapitalized, though the Government partially recapitalized the largest of this group in 2017. The government is seeking strategic investors, but its efforts have thus far been unsuccessful.

8. Overall profitability in the sector has moderately improved, driven by higher loan to deposit ratios, but performance among banks varies significantly. The return on assets 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.

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**Table 1: Key financial sector indicators**

<table>
<thead>
<tr>
<th>Credit to the Private sector</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>Q3 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>y/y growth</td>
<td>19.3%</td>
<td>22.0%</td>
<td>14.2%</td>
<td>4.4%</td>
<td>6.2%</td>
</tr>
<tr>
<td>% of GDP</td>
<td>37.1%</td>
<td>41.0%</td>
<td>43.0%</td>
<td>41.5%</td>
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<table>
<thead>
<tr>
<th>Assets</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>Q3 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>y/y growth</td>
<td>20.4%</td>
<td>15.8%</td>
<td>8.2%</td>
<td>6.6%</td>
<td>8.0%</td>
</tr>
<tr>
<td>% of GDP</td>
<td>83.3%</td>
<td>87.5%</td>
<td>87.0%</td>
<td>86.0%</td>
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<table>
<thead>
<tr>
<th>Deposits</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>Q3 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>y/y growth</td>
<td>17.6%</td>
<td>12.7%</td>
<td>11.6%</td>
<td>8.3%</td>
<td>14.1%</td>
</tr>
<tr>
<td>% of GDP</td>
<td>53.9%</td>
<td>47.2%</td>
<td>48.4%</td>
<td>48.4%</td>
<td></td>
</tr>
</tbody>
</table>

| Loan to deposit ratio (%)   | 89.2%| 98.0%| 98.4%| 93.7%| 87.0%   |

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**Table 2: Financial Soundness Indicators**

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory capital to risk-weighted assets (CAR)</td>
<td>15.83%</td>
<td>15.86%</td>
<td>16.33%</td>
<td>17.84%</td>
<td>18.32%</td>
<td>16.13%</td>
<td>14.31%</td>
<td>13.17%</td>
</tr>
<tr>
<td>Regulatory Tier 1 capital to risk-weighted assets</td>
<td>12.53%</td>
<td>12.13%</td>
<td>12.53%</td>
<td>13.88%</td>
<td>13.59%</td>
<td>11.40%</td>
<td>10.29%</td>
<td>9.85%</td>
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<tr>
<td>Nonperforming loans net of provisions to capital</td>
<td>9.33%</td>
<td>9.07%</td>
<td>8.20%</td>
<td>7.54%</td>
<td>10.24%</td>
<td>9.35%</td>
<td>10.80%</td>
<td>12.22%</td>
</tr>
<tr>
<td>Nonperforming loans to total gross loans (NPL)</td>
<td>3.07%</td>
<td>3.08%</td>
<td>3.09%</td>
<td>3.10%</td>
<td>3.12%</td>
<td>3.13%</td>
<td>3.11%</td>
<td>3.07%</td>
</tr>
<tr>
<td>Return on assets</td>
<td>0.54%</td>
<td>0.46%</td>
<td>0.60%</td>
<td>0.68%</td>
<td>0.80%</td>
<td>0.73%</td>
<td>0.98%</td>
<td>1.51%</td>
</tr>
<tr>
<td>Return on equity</td>
<td>7.77%</td>
<td>6.53%</td>
<td>8.48%</td>
<td>9.38%</td>
<td>10.89%</td>
<td>10.05%</td>
<td>13.88%</td>
<td>21.49%</td>
</tr>
</tbody>
</table>

Source: Bank of Lao PDR
2019. However, performance among banks varied significantly. For example, among 23 commercial banks with publicly available data, three experienced negative return on assets (ROA) in 2018, and only 3 recorded ROA above 2 percent.

9. Though the level of non-performing loans is reportedly low, market participants believe they are understated and rising. The level of non-performing loans is reported at 3.07 percent in Q3-2019. However, there has been a substantial increase in the level of nonperforming loans net of provisions to capital, increasing from 7.5 percent in 3Q:18 to 12.2 percent in Q3-19, which could indicate additional provisions that may be needed relative to capital. The Central Bank (Bank of Lao-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 15+ have a bank account, compared to 70.6 and 57.8 percent for EAP 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+ borrowed from a financial institution or used a credit card in the past year, which is well below EAP 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), 79 non-deposit taking institutions (NDTMIFIs), as well as leasing pawn shops and credit unions, with assets of US$ 450 million. The sector experienced rapid growth between 2015-2017, especially NDTMFIs, but growth has moderated in 2018 in line with overall economic slowdown. The sector is regulated by Financial Institutions department of the Bank of Lao, and a microfinance association provides capacity building. MFIs report monthly to Bank of Lao, but data quality is poor, limiting quality of supervision. Two DTMFIs were closed in 2016, prompting BOL decision to suspend issuance of new licenses. BOL and DPO indicated the need to address weaknesses in the sector to enable deposit taking microfinance Institutions (DTMFIs) to qualify for registration and inclusion under deposit insurance coverage, as mandated by Article 33 of the Deposit Insurance Decree (No. 329/GOL, 25 October 2017). 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 towards a more risk-based approach, has been burdened by the rapid increase in number of banks and credit growth. 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 dedicated resolution unit or a crisis management framework. The reported financial soundness indicators are presented on an aggregate basis\(^1\), which masks

\(^1\) Publication of financial soundness indicators disaggregated by types of banks is an indicative trigger for Green Growth DPO 3.
vulnerabilities in state-owned and some smaller banks. Around 50% 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 Commercial Banking Law (see Sec. 11 below), Bank of Lao 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. **Laotian authorities have begun to address financial sector vulnerabilities with support from the World Bank and the 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 3 years, the World Bank with funding from 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)_see below. Supported by the Lao PDR Green Resilient Growth DPO 2 - (P166839), BOL has produced and published a set of core financial soundness indicators and has amended the Bank of Lao 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 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’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 Bank Law are expected to bring Lao closer to compliance with 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 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 BOL with powers to put in place a more effective - supervisory, corrective and resolution regime. With carefully drafted secondary legislation and capacity building, BOL would be able to carry out risk-based supervision, institute an early warning system and prompt 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 (ELA), Lender of Last Resort (LoLR) and funding for systemically important banks. The BOL law also limits BOL lending, by providing conditions, under which lending by 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 Deposit Protection Office, with World Bank support, conducted a self-assessment against IADI Core Principles for Effective Deposit Protection\(^2\) in 2017, which identified several areas of non-conformity with international best practice (International Association of Deposit Insurers - IADI Core Principles), creating a risk of contagion in the event of bank closure with DPO not ready to promptly execute payouts. The self-assessment raised awareness among authorities of the significant gaps and work required for DPO to carry out its mandate and align the organization and its operations to international best practice. The main areas of non-compliance 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, DPO prepared a prioritized and sequenced action plan to move towards compliance.

Government issued a decree on deposit insurance (No. 329/GOL, October 25, 2017) which is an improvement over previous system and strengthens DPOs legal mandate to undertake many of the reforms necessary to comply with IADI principles. The proposed project will help 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 Depositor Protection Office (DPO) was established on 23 September 1999 tasked with protecting the rights and interests of depositors\(^3\). Since its establishment up to 2006, DPO was a 100% 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 15 November 2007, DPO became financially independent and operated as an SOE under the supervision of 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 DPO further autonomy, but DPO is still not operationally independent. 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 Bank of the Lao PDR).

DPO has a paybox mandate in which the Deposit Insurer is only responsible for the reimbursement of Insured Deposits (BOL is the resolution authority). Effective 2013, depositors of member banks declared bankrupt by BOL are entitled to file a claim with the Depositor Protection Fund 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 for each depositor and for each currency\(^4\). Following issuance of the decree, the DPO Board is expected to approve in 2019 a consolidation of coverage level to equivalent Kip 50 million, or US$5,550. The coverage

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\(^2\) IADI Core Principles for Effective Deposit Insurance Systems (2014).

\(^3\) Agreement of the Minister of Finance on the Establishment of Depositor Protection Fund No. 1285/MOF, dated 23 September 1999.

\(^4\) The maximum deposit insurance coverage has been amended 3 times. In 1999, coverage was 15,000,000 LAK. Starting 2008, the limits were amended to 20,000,000 LAK, 30,000 THB and 1000 US$. 

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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). DPO estimates that about 13% of total deposits are insured under the coverage limit.

Since its establishment, there has never been a bank failure that would have required payout by DPO of insured deposits. On December 24, 2019, Bank of Lao announced the closure of Lao Construction Bank (LCB), a small private bank, with deposits equivalent to 0.1 percent of total system deposits. LCB was non-compliant with prudential requirements and was not insured by DPO. In the past 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 WB technical assistance, BOL now has resolution powers, which allowed it to take the actions, hence recent announcement of the LCB failure.

16. The proposed investment project is part of a wider World Bank engagement, coordinated with IMF, to support the government’s coordinated efforts to strengthen the financial sector safety net comprising of policy based lending (Green Resilient Growth DPO 2 and 3) and programmatic technical assistance (Financial Sector Development Project, P171539). 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.** 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 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 technical assistance 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. Proposed Development Objective(s)

Development Objective(s) (From PAD) to strengthen the financial and institutional capacity of the Deposit Protection Office to enable it to fulfill its deposit insurance mandate.

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6 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.
Key Results

**Strengthened financial capacity of DPO**

- Adequate financial inflows into the DPO during the course of the project, in order to achieve a funding ratio of at least 1% (Percentage)
- Arrangement on back-up funding support in place

**Strengthened institutional capacity**

- DPO performing its legally-mandated function (deposit payout), as evidenced by progress towards compliance with IADI Core Principles\(^7\) (percentage)
- Simulation exercise on deposit insurance claims processing and payment conducted

D. Project Description

17. The proposed instrument is IPF with disbursement linked indicators (DLIs), drawing on experience from recent successful WB projects supporting deposit insurance schemes. In particular, the recent WB projects in Bulgaria (P154219), Serbia (P146248), and Mozambique (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 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 DPO and BOL would require substantial technical assistance, given the large capacity building agenda demonstrated in the recent IADI self-assessment. In parallel to the IPF, World Bank will deliver technical assistance to both BOL and DPO, financed by the Korean Trust Fund.

18. The project comprises two components:

**Component 1: Capitalization of Deposit Protection Fund (US$ 33.25 million)**

19. The first component will capitalize DPO’s deposit protection fund (DPF). It will utilize disbursement linked indicators, whereby the WB funds are disbursed in tranches based upon verification of achievement of the pre-agreed DLIs. The DLIs, in turn, have been formulated based on the World

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\(^7\) This indicator will use as a baseline the World Bank assessment against IADI principles, conducted during project preparation. For consistency, WB will conduct periodic assessments as part of project supervision to track progress, and a final assessment. This assessment will differ from the external assessment supported under DLI#14. Further details on methodology are including in Section VII.
Bank’s assessment of critical actions necessary to strengthen DPO and move towards compliance with IADI core principles. The preliminary list of DLIs, is presented below.

20. **The WB 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 Deposit Protection Reserve Fund to the total insured (covered) deposits or eligible deposits in member financial institutions. According to the International Association of Deposit Insurers, 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, borrowings and recoveries from failed banks. Premium collection will constitute a major contribution to the Fund over the long term, but Fund build-up via 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, DPO requires funding support from the WB.

21. **WB estimates demonstrate that the proposed IDA investment will strengthen the Deposit Protection Reserve Fund, while measures supported by the project such as mobilizing back-up 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 build-up of reserves in the near term is essential to prepare DPO to deal with potential bank failures and system vulnerabilities, while the establishment of a back-up funding facility that can be mobilized in a timely manner will further enhance the credibility and sustainability of the deposit protection system. The Fund ratio with World Bank financing is projected to increase from 0.51% of eligible deposits in 2018 to 1.1% in 2024, or from 3.68% of insured deposits to 8.2% during the same period8. The Fund Reserve, which amounted to Kip 361 billion or about US$41 million at end 2019, is currently enough to cover the payout of the 5th largest bank.

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

23. **The project will finance select technical assistance to strengthen DPO’s institutional capacity, to complement parallel and ongoing TA financed by the World Bank.** World Bank has been providing technical assistance (financed by Bank-executed trust funds) to DPO and BOL since 2016. Substantial technical assistance is needed to support DPOs institutional development, and the project will continue to rely on externally funded technical assistance provided by the World Bank with limited TA financed under the project. The technical assistance will include a consultancy to undertake a public awareness strategy (DLI 12), and general deposit insurance consultancies to help DPO achieve the institutional-capacity related DLIs and other DLIs as necessary. This component

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8 International experience on size of target fund varies significantly, Bulgaria (1% insured), Kosovo 8-9% (insured), South Korea 0.825% to 1.1% (eligible), Philippines (5.5%-8%); Jamaica 8-10% (insured); Indonesia (2.5% eligible). Source: IADI (July 2018). Deposit Insurance Fund Target Ratio. Research Paper.
will also finance consultants to support project implementation, including the following functions: project coordinator, communications, financial management and procurement. This component will also include contingent funding, which could be mobilized to finance additional technical assistance should outside resources prove to be insufficient.

## Legal Operational Policies

<table>
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<th>Triggered?</th>
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<tr>
<td>Projects on International Waterways OP 7.50</td>
<td>No</td>
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<tr>
<td>Projects in Disputed Areas OP 7.60</td>
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## Summary of Assessment of Environmental and Social Risks and Impacts

The screening of social risks and impacts of project activities is 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 for understanding of awareness on deposit insurance and further information needed for inclusivity will be incorporated into the survey design.

Prior to appraisal an Environmental and Social Commitment Plan (ESCP), a Stakeholder Engagement Plan (SEP). As the project preparation moves forward engagement will be undertaken with the implementing agency to understand better their strategy for promoting awareness and literacy about the deposit insurance and their feedback and complaints mechanism. The SEP will be updated periodically in line with implementation of the strategy and survey results findings.

The environmental screening was carried out by discussing the nature of project activities with the Task Team and Deposit Protection Office, it is confirmed that the Bank’s deposit will only be investing on a Government Bond or Stock Market, which will not pose any physical footprint. The project will not finance any infrastructure and/or technical assistance that could conceivably result in any adverse environmental impacts.

### E. Implementation

#### Institutional and Implementation Arrangements

24. DPO will serve as the implementing agency. DPO does not have a prior experience with implementing WB projects, and will need to establish a small technical group to ensure the Project is implemented in accordance with WB’s fiduciary rules. The implementation arrangements are expected to be straightforward and will strive to build upon DPO normal operations to the extent possible. There will be a technical assistance component, which will be closely coordinated with parallel technical
assistance provided by WB. Based on procurement and financial management assessments of institutional capacity, consultancy support will be necessary to learn WB fiduciary procedures and maintain adequate governance and financial management arrangements as well as to prepare disbursements against DLIs. Support will be provided as necessary by the WB fiduciary team. The Bank of Lao and the Ministry of Finance will be important stakeholders. Both of these entities, in addition to the DPO, play a critical role in the financial safety net, and are represented on DPO’s management board, which is co-chaired by BOL and MOF.

25. BOL and MOF buy-in on the project design and implementation. While the project focus is on deposit protection, as members of the financial safety net, BOL and MOF have important roles in project design and implementation. Therefore, the project design and implementation will require buy-in from both parties in order to ensure that the Project Development Objective is achieved. For instance in the case of the DPO decree, 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 DPO holds two funds - reserve and equity funds). Under the project, MOF is responsible for a critical DLI, providing back-up funding for DPO which will bolster the sustainability of the fund in the event of a crisis. BOL is responsible for implementing a DLI which involves approving regulations governing problem bank resolution process framework and prompt corrective action and early intervention. Finally, the project supports the establishment of a Financial Stability Committee, which will include MOF and BOL.

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