

# AFRICAN DEVELOPMENT BANK



Reference No: P-ST-H00-002  
Task Manager: Grace Kyokunda

---

## PROJECT APPRAISAL REPORT

**PAYMENTS SYSTEM INFRASTRUCTURE AND FINANCIAL INCLUSION PROJECT**

**SAO TOME & PRINCIPE**

January 2017

This report is made available only to staff members to whose work it relates. Any further release must be authorized by the Director, PIFD.

# AFRICAN DEVELOPMENT BANK



**PROJECT:** PAYMENTS SYSTEM INFRASTRUCTURE AND FINANCIAL INCLUSION PROJECT

**COUNTRY:** SAO TOME & PRINCIPE (STP)

---

## APPRAISAL REPORT

January 2017

Appraisal Team	Team Leader:	Grace Kyokunda, Chief Financial Analyst, PIFD.1
	Team Members:	Flavio Soares Da Gama, Senior Resident Country Economist, LIST Ndiaye Rachid, Investment Officer, PIFD.1 Helder Costa Neto, Operations Assistance, LIST Laurent Brito, Procurement Consultant, (COAO) Meriem Boulifa, Senior Disbursement Officer, (FIFC.3) Byamugisha Joseph, Senior Financial Management RDGS
	Sector Director:	Stefan Nalletamby, Director, PIFD
	Director General:	Tonia Kadero, RDGS
	Sector Manager:	Kalif Mohamed, PIFD.1
	Resident Representative:	Septime Martin, Resident Representative, COAO
Peer Reviewers		Gabriel Victorien Mougani, Chief Régional Intégration Economist RDRI Busulwa –Kayongo Consultant, PIFD Ceu Pereira, Senior Payment System Expert. World Bank Kohoue, Sodji Agossou Francis, Senior Treasury Information Systems Officer, FITR

## TABLE OF CONTENTS

<b>1. STRATEGIC THRUST &amp; RATIONALE</b> .....	<b>1</b>
1.1 Project Linkages With Country Strategy And Objectives .....	1
1.2 Rationale For The Bank’s Involvement.....	1
1.3 Donor Coordination .....	2
<b>2. PROJECT DESCRIPTION</b> .....	<b>3</b>
2.1 Project Objectives .....	3
2.2 Project Components .....	3
2.3 Technical Solution Retained And Other Alternatives Explored.....	5
2.4 Project Type.....	6
2.5 Project Cost And Financing Arrangements .....	6
2.6 Project Target Area And Population.....	8
2.7 Participatory Process For Project Identification, Design & Implementation .....	8
2.8 Bank Group Experience, Lessons Reflected In Project Design.....	9
2.9 Key Performance Indicators .....	9
<b>3. PROJECT FEASIBILITY</b> .....	<b>10</b>
3.1 Financial Performance .....	10
3.2 Economic Performance .....	11
3.3 Environmental And Social Impacts .....	11
<b>4. PROJECT IMPLEMENTATION</b> .....	<b>12</b>
4.1 Implementation Arrangements.....	12
4.2 Monitoring And Evaluation .....	15
4.3 Governance .....	15
4.4 Sustainability.....	15
4.5 Risk Management .....	15
4.6 Knowledge Building .....	16
<b>5. LEGAL INSTRUMENTS AND AUTHORITY</b> .....	<b>16</b>
5.1 Legal Instrument .....	16
5.2 Condition Associated With The Bank’s Intervention .....	16
5.3 Compliance With Bank Policies .....	16
<b>6. RECOMMENDATION</b> .....	<b>16</b>

## **LIST OF TABLES**

Table 1:	Project Components and Activities
Table 2:	Project Cost Estimates
Table 3:	Project Cost Estimates by Component
Table 4:	Sources of Finance
Table 5:	Project Cost Estimates by Year of Expenditure
Table 6:	Project Cost Estimates by ADF Financed Components
Table 7:	Project Cost Estimates by ADF Financed Components/Expenditure Category
Table 8:	Key Performance Indicators
Table 9:	Key Economic and Financial Figures
Table 10:	Project Risks and Mitigation Measures

## ACRONYMS AND ABBREVIATIONS

ACH	Automated Clearing House
ADB	African Development Bank
ADF	African Development Fund
ADB	African Development Bank Group
ATM	Automated Teller Machine
ATS	Automated Transfer System
BCSTP	Banco Central de São Tomé e Príncipe (Central Bank of STP)
CB	Central Bank of São Tomé e Príncipe
CPIA	Country Portfolio and Institutional Assessment
CSP	Country Strategy Paper
CST	Companhia SaoTomense de Telecomunicacoes
EUR	Euro currency
FSDIP	Financial Sector Development Implementation Plan
GDP	Gross Domestic Product
JAS	Joint Assistance Strategy
MTR	Mid-Term Review
OFSD	Financial Sector Department
ORQR	Operation Quality Assurance Department
PAGEF	Economic and Financial Management Project (PAGEF)
PAR	Project Appraisal Report
PCR	Project Completion Report
PIIP	Payment Infrastructure and Financial Inclusion Project
PIU	Project Implementation Unit
POS	Point of Sale
PRSP	Poverty Reduction Strategy Paper
RGTS	Real Time Gross Settlement
RAS	Regional Assistance Strategy
SC	Steering Committee
SPAUT	Sao Tome Principe Automated Payment System Company
STD	Sao Tome Dobra
STFO	Sao Tome Field Office
STP	Sao Tome and Principe
UA	Unit of Account

# Project Summary

## 1. Project Overview

1.1 The Government of São Tomé and Príncipe (STP) has developed a National Financial Sector Development Implementation Plan (FSDIP), with funding from the World Bank. An important pillar of the FSDIP is the need to upgrade existing financial infrastructure, specifically the payment system in order to promote inclusion and economic development. The Payment Infrastructure and Financial Inclusion project (PIFIP) is responding to the need to enhance the capability of the financial sector access a modern payments infrastructure. The payments infrastructure is underdeveloped, lacking the capacity to process safely and efficiently interbank payments, or retail payments, and to process international retail transactions. As a result, interbank payments, as well as retail payments are difficult and costly and the use of cash is widespread. The project aims at promoting financial inclusion in STP, by assisting the authorities to develop a national payments system, improve its oversight, and enhance the legal framework to include all electronic payments and services as well as supporting the preparation of a national financial inclusion strategy.

1.2 The proposed project is well aligned with the Bank Group Strategies, namely: i) the Country Strategy Paper (CSP), 2012-2016, for STP, especially its Pillar 1 on strengthening Governance<sup>1</sup>. Development and modernisation of Payment Systems was identified as a priority given the importance and significance of the banking system. The need for ensuring safer, more efficient and inclusive payments is critical and as a result, it was specifically programmed in the revised CSP; (ii) the project fits in the Ten Year Strategy (TYS), 2013-2022, particularly its inclusive growth objective and private sector development core priority; (iii) the ultimate objective is in line with the Industrialise Africa, which is one of the Bank Group's High-5 institutional priorities; and (iv) it is aligned to the Financial Sector Development Strategy--the financial inclusion pillar.

1.3 As a result of the proposed intervention, the STP economy will benefit from a robust payment system in many ways. First, merchants and businesses are looking at more efficient payment processing which will be faster and more technologically advanced, cost effective, and with minimal manual system errors. Second, the population will benefit from a wider supply and better access of financial services, namely deposits and transfers, savings, loans and insurance products. Third, the project will promote private sector development through a more competitive financial sector, ranging from traditional banking to mobile banking, remittances, agent banking, micro-financing and micro-insurance. Fourth, by enhancing the performance of the financial sector, through the upgraded payment system infrastructure, providing for interconnectivity to international credit cards like Visa and MasterCard will offer enabling conditions and help the country better position itself to attract more tourists, increase regional and international trade and enhance the private sector growth.

1.4 São Tomé and Príncipe is one of the smallest countries in sub-Saharan Africa with a population of 197,900 on two islands with a land mass of 1,000 square kilometers in the Gulf of Guinea off the western equatorial coast of Central Africa. It is a lower income country with a per capita income of USD 1,570 in 2014. It is highly dependent on external support with 80% of its budget financed by development partners. The economy grew 4% in 2015 in line with regional growth rates, but remains vulnerable to external shocks. Slow growth in key trading partners, particularly Europe, reduced demand for exports and tourism as well as the supply of aid and investments. Foreign direct investment fell to USD 19.2 million in 2015 against USD 31.5 million in 2011.

---

<sup>1</sup> This pillar focuses on strengthening key public institutions, including human resource capacities as well as country systems and strategic, legal and regulatory frameworks over a sustained period. The CSP also has a second pillar focusing on promotion of agriculture infrastructure.

## **2. Project Cost and Financing**

The total cost of the project is estimated at STD 64.7 billion (UA 2.11 million). The African Development Bank and the World Bank are co-financing this project with UA 1.50 million from ADF resources and USD 299,000 from the World Bank. A request for additional resources from trust funds has been submitted to the Government of Portugal for EUR 400,000, and USD 2.4m from Nigerian Trust fund but no positive response has been received to date. The Government of Sao Tome and Principe will contribute STP Dobra 2.35 billion. The ADF resources amounting to UA 1.5 million and STP Government contribution will finance phase 1 of the project. Funds expected from the Nigeria Trust Fund will fund phase 2 of the project. The Portuguese trust fund grant resources if approved will finance institutional capacity building for the Central Bank.

## **3. Implementation**

The Central Bank of STP (CBSTP) will be responsible for project implementation and a Project Steering Committee (PSC) that will be setup to provide oversight. The PSC will have membership drawn from the (CBSTP), Ministry of Finance, Association of Bankers and representative from the Telecommunication companies. The PSC shall provide overall strategic direction to the project. The Central Bank has already designated staff to man the project implementation unit (PIU) but since they do not have the requisite expertise to manage the day to day activities of the proposed project, technical experts will be recruited to support the team at the start and these will provide on job training and mentoring of the staff. The preparation process, (Phase 0), has already started and the process of recruiting technical experts has been launched to hire experts to support the CBSTP staff in preparing procurement documents and facilitate in putting together robust and appropriate financial management systems. Recruitment is underway to recruit Technical assistance to restructure SPAUT, train staff and prepare them to better manage the payment system. The CBSTP staff will be facilitated to go for study tours in countries like Portugal to get a better understanding of modern payment systems and enable them to better actively participate in the procurement of equipment during project implementation. The World Bank (First Initiative) has already agreed and approved Technical Assistance (TA) to support the Central Bank (CBSTP) to develop relevant laws and regulations. In addition, the World Bank will also provide a technical expert to assist the CB in drafting the technical specifications for the procurement and implementation of the payment system.

## **4. Bank's Added Value**

The Bank's intervention in this project will add significant value to STP economy by improving the performance and competitiveness of the financial sector in the country. The investment will entail upgrades to the payment system in terms of hardware and software and a complete overhaul of the management, governance, processes and procedures to identify and manage financial, operational and business risks. This will contribute to ensuring business continuity and a high level of security and full international connectivity. Providing international connectivity and acceptance of internal card payments will boost tourism and trade. This will also allow for a diversification of services provided at ATM's, (electronic transfers, topping-up of mobile phone, bill payment etc.) and should provide an interoperable and open platform to process mobile payment transactions when mobile payments are introduced in the market. Under phase 2, the modernization of the payment systems infrastructure by acquiring an automated system (ATS), to replace the current manual checking system will allow for a safer and more efficient processing of interbank payments and can be leveraged for the migration of government payments. Migration of government payments to electronic platforms and an increased level of automation will promote efficiency, reduce costs and encourage the usage of formal financial services. This will result in an increase in the usage of electronic payments in the country, and a consequent increase in the volume of transactions in the card system and the planned ATS, and will contribute to the government's e-governance strategy. The Bank invited the World Bank to participate by providing TA to review the Legal framework in line with international standards with a view to

covering electronic payments and transactions, enabling the provision of innovative payment services such as mobile payments, development agent networks, and in general ensure a high level of safety, efficiency, transparency and consumer protection. The World Bank TA will support the Central Bank to establish a Unit responsible for oversight of the payment system. The TA will also provide training and skills improvement. The Bank through an existing project for institutional capacity building (PAGEF) is already providing support to the Central Bank to prepare them to manage the project, while building their skills and restructuring Sao Tome Principe Automated Payment System Company (SPAUT) to improve its governance and process efficiency as a payment system operator.

## **5. Knowledge Management**

The knowledge gained through the implementation of several projects<sup>2</sup> and studies in the sector in STP has been duly applied in designing this project. During the project appraisal, the team realized that capacity to implement the project was an issue and provided upfront support from an on-going project to the Central Bank. At the onset, the Bank advised the government of STP to conduct a diagnostic study to inform both the Bank and the stakeholders on the best option to choose in modernizing the payment system for the country. The Government hired Sociedade Interbancaria de Servicos (SIBS), a Portuguese company operating the card switch and ACH in Portugal, to conduct a diagnostic study which provided various options and information that guided the design of the project. The ADB and World Bank teams also drew lessons from previous operations across the world from small markets like Sao Tome and Principe.

---

<sup>2</sup> Lessons learnt from the on-going Bank funded projects in EAC and WAMZ indicated that capacity building and exposure for Central Bank staff should be done before project implementation commences.



## Result-based Logical Framework

**Country and project name: Sao Tome & Principe: Payment System Infrastructure and Financial Inclusion Project**

**Purpose of the project:** The overall development goal is to improve inclusive growth in STP while the specific project objective is deepening financial inclusion and creating a competitive financial sector through the internationalization of the payment system as well as improved strategic framework and e-payment instruments.

	RESULTS CHAIN	PERFORMANCE INDICATORS			MEANS OF VERIFICATION	RISKS/MITIGATION MEASURES
		Indicator	Baseline	Target		
IMPACT	Deeper inclusive growth, competitive financial sector and improved tourism development.	1) Real GDP growth rate (%) 2) Financial sector contribution to GDP (%) 3) Tourism sector contribution to GDP (%) 4) Women share of economic activity (%)	1) 5.0% (2014) 2) 23% (2014) 3) 15% (2015) 4) 18% (2014)	6.0% (2018) 30% by 2018 20% (2018) .20% (2018)	Central Bank financial statistics  Directorate of Tourism record	<b>Risk 1:</b> Full functionality of the payment system if the new international system is not fully compatible with the old Dobra24 system.  <b>Mitigation:</b> This risk can be mitigated by installing a new integrated system that can handle both domestic and international transactions.
	1. Improved national payments system with international connection and competitive financial sector.	1) Decrease in transactions costs 2) Volume of credit cards transactions 3) Tourism arrival (Number) 4) Enhanced Institutional Capacity of SPAUT 5) Increased volume of regional trade	1). Transactions cost to banks: USD 2,000 per month in 2015 2) 0 in 2015 3). 11,258 in 2013 (available data) 4) Weak SPAUT Capacity	1). Transactions cost to banks decrease by 20% in 2018. 2) 37000 in 2018 3) 20,000 by 2018 4) 17 SPAUT staff trained and re-organised SPAUT operational and staffed 5) 35% by 2018	SPAUT Progress reports    ECOWAS Trade data	Risk: Weak capacity of the commercial banks to be involved in the new payment system and the capacity of the legal department of the Central Bank in monitoring and mitigating credit cards security risks.  <b>Mitigation:</b> This risk is mitigated by the Technical Assistance and capacity building incorporated into the project design
OUTCOMES	Overall national payment system improved and financial inclusion strengthened	1) % of adults with a transaction account	5% in 2016	25% 2018	SPAUT and CB annual reports.; Telephone companies	
	<b>Component 1: Strengthening Payments System Infrastructure</b>					
OUTPUTS	Modern national payment system hardware and software infrastructure installed	1) Procurement and installation of a modern payment system infrastructure 2) Tele-clearing system for mass payments at the country level 3) Connections to international networks.	1). Weak and semi-automated Dobra24 network 2) Lack of a stable, safe and efficient system to process retail payments initiated by means of a card or mobile phones 3) Domestic system does not accept use of international credit cards.	1) Efficient and well maintained payment system infrastructure processing retail payments initiated by card or mobile phones 2) An upgraded card system that is able to process safely and efficiently domestic as well as international retail payments initiated by means of a card or a mobile phone 3) Domestic system connected to international networks with accreditation to issue and use international credit cards.	SPAUT annual reports  Hotel records	<b>Risk 2:</b> Possible capacity and commitment risk of the Central Banks and commercial banks to the new payment system.  <b>Mitigation:</b> This risk is mitigated by the commercial gains of the new system. Some of the banks have even wanted to go ahead to introduce credit cards.  <b>Risk 3:</b> Limited use of the new system due to lack of the understanding of the new system by clients  <b>Mitigation:</b> This risk is mitigated by the sensitization program as part of project design.
	Enhanced capacity for SPAUT to manage financial, operational and business risks	Enhanced Payment system safety and efficiency	Weak SPAUT capacity to manage risks	Enhanced SPAUT capacity and efficiency.	Progress reports from SPAUT/CBSTP	
<b>Component 2: Review and modernising Payment systems regulatory framework and oversight</b>						

	Revise and update payment system laws and regulations.  Central Bank takes responsibility for oversight of payments systems in the country	Payments systems legal framework developed in line with international standards  A dedicated Department established in Central Bank to provide oversight.	Outdated payment laws exist,  no provision for oversight on payment systems	Payment systems laws and regulations revised  A dedicated unit established at Central Bank to provide oversight  Central Bank staff trained	Annual project progress report  Progress report	Delays by parliament to approve the revised laws and regulations; <b>Mitigation:</b> there is political willingness.
	Component 3: Project management					
	Improved project implementation and coordination.	Preparation and submission of the relevant reports to the bank	N/A	a) Annual audit reports b) Mid-term results assessment report by 2019	Progress reports; Supervision reports.	
KEY ACTIVITIES	<b>COMPONENTS</b>					
	- Component 1: Strengthening payment system infrastructure  Component 3: Project management				- ADF Loan: UA 1.5 million Central Bank:  - Mission: Appraisal, supervision, completion report  - Capacity building for SPAUT & PIU	

## **1. STRATEGIC THRUST & RATIONALE**

### **1.1 Project Linkages with Country Strategy and Objectives**

1.1.1 This operation is conceived in the context of the first priority of the National Poverty Reduction Strategy II (NPRS.II), 2012-2016, (*Estratégia Nacional da Redução da Pobreza, 2012-2016*). The NRSP.II has four priority areas namely: (i) Reforming public institutions and strengthening the strategy of good governance; (ii) Promoting integrated and sustainable economic growth; (iii) Developing human capital and improving basic social services; and (iv) strengthening social cohesion and protection. Specifically, the project is aligned with the strategic objectives of inclusive growth and poverty reduction, as well as Pillar 1 of NPRS II focusing on reforming public institutions and strengthening the strategy of good governance. Also, the internationalization of the payment system is highlighted as a top priority in the Financial Sector Development Implementation Plan (FSDIP)<sup>3</sup>. None of the banks on the island is so far licensed by the global card schemes because government prefers a centralized system given the smallness of the economy<sup>4</sup>.

1.1.2 The proposed project is well aligned with a number of Bank Group Strategy documents. First, it is aligned with the Country Strategy Paper (CSP), 2012-2016, for Sao Tome and Principe (STP), namely its Pillar 1 on strengthening Governance<sup>5</sup>. This pillar focuses on strengthening key public institutions, including human resource capacities as well as country systems and strategic, legal and regulatory frameworks over a sustained period. By investing in improving the country's payment system, the project is aligned with the CSP's governance pillars as an improved transparency in the payment systems will help enhance value for money and reduce corruption. It will also contribute to the country's full compliance with the international standards on payment systems. In addition, the project fits in the Ten-Year Strategy (TYS), 2013-2022, particularly its inclusive growth objective and private sector development core priority. Third, it is in line with one of the Bank Group High-5 institutional priorities, which is Industrialize Africa. Finally, the project links very well with the Financial Sector Development Strategy (its financial inclusion pillar).

1.1.3 The project will contribute to poverty reduction and women empowerment efforts through catalysing increase in tourism activity and improved domestic/regional trade. It will support inclusive growth, which is one of the twin objectives of the TYS. It also aims to support modernisation of the payment system and deepening of financial inclusion, which will result in increased access to financial services for the local population and increase in the flow of tourists in the country as a result of the internationalization of the payment system. The preparation of a Financial Inclusion Strategy, and enabling mobile money, mobile banking and other e-payment instruments, as well as development of secure transactions will support the government to initiate the process of increasing access to financial services for the majority of the population.

### **1.2 Rationale for the Bank's Involvement**

1.2.1 São Tomé and Príncipe's current financial infrastructure is insufficient to meet the needs of a growing and inclusive economy. Existing payments systems lack safety and efficiency and do not allow connectivity to international payments networks (e.g. Visa or MasterCard).

---

<sup>3</sup> *The Draft FSDIP (September 2015) also has four building blocks namely: broader financial inclusion, robust and efficient financial infrastructure, sound and stable financial system, and modern legal and regulatory framework.*

<sup>4</sup> *Some of the banks wanted to obtain license on their own by were not permitted by the government to do so. Recently however, the ECO Bank Corporation, in collaboration with MasterCard Inc and IFC has initiated the process of deploying credit card solution in 23 African countries including STP, over the next ten years.*

<sup>5</sup> *This pillar covers strengthening key public institutions, including human resource capacities as well as country systems and strategic, legal and regulatory frameworks over a sustained period. The CSP also has a second pillar focusing on promotion agriculture infrastructure.*

The current manual check-clearing system does not meet the needs of the banking sector to exchange time-critical, high-value payments. The current card system also suffers from a number of problems related to a lack of safety and efficiency. Those problems translate into the network being unavailable more than 3 hours a day on average and a poor customer experience, which puts at risk the overall objective of the system and trust in card payments. Given the weakness of the financial infrastructure in STP, the Bank Group involvement and support is seen as a major contribution to the economic development of the country.

1.2.2 First, the internationalization of the payment system will add great value to the current domestic payment system, enhance competitiveness of the banking sector, boost tourism and enhance the franchise value of the Bank as a “partner of choice” in STP. The country is endowed with natural resources especially endemic animal and plant species, beautiful natural reservoir sites and cultural diversity, which are great assets to tourism development. Tourism is the main component of services exports of STP and is currently a greater source of foreign exchange earnings than goods exports. However, the tourism sector current contribution to GDP of 15% in 2015 is substantially below its potential, largely due to the limitations of the existing payment system, which does not permit tourists and foreign visitors to freely use international credit cards on the islands<sup>6</sup>. Tourists have to pay using cash which poses a risk. This state of affairs also locks out hotels and international travel companies that would otherwise promote STP as a tourist destination but because of the inability of local service providers to accept electronic/international credit card payments, this potential international publicity has not been exploited. The Bank’s proposed intervention will eliminate this constraint.

1.2.3 Second, the project has a potential impact on domestic and cross-border trade. Wide-spread use of international credit cards on the islands will boost domestic trade as tourists will be able to spend more on locally produced goods. Ability of more nationals to hold locally issued credit cards, linked to major international credit cards networks, will boost cross-border trade and regional integration, which is an important mandate of the Bank Group. The government also accords regional integration a key priority in its NPRS.II, 2012-2016. The ability of nationals to use such cards abroad will render the risk of carrying huge cash on trips unnecessary and also increase accountability in the use of public funds. It also has the added advantage of mitigating money laundering and illicit financial flows, which is in accord with the Bank’s new strategy in this area.

1.2.4 Finally, the project has a potential impact on Gender and women empowerment. Women dominate local and cross-border trade in STP and constitute a greater proportion of employees in the hospitality industry (50-60%) according to views expressed by stakeholders. The project will therefore contribute to improvement in women empowerment, employment and poverty reduction. If more tourists are able to visit STP, women will benefit by providing services and handmade crafts that are very attractive to foreign tourists.

### **1.3 Donor Coordination**

1.3.1 At present, there is no donor intervention in the financial sector in STP. Although, the World Bank assisted the Government in preparing the FSDIP with funding by the First Initiative, it has indicated that it has no funding to support or be part of the payment system project. However, the proposed intervention by the ADB will be supplemented by the FIRST initiative Trust Fund at the World Bank. The activities to be financed under the FIRST initiative will include capacity building for Central Bank staff, which will include establishing a dedicated payment system unit within the Central Bank to carry out the operations, oversight, and policy development. In addition, a request has been submitted to the Portuguese government to provide funding for institutional capacity building to enable the Central Bank establish a Project Implementation Unit. Similarly, a request for funding has also been submitted to the Nigerian technical cooperation fund.

---

<sup>6</sup> A few big hotels accept Visa and Master Card for bill settlement through a special arrangement with a Portuguese Bank and also operate cash-back system for their clients while in STP.

1.3.2 The ADB has in the past been collaborating with other partners, including the World Bank, International Climate Facility (ICF), the United Nations Development Programme (UNDP), and the European Union (EU) to identify areas of complementarity and synergy. These efforts have been instrumental in mobilizing co-financing to complement the Bank's limited performance-based allocation to STP. Specifically, co-finance was mobilized for a trade facilitation project from the World Bank Group. Similarly, discussions are ongoing with the EU towards co-financing of the new integrated agriculture development program.

## **2. PROJECT DESCRIPTION**

### **2.1 Project Objectives**

2.1.1 The broad development goal of the project is to promote a competitive financial sector and financial inclusion in São Tomé and Príncipe, by assisting the authorities to develop a national payments system, improve its oversight, enhance the legal framework to include all electronic payments and services and support preparation of a national financial inclusion strategy.

2.1.2 The specific project objective is developing a competitive financial sector and deepening financial inclusion through the internationalization of the payment system, improved strategic framework and e-payment instruments, and secure lending.

### **2.2 Project Components**

2.2.1 The proposed project has three mutually reinforcing components: (i) Institutional Preparation; (ii) Strengthening Payments System Infrastructure and institutions; and (iii) Institutional Capacity Building. The Bank is in the process of mobilising funds for Procurement of the Automated Transfer System (ATS).

2.2.2 ***The Institutional Preparation (Phase 0)*** aims at creating the necessary conditions for a smooth implementation of the subsequent phases (1 and 2). For this initial phase, the ADB will provide technical assistance support to CBSTP for the initial training of the CBSTP payment systems staff, focusing on awareness activities, study visits, and establishment of the PIU unit (accounting, financial management, elaboration of terms of reference, expression of interest and request for proposal, procurement rules) and for capacity building of São Tomé and Príncipe Automated Payments (SPAUT) new management. To finance the capacity building phase, the Bank will utilise funds from the on-going PAGEF project in STP.

2.2.3 ***Strengthening Payment System Infrastructure (Phase 1)***: This will entail upgrading Dobra 24, and ensuring that it meets the relevant international standards with regard to safety and efficiency. It will involve procurement and installation of upgrades to Dobra24's hardware and software, implementation of the necessary processes to obtain Visa/MasterCard PCI-DSS (payment cards industry - data security standards) certification, installation of additional modules for mobile payments, bill payment, and payment of government taxes among other activities. It will also involve training of personnel and establishing a disaster recovery centre.

2.2.4 The country's Dobra24 ATM network is operated by SPAUT, which has the exclusive rights to operate all point of sale (POS) devices. Dobra24 has inadequate management, weak controls of operational risk and business risk, and deficiencies in terms of hardware, software, processes, and system security, including business continuity. Due to a deficient management of operational risk and security, Dobra 24 did not get the PCI-DSS certification that would enable connectivity with Visa and MasterCard networks. Consequently, local banks only offer domestic debit cards. Banks cannot offer credit cards and foreign visitors with such cards cannot use them widely in STP, which encourages the use of cash and limits commercial transactions. To service tourists and foreign visitors many international hotels have developed a relationship with an overseas bank in order to accept international

credit cards. This keeps domestic banks out of a potentially important fee-income source (i.e., merchant fees), limits their ability to offer revolving credit via credit cards and limits the tourism business. SPAUT also manages 26 ATMs and 56 point of sale devices in the country.

2.2.5 The output of this component will be an upgraded payment system that meets the preconditions to be certified by international card schemes, such as Visa and MasterCard. The planned improvements will include the possibility to process mobile payments, hence contributing to financial inclusion.

2.2.6 ***Institutional Capacity Building:*** This component involves setting up a new Project Implementation Unit (PIU) at the Central Bank, and supporting the PIU with a Project Manager, Procurement Specialist, Payment Expert, Admin and Finance Officer, Monitoring and Evaluation (M&E) Officer. It will also include PIU project operating expenses as well as cost of the annual audits during project implementation. The outcome of this component will be effective management of the above-mentioned project phases.

2.2.7 ***The Bank has initiated resource mobilisation from the NTF to procure ATS later.*** *ATS* will consist of the procurement of an ATS that will replace the manual check-clearing systems. ATS systems include Real Time Gross Settlement modules (RTGS) and Automated Clearing House (ACH) functionalities that support the clearing and settlement of high-value and retail payments. Through RTGS, high-value transfers (in particular inter-bank transfers, and transfers between the banks and BCSTP, including monetary policy operations) are settled in central bank money, and in real time, reducing liquidity and credit risks in the system. ACH clears low-value (retail) payments throughout several clearing cycles in the day and provides for settlement in the RTGS component. As a result, retail payments (such as transfers and direct debits) are processed more quickly and efficiently with reduced probability of leakage as opposed to what is happening in the existing manual system. There are no resources to finance Phase 2. Nevertheless, a request has been submitted to the Nigeria Trust Fund, and a provision has also been made in the next ADF allocation fund for acquiring the ATS.

2.2.8 The output of this component will be the ATS system that is based on the latest technical innovations provided by a specialized firm at a lower cost as compared to separate RTGS and ACH elements. In addition, the ATS system offers the possibility to integrate a central securities depository element in order to facilitate the provision of intra-day liquidity to the participants in the system. Further, the ATS will support a safer mechanism to settle the multilateral balances of the Dobra24 system. ATS system will also support e-government, as it will have the capability to handle large value and low value transactions emanating from the government in a safe and efficient manner. The implementation of the ATS will facilitate the phasing-out of cheques, the decrease in the use of cash, and in general a smooth migration to electronic payments. As an outcome, the ATS will improve the overall national payment system, which in turn will contribute to economic growth and poverty reduction. This phase will be funded from the Nigeria Trust fund.

2.2.9 A summarised description of the activities of the proposed components of the Bank's intervention is presented in Table 1.

**Table 1: Project Components and Activities**

Table 1: Payment System Infrastructure Project:		
Components	Amount	Activities
Phase 0 Institutional Preparation	USD 336,209( Euros 300,000)	(i) System maintenance and management through specialized training programs
Phase 1 Strengthening Payment System Infrastructure		(i) Procurement and installation of an upgraded solution for Dobra 24 payment's module, including the necessary replacements /upgrades in hardware and software, with a view to ensuring resiliency, scalability, redundancy, and a high-level of availability of the system, and in general ensuring a high level of compliance with international standards; (ii) The procurement of a new data center and a disaster recovery center to ensure a high level of security and business continuity; these should have the capacity to also host the ATS system in phase 2; (iii) The implementation of the necessary equipment and processes to obtain Visa/MasterCard PCI-DSS certification; (iv) The procurement and installation of additional modules allowing for the safe and efficient processing of mobile payments and additional services such as bill payment and payment of government taxes; (v) The reinforcement of SPAUT's capacity to manage the new system and adequately manage operational risks and on-the-job training and knowledge transfer; and (vi) Strengthening the capacity of SPAUT for efficient system maintenance and management through specialized training programs.
Project management and institutional capacity building.		(i) Setting up of a new Project Implementation Unit (PIU) at the Central Bank; (ii) Supporting the PIU with: (a) Project Manager, (b) Procurement Specialist ( to get additional support from other ADB funded projects) (c) Payment Expert ( TA) (d) Admin and Finance Officer, (e) Monitoring and Evaluation (M&E) Officer (iii) PIU project operational expenses (iv) Cost of the annual audits during project implementation

**2.2.10 Other related Interventions:** The planned intervention indicated above to be funded by ADB will be supplemented by the FIRST initiative Trust Fund at the World Bank. The approved amount under the initiative is USD 299,000. The activities to be financed under the FIRST initiative will include capacity building for Central Bank (CB) staff, which entails establishing a dedicated unit within the CB to carry out the following: (a) operations, (b) oversight, and (c) policy development). The TA will consist of; (i) training on international standards and best practices; (ii) assistance in drafting of an oversight framework on payment systems and payment instruments, and developing a national payment system development framework; and (iii) a retail payments strategy, including the development of mobile payments. In addition, the TA activities will include strengthening the existing legal framework in order to adequately cover all electronic payments, including the systems, the services and the payment instruments, in conformity with international standards and best practices.

2.2.11 The activities financed by FIRST would span over phases 1 and 2, according to priorities established in close coordination with CBSTP and the ADB. The World Bank /First Initiative will support the Central Bank to establish, staff and equip a unit within the Central Bank to exercise the supervision (regulate and oversee) the national payment system, in order to ensure systemic stability and efficiency, as well as the safety and the proper use of payment instruments. The oversight of payments systems is essential to ensuring the normal performance of the monetary and financial markets (domestic and international) and the stability of the economy.

### 2.3 Technical Solution Retained and Other Alternatives Explored

2.3.1 The technical solution adopted for training takes into consideration the country's weak institutional capacity, fragile nature and the need for sustainability and effective knowledge transfer. Portugal and South-South cooperation has been identified as the most appropriate mechanism for knowledge sharing. At the time of appraisal the government had proposed that the project should

support repairs of existing infrastructure but considering the state of the equipment it was agreed that a complete overhaul be conducted to ensure security and value for money.

## 2.4 Project Type

2.4.1 The project is for modernising and upgrading the STP’s payment systems infrastructure in order to improve the capacity to process safely and efficiently interbank payments, retail payments, and to process international retail transactions. The project will support modernization of the payment system to a fully interoperable card payment system with international linkages to allow use of international cards like MasterCard and Visa. The intervention will also support institutional capacity building by supporting the restructuring and strengthening of the Central Bank and creation of a dedicated department to provide oversight and supervision of the payment systems in the country with support from World Bank/First Initiative. Support to restructure and strengthen SPAUT--the institution that manages the DOBRA 24--following a diagnostic of current payments infrastructure, software and management.

## 2.5 Project Cost and Financing Arrangements

2.5.1 The total project cost, including physical and price contingencies, is estimated at EUR 2.67 million (UA 2.14 million) net of taxes and duties. Details of project cost estimates are presented in Table 2.

**Table 2: Project Cost Estimate**

<b>Component</b>	<b>EUR</b>	<b>UA</b>
<b>1. Infrastructure</b>	<b>387,800</b>	<b>310,240</b>
1.1 Main processor	284,600	227,680
1.2 DR processing center	77,400	61,920
1.3 Travel and Subsistence costs	25,800	20,640
<b>2. Payment solution</b>	<b>704,750</b>	<b>563,800</b>
2.1 Replacement cost	308,750	247,000
2.2 Payment services	67,200	53,760
2.3 Wages payment/ pensions and automated transfer service	212,000	169,600
2.4 Implementation - Acceptance & Visa Issuance	116,800	93,440
<b>3. Mobile Banking Solution</b>	<b>309,000</b>	<b>247,200</b>
3.1 Additional Infrastructure - Main processing center	30,000	24,000
3.2 Additional Infrastructure - DR processing center	10,000	8,000
3.3 Mobile banking solution	225,000	180,000
3.4 Training in solution and in the equipment	20,000	16,000
3.5 Travel and Subsistence costs	24,000	19,200
<b>4. Consulting &amp; capacity building</b>	<b>400,000</b>	<b>320,000</b>
4.1 Support for migration from current solution including integration services	220,800	176,640
4.2 Support for business components/training on the job x 14 months	89,600	71,680
4.3 Technical support / training on the job x 14 months	89,600	71,680
<b>5. Project Management</b>	<b>387,600</b>	<b>310,080</b>
sub-TOTAL	2,189,150	1,751,320
Price Contingency	218,915	175,132
<b>TOTAL</b>	<b>2,408,065</b>	<b>1,926,452</b>

2.5.2 Table 3 summarises the project cost estimates by components.



**Table 3: Project Cost Estimates by Component**

Component (	Foreign cost UA	Local Cost UA	Total Cost UA	Total Cost EUR
1. Infrastructure	310,240	-	310,240	387,800
2. Payment solution	563,800	-	563,800	704,750
3. Mobile Banking Solution	247,200	-	247,200	309,000
4. Consulting Services	320,000	-	320,000	400,000
5. Project Management	-	310,080	310,080	387,600
<b>Sub-Total</b>	<b>1,441,240</b>	<b>310,080</b>	<b>1,751,320</b>	<b>2,189,150</b>
Price contingency	144,124	31,008	175,132	218,915
<b>Total</b>	<b>1,585,364</b>	<b>341,088</b>	<b>1,926,452</b>	<b>2,408,065</b>

2.5.3 Project cost estimate by source of finance is presented in Table 4. The Bank will provide a financing of up to a maximum of UA 1.50 million. Other source of finance includes the World Bank (USD 299,000 or UA 213,571), and the Government of São Tomé and Príncipe (UA 212,881).

**Table 4: Sources of Finance**

Financing Source	Foreign Cost UA	Local Cost UA	Total Cost UA	Total Cost EUR	%
ADB	1,364,000	136,000	1,500,000	1,875,000	78%
World Bank	213,571	-	213,571	266,964	11%
Government of STP	-	212,881	212,881	266,101	11%
<b>Total</b>	<b>1,577,571</b>	<b>348,881</b>	<b>1,926,452</b>	<b>2,408,065</b>	<b>100%</b>

2.5.4 The project will be implemented in 4 years. The project cost estimates by year of expenditure is summarised in Table 5.

**Table 5: Project Cost Estimates by Year of Expenditure**

Component (UA)	Year 1	Year 2	Year 3	Year 4	Total
	50%	20%	20%	10%	100%
1. Infrastructure	155,120	62,048	62,048	31,024	310,240
2. Payment solution	281,900	112,760	112,760	56,380	563,800
3. Mobile Banking Solution	123,600	49,440	49,440	24,720	247,200
4. Consulting & Training	160,000	64,000	64,000	32,000	320,000
5. Project Management	155,040	62,016	62,016	31,008	310,080
Contingencies	87,566	35,026	35,026	17,513	175,132
<b>Total</b>	<b>963,226</b>	<b>385,290</b>	<b>385,290</b>	<b>192,645</b>	<b>1,926,452</b>

2.5.5 The Bank will provide UA 1.50 million towards project cost. The Bank will finance 100% of the Infrastructure, Payment Solution and Mobile Banking Solution components. The Bank will also finance part of the Consulting Services and Project Management components. The World Bank will finance part of the consulting services and the Government of Sao Tome and Principe will finance part of the Project Management expenses. The project components to be financed by the ADB are presented in Table 6.

**Table 6: Project Cost Estimates by ADF Financed Components**

Component	Foreign Cost UA	Local Cost UA	Total Cost UA	Total Cost EUR
1. Infrastructure	310,240	-	310,240	387,800
2. Payment Solution	563,800	-	563,800	704,750
3. Mobile Banking Solution	247,200	-	247,200	309,000
4. Consulting Services	120,000	-	120,000	150,000
5. Project Management ( TA)	-	123,200	123,200	154,000
<b>Sub-Total</b>	<b>1,241,240</b>	<b>123,200</b>	<b>1,364,440</b>	<b>1,705,550</b>
Price contingency	124,124	12,320	136,444	170,555
<b>Total</b>	<b>1,365,364</b>	<b>135,520</b>	<b>1,500,884</b>	<b>1,876,105</b>

2.5.6 Table 7 provides project cost estimates by ADF financed components, as well as by category of expenditure. The cost estimates include contingencies.

**Table 7: Project Cost Estimates by ADF Financed Components/Expenditure Category**

Expenditure Category	EUR			UA		
	Local	Foreign	Total	Local	Foreign	Total
Goods	-	1,541,705	1,541,705	-	1,233,364	1,233,364
Consulting Services	169,400	165,000	334,400	135,520	132,000	267,520
<b>Total</b>	<b>169,400</b>	<b>1,706,705</b>	<b>1,876,105</b>	<b>135,520</b>	<b>1,365,364</b>	<b>1,500,884</b>

*Includes contingencies*

## 2.6 Project Target Area and Population

2.6.1 The project is targeting the entire country and the entire population of São Tomé and Príncipe. The population will benefit from increased financial inclusion as a result of the proposed project. The country consists of two small main islands and two islets in the Gulf of Guinea about 240 km off West Africa. It is one of the smallest economies in Africa with about 198,000 inhabitants and classified as a lower middle-income country with a per capita income of USD 1,570 in 2014.

2.6.2 The project is targeting in particular the financial sector of STP, which is dominated by commercial banks that account for 98% of total assets in the system. The domestic Dobra24 network payment system is operated by Sao Tome Principe Automated Payments (SPAUT)<sup>7</sup>, which currently provides services to all the 7 commercial banks, 27 bank branches in five of the seven districts, 26 ATMs and 59 POS devices. The project aims at upgrading and modernising the Dobra24 to meet the international standards and requirements.

2.6.3 The project is targeting the payment system infrastructure for the entire country. The system is inefficient in several respects. Multiple pieces of the payment system are semi-automated. This makes the payment system more prone to risk, creates inefficiencies and increases the cost to users. The system lacks international connection to any international credit card network, thus resulting in inability of tourists and foreign visitors to STP to use their credit cards widely on the islands<sup>8</sup>. The local banks are also unable to offer credit card services to their customers. The internationalization of the payment system has been highlighted as a top priority in the government draft Financial Sector Development Implementation Plan (FSDIP), prepared with the assistance of the World Bank and funding by the First Initiative<sup>9</sup>.

2.6.4 The proposed project target is to modernize and improve the quality of the payment systems infrastructure for STP. The project will benefit the local population as well as the international visitors, especially tourists and business people.

## 2.7 Participatory Process for Project Identification, Design & Implementation

2.7.1 During project preparation, extensive consultations were held with various stakeholders including officials of the Central Bank; Ministry of Finance and Public Administration; Ministry of Economy and International Cooperation; SPAUT; Chambers of Commerce, Industry, Agriculture and Services; Directorate of Tourism; Institute for the promotion of Gender; International Monetary Fund; commercial banks and their umbrella association; hotel operators and other businesses in the country. These series of consultations helped the team to obtain first-hand information from both the providers

<sup>7</sup> SPAUT is jointly owned by the Central Bank (42%), the Commercial Banks (8% each), and the National Telecommunications Company, Companhia SaoTomense de Telecomunicacoes (CST).

<sup>8</sup> To service tourists and foreign visitors a few international hotels have gone around this legal requirement and developed relationship with a Portuguese bank to accept international credit cards for bill settlement.

<sup>9</sup> The development of the FSDIP involved extensive stakeholders consultation in which the Bank's field Office in STP (STFO) actively participated.

and users of the Dobra24 network on the weaknesses of the existing system and the importance of an efficient technical solution with connection with major international credit cards networks.

2.7.2 SPAUT, the company that runs Dobra24 was previously owned by Commercial Banks, Telephone companies and Central Bank. The team took time to discuss with the owners and end users. It was important to engage stakeholders because the proposed project will entail important aspects such as integrity, safeguards and compliance. In addition, it is important that the various stakeholders take ownership of the project because the Banks and TELCOS will eventually take over the ownership of SPAUT.

## **2.8 Bank Group Experience, Lessons Reflected in Project Design**

2.8.1 The ADB currently has no activity in the financial sector in STP. As at 31 August, the Bank had 5 ongoing operations in the country amounting to a total of UA 28.6 million. Sectoral distribution of the operations is: agriculture (63.2%), multi-sector (34%), and water and sanitation (3%). The 2014 portfolio review rated overall portfolio performance as satisfactory (2.16 on a scale of 0 to 3), no project at risk and no aging projects (2.2 years average portfolio age). Satisfactory portfolio performance was attributed to improved quality at entry and enhanced bi-annually supervision missions. However, delays in compliance with loan conditions and poor performance of local contractors remain key challenges to portfolio performance.

2.8.2 During the design of the project, the team drew on the lessons learned from the ongoing operations and the review of the main underpinning analytical work particularly the FSDIP. The lessons indicated by 2014 Portfolio Review include the need to: (i) provide regular training on the Bank's policies and procedures, including financial management and procurement; (ii) systematically integrate into new operations a component related to capacity building and skills development; (iii) improve the programming of counterpart funds; and (iv) seek strategic partnerships to improve coordination with partners and help catalyse additional funds through co-financing and trust funds to finance government's priority projects.

2.8.3 The team also drew lessons from other ADB funded projects in the sector like the EAC Payment systems and Settlement Integration project (EAC-PSSIP) and the WAMZ payment strengthening project and these two project suffered delays in implementation due to lack of capacity of implementing agencies and familiarity with available technologies on the market. Therefore, during project design, funds were re-allocated from an on-going project (PAGEF) to provide capacity building for the BCSTP staff to make them get acquainted with similar systems that are going to be acquired under the project. It was also deemed important for users to learn more about available technology on the market as this has proven to delay implementation of similar project funded by the ADB in other countries.

## **2.9 Key Performance Indicators**

2.9.1 The key performance indicators for monitoring the project achievements are outlined in the project's Results-based Logical Framework. The key outcomes are: (i) Broader financial Inclusion; ii) Robust and efficient national payments system with international connectivity; (ii) strengthened oversight to oversee payment systems; iii) sound, stable and competitive financial sector; iv) and (v) increased financial inclusion. The overall impact include deeper inclusive growth, competitive financial sector and improved tourism development.

2.9.2 The key indicators are increased population with Mobile Money Account, women in the population with mobile money account, adult population with access to financial services, decrease in transactions costs, increased volume of credit cards transactions, increased number of tourism arrivals, and enhanced institutional capacity of SPAUT. These indicators will be collected and analysed regularly by the Project Implementation Unit (PIU).

2.9.3 The PIU will prepare quarterly project progress reports, presenting the progress made on implementation and achievements on output indicators. Indicators will be updated in the Implementation Progress Report (IPR) and necessary adjustments will be made as appropriate. A medium term report (MTR) and Project Completion Report (PCR) will be prepared to provide an assessment of the project. The PCR will provide information on achievements in terms of outputs and outcomes. All of these reports will be circulated widely within the Government, the Bank and to other development partners.

2.9.4 The potential outputs and outcomes are summarised in Table 8.

**Table 8: Key Performance Indicators**

Component		Outputs (By end of Project Implementation)	Outcome (Long term benefits)
0	Capacity Building	<ul style="list-style-type: none"> <li>• Implementation Unit (PIU) established</li> <li>• Project Recruited staff for PIU</li> <li>• Trained staff for PIU</li> </ul>	<ul style="list-style-type: none"> <li>i) Central Bank of STP (CBSTP) becomes majority shareholder of SPAUT</li> <li>ii) A Payment Systems Department at CBSTP set-up.</li> <li>iii) CBSTP payment systems staff trained.</li> <li>iv) Establishment of a PIU unit and trained staff</li> <li>v) Training of SPAUT management on general management skills</li> </ul>
1	Strengthening Payment System Infrastructure	<ul style="list-style-type: none"> <li>• Modern national payment system hardware and software infrastructure installed Modern national payment system hardware and software infrastructure installed</li> <li>• Strengthened payment system institution.</li> </ul>	<ul style="list-style-type: none"> <li>• Improved national payments system with international connection</li> <li>• Improved competitive financial sector</li> <li>• Improved financial inclusion</li> <li>• Increase in number of tourists to the country</li> <li>• Increase in volume of trade within the region</li> </ul>
2	Project Management	<ul style="list-style-type: none"> <li>• Improved project implementation and coordination</li> </ul>	<ul style="list-style-type: none"> <li>• High quality project outputs and outcomes</li> </ul>

### 3. PROJECT FEASIBILITY

#### 3.1 Financial performance

3.1.1 The project operations during the first phase will be based on the improved performance of SPAUT and it is considered financially and economically viable. At full operation, SPAUT will be making a gross income of about USD 2 million per year. The analysis of SPAUT was done based on projections of earnings from commissions earned from ATMs and other points of sale. With international connectivity, it is expected that more tourists will be able to use their international credit cards. The discounted cash flow (DCF) analysis carried out on the net cash-flow gave a Financial Net Present Value (NPV) of USD 5,493,952 at a discount rate of 4% (the average cost of borrowing). The projected profitability of SPAUT is very important because at the end of the project, SPAUT will be privatized so that the commercial Banks and TELCOs can take up majority shares.

3.1.2 Key economic and financial figures are summarized in Table 9.

**Table 9: Key Economic and Financial Figures**

Indicator	Result
NPV (USD Million)	<b>5.49</b>
FRR (base case)	<b>37.7%</b>

## 3.2 Economic Performance

3.2.1 **Economic Benefits:** The Banking system of STP will be the main beneficiary of the proposed project. It is composed of the Central Bank that operates (i) the Interbank Clearing System (SICOI), (ii) the Automated Transfer System and (iii) the SWIFT along with the Dobra24 Network operated by SPAUT and the 7 commercial banks that are minority shareholders of SPAUT. Having a sustainable payment system prevents leakages and creates savings from reduced transaction costs and from administrative and overhead costs. STP economy as a whole will benefit from a robust payment system in many ways. Merchants and Businesses are mainly looking at more efficient processing leading to savings from processing time, cost, and manual system errors.

3.2.2 **Financial Inclusion:** A robust payment system will ultimately allow for deeper financial inclusion. The population will benefit from a wider supply and better access of financial services, namely deposits and transfers, savings, loans and insurance products. The project will deepen financial inclusion and create a competitive financial sector through the internationalization of the payment system. The project will also deepen financial inclusion through enlarged tourism sector via the internationalization of the payment system. By promoting poverty reduction and women empowerment through expanded tourism sector and improved domestic/regional trade, the project will support inclusive growth, which is one of the twin objectives of the TYS. The planned improvements will include the possibility to process mobile payments, hence contributing to financial inclusion. The improvement of the payment system infrastructure in a sustainable manner will pave the way for further inclusion.

3.2.3 **Private Sector and Tourism Development:** The expected development outcomes of the proposed project are private sector and tourism development. The medium-term project outcomes will include improved financial sector performance and increased tourism and international trade. The long-term impact will be enhanced economic growth; regional integration through increased trade; private and financial sector development; and poverty reduction. Thus, the project will promote private sector development through improvement of the financial sector performance, ranging from traditional banking to mobile banking, remittances, agent banking, micro-financing and micro-insurance. Financial inclusion entails bringing more people into the formal financial system and leads to an increase in economic growth and stability in the country.

3.2.4 **Overall Development Impact:** By enhancing the performance of the financial sector, through the upgraded payment system infrastructure, the country will be in better position to attract more tourists, increase regional and international trade and grow the private sector. The direct impact of these developments will include the creation of more employment, an increase in fiscal tax receipts by governments, and development of capital, which will ultimately foster economic growth and wealth distribution in the country. Supporting growth in financial services by investing in financial infrastructure is a precondition for growth and necessary for wealth creation on an individual level and wealth distribution on a societal level.

## 3.3 Environmental and Social Impacts

3.3.1 **Environment:** The assessment made concluded that there are no negative environmental effects related to this project and only positive social effects are expected. In terms of social impact, there are no effects such as displacement, emigration of workers associated with the project, therefore there is no need for an ESMP.

3.3.2 **Gender:** The project will have a positive impact on Gender and women empowerment. The increase in tourism arrivals as a result of the project, will lead to an increase in employment opportunities for women, since they are the main source of labour supply in the hospitality industry (50-60%).

3.3.3 **Social:** The project will have positive social impacts that include an increase in transparency and efficiency in the financial sector.

## **4. PROJECT IMPLEMENTATION**

### **4.1 Implementation Arrangements**

4.1.1 Project implementation will be the responsibility of the Central Bank (CB), through a Project Steering Committee (PSC) that will be setup. The PSC will have membership drawn from the CB, Ministry of Finance, Association of Bankers and representative from the Telcos. The PSC shall provide overall strategic direction to the project. Since the CB has not managed any donor funded projects in the recent past, the Central Bank has identified staff to be part of the Project Implementation Unit (PIU). Most of the staff do not have the requisite expertise to manage the day to day activities of the proposed project and to mitigate this, experts will be recruited to support the PIU. The PIU will be headed by an experienced Project Coordinator (PC) with a minimum of 5 years' experience.

4.1.2 The PC shall be supported by a Financial Management Specialist (FMS) who will also double as the administrative officer of the project, a Procurement Specialist, Payments System TA consultant and Accounts Assistant (to be seconded to the PIU by the Central Bank).

#### **4.1.3 Procurement Arrangements**

***(Phase 0/ Institutional Preparation): Phase 0/ Institutional Preparation:*** Procurement activities under this phase will be implemented using funds for ongoing PAGEF's Bank-funded Project. Therefore, all procurements of goods and consultancy services financed through PAGEF funds will be conducted in accordance with Bank Rules of Procedure for Procurement of Goods and Works (May 2008 edition revised in July 2012) or Rules of Procedure for the Use of Consultants (May 2008 edition revised in July 2012), as applicable, using the Bank's standard bidding documents as underlined in PAGEF's Financing Agreement. A consultant, with procurement experience in the industry, will be recruited to enhance the capacity of BCSTP and to support the PIU with procurement skills throughout the implementation of the project, as the implementing agency does not have experience with implementation of Bank's projects. Participation to trainings, study tours, workshops will be consolidated in a plan to be submitted for Bank's approval prior to its implementation and should not involve procurement activities but rather costs related to the implementation of such activities (travel, accommodation, per diem, tuition), and will follow procedures in use at BCSTP. It is anticipated that Study tours will be conducted in few Portuguese speaking countries where there are similar systems and ease of communication. In addition, there are few countries that could be willing to host the Central Bank officials

***Phase 1 (Strengthening Payment System Infrastructure)*** of the project will be implemented according to the "Procurement Policy for Bank Group Funded Operations", dated October 2015, utilizing available Bank's Standard Solicitation Documents (SSDs). All Procurement of Goods (equipment, software) under phase 1 will be based on Open Competitive Bidding (OCB), using International Competitive Bidding (ICB) method. Two contracts are anticipated: i) Contract 1: strengthening and modernization of payment system including commissioning and training; and ii) Contract 2: Disaster Recovery system. Installation and training will be part of each contract and will be included in the package so that the supplier of goods will install, train and commission. Individual consultants, such as (i) Financial Management Specialist (FMS), (ii) Procurement Specialist, (iii) Payments System TA consultant and (iv) Accounts Assistant will be recruited using the Selection of Individual Consultants method. The selection of an independent external auditor will be carried out using the Least Cost Selection (LCS) method.

Special arrangements - In case of joint financing with other partners (i.e. the Portuguese Cooperation), procurement for technical assistance will be based on Bank rules and procedures for procurement, on the basis of an agreement to be entered into with the other financier. It is expected that other partners may support the implementation of the project, such as the World Bank. This will be a parallel financing for which Bank's Procurement Framework shall apply to the contracts financed solely by the Bank.

**4.1.4 Executing Agency (EA) Capacity Assessment:** For Phase 0, the procurement activities will be implemented through the PIU of the PAGEF project, which has adequate capacity for the execution of procurement activities for that phase. For Phase 1, the EA will be the BCSTP, through a Project Implementation Unit (PIU) which has been established, and will be responsible for the procurement of goods, works, and acquisition of consulting services. Overall, the resources, capacity, expertise and experience of BCSTP (including the PIU) are inadequate to carry out the procurement for the project. A qualified consultant, with procurement skills, will be recruited (during Phase 0) to support BCSTP during the project implementation period. The Project Coordinator shall be supported by consultants such as a Financial Management Specialist (FMS) who will also double as the administrative officer of the project, a Procurement Specialist, Payments System TA consultant and Accounts Assistant.

**4.1.5 Procurement Risks and Capacity Assessment (PRCA):** the assessment of procurement risks at the country, sector, and project levels and of procurement capacity at the executing agencies, were undertaken for the project and the output has informed the decisions on the procurement regimes being used for specific transactions or groups of similar transactions under the project.

#### **4.1.6 Financial Management**

4.1.7 The CB PIU will be responsible for the financial management functions of the proposed Project. The assessment of the capacity of staff members of the Finance Department revealed capacity gaps that could impair the effective financial management of the Project. The staff do not have the necessary experience in the management of donor-funded or similar projects. The CB will however allocate an interim Project Accountant to work within the PIU in the initial stages of the project as the recruitment of an FMS is undertaken. Consequently, in order to mitigate the potential FM risks, a qualified and experienced Financial Management Specialist (FMS) will be recruited to handle all FM related issues of the proposed project. The contracted FMS will be subjected to an annual performance evaluation to ensure that he/she supports the borrower's compliance with the Bank's financial management requirements.

4.1.8 The CB uses the SIBANC accounting application for transaction processing and financial reporting. The proposed project will be created as a profit centre in the SIBANC system to enable the PIU to generate the related accounting information and reports. It is noted that each department currently has its own customized accounting manual and the manuals do not incorporate donor processes and procedures. The Accounts Department is currently updating and consolidating the separate manuals into a single document that will incorporate procedures aligned to Bank requirements.

4.1.9 The CB engages private external auditors on six-yearly audit cycle to audit the financial statements of the bank. The Central Bank's auditors will audit the annual accounts and financial statements of the proposed project subject to compliance with ADB procurement guidelines and in line with terms of reference acceptable to the Bank. The project will prepare and submit annual financial statements, audited by the independent private audit firm, together with the auditor's opinion and management letter to the Bank not later than six (6) months after the end of the financial year. The cost of audit will be financed by the ADB financing. The PMU will ensure compliance with the audit submission deadlines. The project will also be required to prepare and submit a quarterly progress report to the Bank not later than forty-five (45) days after the end of each calendar quarter.

4.1.10 The CB prepares a consolidated budget covering all its departments which is approved by the Governing Board, forwarded to Cabinet for authority to spend and then submitted to Parliament for approval. The PIU will prepare an annual budget and work plan which will be approved within the CB and then submitted to the Bank for no objection. A comparison of budgeted versus actual expenditure is done on a quarterly basis in its financial reports.

4.1.11 Based on the financial management assessment, the CB's budgeting and internal controls are assessed as adequate and will be adopted for use by the proposed project. The CB will also use the existing SIBANC accounting application to process financial transactions and reporting of the proposed project. The overall conclusion of the assessment is that the CB's capacity to handle the FM aspects of the project, satisfies the Bank minimum requirements as per the Bank FM guidelines. The overall FM Risk is assessed as Moderate.

***Disbursement Arrangements:***

4.1.12 The project will make use of the Bank's various disbursement methods including (i) Direct Payment, (ii) Special Account (SA) and (iii) Reimbursement methods in accordance with Bank rules and procedures as laid out in the Disbursement Handbook. The Direct payment method will be used in making eligible payments against larger contracts concluded between the project and contractors/suppliers. The Special Account method will be used for meeting recurrent expenses and small contracts. A segregated USD-denominated Special Account will be opened at the Central Bank (CB), with the approval of the Minister of Finance (MoF). A local currency account will be opened at the CB to receive transfers from the segregated SA USD account for making payments in local currency. A second separate local currency account will be opened at the CB to receive its counterpart funding contributions. Both accounts will be managed by the CB. In addition, the Bank will issue a Disbursement Letter whose content will be discussed and agreed during negotiations.

4.1.13 The pre-conditions for first disbursement are as follows: (i) opening of a special bank account; (ii) an official letter nominating the project coordinator; and (iii) proof showing that the Government is the majority shareholder of SPAUT.

4.1.14 ***Audit Arrangements:*** The Tribunal de Contas (the Court of Accounts) is the Supreme Audit Institution of Sao Tome and Principe. The Constitution of the Republic provides provision for establishment of the Court of Auditors. Its functions include audit of: (i) state accounts; and (ii) financial statements of the ministries Special Autonomous Region of Principe, district councils, state owned enterprises, and those where the government owns more than 50% of the shares. However, the Act establishing the CB requires the annual accounts and financial statements audited by private external auditors. Therefore, CB engages private external auditors on six-yearly audit cycle to audit the financial statements of the bank. The current auditors mandate expires with the audit and submission of the 2014 financial statements. The process of recruiting the new auditors of the CB will be reviewed and if it falls in line with those of ADB and IDA, auditors may be allowed to audit the annual accounts and financial statements of the proposed project for a period not exceeding 36 months in line with ADB guideline. Subsequent audits of the proposed project shall be outsourced to another audit firm on terms of reference acceptable to the ADB. The ADB's procurement guidelines for the engagement of the audit firms shall apply to the selection of the auditor, with all due consideration for harmonization and coordination with IDA. Audited financial statements and associated management letter of the proposed project shall be submitted to the ADB/IDA within six months of the end of each audited financial year.

4.1.15 ***Overall Conclusion:*** The CB Budgeting and Internal Control systems appear adequate and the associated risk was assessed as moderate. The proposed project may use the country systems in line with ADB / IDA policies on the use of these systems. The CB may also use the existing SIBANC accounting application to process financial transactions and reporting of the proposed project. The other FM elements have all been assessed as reasonably adequate and the associated risks are **Substantial**. It is therefore the overall conclusion of the FM capacity assessment that the CB will need to address the



challenges associated with the weaker FM elements in accordance with the action plan in the Table below, in order for the CB to have adequate capacity to manage the FM and External Auditing arrangements of the proposed project and ensure that: (a) project funds are used only for the intended purposes in an efficient and economical way; (b) accurate, reliable and timely periodic and annual financial reports are prepared; and (c) all project assets are adequately safeguarded. The overall **FM Risk** is assessed as Substantial.

## 4.2 Monitoring and Evaluation

4.2.1 The Bank will carry out supervision missions annually while the STFO will undertake continuous implementation monitoring. Government will submit quarterly and annual progress reports in line with the Bank’s standard format. A project completion report will be prepared at the close of the project to evaluate progress against outcomes and draw lessons.

## 4.3 Governance

4.3.1 The diagnostic assessment made on the health financial sector/SPAUT revealed several deficiencies including weak technical capacities, the need to upgrade the system among others. The proposed project was designed by taking into consideration the country context and system as well as the weak institutional capacity. Implementation of the PIU with qualified staff would be a mitigation measure. Other measures will include involvement of national agencies (audit court) and an independent audit firm.

## 4.4 Sustainability

4.4.1 The project sustainability will depend on the government’s commitment and participatory approach during the overall process. The payment system is crucial for the financial sector and tourism to thrive, the Banks, and Hotel operators are very keen to use the developed and modernised payments system especially with international connectivity. A restructured and efficiently run SPAUT will be co-owned by commercial Banks and Telecommunication companies who will ensure that it’s properly run. SPAUT new system will offer more services on their ATMs, like. Mobile payments, airtime, bill payments thus increasing their revenue collection to sustain operations and maintenance of software and infrastructure. The establishment of a dedicated unit in the Central Bank whose staff will be trained will provide more guidance. Project will train and send staff teams to study tours to understudy similar systems ensuring effective knowledge transfer.

## 4.5 Risk Management

4.5.1 The principal risks associated with the project including mitigation measures are summarised in Table 10.

**Table 10: Project Risks and Mitigation Measures**

No	Risk	Probability/Impact	Mitigating Measures
1	<b>Design Risks</b> Project design is too ambitious given the funding envelope.	Low risk	The project will leverage additional resources, particularly from other multilateral development partners, which will help complement the technical assistance. The project will also potentially be supported by a World Bank development policy operation (DPO) prior action on payment system.
2	Failure to implement the project successfully		The Capacity building phase to be funded by ADF will minimise this problem.
3	Issue of full functionality of the payment system if the new international system is not	Medium/	This risk is mitigated by installing a new modern integrated system that can handle

	fully compatible with the old Dobra24 system.	High	both domestic and international transactions.
4	Possible lack of commitment of Central Bank and commercial banks to the new payment system.	Medium/High	This risk is mitigated by the commercial gains of the new system. Some of the banks have even wanted to go ahead to introduce credit cards on their own.
5	Limited use of new system due to lack of knowledge of the system by potential clients. Interoperability between the new international system and the existing proprietary systems of commercial banks.	Medium	This risk is mitigated by the sensitization program as part of project design as well test or trial runs during implementation.
6	Weak capacity of the commercial banks to be involved in the new payment system and the capacity of the of the legal department of the Central Bank in monitoring and mitigating credit cards security risks.	Medium/High	This risk is mitigated by the Technical Assistance and capacity building incorporated into the project design.

## 4.6 Knowledge Building

4.6.1 This project is based on the knowledge sharing from lusophone Portuguese speaking countries. A study conducted by SIBS Portugal, at the request of the Government, was the guiding instrument for project design. In addition, a study on financial inclusion will be also undertaken. The impact of the project will be strengthening the capacity of commercial bank staff and technicians of SPAUT and Central Bank in payment system by directly involving them in training to be provided.

## 5. LEGAL INSTRUMENTS AND AUTHORITY

### 5.1 Legal Instrument

5.1.1 The project will be financed using the following instrument: an ADF Loan Agreement in the amount not exceeding UA 1.5 million will be signed between the ADF and the democratic Republic of Sao Tome and Principe.

### 5.2 Condition Associated with the Bank's Intervention

5.2.1 *Conditions Precedent to Entry into Force of the Loan Agreement:* The entry into force of the Loan Agreement shall be subject to the fulfilment by the Borrower of the provisions of Section 12.01 of the General Conditions Applicable to Loans and Guarantee Agreements of the ADF.

5.2.2 *Conditions Precedent to First Disbursement of the Loan:* The obligation of the Bank to make the first disbursement of the loan shall be conditional upon entry into force of Loan Agreement in accordance with 5.2.1 above and:

- (i) provide evidence of the opening of a special bank account and
- (ii) Proof showing that the Government is the majority shareholder of SPAUT.

### 5.3 Compliance with Bank Policies

5.3.1 This Project complies with all applicable Bank policies.

## 6. RECOMMENDATION

Management recommends that the Boards of Directors of the Bank approve the proposed ADF loan of UA 1.5 million to the Republic of Sao Tome & Principe for the purposes of financing the Payment System Infrastructure and Financial Inclusion Project, and subject to the conditions stipulated in this report.