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The World Bank

Report No: 30936

IMPLEMENTATION COMPLETION REPORT  
(SCL-45670)

ON A

LOAN (Loan No. 4567-EC)

IN THE AMOUNT OF US\$ 10 MILLION

TO THE

REPUBLIC OF ECUADOR

FOR A

FINANCIAL SECTOR TECHNICAL ASSISTANCE LOAN

December 29, 2004

**Finance, Private Sector and Infrastructure Department  
Bolivia, Ecuador, Peru and Venezuela Country Management Unit  
Latin America and the Caribbean Region**

## CURRENCY EQUIVALENTS

(Exchange Rate Effective )

Currency Unit = US Dollar

1 = US\$ 1

US\$ 1 = 1

Republic of Ecuador

FISCAL YEAR

January 1 December 31

## ABBREVIATIONS AND ACRONYMS

AGD	Deposit Guarantee Agency ( <i>Agencia de Garantía de Depósitos</i> )
BCE	Central Bank of Ecuador ( <i>Banco Central de Ecuador</i> )
BTOR	Back-to-Office Report
CAF	Andean Development Corporation ( <i>Corporación Andina de Fomento</i> )
CAMELS	Capital, Assets, Management, Earnings, Liabilities and Sensitivity
CAS	Country Assistance Strategy
CDR	Rescheduled Deposit Certificate ( <i>Certificado de Depósito Reprogramado</i> )
COF	Co-financing
FSTAL	Financial Sector Technical Assistance Loan
GDP	Gross Domestic Product
GOE	Government of Ecuador
ICB	International Competitive Bidding
IADB	InterAmerican Development Bank
IFI	International Financial Institution
IMF	International Monetary Fund
MEF	Ministry of Economy and Finance ( <i>Ministerio de Economía y Finanzas</i> )
MOP	Memorandum of the President
MTR	Mid-Term Review
NBF	Non-Bank Financed
NCB	National Competitive Bidding
NPV	Net Present Value
PAD	Project Appraisal Document
PMR	Project Management Report
PIU	Project Implementation Unit
PSR	Project Status Report
SAL	Structural Adjustment Loan
SBS	Superintendency of Banks and Insurance ( <i>Superintendencia de Bancos y Seguros</i> )
SFO	Special Financial Operations
SME	Small and Medium Enterprises
TA	Technical Assistance
TAL	Technical Assistance Loan
TOR	Terms of Reference
UEGI	Management and Implementation Executing Unit ( <i>Unidad Ejecutora de Gestión e Implementación</i> )
URC	Debt Restructuring Unit ( <i>Unidad de Reestructuración de Créditos</i> )

Vice President:	David de Ferranti
Country Director	Marcelo Giugale
Sector Manager	John Henry Stein
Task Team Leader/Task Manager:	Mcdonald P. Benjamin

**ECUADOR**  
**FINANCIAL SECTOR TECHNICAL ASSISTANCE LOAN**

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<i>Project ID:</i> P064045	<i>Project Name:</i> EC Fin Sectr TA Ln
<i>Team Leader:</i> Mcdonald P. Benjamin	<i>TL Unit:</i> LCCEC
<i>ICR Type:</i> Core ICR	<i>Report Date:</i> December 29, 2004

## 1. Project Data

*Name:* EC Fin Sectr TA Ln *L/C/TF Number:* SCL-45670  
*Country/Department:* ECUADOR *Region:* Latin America and the Caribbean Region

*Sector/subsector:* Central government administration (50%); Banking (35%); Capital markets (10%); Law and justice (5%)

*Theme:* Other public sector governance (P); Corporate governance (P); State enterprise/bank restructuring and privatization (P); Legal institutions for a market economy (S)

### KEY DATES

	<i>Original</i>	<i>Revised/Actual</i>
<i>PCD:</i> 10/15/1999	<i>Effective:</i> 02/22/2001	02/22/2001
<i>Appraisal:</i> 11/15/1999	<i>MTR:</i>	05/04/2003
<i>Approval:</i> 06/22/2000	<i>Closing:</i> 06/30/2004	06/30/2004

*Borrower/Implementing Agency:* REPUBLIC OF ECUADOR/SUPERINTENDENCY OF BANKS  
*Other Partners:*

STAFF	Current	At Appraisal
<i>Vice President:</i>	David de Ferranti	
<i>Country Director:</i>	Marcelo Giugale	
<i>Sector Manager:</i>	Jack Stein	
<i>Team Leader at ICR:</i>	Mcdonald P. Benjamin	
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## 2. Principal Performance Ratings

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HL=Highly Likely, L=Likely, UN=Unlikely, HUN=Highly Unlikely, HU=Highly Unsatisfactory, H=High, SU=Substantial, M=Modest, N=Negligible)

*Outcome:* U  
*Sustainability:* L  
*Institutional Development Impact:* M  
*Bank Performance:* S  
*Borrower Performance:* U

*Quality at Entry:* QAG (if available) ICR  
*Project at Risk at Any Time:* Yes S

### 3. Assessment of Development Objective and Design, and of Quality at Entry

#### 3.1 Original Objective:

#### 3.0. Relevant Project Context:

The Financial Sector Technical Assistance Loan was put in place as part of a joint multilateral response to support the Ecuadorian Authorities' efforts to deal with a major economic and financial sector crisis in 1999.

**Ecuador's banking crisis came about as a result of a combination of weak governance and supervision of banks as well as multiple external shocks.** In 1994 legal reforms promoted banking sector liberalization while at the same time substantially weakening banking supervision by restricting the intervention powers of the Superintendency of Banks and Insurance (SBS). This contributed to a quick deterioration in banks' financial strength as a result of questionable lending and prudential practices. Moreover, macroeconomic volatility and high inflation rates led to high real interest rates and short loan terms for corporates, increasing the financial burden for corporates, which for tax law and other reasons were already inclined to over-leverage their balance sheets. This made them even more vulnerable to the multiple external shocks that struck Ecuador between 1997-99, including the *El Niño* phenomenon, tumbling prices for oil and banana exports, the devastation of shrimp production by "white spot" disease, as well as capital flight from the region following the East Asian and Russian crises. Finally, many corporates had borrowed in dollars due to lower interest rates than on loans in *sucres*, but had not hedged their foreign exchange risks adequately, and when the worsening macroeconomic situation led to rapid depreciation of the *sucre*, non-performing loans rose quickly particularly for dollar-denominated loans, leading banks to become increasingly illiquid and in some cases insolvent.

**The Government responded to the crisis by providing liquidity advances to banks, introducing a blanket guarantee on deposits in late 1998 through a new Deposit Guarantee Agency (AGD), freezing access to all deposits in March 1999, and thereafter intervening several banks and gradually restoring the functioning of the financial system.** External audits of all banks were commissioned by AGD in June 1999, so as to classify banks into three categories according to their relative financial strength and quality of management: a) banks to be reopened, b) to be publicly managed till re-privatized and c) to be liquidated. The first two categories reopened their doors after the audit results were announced in mid-1999, while the Authorities also designed a program for gradual unfreezing of the deposits of relatively viable banks, starting with current accounts in September 1999. However, the fiscal crisis that Government faced in addition to the banking crisis led to a default on Brady bonds in August 1999, accelerating capital flight, and eventually resulting in formal dollarization in January 2000. This measure, while helping to stabilize the economy (including the financial system), also implied that the Central Bank could no longer act as lender of last resort and therefore increased the need for sound liquidity management within the banking system, even as deposits were still being un-frozen. Full access to time deposits for open banks was restored in March 2000, with implicit backing through a \$2 billion rescue package announced by multilateral donors that included the World Bank's FSTAL loan. With the number of open banks down from 38 to 21 between 1998 and 2000, the number of open finance companies halved to 12, the ratio of bank credit to GDP down from 25% to 10%, and close to 70% of banking assets under public (i.e. AGD) management by early 2000, the challenge that the Financial Sector Technical Assistance Loan (FSTAL) faced in early 2000 was to support the Authorities' efforts to achieve an orderly and rapid resolution of closed banks, re-privatize viable banks under public administration, and strengthen the legal, prudential and supervisory framework so as to foster a sustainable long-term recovery of the financial system.

#### 3.1. Original Objective:

The FSTAL aimed at assisting the Ecuadorian government to manage and confront the deep financial

sector crisis faced by the country, and strengthening the regulatory framework and supervisory capacity of the Authorities in order to foster the long term soundness and efficiency of the banking system.

Short-term objectives of the loan included: (i) strengthening the institutional capacity of the Superintendency of Banks and Insurance (SBS) and the Deposit Guarantee Agency (AGD) to manage the banking crisis; (ii) developing a comprehensive strategy that adequately links the programs for bank recovery, debt restructuring and asset sale under a coherent framework to resolve the crisis and minimize its fiscal cost; (iii) promoting orderly and efficient recovery of assets acquired by AGD; (iv) improving the capacity of authorities to temporarily manage the banks under public ownership; (v) re-privatizing open banks under public ownership, (since the loan amendment of March 2002, this has meant supporting the re-privatization of the open bank under the management of the Central Bank of Ecuador (BCE)); (vi) strengthening banking regulation, supervision and enforcement, adopting international standards; and (vii) developing a framework for effective corporate and household debt restructuring that provides debt relief to viable debtors while helping them to restore their long term solvency and profitability.

The longer-term objectives included helping the banking system resume fully normal credit operations, and establishing the basis for a sound and efficient financial system.

*Assessment of the Development Objective:*

**The FSTAL's Development Objective was clearly anchored in the matrix of actions for financial sector crisis resolution agreed by Government with the four international financial institutions (IFIs),** especially the World Bank and International Monetary Fund (IMF). The FSTAL was part of the Bank's \$425 million contribution to the overall donor package, as described in the CAS Progress Report for 2000-2002 prepared in the lingering crisis conditions of early 2000. Thus the \$10m FSTAL was presented to the Bank's Board of Directors with the CAS and with a \$151.5m Structural Adjustment Loan (EC-SAL-P070337) in June 2000.

**The FSTAL provided direct support to help Ecuadorian Authorities fulfill the SAL's second tranche conditionalities under the financial sector component.** Structural adjustment operations do not include funding for TA, which was greatly needed in this case to help the Ecuadorian Authorities chart a strategy for the financial sector, improve supervisory practices and push forward with the corporate and household debt restructuring for debtors owing more than US\$50,000. As such, the FSTAL's stated objective was clear, corresponded to important country needs, and was responsive to key Government priorities.

**Nevertheless, the development objectives stated for the FSTAL appear overly ambitious in the sense that they downplay the institutional weakness of the main beneficiary agency, i.e. the newly created AGD, as well as its potential vulnerability to political influence.** This project should have been flagged as high (rather than substantial) risk from the beginning because the main component's beneficiary agency did not have a proven track record of institutional continuity and had a new and very sensitive mandate, and there were already indications at the time of project design that AGD could be vulnerable to political pressures. Furthermore, the PIU located in the SBS found it difficult to coordinate with AGD for project execution. While the Project Appraisal Document (PAD) reckoned that the project faced substantial risks, none of them clearly pointed at the intrinsic fragility of AGD as an institution, nor were the risk mitigation mechanisms adequate to address the challenges presented by an institution with weak governance subject to rapid staff turnover, and with a mandate to recover large non-performing loans from large and at times politically powerful debtors.

*3.2 Revised Objective:*

**The project's overall development objective was not revised.** An amendment to the loan in 2002 introduced BCE as a beneficiary agency but did not change any of the development objectives. The second loan amendment that was attempted in 2003 but could not be effected before Project Closing in June 2004

would have maintained the overall objective but shifted the priorities of the loan away from asset management and from re-privatization of intervened banks, towards legal reform and institutional capacity building in BCE and SBS, in line with the government's financial sector strategy prepared in consultation with the Bank, as a basis for developing a robust, deep and efficient financial system in the long term.

### *3.3 Original Components:*

The project consisted of three main technical assistance components directed respectively to the Deposit Guarantee Agency, the Superintendency of Banks and Insurance, and the Debt Restructuring Unit (URC, part of the SBS). A residual amount was dedicated to PIU support.

#### **Component 1: Strengthening of Deposit Guarantee Agency, AGD (\$6.3 million)**

Under this component, the project was to finance activities that would help: prepare and update regularly a coherent banking and corporate sector strategy; modernize the legal framework; prepare a study to identify obstacles for the sale of assets of closed banks; implement AGD's Business Plan; strengthen AGD institutionally; Upgrade AGD's information technology; manage and sell the assets of closed banks; conduct due diligence on AGD banks' largest assets; provide advisory and executive services to improve the management of public banks; and provide advisory services to re-privatize AGD's open banks.

#### **Component 2: Strengthening of Banking Supervision (US\$4.6 million, including US\$1.6 million financed by the Bank)**

The Bank-financed portion was to finance activities to strengthen *in-situ* supervision; conduct complementary audits (of *sociedades financieras*); and modernize the legal framework for banking supervision. In parallel, an Inter-American Development Bank (IDB) program was to focus on effective organization and human resources policies, quality control systems, enhanced prudential regulations that comply with Basle Core Principles, strengthening *extra-situ* supervision, including risk models and an updated chart of accounts, and the upgrading of information systems of the SBS. Parallel financing by the Andean Development Corporation (CAF) was to focus on strengthening the Project Implementation Unit.

#### **Component 3: Corporate and Household Debt Restructuring (US\$1.4 million)**

This component had activities to prepare and implement a framework for corporate and household debt restructuring; eliminate the obstacles to corporate and household debt restructuring; and develop a program for debt restructuring of SMEs.

#### **Component 4: Project Management (US\$1.14 million, of which US\$0.1 million Bank-financed)**

Bank financing was destined to training of PIU staff on auditing, procurement, financial management and other aspects of project implementation.

### Assessment of Project Design Components

**The project components were designed in line with overall project objectives and included activities designed in response to evolving needs identified through extensive dialogue with the Authorities and the IFIs.** The Bank had been closely involved in policy discussions with Ecuadorian counterparts together with the IMF, IDB and CAF since 1998. The design of a TAL and its core activities had first been contemplated in early 1999, when it became evident that an Institutional Development Fund (IDF) grant would be inadequate given the amount of TA and capacity building required. However, the specific components to be included in the TAL evolved over time, first in response to changes in counterpart needs as Government met urgent requirements with own resources (e.g. AGD funded the international audits in mid-1999), second to a sequence of significant monetary, fiscal and regulatory decisions by the Ecuadorian Authorities, including passage of omnibus legislation in March 2000 that amended financial and corporate sector laws, and third to address related strategy design, regulatory strengthening and troubled bank management activities identified in the IMF and Bank portions of the joint policy matrix with the IFIs. As such, the FSTAL helped implement the financial and corporate elements of the SAL.

**The design of the largest component, AGD institutional strengthening, would have benefited from defining ways to mitigate the risks stemming from this institution's weak capacity and governance.** The activities proposed under this component constituted a logical sequence towards a combination of troubled banks' resolution and AGD capacity building, but the implicit assumption that AGD would consistently be a willing and cooperative counterpart in this project failed to reflect already clear signs that this new institution was evolving in a volatile regulatory and political environment, with ongoing changes in the scope of its powers and its key personnel (the balance of institutional responsibilities between AGD, BCE and SBS was changing, and AGD had high rotation in its leadership). Greater risk mitigation could have been implemented, for example, by exploring the possibility of seeking agreement with the Authorities under the complementary IMF or Bank SAL programs regarding the mechanisms for nomination and the incentives for management of the banks under AGD control, as well as clearly defining reporting and oversight arrangements for those banks.

**The FSTAL risk mitigation mechanisms relied heavily on plan for "exceptionally intensive supervision" and implicitly relied on cross-conditionality with IFI policy matrices.** The use of the mechanism of cross-conditionality was not highlighted explicitly in the PAD and presented its own risks for the project, insofar as e.g. the IMF decided to waive or adapt conditions within its portion of the matrix in response to changing circumstances, creating an unidentified risk for the Bank's FSTAL project.

**Evidence of lack of ownership of some activities by the beneficiary agencies includes repeated requests of extensions to comply with some of the conditions for loan disbursement, or simple lack of implementation.** Under the loan agreement, AGD and SBS were supposed to push respectively for drafting amendments to the Law for Reordering Economic Matters in Tax and Financial Areas and to the Financial Institutions Law as part of the loan conditions. Similarly, AGD was supposed to conduct due diligence on its large credits portfolio. These legal and due diligence activities were repeatedly deferred and ultimately never submitted, possibly because the timing was politically inopportune for revamping the laws, especially given advances achieved through earlier amendments introduced between 1998-2000 to handle the crisis. Another reason for postponement, in the case of the Financial Institutions Law, was that the SBS reached agreement with the Bank on the need to design the desirable architecture for the financial system before submitting the legal reforms.

**Some loan activities appear to have had inadequate design.** This is the case for the corporate governance regulation under corporate restructuring component. One reason why this never materialized is that it was not under SBS control but rather an area for the Superintendency of Companies, which was not interested in promoting it. A similar problem occurred with restructuring of loans for small debtors (under \$50,000),

which had already become redundant by the Board date through the adoption of the first omnibus law.

### *3.4 Revised Components:*

#### **Component 4: Assist BCE with Management and Privatization of an Intervened Bank**

Following a legal problem in May 2001 with AGD's recapitalization of an intervened bank, the Central Bank of Ecuador assumed full ownership of that bank. In order to support international management and re-privatization of said bank, a loan amendment was signed in March 2002 whereby BCE became a beneficiary agency and US\$3.5 million of the US\$6.3 million originally assigned to AGD were passed to BCE.

**In the course of the Mid-Term Review (MTR) mission of May 4-8, 2003, the Bank and the Borrower attempted to restructure the project.** The new AGD management that took over early in 2003 indicated that it would not require most of the \$2.8 million remaining in its component (although it only confirmed its intent to exit entirely from the project in August 2003). The BCE also confirmed its intent not to use the \$3.5 million assigned to it for bank management and re-privatization, but it identified new TA requirements in the areas of payments systems, the liquidity mechanism, an early warning system, monitoring of real estate markets and asset disposition, for a total of US\$1.6 million. The SBS identified as a key requirement upgrading of information technology, particularly installing a new main server, and upon recommendation of the Bank, rationalizing information requirements and establishing an emergency back-up system for its central information system. Other key areas involved increased support for broader legal and regulatory reform and related training, as well as strengthening the research and early warning system areas. The total planned SBS support amounted to US\$5 million.

**The second loan amendment never took place due to lack of agreement within government agencies.** Although the loan restructuring proposals were submitted to the Ministry of Economy and Finance (MEF) in September 2003 and received early support in October that year, a series of legal problems and other concerns emerged from a MEF analysis the day before planned renegotiation of the FSTAL in November 2003, leading to a further restructuring process over the next four months with substantial field-based support from the task manager. Whereas the concerns raised by MEF appeared to have been settled by mid-April 2004, for the second time on the verge of a planned renegotiation of the loan agreement, a difficulty emerged as MEF advised the beneficiary agencies, BCE and SBS, that they would need to assume responsibility for repaying the TA loan. The latter were unwilling, and in the case of SBS legally unable, to assume this responsibility, since the original loan agreement did not require this and the expected benefits went well beyond their particular agencies. Since this problem of financial liability could not be resolved before the Closing Date of June 30, 2004, the proposed loan restructuring and second loan amendment never took place.

### *3.5 Quality at Entry:*

The project is rated **Moderately Satisfactory** for overall quality at entry.

The project was highly relevant to the CAS objectives of transparent financial crisis resolution and strengthening bank supervision to minimize the risks of a recurrence. The FSTAL was designed to support these objectives, which were enshrined in a broader policy reform matrix agreed between government and the IFIs. The government was keen on getting all possible support to resolve the ongoing crisis. The FSTAL was also an appropriate complement to financial and corporate aspects of the SAL. Due to the nature of the support, the Bank's safeguard policies were reasonably considered not to constitute an issue for the FSTAL. Moreover, as the next section indicates, the areas that were implemented had important and sustainable benefits.

The objectives of the project components were in line with the country priorities in restoring normal

banking sector operations by ensuring a smooth resolution of intervened banks and a comprehensive restructuring process for corporate and household debt. The project also aimed at strengthening the institutional capacity of two key agencies with an important mandate: the AGD to manage the process of asset recovery, insured deposits repayments and banks re-privatizations; and the SBS to strengthen financial institutions' practices for a sounder system, more capable of withstanding unfavorable economic cycle. Moreover, the project design was done by a team of seasoned experts in the areas of banking supervision, banking resolution and corporate and household debt restructuring, with extensive exposure to previous banking crises such as the East Asian crisis. On the Ecuadorian side, the Authorities established an implementation coordination agency (UEGI) in SBS, staffed by line officials, and headed by a seasoned senior official, to work closely with the FSTAL team and those of the other IFIs.

Given that the main beneficiary agency AGD was newly created, the project team did provide it with extensive technical support to help it get ready for the project effectiveness and implementation. On the other hand, this support was focused on only certain institutional aspects and on planned project activities, even as AGD suffered from additional institutional weaknesses due to high key staff turnover and a politically sensitive mandate, thus affecting the agency's capacity to sustain its commitment as a counterpart in project implementation. This risk was understated and the corresponding risk-mitigation measures proved inadequate. Moreover, by the time loan became effective, a few activities had become redundant, and the Ecuadorian Authorities had received significant in-kind TA from donors, thus weakening their interest in the TAL instrument. Finally, the time-line for TAL actions, particularly for the procurement of international consultancies, was over-optimistic, reflecting a mismatch between the Bank's procurement policies for large-value consultancies and the need to respond quickly under crisis circumstances, which has been a generic challenge for these types of financial TALs.

#### **4. Achievement of Objective and Outputs**

##### *4.1 Outcome/achievement of objective:*

**The final Development Outcome rating for this project is Unsatisfactory, in line with the final Project Status Report.** The development outcome had been rated satisfactory until 2003 due to advances in certain aspects of the project, namely corporate debt restructuring and strengthening of banking supervision. The main reasons for the final Unsatisfactory rating are, first, low disbursements (only 16 percent); second, failure to achieve most of its major original objectives; and third, failure to adopt the second loan amendment that would have extended its execution and delivered a wide set of TA activities to BCE and SBS. This amendment had become essential because, over time, the original project components diverged increasingly from the beneficiary agencies' immediate needs and priorities.

##### *4.2 Outputs by components:*

## **Component 1: Strengthening of AGD**

**The outputs for this component are rated Unsatisfactory, as the activities foreseen in this component were never undertaken.** In the process of complying with the FSTAL's effectiveness conditions, AGD received a significant amount of free technical support through the Bank's Special Financial Operations (SFO) unit, to come up with an institutional organization and business strategy, criteria for due diligence and sale of assets, and criteria for evaluation of open banks' administrators, *inter alia*. Once project implementation had begun, even though procurement procedures were initiated to contract international administrators for two of the larger intervened banks that were expected to be re-privatized, in the case of one bank, as mentioned above, AGD's capitalization of the bank was questioned legally and the bank was transferred to BCE, whereas in the case of the other bank, MEF informed the World Bank in May 2001 that the procurement process for the international administrators—which had already been adversely affected by the steady withdrawal of bidders—would be suspended due to a rapid deterioration in the bank's financial position, making it essential to contract an international firm to enter immediately. MEF was concerned about the potential for systemic contagion due to the delays, and estimated that the Bank's procurement procedures would have taken one year from start to finish, which the country could not afford<sup>1</sup>.

The first FSTAL amendment was sent to Government in August 2001, not only to transfer US\$3.5 million from the AGD component to BCE as a new beneficiary agency, but also to reaffirm that the remaining US\$2.8 million in the AGD component would be used to assist AGD with institutional strategy, asset recovery, information technology support and capacity enhancement. Thanks to extensive Bank support, AGD had all but completed all the needed procurement steps to proceed with asset due diligence and sale in May 2001 but there was a sudden management change and the very future of AGD came into question for a few months in late 2001. While the Government reaffirmed AGD's mandate by the end of the year, new AGD management informed the Bank in late 2001 that it would not use FSTAL proceeds to hire external consultants since it decided to manage the assets of closed banks on their own. This decision was confirmed by AGD's Board of Directors only in May 2002. The component was not immediately cancelled though, since there were upcoming elections and the need for such FSTAL assistance was still deemed manifest in light of AGD's limited results with asset inventories, management and disposition, and with loan collection through the closed banks it oversaw. On the other hand, after the elections the management appointed by the new Administration that assumed power in January 2003 informed the Mid-Term Review mission of its decision to use no FSTAL resources except perhaps for computers which it lacked. Only in August 2003 was a final decision taken by AGD not to use any FSTAL funds and to cease to act as a beneficiary agency.

Unfortunately AGD did not achieve the expected results with its own resources. Notwithstanding extraordinary legal powers for loan enforcement (known as *coactiva*), AGD has not been as effective as hoped in loan collection, and the institution has suffered from weak governance, managerial instability and political pressures. Moreover, AGD falls into a supervisory void, since SBS is not supervising AGD's management of the closed banks, and oversight by the Controller General of the State (CGE) is only accounting-related but not risk based.

## **Component 2: Strengthening of Banking Supervision**

**The overall rating for the outputs of this component is Moderately Satisfactory.** Despite the fact that amounts disbursed (60 percent of the loan amount for this component) and outputs achieved under this component were only partial, FSTAL assistance had a sizeable impact on SBS as it helped develop on-site and risk-based supervision and build capacity among personnel. Due to the failure to pass the second loan amendment and extension, the project fell short of achieving the expected reforms to the legal framework and the complementary audit of financial companies.

**Ecuador achieved substantial improvement in its banking regulation and supervisory practices as a result of the efforts undertaken by the SBS after the banking crisis, with the help of the Bank's FSTAL as well as of the IDB.** On the regulatory side, the SBS introduced provisions to eliminate connected lending in 2000, and required a new single catalogue of accounts for financial institutions as of June 2001. This complemented requirements to publish quarterly financial statements together with financial ratios compared with industry averages, and above all, SBS phased in capital requirements in line with Basle Core Principles by December 2003. The dialogue with the Bank and FSTAL support contributed partially to these advances. On the supervisory side, the FSTAL financed the development of a new operational manual for on-site examination and related training, thereby substantially upgrading examination procedures, while the IDB provided complementary support for off-site monitoring. The new supervisory approach of the SBS is based on the CAMELS<sup>2</sup> methodology; it is well focused, the banking industry has noted a considerable improvement in on-site examination, and it should increasingly bear fruit as SBS progressively internalizes and implements the more risk-oriented approach.

**The modernization of the legal framework for the financial sector, planned as part of the FSTAL support to SBS, did not take place.** The FSTAL was supposed to finance the revision of the General Law of Financial Institutions to simplify and strengthen the legal framework for the sector. One of the root causes of the pre-crisis deterioration of Ecuadorian banks was the weakening of laws governing SBS's supervisory functions. After 1998, a patchwork of amendments had been introduced to address immediate crisis requirements, thus, it was important to revise, unify and simplify the legislation in line with international best practices. As the timing was not considered politically opportune prior to the October 2002 general elections, the Authorities began by commissioning two papers under the FSTAL to propose a new financial architecture for Ecuador. These papers served as an input to the "Financial Sector Strategy and Action Plan", prepared in March 2003 by the Ecuadorian Authorities with FSTAL team support. This core document detailed, among others, the legal changes required to help SBS carry out efficiently its supervisory functions, including for example enhanced legal protection for banking supervisors and de-politicizing the position of Banking Superintendent. In addition, a series of activities was recommended to develop an Early Warning System to detect weak financial institutions and deal with them. SBS developed a detailed action plan for the strategy, that would have been supported through increased FSTAL resources under the second loan amendment, and in April 2004 the FSTAL team sent a Bank expert to Ecuador to discuss legal and regulatory reforms governing the increasingly important area of micro-finance, however the failure to adopt the second loan amendment meant that the planned legal and regulatory reform and related training was not undertaken.

**The complementary audits of finance companies contemplated under the FSTAL never materialized.** This activity was postponed until it was eventually too late to conduct the audit within the time-frame of the project. The detailed TORs for the audits had been prepared in 2002, fine-tuned in 2003 and in late 2003 the project team gave its no objection to an increase in the amount allocated for these audits from US\$300,000 to US\$480,000 using excess funds under the *in-situ* supervision sub-component. The procurement had been successfully completed but disbursement did not happen, partially because the MEF had set a cap of US\$100,000 for total disbursements under the FSTAL for 2004 due to tight overall fiscal space and to the slow disbursement record of the loan. This cap was not sufficient to allow SBS to proceed with signature of the contracts. While this activity was re-incorporated in the second amendment, the latter was never implemented.

**The overall impact of the SBS strengthening was severely reduced by the non-adoption of the second loan amendment,** which was not only going to deliver on the legal and audit items, but also provide much needed upgrading of technology and information analysis and staff capacity building. These are still key areas of institutional development in need of support.

### **Component 3: Corporate and Household Debt Restructuring**

**The rating of the outputs for this component is Satisfactory, but moderately so.** While only 30 percent of the loan amount allocated to this component was disbursed, the support provided through the FSTAL was critical in the corporate and household debt restructuring process for debtors with loans above US\$50,000 and while the competition and bankruptcy laws drafted have not been adopted, they are being used as a basis for future multilateral support. Had the loan been extended through the second amendment, a US\$0.76 million amount would have provided much needed financial support for adequate follow up on debt restructuring results.

*3.(a) Preparation and implementation of a framework for corporate and household debt restructuring:*

**Instead of yet another generalized debt forgiveness scheme, the FSTAL supported Ecuadorian Authorities' efforts to implement an orderly restructuring of corporate debt while minimizing publicly-financed subsidies.** The key elements of this framework were the following: (i) streamlined methods for loans under US\$50,000, which accounted for 99 percent of borrowers as of January 2000 but only 15 percent of non-performing loans; (ii) an incentive-compatible mechanism to encourage negotiated resolution of non-performing loans above US\$50,000. This mechanism required creditors to vote collectively on creditor committees (and therefore to share information), whenever a single non-performing borrower group had multiple creditors, and to weight loan loss provisions according to the system-wide repayment record of the borrower group. Borrowers in turn were required to declare their global assets if they wanted to participate in the restructuring and avoid the *coactiva* process, and were required to use assets not just from the non-performing debtor company but from its entire corporate group to repay overdue loans. The entire process of creditor committees and borrower-creditor negotiations for loan repayments and restructuring was overseen by a debt restructuring unit (URC) financed by the FSTAL. Finally, when debtors owing large debts to intervened banks suggested a generalized restructuring of all debts above US\$50,000 after August 2001, the FSTAL team played a critical role together with other IFIs in supporting Government measures to avoid a costly generalized bailout and maintain payment discipline, by promoting an amendment to the restructuring mechanism whereby an independent, specialized Unique Representative was contracted with bilateral donor support to accelerate the restructuring process for eligible large debtors and negotiate larger and more complex debts in a comprehensive way on behalf of public banks.

**The results achieved through this restructuring process were mixed, but represented an improvement in Ecuador's credit culture.** The initial universe of the debt restructuring unit (URC) work—as of December 2000—stood at US\$2.37 billion in bad debt (close to 20 percent of GDP at that time), half of which was classified as E (i.e. past due loans classified as total write-offs, requiring full provisioning). Of this, US\$1.98 billion applied for restructuring before 23rd April 2001—the deadline set by Presidential Decree 1168 prepared with FSTAL team support—and debtors owing US\$1.46 billion presented the required documents by June 2001 to proceed with negotiations towards loan restructuring, which ended in December 2002. Close to 90 percent of these were bad debts with banks under public management (most notably the two previously mentioned banks with 57 percent, and AGD banks with 17 percent). By December 2002, around US\$600 million had been restructured or repaid<sup>3</sup> while more than US\$800 million had failed or not gone through the restructuring process. These results are comparable to similar financial crisis experiences, such as in East Asia. Public banks were hampered in the negotiations by the inability to offer new working capital loans to the debtors, and so the outcomes of restructuring negotiations were slightly less favorable than for private banks, which negotiated somewhat higher interest rates and shorter repayment terms. Overall, no loans were restructured beyond 12 years or for less than 70 percent of the market reference lending rate. Moreover, efforts of the Unique Representative designated in mid-2002 led to negotiation of 32 percent of the volume that went through the restructuring process, including all of the

larger and many of the more difficult loans.

**SBS created a unit in 2003 to follow-up on the results of debt restructuring process to ensure sustainability of the restructuring results.** By June 2004, 15 percent of US\$400 million in restructured loans had been repaid and 6 percent of US\$1.2 billion loans in the judicial process had been repaid. However, close to 60 percent of the restructured loans have past-due amounts. These loans are being collected by the respective banks, including AGD's closed banks. A potential deficiency of the restructuring process is therefore that the public banks' restructured loans were not disposed of through sales to private open banks or other potentially interested buyers. On the SBS side, efforts to follow up on the restructuring results would have benefited from the proposed second loan amendment, as the monitoring unit is under-funded and the FSTAL resources could have filled this gap in order to push for better asset recovery by the publicly managed banks.

**The corporate governance regulation planned under the FSTAL as part of debt restructuring work was never undertaken.** The main reason provided for this is the lack of interest of the Superintendency of Companies and lack of direct SBS responsibility for this topic. On the other hand, the governance of financial institutions was handled indirectly via the *in-situ* supervision manual. As indicated earlier, this points to inadequate design for this activity.

*3.(b) Elimination of legal obstacles for the productive sector:*

**SBS used the FSTAL to finance draft competition and bankruptcy/preventive recourse laws, but these were never passed.** In case of the competition law, a draft was produced in close cooperation with the juridical department of SBS and was submitted to the Presidency of the Republic. Unfortunately, another version of the law had been developed in parallel by a Congressional committee and was even approved by Congress, but was thereafter vetoed by the Presidency. The competition law—which is essential insofar as Ecuador stands out in South America in not having anti-monopoly legislation—is now being reviewed as part of a Bank-supported programmatic loan, using the FSTAL draft as one of the inputs. The FSTAL also supported a review of the Law of Preventive Recourse and Bankruptcy, however two different drafts were respectively prepared by a local and an international consultant, and the juridical department of SBS did not follow up on the two drafts, e.g. via a workshop, due to lack of participation and ownership up-front in the process, unlike in the case of the competition law—they also regard the two drafts as conflicting with each other as well as too technically dense and rigid. The need for reforms in bankruptcy legislation remains, and IDB is currently picking up this issue again as part of a policy-based loan.

*3. (c) Development of a program for debt restructuring of SMEs:*

This activity planned at project design was quickly eliminated given that the omnibus laws approved in 2000 made it redundant, as they provided for streamlined restructuring for loans below the US\$50,000 cutoff. This small debtors resolution mechanism enacted in the omnibus laws of 2000 was designed with the support of Bank FSTAL team members and IMF staff.

**Free Bank technical assistance may have undermined disbursement of the FSTAL.** The Bank's Special Financial Operations (SFO) unit—established in 1998 to deal with banking crises in the wake of the East Asian crisis but discontinued in 2001—had a large operating budget, which was used to finance significant free TA by Bank experts and consultants, particularly in the corporate debt restructuring component and in preparing AGD to work under the project and meet effectiveness conditions. This work was seen as beneficial to the Borrower, but due to partial overlap of SFO support with planned FSTAL activities, may in part have hindered the FSTAL's disbursement potential in the corporate debt restructuring area, as there was no linkage or matching of free TA with loan disbursements.

#### **Component 4: Assist BCE to manage and re-privatize the intervened bank under its management.**

**The outputs for this component are rated Unsatisfactory, as the activities foreseen in this component were not undertaken under the project.** The FSTAL was not used for contracting international management for the BCE-controlled bank. Indeed the General Controller of the State ruled that the bidding process for the international management, which had been virtually completed by AGD, would have to be begun from scratch by BCE. The latter, in light of the urgency, opted to use its own resources to finance the international management of the bank, and in October 2001 drew on the winning bidder in the AGD-initiated procurement process. When BCE considered that international management had enhanced the value of this bank sufficiently, it was ready to explore re-privatization. However, a Stand-By Arrangement signed by the Government with the IMF in March 2003 set too short a horizon for bringing this bank to point of sale to allow BCE to fulfill the Bank's procurement requirements and use FSTAL resources. Thus BCE again used its own resources, and the revised component was never implemented with FSTAL resources. As of November 2004, the re-privatization of this bank has yet to happen for market reasons. While BCE made constructive proposals for alternative uses for part of the funds assigned to it (US\$1.6 million) the second loan amendment never took place. This is regrettable given that those proposals were key components of BCE's action plan to implement the financial sector strengthening strategy.

1. The Bank had provided significant support to the procurement process launched in 2000, including drafting of TORs for the international administrators, and in October 2000 the Government sought expressions of interest, however by May 2001 only one company was left as a valid candidate in the procurement process for the roughly \$1.3million activity. Although the process was suspended, this company was later hired by BCE with its own funds to manage the second open bank..

2. CAMELS stands for risk-based ratings given to financial institutions by supervisors on the topics of "Capital, Assets, Management, Earnings, Liabilities and Sensitivity". The rating indicates the level of intensity of oversight needed, i.e. the riskier/weaker the institution, the higher the need for intensive supervision, prompt corrective actions and eventually intervention.

3. Close to 30 percent of \$180 million in payments received up-front were in *Certificados de Depósitos Reprogramados* (CDRs), which are bonds issued by Government to depositors in exchange for their deposit claims against intervened banks. The banks had to accept the CDRs from debtors at face value while they were being negotiated at deep discount on the secondary market.

#### *4.3 Net Present Value/Economic rate of return:*

N.A.

While the PAD mentioned the impact of AGD asset recovery to reduce the fiscal cost of the crisis as a measure of project return, the potential return was not calculated at appraisal. As of project completion, the FSTAL is believed to have: (a) contributed to an important but un-quantifiable increase in loan recoveries compared to the counterfactual of no support for the URC or for the design of an incentive-compatible debt restructuring mechanism. In particular, when proposals were floated in August 2001 for generalized loan restructuring of all non-performing loans above \$50,000 at as little as 3 percent over 15 years, one IMF estimate suggested that the fiscal cost of such largesse could have cost the Government US\$500 million in NPV. The FSTAL-supported mechanism and the FSTAL team members' follow-up contributed in part, together with several other partners, to the Government's rejection of this option, and thereby also improved incentives for loan repayment to private open banks, although this benefit cannot be quantified; and (b) the Bank team believes there has been a similarly un-quantifiable but positive benefit to the country arising from a significantly improved regulatory and supervisory framework, as these are believed to lower the likelihood and/or severity of possible future financial sector crises, and (c)

the above two points are likely to have contributed to better credit practices and an improved credit culture and lower risks, and therefore lower interest rates in the long-term. Therefore, notwithstanding the low disbursements of only \$1.6 million under the FSTAL, the Bank estimates that the net financial and economic impact of the loan is substantially positive for the Borrower.

#### *4.4 Financial rate of return:*

N.A.

#### *4.5 Institutional development impact:*

##### **The overall institutional development impact of the project is deemed Modest**

**The project had no significant institutional development impact on AGD and BCE**, given that no proceeds were ever disbursed to support these institutions for direct institutional development. However, it can be argued that an indirect benefit was provided (a) through SFO support provided to AGD in the run-up to loan effectiveness on its organizational structure and business plan, and on plans for hiring consultants; (b) the ongoing dialogue with these institutions as part of project implementation, e.g. on payments systems with BCE; (c) through the support of the URC to AGD's loan recovery efforts; and (d) through support for the development of the financial sector strategy, which assisted BCE's planning efforts.

**The project had a substantial institutional development impact on SBS.** SBS is still a relatively fragile institution with an inadequate personnel skill mix, significant technological upgrading requirements and insufficient legal support for its mandate. However, and by all accounts, SBS has come a long way since 1999 and the FSTAL has been instrumental in designing SBS on-site examination practices, many of its regulations as well as the institution's ongoing relevance in the area of corporate debt restructuring, which is cross-feeding into the supervisory process.

## **5. Major Factors Affecting Implementation and Outcome**

### *5.1 Factors outside the control of government or implementing agency:*

One of the main impediments faced by Government was the Bank's procurement policy for large-value consultant contracts, which inevitably implied delays and on various occasions made it impossible to use FSTAL funds. There was also insufficient proactivity by the Bank's project team in restructuring the loan during the first years of implementation and at times slow Bank no objection responses which delayed work. Other challenges were the rapid worsening of the financial position of at least one of the two major intervened banks in 2001, requiring changes in approaches; a challenging political environment and related pressures; and a laborious judicial system that presented grave obstacles to loan collections.

### *5.2 Factors generally subject to government control:*

Overall, there was uneven ownership from the Government for the most difficult yet important changes, especially legal changes (such as new competition, bankruptcy and financial sector legislation), intervened banks resolution and asset recovery. This is also shown by the lack of compliance with conditions initially agreed for loan disbursement. Political factors may have contributed to the high level of turnover in key officials in AGD management, and to a lesser extent in SBS management. AGD showed weak implementation capacity and governance, was not able to share audited and complete accounting information with the FSTAL team due to its asset management challenges, operated in a supervisory void, and demonstrated no inclination to avail of FSTAL resources to achieve agreed project objectives during more than half of the life of the project. The decision of the Controller General of the State to negate a virtually completed procurement process for international management of a major intervened bank because of a change in owners from AGD to BCE meant the Government could not use FSTAL funds for management of said bank. The Government proved slow in processing key loan documents, including a

delay of four months from Board Approval in June 2000 for loan signing, notwithstanding the crisis situation, seven months for signing the first loan amendment (August 2001 to March 2002), and of seven months in clearing the second loan amendment for negotiation (September 2003 to April 2004). Finally, there were shortcomings in coordination between key government entities (MEF, BCE and SBS), most notably on reaching agreement for the second loan amendment, and especially on responsibility for repaying the loan when it was broadly agreed that it was in the national and particular interest of the various parties that the loan continue.

### *5.3 Factors generally subject to implementing agency control:*

During its implementation, the FSTAL was the only Bank-supported loan to be implemented by a PIU integrated into a Government agency and staffed from it, as opposed to a team of consultants. The experience was a positive one. Generally the project implementing unit (known as UEGI) showed great dedication and performed according to the standards specified in Bank loan conditions, including in the submission of semi-annual project reports. There were occasional delays in procurement and in the Project Management Report (PMR) process, which the FSTAL was the first and only project to implement in Ecuador and therefore involved a learning process.

### *5.4 Costs and financing:*

Significant delays arose in the project's actual disbursements versus the planned schedule. The latter was quite optimistic in the PAD and the PSRs displayed a lag in registering likely delays, so that estimates were generally higher than actuals all through the life of the project. The main reasons for this are the same as those that led to the failure of the project in achieving its Development Objective, i.e. repeated postponements of activities by the government, at times long reaction time from the Bank, and a volatile institutional and economic environment during the life of the project. The project closed having disbursed only 16 percent of the total loan.

## **6. Sustainability**

### *6.1 Rationale for sustainability rating:*

Overall, the sustainability of project outcomes is rated **Likely** for the amounts disbursed and activities carried out as part of this project, i.e. under SBS institutional strengthening and corporate debt restructuring components. For the activities never done and amounts never disbursed (eg: components for AGD, BCE, audit of finance companies and corporate governance regulations) and the attempted but failed second amendment, the sustainability rating would be **“Not Applicable”**.

By all accounts, SBS *in-situ* supervision and risk-based regulations have come a long way since 1999. FSTAL financed manuals are living documents, i.e. actively used and continuously adapted for added regulations, tailored to specific categories of financial institutions—including new sections on public banks, credit cooperatives, micro-credit institutions, etc. The main threats to sustainability of achievements come from SBS's institutional weaknesses, inadequate legal protection for banking supervisors, and shortcomings in institutional autonomy. This can make supervisors less able or willing to take tough stances with non-compliant banks that enjoy strong political support. BCE and SBS have also continued to draw on FSTAL-supported analytical work for developing a financial sector strategy.

It is **Likely** that the outputs of corporate and household debt restructuring would be sustained thanks to the detailed and ongoing work by the SBS debt monitoring unit. As of June 2004, 40 percent of restructured credits (originally classified as category E or total write-offs) were current, while the remainder were at various levels of past due obligations.

The work done on drafting bankruptcy legislation is **Not Likely** to be sustained. The reforms drafted with

FSTAL support were largely modifications in existing Ecuadorian legislation, although at least one FSTAL consultant had recommended a more fundamental reform, and IDB is now supporting the drafting of a more fundamental reform to meet international standards.

Work done on the competition law might end up achieving some sustainability, since it is being used as an input to work supported by a Bank-financed programmatic loan, whereby Government will submit a new draft law to Congress.

#### *6.2 Transition arrangement to regular operations:*

As mentioned earlier, SBS has internalized the use of manuals and regulations and believes in the need to update them regularly; SBS has also created a unit following up on the actual recovery rates on restructured corporate and household loans; finally, the draft competition law is being used as an input to a new Bank-supported programmatic lending operation in coordination with various public, private and donor agencies to present an updated law for consideration by Congress. Nevertheless, it will be important to continue drawing public attention and building support for essential reforms in the financial sector that could not be completed under the FSTAL.

## **7. Bank and Borrower Performance**

### ***Bank***

#### *7.1 Lending:*

Bank performance in the identification, preparation assistance, and appraisal of the project is considered **Moderately Satisfactory**. The project design responded to the CAS and Government priorities to resolve the ongoing banking crisis and strengthen its key institutions. In the run-up to project effectiveness, the project team provided extensive policy advice and support to the Ecuadorian Authorities dealing with crisis resolution. Also, the experience of preparing the FSTAL in close coordination with other IFIs under the framework of a joint policy matrix was widely perceived as very successful in conveying a consistent and clear policy advice to the Authorities. The shortcomings were that the team underestimated the risks stemming from the institutional and governance weaknesses of the main beneficiary agency, AGD, and overestimated the mitigation role that intensive supervision could play in reducing risks. Moreover, between project design and loan effectiveness, intensive donor TA and rapidly changing circumstances had removed the need for a few planned areas of support.

#### *7.2 Supervision:*

Bank supervision is considered overall **Moderately Satisfactory**. The project team had very frequent visits to the field related to FSTAL and SAL supervision, and constant contact with the Borrower, implementing agencies and partner IFIs, as well as field-based support out of the World Bank Office in Quito. These helped provide the Ecuadorian Authorities with high quality technical advice, particularly on liquidity management, legal and regulatory reform, corporate debt restructuring, and development of a strategy for the financial sector. The project team also put in an exceptional amount of effort to design a substantial and comprehensive second amendment to the loan jointly with the Authorities. Unfortunately these efforts were unsuccessful in the end as the government agencies could not reach a consensus on who should bear the loan repayment.

The shortcomings were in the speed of procurement processes, including no objections, and in the timing of efforts to restructure the loan or downgrade it in Project Status Reports (PSRs). The PSRs were updated regularly though it was not until a regional portfolio review in 2003 that the project Implementation Performance was downgraded to Unsatisfactory due to low disbursements. While it was clear relatively early on in project implementation that a large part of the project would not be used as planned for AGD and BCE activities, the project team chose to give more time to Ecuadorian Authorities to propose

alternative uses for the funds, rather than cut back on the loan. Moreover, the Mid-Term Review, which should have taken place by June 2002, was delayed by one year due in part to delays in decisions about the transition in Bank project management, and much more importantly, to the election cycle in Ecuador, and the expectation that BCE and AGD components could move forward more rapidly with the new Administration.

### *7.3 Overall Bank performance:*

The Bank's overall performance is considered **Moderately Satisfactory**. The ongoing technical dialogue between the project team and the government counterparts as well as other IFIs throughout project preparation and supervision helped achieve certain successful outputs during project implementation, and to keep critical processes on track, notably in strengthening banking supervision and in corporate debt restructuring. However, the FSTAL proved to be a rather slow response tool when it comes to strengthening institutions that are evolving in a financial crisis environment, which has been a generic challenge for TALs under these circumstances.

### **Borrower**

#### *7.4 Preparation:*

Government performance in the project preparation is considered **Moderately Unsatisfactory**. The project as designed was adequately addressing major institutional and regulatory weaknesses that were essential to address in the resolution of Ecuador's severe banking crisis; on the other hand, it is not clear that the project enjoyed the level of ownership by key agencies, notably AGD, that would be required for a project of this importance.

#### *7.5 Government implementation performance:*

Government performance in the implementation of the project is considered **Unsatisfactory**.

The main reasons for this rating are:

- Delays in enacting some of the key loan disbursement covenants.
- Lack of implementation on the AGD/BCE components, representing 63 percent of the project.
- Slow response process creating bottlenecks: in adopting the first amendment, in confirming lack of interest in using FSTAL proceeds, in reviewing second project restructuring proposal.
- Failure to follow up on key legislation drafted by project consultants (bankruptcy/preventive recourse, competition), through e.g. workshops, dialogue and presentation to Congress.
- An unrealistically low budget ceiling for disbursements for the FSTAL in FY04, impeding work under already advanced procurement processes, thus wasting administrative resources.

Shortcomings in coordination between government agencies in the preparation and review of the second project amendment, leading to the loss of almost one year of intensive effort by government's teams (BCE, SBS, and MEF), and failure to reach an agreement on the extension of the project, which would have provided much needed support for BCE and SBS within the framework of the Government's Financial Sector Strengthening Strategy.

#### *7.6 Implementing Agency:*

Performance of the Implementing Agency is considered **Satisfactory**. Overall, the team did a fair job in coordinating, following up with the various SBS departments, AGD and BCE on their respective areas. They reported in a prompt and detailed manner on project progress. The main weakness of UEGI was its lack of leverage when partner agencies decided not to cooperate.

### *7.7 Overall Borrower performance:*

Overall borrower performance is considered **Unsatisfactory**. Overall, the government has been unable and/or unwilling to tap into the support provided by the FSTAL to make substantial institutional strengthening changes, some of which continue to be essential for the soundness and efficiency of their financial system.

## **8. Lessons Learned**

The following lessons from the FSTAL warrant consideration:

- Client ownership and the Government's political will in implementing a program like the FSTAL are critical.
- The Bank should have flagged risks more realistically at the outset, and focused more on risk mitigation mechanisms.
- In a difficult political environment, a TAL on its own does not offer enough monetary leverage or political cover to encourage tough legal reforms or institutional changes. Thus the parallel SAL could have been used more effectively to mitigate risks for the FSTAL, particularly in relation to the governance of AGD. And yet, reliance on parallel budgetary support loans in crisis period can lead to unexpected risks, namely that conditions (including those agreed with partner IFIs) may be waived, with an impact on the TAL.
- While not a guarantee of total success, it helped that multilateral donors maintained on-going coordination and consulted each other in developing a unified framework for financial crisis resolution with Government, within which the FSTAL contributed positively.
- Project management has to be highly proactive when the environment is changing quickly.
- An emergency TAL should have as much flexibility as possible in terms of redefining or changing the tasks and even the counterpart agencies if necessary within the government, as well as in accelerating procurement procedures.
- Local project supervision, while very helpful in cases like these, needs to be complete, i.e. involve close procurement support as well as specific (in this case financial) sector skills.

## **9. Partner Comments**

### *(a) Borrower/implementing agency:*

Señor

Eduardo Somensatto

**GERENTE DEL BANCO MUNDIAL EN ECUADOR**

Ciudad.

De mi consideración:

Me refiero a su oficio No. BIRF-EC-189-04 de 28 de octubre de 2004 mediante el cual solicita la presentación de un informe de evaluación final del Convenio de Préstamo de Asistencia Técnica al Sector Financiero No. IBRD-4567-EC.

Sobre el particular, me es grato presentar a usted el siguiente informe elaborado sobre la base del documento preparado por la Superintendencia de Bancos y Seguros:

### **I. ANTECEDENTES**

Como consecuencia de la crisis financiera que atravesó el Ecuador entre 1998 y 1999, el Gobierno

Nacional, conjuntamente con los Organismos Multilaterales de Crédito (Banco Mundial, Banco Interamericano de Desarrollo, Corporación Andina de Fomento y Fondo Monetario Internacional), emprendió un plan de fortalecimiento del sistema financiero. Así, el 26 de octubre del año 2000, se suscribió con el Banco Mundial el Convenio de Crédito No. 4567 EC por un valor de US\$ 10'000.000,00 denominado "Proyecto de Asistencia Técnica para el Sector Financiero".

El Proyecto original tuvo los siguientes componentes:

PARTE A "Fortalecimiento de la AGD".

PARTE B "Fortalecimiento de la Supervisión Bancaria".

PARTE C "Reestructuración de Deuda Corporativa y de Hogares".

PARTE D "Gerencia del Proyecto".

En el mes de marzo del año 2002, se suscribió una enmienda al Convenio, que incorporó al Banco Central del Ecuador a través del componente E "Apoyo al Banco Central" para desarrollar el proyecto sobre los bancos abiertos administrados por esa entidad.

En el mes de mayo del mismo año, la Agencia de Garantía de Depósitos resolvió no utilizar los recursos del referido préstamo, por lo que el Banco Mundial solicitó a la Superintendencia de Bancos y Seguros y al Banco Central del Ecuador propongan actividades que las dos instituciones consideren necesarias para ser financiadas con los fondos no utilizados por la AGD.

En septiembre del año 2003, la Superintendencia de Bancos y Seguros solicitó al Ministerio de Economía y Finanzas la presentación al Banco Mundial de una segunda enmienda al Convenio a fin de incorporar nuevos proyectos que serían ejecutados por el Banco Central del Ecuador y por la propia Superintendencia, por un monto total de US\$ 5'120.000,00. Solicitó además la cancelación de US\$ 1'800.000,00 del crédito que sería el saldo no utilizable luego de aprobarse la modificación planteada, así como la ampliación del plazo de ejecución hasta el 31 de diciembre del año 2005. Inmediatamente, este Ministerio solicitó al Banco Mundial incorporar al Convenio la petición de la Superintendencia y remitir la modificación del Convenio de Crédito IBRD-4567-EC para el trámite correspondiente.

Al respecto, en el mes de abril del presente año, el Ministerio de Economía y Finanzas comunicó a la Superintendencia de Bancos y Seguros que una vez aprobada la segunda enmienda, el monto de los recursos que recibirá por concepto de este crédito para la ejecución de las actividades a su cargo, deberá ser restituido al Estado Ecuatoriano, planteamiento que no fue aceptado por el organismo de control en atención a los términos estipulados en el Convenio de Crédito citado.

Finalmente, al no prosperar la negociación de la segunda enmienda, el 30 de junio de 2004 se cerró el Convenio.

## **II. COMPONENTES Y PROYECTOS POR ENTIDAD EJECUTORA**

### **PARTE A "Fortalecimiento de la AGD"**

1. Preparación de una estrategia para ligar los programas del Prestatario para la reestructuración de la deuda corporativa y de hogares, recuperación de la banca y administración de activos al amparo de un marco referencial que promueva la resolución rápida y eficiente de la crisis bancaria.
2. Preparación de una propuesta legislativa para reformar la Ley de Reordenamiento en Materia

Económica, en el área tributario – financiera y sus regulaciones de implementación.

3. Llevar a cabo un estudio para identificar y superar los obstáculos legales, regulatorios y judiciales para la venta rápida de los activos manejados por la AGD.
4. Desarrollar un plan de negocios para manejar y vender rápidamente los activos manejados por la AGD sobre la base de precios referenciales y de mercado.
5. Provisión de asistencia técnica para el ejercicio de debida diligencia precedente a la venta de: (a) la cartera de crédito incluida en los activos manejados por la AGD que están compuestos de activos individuales por un monto superior a US\$ 500.000; y (b) la cartera de crédito incluida en los activos manejados por la AGD.

Al respecto, el 22 de mayo de 2001 el Banco Mundial otorgó la no objeción a la evaluación combinada de los aspectos técnicos y financieros de las propuestas presentadas por las firmas: Asociación KPMG – Arden Price Consulting (Valoración de cartera) y Arthur Andersen (Venta de Cartera). Este proceso no concluyó por falta de definición de la AGD.

6. Fortalecimiento de la AGD a través del desarrollo de una nueva estructura, organización; la provisión de capacitación para su personal; y, la provisión de servicios de consultoría para apoyar a la AGD en su plan de negocios.

Mediante Resolución No. AGD-00-007 de 16 de febrero de 2000 la Agencia de Garantía de Depósitos expidió su Manual Orgánico Funcional.

7. Mejoría de la infraestructura tecnológica de información de la AGD.
8. Provisión de servicios de consultoría para asistir a la AGD en el manejo eficiente de los bancos abiertos al amparo de su control.

El 23 de mayo de 2001 el Banco Mundial otorgó la no objeción a fin de proceder a la negociación con la firma Interdin & Ahead/Hay Group para la administración de Filanbanco; sin embargo, por decisión gubernamental, el Ministerio de Economía y Finanzas comunicó al BIRF que no se utilizarían estos recursos para ese banco, y que en su lugar se requeriría la no objeción para que la firma Interdin pase a administrar el Banco del Pacífico, situación que fue aceptada. Una vez incorporado el Banco Central como entidad beneficiaria, a partir de la primera enmienda tuvo la responsabilidad de ejecutar esta actividad.

9. Provisión de servicios de consultoría legal y financiera para asistir a la AGD en el proceso de reprivatización de los bancos al amparo de su administración.

La AGD, en coordinación con la Unidad de Ejecución y Gestión Institucional, UEGI, invitó a firmas de reconocido prestigio a nivel internacional a que presenten sus expresiones de interés para la ejecución de esta actividad. La UEGI preparó para discusión y aprobación de la AGD, una primera versión de los Términos de Referencia y del Pedido de Propuestas para la contratación de firmas internacionales. Una vez incorporado el Banco Central como ejecutor de la parte E del Apéndice 2 del Convenio, asumió la responsabilidad de ejecutar esta actividad.

## PARTE B “Fortalecimiento de la Supervisión Bancaria”

10. Provisión de asistencia técnica a la Superintendencia de Bancos para la reforma de las leyes del sector financiero.

Se acordó conjuntamente con el Gerente del Proyecto FSTAL 4567-EC que, como paso previo a la elaboración de los proyectos de reforma a la Ley General de Instituciones del Sistema Financiero y a la Ley de Reordenamiento en Materia Económica, en el Area Tributario – Financiera, debía definirse la nueva estructura y arquitectura del sistema financiero.

En este sentido, se contrató al consultor internacional Martín Naranjo para desarrollar la propuesta de nueva Estructura Financiera del Ecuador, así como al consultor Egidio Luis Miotti para que revise la propuesta de nueva Arquitectura Financiera del Ecuador preparada por el Banco Central del Ecuador. Los informes entregados sirvieron de base en la definición de la Estrategia y Plan de Acción para el fortalecimiento del Sector Financiero del Ecuador.

Es importante señalar que, como parte de los proyectos a ser ejecutados al amparo de la segunda enmienda del Convenio, estaba contemplada la ejecución del proyecto de Reforma al Marco Legal, con las siguientes actividades: A) Formulación y diseño del proyecto de una nueva Ley para el Sistema Financiero y de su Reglamento, reformas a leyes conexas; y, propuestas de normativa; B) Difusión y capacitación sobre la nueva normativa, al personal de las instituciones públicas involucradas y del sistema financiero ecuatoriano; C) Revisión de la propuesta de Ley de Bancarrotas y Quiebra; y, D) Formulación y diseño del proyecto de Ley para prevención del lavado de dinero, medidas contra el financiamiento del terrorismo, reforma a leyes conexas; y, propuestas de normativa.

11. Revisión y mejoría de los manuales existentes para: (i) Supervisión in situ de los bancos; (ii) Procedimientos para auditorías de control internas y externas; (iii) Auditorías de sistemas de información; y, (iv) Evaluación del riesgo de mercado y provisión de capacitación para la aplicación de los manuales.

El 28 de mayo de 2001 se suscribió un contrato entre la Superintendencia de Bancos y la compañía Deloitte & Touche del Ecuador Cía. Ltda. para la ejecución del proyecto de Fortalecimiento del Proceso de Supervisión In Situ, cuyo informe final fue entregado en el mes de marzo de 2002.

12. Contratación de auditorías externas para instituciones financieras.

La negociación de los contratos finalizó en el mes de noviembre de 2003. Sin embargo no pudo concluirse el proceso precontractual debido a la falta de asignación de recursos en el Presupuesto General del Estado.

## PARTE C “Reestructuración de Deuda Corporativa y de Hogares”

13. Desarrollo de una estrategia comprensiva para facilitar la reestructuración de las deudas corporativas y de hogares (Superintendencia de Bancos y Seguros).

El 31 de diciembre de 2002 culminó el trabajo de la Unidad de Reestructuración de Créditos, URC, creada mediante Decreto Ejecutivo No. 1168 (Registro Oficial No. 257 de 1 de febrero de 2001). Con la culminación de labores de esa unidad concluyó también la tarea de la firma Chemonics Inc., la misma que, con el apoyo de la USAID contrató al Representante Único. La acción de la Unidad de Reestructuración de Créditos se centró en la resolución de 1351 casos por 1.457,6 mil millones de

dólares (Tomado del Informe Final de la Unidad de Reestructuración de Créditos presentado el 17 de enero de 2003).

14. Preparación de un estudio para identificar y superar los obstáculos legales y regulatorios para la rápida reestructuración de la deuda corporativa (Superintendencia de Bancos y Seguros).

En este proyecto, conjuntamente con el Banco Mundial, se determinó la necesidad de elaborar leyes de competencia y de quiebras, así como reformar la Ley de Concurso Preventivo y otras leyes relacionadas con la reestructuración de deudas. Al respecto, se destaca lo siguiente:

Proyecto de Ley de Competencia: El Congreso Nacional discutió y aprobó un proyecto de “Ley de Promoción y Defensa de la Competencia Económica”. Sin embargo, mediante oficio No. T.1913-DAJ-2002-6484 de 13 de noviembre de 2002 el Presidente de la República vetó totalmente el proyecto.

Proyecto de Ley de Quiebras y Concurso Preventivo: Se elaboraron los dos proyectos de leyes, los mismos que deben ser analizados en el marco de la Cooperación Técnica No Reembolsable No. ATN/SF-8593-EC del BID.

15. Establecimiento de un marco de referencia comprensiva para la reestructuración de deudas de pequeñas y medianas empresas (Superintendencia de Bancos y Seguros).

#### PARTE D “Gerencia del Proyecto”

16. Capacitación de funcionarios de la Unidad Ejecutora en auditorías, adquisiciones, gerencia financiera y otros aspectos de la implementación del Proyecto (Superintendencia de Bancos y Seguros).

Informes de Administración del Proyecto: Se prepararon los Informes de Administración del Proyecto en forma trimestral y fueron remitidos al Banco Mundial, obteniéndose las correspondientes aprobaciones.

Auditoría Externa independiente del Proyecto: El 6 de junio de 2001 se suscribió el contrato para la prestación de servicios de auditoría independiente con la firma Núñez Serrano & Asociados Cía. Ltda.

Estados financieros auditados del Proyecto: Se cuenta con estados financieros y los correspondientes informes de auditoría externa por los períodos terminados al 30 de junio de 2001, 31 de diciembre de 2001, 31 de diciembre de 2002 y 31 de diciembre de 2003, debidamente aprobados por el Banco Mundial y enviados además a la Contraloría General del Estado.

Capacitación de los funcionarios de la Unidad Ejecutora: Se capacitó a los funcionarios de la Unidad de Ejecución y Gestión Institucional.

#### PARTE E “Apoyo al Banco Central”

17. Provisión de servicios de consultoría para asistir al Banco Central en el manejo eficiente de los bancos abiertos bajo su administración.

Las acciones relacionadas con la ejecución de esta actividad constan en el proyecto No. 8.

18. Provisión de servicios de consultoría legal y financiera para asistir al Banco Central en el proceso

de reprivatización de los bancos abiertos bajo su administración.

Las acciones relacionadas con la ejecución de esta actividad constan en el proyecto No. 9.

### III. RESULTADOS Y EVALUACION DEL CONVENIO

Los recursos asignados se utilizaron de acuerdo al siguiente detalle:

COMPONENTE	VALOR ASIGNADO	VALOR EJECUTADO	GRADO DE UTILIZACION
PARTE A: Fortalecimiento de la AGD	2'786.000,00	0,00	0%
PARTE B: Fortalecimiento de la SBS	1'600.000,00	986.128,00	62%
PARTE C: Reestructura del Sector Productivo	1'400.000,00	419.456,00	30%
PARTE D: Coordinación y Administración del Proyecto	100.000,00	56.289,00	56%
PARTE E: Asistencia al Banco Central del Ecuador	3'514.000,00	0,00	0%
Front end fee	100.000,00	100.000,00	100%
Contingencias	500.000,00	36.624,00	7%
<b>TOTAL</b>	<b>10'000.000,00</b>	<b>1'598.497,00</b>	<b>16%</b>

### IV. SOSTENIBILIDAD DE RESULTADOS

- El Manual de Supervisión In Situ elaborado por la firma Deloitte & Touche está siendo aplicado por los equipos de auditoría de la Superintendencia de Bancos y Seguros en la supervisión de las instituciones financieras.
- Con el propósito de dar seguimiento a los convenios de reestructuración y propiciar la recuperación de los créditos sometidos a procesos de coactiva, se ha conformado dentro de la Superintendencia de Bancos y Seguros una unidad administrativa que tiene a su cargo tal responsabilidad.
- Respecto al proyecto de Ley de Quiebras, la República del Ecuador y el BID suscribieron el Convenio de Cooperación Técnica No Reembolsable No. ATN/SF-8593-EC. Desarrollo de un Programa de Mejoramiento de la Competitividad, dentro del cual se tiene previsto desarrollar el componente "Acceso a Financiamiento", que en su literal B) "Entorno de Negocio", establece la necesidad de expedir leyes que establezcan un marco legal moderno y eficiente para tratar empresas en quiebra (Ley de Quiebras) y perfeccionar los registros de propiedad para facilitar el uso y ejecución de las garantías muebles e inmuebles (Ley de Garantías Reales).

### V. EVALUACION DEL DESEMPEÑO DE LA UNIDAD DE EJECUCION Y GESTION INSTITUCIONAL, UEGI, DURANTE EL DESARROLLO E IMPLEMENTACION

- El manejo de los recursos financieros asignados no ha tenido ninguna observación en los informes de auditoría externa que cuentan con la aprobación del Banco Mundial.
- Los procesos de selección y contratación de firmas consultoras y expertos individuales se han realizado a base de los requerimientos del Banco Mundial, según se manifiesta en la Minuta de la Misión de Medio Término que tuvo lugar del 5 al 8 de mayo de 2003 y se ratifica en los informes de auditoría externa emitidos por la firma Núñez Serrano & Asociados Cía. Ltda.
- Durante el desarrollo del proyecto, la Unidad de Ejecución y Gestión Institucional mantuvo una

constante coordinación con las instituciones directamente involucradas en el desarrollo del Proyecto como son: Ministerio de Economía y Finanzas, Agencia de Garantía de Depósitos, Banco Central del Ecuador y Banco Mundial.

- La Superintendencia de Bancos y Seguros realizó importantes gestiones y acciones orientadas a la consecución de la segunda enmienda al Convenio de Crédito IBRD 4567-EC.

## **VI. CONCLUSIONES**

- La ejecución del Proyecto por parte de varias instituciones se vio afectada en la medida que existen actividades que son de particular interés para una u otra institución.
- Los excesivos trámites y tiempos de espera, tanto a nivel nacional como con el propio Banco Mundial dilataron la ejecución de los procesos.
- Las medidas adoptadas por los responsables de la política económica del país, en el sentido que las instituciones ejecutoras asuman el servicio de la deuda con recursos propios, afectaron las negociaciones orientadas a la consecución de la segunda enmienda del Convenio y por tanto a la ejecución completa del Proyecto.
- El Banco Mundial colaboró en la ejecución de este Proyecto. No obstante, consideramos que una participación más activa hubiese permitido encontrar los mecanismos para concretar la segunda enmienda y con ello la ejecución de nuevos proyectos orientados al fortalecimiento del sistema financiero ecuatoriano.

En resumen, los resultados de la ejecución del Convenio de Crédito IBRD-4567-EC debe servirnos como experiencia, tanto para el Gobierno Nacional como para el Banco Mundial, para optimizar la cooperación internacional y lograr los objetivos propuestos.

## **VII. RECOMENDACIÓN**

Se requiere sensibilizar al público sobre la relevancia de ejecutar las actividades propuestas en la segunda enmienda, para dotar al sistema financiero de las medidas y precauciones necesarias que permitan reforzarlo y que garantice su función de intermediario entre el ahorro y la inversión.

Atentamente,  
POR EL MINISTRO DE ECONOMIA Y FINANZAS

Ing. Vicente C. Páez  
**SUBSECRETARIO GENERAL DE COORDINACION**

c.c. Superintendencia de Bancos y Seguros  
Banco Central del Ecuador

### *(b) Cofinanciers:*

The partner IFIs (IMF, IDB and CAF) praised the quality of coordination from the FSTAL team as each entity proceeded with the implementation of their crisis resolution actions which had cross-references or impacts on the same issues as the FSTAL:

- The IMF notes that the continuous dialogue across donors helped support crisis resolution actions

more effectively and were helpful for the Fund's emergency programs for Ecuador. IMF staff believe the Bank was an excellent partner in this crisis resolution program. As stated before, the FSTAL objectives were fully in line with IMF's policy matrix and FSTAL team worked closely with IMF staff.

- IDB staff praised the quality of cooperation between their efforts and those of the FSTAL in the areas of on-site and off-site supervision. There was good coordination in both the design and execution of the TA programs, where the IDB focused on *extra-situ* and the World Bank on *in-situ* supervision. Both activities were carried out by the same consulting company, which helped further in achieving a smooth integration of products. The IDB believes that the capacities of the SBS improved significantly in both areas.
  - CAF reinforced the message that the joint effort made by the IFIs in supporting the Government during the 1999 economic crisis was a fundamental factor in dealing with the delicate situation faced by the country and initiating the economic recovery process. CAF also commented favorably on the UEGI's performance, which was supported with CAF financing.
- Overall, cooperation among the IFIs in this project and through the Ecuador crisis resolution process has been very good. The design and implementation of the overall financial sector program have been truly an integrated teamwork effort from the management and technical staff of the IFIs.

*(c) Other partners (NGOs/private sector):*

## **10. Additional Information**

## Annex 1. Key Performance Indicators/Log Frame Matrix

### Outcome / Impact Indicators:

Indicator/Matrix	Projected in last PSR <sup>1</sup>	Actual/Latest Estimate
(i) Improve authorities' capacity to manage the financial sector crisis:	NR but PSR implies U	U
-- Authorities capacity to effectively identify and resolve non-viable banks.	NR but PSR implies U	U
-- Appropriate asset management and disposition; temporary administration and eventual reprivatization of AGD/BCE managed banks	NR but PSR implies U	U
-- Corporate and household debt restructuring consistent with financial sector recovery.	NR but PSR implies S	Moderately S
(ii) Strengthening of banking regulation and supervision:	NR but PSR implies S	Moderately S
-- Appropriate banking laws and regulations issued and enforced	NR but PSR implies Partially S	Partially S
-- Eventual compliance consistent with Basle Core Principles.	NR but PSR implies Partially S	Partially S

### Output Indicators:

Indicator/Matrix	Projected in last PSR <sup>1</sup>	Actual/Latest Estimate
(i) Strengthening of Deposit Insurance Agency:	U	U
-- Draft necessary legislation and prudential regulations; asset recovery targets; improvement of management of state-owned banks; reprivatization of public banks; and institutional strengthening of AGD		
(ii) Strengthening of Superintendency of Banks:	S	Moderately S
-- Draft necessary legislation & regulations. Carry out consolidated supervision. Supervision manuals completion and progress in manuals' implementation		
Progress in training of SB's examiners in the area of in situ supervision		
(iii) Corporate and household debt restructuring:	S	Moderately S
-- Design and implement a program for corporate and household debt restructuring.		
(iv) Project Coordination Unit:	S	S
Effective management of the Technical Assistance Loan Project		
Management and Reprivatization of BCE controlled bank	NR but PSR write-up implies U	Unsatisfactory

<sup>1</sup> End of project

## Annex 2. Project Costs and Financing

Project Cost by Component (in US\$ million equivalent)

Component	Appraisal Estimate US\$ million	Actual/Latest Estimate US\$ million	Percentage of Appraisal
1 FORTALECIMIENTO INSTITUCIONAL DE LA AGD	6.30	0.00	0
2 FORTALECIMIENTO DE LA SUPERINTENDENCIA DE BANCOS	1.60	0.99	61.88
3 REESTRUCTURA DEL SECTOR PRODUCTIVO	1.40	0.42	30
4 ASISTENCIA AL BANCO CENTRAL DEL ECUADOR	0.00	0.00	0
5 COORDINACION Y ADMINISTRACION DEL PROYECTO	1.34	1.08	80.6
6 CONTIGENCIAS	0.50	0.04	8
<b>Total Baseline Cost</b>	11.14	2.53	
<b>Physical Contingencies</b>			22.71
<b>Total Project Costs</b>	11.14	2.53	
Front-end fee	0.10	0.10	100.00
<b>Total Financing Required</b>	11.24	2.63	

1. Appraisal Estimate does not include \$3 million component of IDB/CAF for SBS institutional strengthening, that were financed in parallel but outside of the FSTAL itself.

2. Total Financing Required includes Local Counterpart resources for an amount of \$1.24 millions.

3. With the amendment signed in March 2002, the amount assigned to each component were revised as follows:

Component 1: US\$ 2.80 million

Component 2: US\$ 1.60 million

Component 3: US\$ 1.40 million

Component 4: US\$ 3.50 million

Component 5: US\$ 1.34 million

Component 6: US\$ 0.50 million

Front end fee: US\$ 0.10 million

Total Financing required: US\$ 11.24 million

Project Costs by Procurement Arrangements (Appraisal Estimate) (US\$ million equivalent)

Expenditure Category	Procurement Method <sup>1</sup>			N.B.F.	Total Cost
	ICB	NCB	Other <sup>2</sup>		
<b>1. Works</b>	0.00 (0.00)	0.00 (0.00)	1.00 (1.00)	0.00 (0.00)	1.00 (1.00)
<b>2. Goods</b>	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
<b>3. Services</b>	0.00 (0.00)	0.00 (0.00)	1.30 (1.30)	0.00 (0.00)	1.30 (1.30)
<b>4. Consultants</b>	0.00 (0.00)	0.00 (0.00)	7.50 (7.50)	3.00 (0.00)	10.50 (7.50)
<b>5. Operating Costs (plus front-end-fee)</b>	0.00 (0.00)	0.00 (0.00)	1.20 (0.10)	0.00 (0.00)	1.20 (0.10)
<b>6. Front-end-fee</b>	0.00	0.00	0.10	0.00	0.10

	(0.00)	(0.00)	(0.10)	(0.00)	(0.10)
<b>Total</b>	0.00	0.00	11.10	3.00	14.10
	(0.00)	(0.00)	(10.00)	(0.00)	(10.00)

\* NBF = Not Bank Financed: includes elements provided under parallel cofinancing procedures, consultants under trust funds, any reserved procurement and any other miscellaneous items. The procurement arrangements for items listed under "Other" and details of the items listed as NBF need to be explained in the footnotes to the table.

\*\* IDB/CAF parallel funding for SBS strengthening.

#### Project Costs by Procurement Arrangements (Actual/Latest Estimate) (US\$ million equivalent)

Expenditure Category	Procurement Method <sup>1</sup>			N.B.F.	Total Cost
	ICB	NCB	Other <sup>2</sup>		
<b>1. Works</b>	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
<b>2. Goods</b>	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
<b>3. Services</b>	0.00 (0.00)	0.00 (0.00)	1.48 (0.00)	1.05 (0.00)	2.53 (0.00)
<b>4. Consultants</b>	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
<b>5. Operating Costs (plus front-end-fee)</b>	0.00 (0.00)	0.00 (0.00)	0.10 (0.00)	0.00 (0.00)	0.10 (0.00)
<b>6. Front-end-fee</b>	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
<b>Total</b>	0.00 (0.00)	0.00 (0.00)	1.58 (0.00)	1.05 (0.00)	2.63 (0.00)

<sup>1/</sup> Figures in parenthesis are the amounts to be financed by the Bank Loan. All costs include contingencies.

<sup>2/</sup> Includes civil works and goods to be procured through national shopping, consulting services, services of contracted staff of the project management office, training, technical assistance services, and incremental operating costs related to (i) managing the project, and (ii) re-lending project funds to local government units.

#### Project Financing by Component (in US\$ million equivalent)

Component	Appraisal Estimate			Actual/Latest Estimate			Percentage of Appraisal		
	Bank	Govt.	CoF.	Bank	Govt.	CoF.	Bank	Govt.	CoF.
<b>1 FORTALECIMIENTO INSTITUCIONAL DE LA AGD</b>	6.30		6.30				0.0		0.0
<b>2 FORTALECIMIENTO DE LA SUPERINTENDENCIA DE BANCOS</b>	1.60		1.60	0.99		0.99	61.9		61.9
<b>3 REESTRUCTURA DEL SECTOR PRODUCTIVO</b>	1.40		1.40	0.42		0.42	30.0		30.0
<b>4 ASISTENCIA AL BANCO CENTRAL DEL ECUADOR</b>									
<b>5 COORDINACION Y</b>	0.10	1.24	1.34	0.03	1.05	1.08	30.0	84.7	80.6

<b>ADMINISTRACION DEL PROYECTO</b>									
<b>6 CONTIGENCIAS</b>	0.50		0.50	0.04		0.04	8.0		8.0
<b>7 FRONT END FEE</b>	0.10		0.10	0.10		0.10	100.0		100.0
<b>TOTAL</b>	10.00	1.24	11.24	1.58	1.05	2.63	15.8	84.7	23.4

### **Annex 3. Economic Costs and Benefits**

As was mentioned in section 4.3, no potential return was explicitly calculated for the loan at appraisal, however the loan is believed to have had for the client a positive but un-quantifiable impact in terms of:

1. An important but un-quantifiable increase in loan recoveries compared to the counterfactual of no support for the URC or for the design of an incentive-compatible debt restructuring mechanism. In particular, when proposals were floated in August 2001 for generalized loan restructuring of all non-performing loans above \$50,000 at as little as 3 percent over 15 years, one IMF estimate suggested that the fiscal cost of such largesse could have cost the Government US\$500 million in NPV. The FSTAL-supported mechanism and the FSTAL team members' follow-up contributed in part, together with several other partners, to the Government's rejection of this option, and thereby also improved incentives for loan repayment to private open banks, although this benefit cannot be quantified;
2. A similarly un-quantifiable but positive benefit to the country arising from a significantly improved regulatory and supervisory framework, as these are believed to lower the likelihood and/or severity of possible future financial sector crises;
3. Better credit practices and an improved credit culture and lower risks, and therefore lower interest rates in the long-term.

## Annex 4. Bank Inputs

(a) Missions:

Stage of Project Cycle	No. of Persons and Specialty (e.g. 2 Economists, 1 FMS, etc.)		Performance Rating		
	Month/Year	Count	Specialty	Implementation Progress	Development Objective
<b>Identification/Preparation</b>					
November 1999	12	Mission co-leaders (2); Sector Leader (1); Team Assistant (1); Economist (1); Banking specialists (3); Private Sector Development Specialist (Corporate Restructuring and Governance Group (1); Knowledge Management Officer (1); Financial Economist (1); External Consultant (1)			
<b>Appraisal/Negotiation</b>					
December 1999	13	Task Managers (2); Procurement Specialist (1); Economist (1); Lead Economist (2); Financial Sector Specialist (3); Research Analyst (1); Banking Specialist (2); Regional Financial Services Advisor (1)			
January 2000	3	Task Manager (1); Financial Economist (1); Principal Financial Sector Specialist (1)			
May 2000	2	Task Manager (1); Lead Economist (1)			
June 2000	3	Task Manager (1); Lead Economist (1); Private Sector Development Specialist (1)			
<b>Supervision</b>					
October 2000	3	Task Manager (1); Bank Restructuring Specialist (1), Advisor (1)	S	S	
November 2000	4	Task Manager (1); Bank Restructuring Specialist (1); Banking Supervision Specialist (1); Corporate Debt Restructuring Specialist (1)	S	S	
February 2001	1	Task Manager (1)	S	S	
June 2001	4	Task Manager (1); Bank Restructuring Specialist (1); Banking Specialist (1); Debt Rest. Legal ASP. (1)	S	S	
November 2001	1	Task Manager (1)	S	S	
December 2001	2	Task Manager (1), Senior	S	S	

	May 2002	3	Financial Specialist (1) Task Manager (1); Sr. Financial Specialist (1); Financial Economist (1)	S	S
	December 2002	2	Task Managers (2 - transition)	S	S
	May 2003 - MTR	6	Task Manager (1); Banking Supervisor (2); Payments System Specialist (1); Procurement Specialist (1); Financial Management Specialist (1)	S	S
	May 2003	4	Task Manager (1); Advisor (2); Sr. Financial Economist (1)	S	S
	January 2004	3	Banking Supervisor (2); Payments System Specialist (1)	U	U
	April 2004	3	Task Manager (1); Banking Supervisor (1); Microfinance Specialist (1)	U	U
<b>ICR</b>	October 2004	2	Task Manager (1); Financial Specialist (1)	U	U

In addition to the above missions, there were various missions by the intitial TTL (in his quality of program manager Special Financial Operations Unit), Lead Private Sector Specialist for corporate restructuring component and continuous field supervision from the second TM, based in Ecuador, starting December 2002.

(b) Staff:

Stage of Project Cycle	Actual/Latest Estimate	
	No. Staff weeks	US\$ ('000)
Identification/Preparation	34.0	223,300.00
Appraisal/Negotiation	38.88	145,541.02
Supervision	52.58	224,125.96
ICR	3.79	11,103.87
Total	129.25	604,070.85

FSTAL time dedicated by staff is underestimated due to indirect support for FSTAL activities financed under SFO and the SAL of IBRD.

## Annex 5. Ratings for Achievement of Objectives/Outputs of Components

(H=High, SU=Substantial, M=Modest, N=Negligible, NA=Not Applicable)

	<u>Rating</u>				
<input type="checkbox"/> <i>Macro policies</i>	<input type="radio"/> H	<input type="radio"/> SU	<input checked="" type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Sector Policies</i>	<input type="radio"/> H	<input type="radio"/> SU	<input checked="" type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Physical</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input checked="" type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Financial</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> NA
<input type="checkbox"/> <i>Institutional Development</i>	<input type="radio"/> H	<input type="radio"/> SU	<input checked="" type="radio"/> M	<input type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Environmental</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> NA
<i>Social</i>					
<input type="checkbox"/> <i>Poverty Reduction</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> NA
<input type="checkbox"/> <i>Gender</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> NA
<input type="checkbox"/> <i>Other (Please specify)</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> NA
<input type="checkbox"/> <i>Private sector development</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input checked="" type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Public sector management</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input checked="" type="radio"/> N	<input type="radio"/> NA
<input type="checkbox"/> <i>Other (Please specify)</i>	<input type="radio"/> H	<input type="radio"/> SU	<input type="radio"/> M	<input type="radio"/> N	<input checked="" type="radio"/> NA

## Annex 6. Ratings of Bank and Borrower Performance

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HU=Highly Unsatisfactory)

### 6.1 Bank performance

#### Rating

- |                                      |                          |                                    |                         |                          |
|--------------------------------------|--------------------------|------------------------------------|-------------------------|--------------------------|
| <input type="checkbox"/> Lending     | <input type="radio"/> HS | <input checked="" type="radio"/> S | <input type="radio"/> U | <input type="radio"/> HU |
| <input type="checkbox"/> Supervision | <input type="radio"/> HS | <input checked="" type="radio"/> S | <input type="radio"/> U | <input type="radio"/> HU |
| <input type="checkbox"/> Overall     | <input type="radio"/> HS | <input checked="" type="radio"/> S | <input type="radio"/> U | <input type="radio"/> HU |

### 6.2 Borrower performance

#### Rating

- |  |                          |                                    |                                    |                          |
|--|--------------------------|------------------------------------|------------------------------------|--------------------------|
| <input type="checkbox"/> Preparation                           | <input type="radio"/> HS | <input type="radio"/> S            | <input checked="" type="radio"/> U | <input type="radio"/> HU |
| <input type="checkbox"/> Government implementation performance | <input type="radio"/> HS | <input type="radio"/> S            | <input checked="" type="radio"/> U | <input type="radio"/> HU |
| <input type="checkbox"/> Implementation agency performance     | <input type="radio"/> HS | <input checked="" type="radio"/> S | <input type="radio"/> U            | <input type="radio"/> HU |
| <input type="checkbox"/> Overall                               | <input type="radio"/> HS | <input type="radio"/> S            | <input checked="" type="radio"/> U | <input type="radio"/> HU |

## **Annex 7. List of Supporting Documents**

1. FSTAL PAD
2. URC final report
3. Subgerencia de seguimientos' report, as of June 2004
4. UEGI report
5. IFI matrix policy
6. SAL MOP
7. SAL ICR
8. 12 PSRs
9. "Banking Currency and Debt Meltdown: Ecuador Crisis in the late 90s" by Augusto de la Torre, Roberto Garcia-Saltos and Yira Mascaro
10. FSTAL Loan Agreement
11. Amendment to Loan Agreement sent August 2001 and signed March 2002
12. Draft second Amendment to Loan Agreement
13. "Estrategia y Plan de Acción Para el Fortalecimiento del Sector Financiero del Ecuador" March 2003
14. Miscellaneous correspondence and documents in FSTAL project files
15. BTOR ICR October 2004

