

Document of
The World Bank

Report No: 26780 HO

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 7.2 MILLION (US\$9.9 MILLION EQUIVALENT)

TO THE

REPUBLIC OF HONDURAS

FOR A

FINANCIAL SECTOR TECHNICAL ASSISTANCE CREDIT

May 29, 2003

**Finance, Private Sector and Infrastructure
Central America Country Management Unit
Latin America and Caribbean Region**

CURRENCY EQUIVALENTS

(Exchange Rate Effective May 2, 2003)

Currency Unit = Lempiras (Lps.)
1 Lempira = US\$0.06
US\$1 = Lps.17.20

FISCAL YEAR

July 1, 2002 -- June 30, 2003

ABBREVIATIONS AND ACRONYMS

AML	Anti-Money Laundering
BCH	(Banco Central de Honduras) Honduras Central Bank
BCP	Banking Consolidation Program
BCV	(Bolsa Centroamericana de Valores) Central American Stock Exchange
CAR	Capital Adequacy Ratio
CAS	Country Assistance Strategy
CEPROBAN	(Centro de Procesamiento Bancario) Bank Processing Center
CFT	Combating Financing of Terrorism
CNBS	(Comision Nacional de Bancos y Seguros) National Commission of Banking and Insurance
CPSS	Committee on Payment and Settlement Systems
CSD	Central Securities Depository
DVP	Delivery-Versus-Payment
FIU	Financial Intelligence Unit
FOGADE	(Fondo de Garantía de Depósitos) Deposit Guarantee Fund
FOSEDE	(Fondo de Seguro de Depósitos) Deposit Insurance Fund
FSPC	Financial Sector Policy Committee
FSTAC	Financial Sector Technical Assistance Credit
FSAC	Financial Sector Adjustment Credit
GDP	Gross Domestic Product
FSAP	Financial Sector Assessment Program
IDA	International Development Association
IDB	Inter-american Development Bank
IMF	International Monetary Fund
LISF	(Ley de Instituciones del Sistema Financiero) Law of Institutions of the Financial System
OPD	Operations and Policy Department (WB)
PHRD	Japan Policy and Human Resources Development Fund
PCU	Project Coordination Unit
ROA	Return on Assets
ROE	Return on Equity
SML	Securities Market Law
SRA	Supervisory Risk Assessment

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HONDURAS
FINANCIAL SECTOR TECHNICAL ASSISTANCE CREDIT

CONTENTS

	Page
A. Project Development Objective	
1. Project development objective	2
2. Key performance indicators	2
B. Strategic Context	
1. Sector-related Country Assistance Strategy (CAS) goal supported by the project	2
2. Main sector issues and Government strategy	3
3. Sector issues to be addressed by the project and strategic choices	7
C. Project Description Summary	
1. Project components	8
2. Key policy and institutional reforms supported by the project	13
3. Benefits and target population	13
4. Institutional and implementation arrangements	13
D. Project Rationale	
1. Project alternatives considered and reasons for rejection	15
2. Major related projects financed by the Bank and/or other development agencies	16
3. Lessons learned and reflected in the project design	16
4. Indications of borrower commitment and ownership	17
5. Value added of Bank support in this project	17
E. Summary Project Analysis	
1. Economic	18
2. Financial	18
3. Technical	18
4. Institutional	18
5. Environmental	20
6. Social	20
7. Safeguard Policies	22

F. Sustainability and Risks	
1. Sustainability	22
2. Critical risks	23
3. Possible controversial aspects	23
G. Main Credit Conditions	
1. Effectiveness Condition	24
2. Other	24
H. Readiness for Implementation	24
I. Compliance with Bank Policies	25
Annexes	
Annex 1: Project Design Summary	26
Annex 2: Detailed Project Description	29
Annex 3: Estimated Project Costs	36
Annex 4: Cost Benefit Analysis Summary	37
Annex 5: Financial Summary	38
Annex 6: (A) Procurement Arrangements	39
(B) Financial Management and Disbursement Arrangements	44
Annex 7: Project Processing Schedule	48
Annex 8: Documents in the Project File	49
Annex 9: Statement of Loans and Credits	50
Annex 10: Country at a Glance	52

HONDURAS
Financial Sector Technical Assistance Credit

Project Appraisal Document

Latin America and Caribbean Region
LCSFF

Date: May 29, 2003		Team Leader: Modibo Khane Camara							
Sector Manager/Director: Fernando Montes-Negret, Danny M. Leipziger		Sector(s): Banking (100%) Theme(s): Other public sector governance (P)							
Country Manager/Director: Jane Armitage									
Project ID: P040177									
Lending Instrument: Technical Assistance Loan (TAL)									
Project Financing Data									
<input type="checkbox"/> Loan <input checked="" type="checkbox"/> Credit <input type="checkbox"/> Grant <input type="checkbox"/> Guarantee <input type="checkbox"/> Other:									
For Loans/Credits/Others:									
Amount (US\$m): 9.9 (SDR 7.2 million)									
Proposed Terms (IDA): Standard Credit									
Grace period (years): 10		Years to maturity: 40							
		Service charge: 0.75%							
Financing Plan (US\$m):		Source							
				Local					
				Foreign					
				Total					
BORROWER				0.15					
IDA				0.95					
				1.10					
				1.32					
				8.58					
				9.90					
Total:				1.47					
				9.53					
				11.00					
Borrower: REPUBLIC OF HONDURAS									
Responsible agency: COMISION NACIONAL DE BANCOS Y SEGUROS/BANCO CENTRAL HONDURAS									
Comisión Nacional de Bancos y Seguros (CNBS)									
Address: Apartado Postal No. 20074									
Comayagua, M.D.C Honduras, C.A.									
Contact Person: Dra. Ana Cristina de Pereira									
Tel: (504)238-0580		Fax: (504)237-6232		Email: apereira@cnbs.gov.hn					
Estimated Disbursements (Bank FY/US\$m):									
FY	2003	2004	2005	2006	2007				
Annual	0.0	1.89	5.67	1.54	0.80				
Cumulative	0.0	1.89	7.56	9.10	9.90				
Project implementation period: 2003-2007									
Expected effectiveness date: 09/30/2003		Expected closing date: 09/30/2007							

A. Project Development Objective

1. Project development objective: (see Annex 1)

The proposed project will support the development of the institutional capacity of the Comisión Nacional de Bancos y Seguros (CNBS) and the Banco Central de Honduras (BCH) to address vulnerabilities of the Honduran financial system. In this context, the project development objective is capacity-building for dealing with weaknesses of the banking system, a prerequisite for sustainable growth and poverty alleviation. The project would achieve this objective by providing technical assistance for: (i) the design and implementation of a banking sector consolidation program, (ii) the reform of the payments system, and (iii) the improvement of selected aspects of the financial system infrastructure. A financial sector adjustment operation is planned in FY04 to complement the proposed technical assistance operation and achieve the objectives defined in the Country Assistance Strategy.

2. Key performance indicators: (see Annex 1)

1. Compliance of all systemically important banks with CNBS prudential regulation, including capital adequacy norms.
2. Improved risk management by the banking sector and increased cost efficiency (see section 2.a).
3. Reduced legal uncertainty in payments systems and improved risk management.
4. Effective special unit against money laundering within the CNBS leading to increased volume and quality of on-site examinations.
5. Increased quality, transparency and timeliness of the information available to CNBS and BCH on bank soundness and major corporate clients.
6. Reduced levels of non-performing loans from the top 50 Honduran corporate borrowers.
7. Increased efficiency of corporate restructuring and orderly liquidations, both judicial and extra-judicial.

B. Strategic Context

1. Sector-related Country Assistance Strategy (CAS) goal supported by the project: (see Annex 1) **Document number:** 20072-HO **Date of latest CAS discussion:** 12/14/1999

The proposed technical assistance credit is well embedded within IDA's assistance strategy to Honduras. On the basis of its importance for economic reactivation, growth and poverty reduction, the strengthening of the Honduran financial system was already singled out as a key issue in the last CAS, which was discussed by the World Bank's Board on December 14, 1999.

The new CAS - being submitted to the Board in parallel to this credit - continues IDA's past emphasis on achieving high economic growth to reduce poverty while promoting social development. Six priority areas are selected for strategic focus: (i) accelerating equitable and sustainable growth to levels consistent with the income poverty reduction targets; (ii) reducing rural poverty; (iii) reducing urban poverty; (iv) enhancing investment in human capital; (v) strengthening social protection for specific vulnerable groups; and, (vi) ensuring the sustainability of the strategy through governance and institutional reforms. The weakness of the Honduran financial system is clearly identified as a potential constraint to the achievement of the first objective of accelerating equitable and sustainable economic growth to levels consistent

with the poverty reduction targets; and this assessment is consistent with the outcome of the FSAP diagnostic recently completed.

The proposed project is primarily designed to help reduce the risks of systemic instability in the Honduran financial system. A banking sector consolidation program will be designed, coupled with selected measures in the corporate sector, to establish a sound and stable foundation for the recovery of the Honduran financial sector. A reform of the payments system will also be conducted to improve the efficiency of the financial system and facilitate business transactions. Finally, technical assistance will be provided to improve selected aspects of the financial sector infrastructure and enable the early recognition and more efficient handling of future problems in the financial sector. It is expected that these measures will be complemented by a financial sector adjustment program in FY04, which should help ensure that the appropriate policy framework is in place to achieve the goals stated in the new CAS.

2. Main sector issues and Government strategy:

a. Weakness of Domestic Financial Institutions

The Honduran financial sector suffered a severe shock in October 1998, when Hurricane Mitch hit the country with devastating effects in terms of human lives and disruption of economic activity. In its immediate aftermath, the financial sector was faced with an upsurge in the volume of bad debts and substantial financial losses. A mid-sized bank had to be liquidated by the Comision Nacional de Bancos y Seguros (CNBS) and most financial institutions were forced to request new injections of capital from their shareholders to restore their solvency.

Five years after Mitch, the soundness of the Honduran banking sector - which accounts for about 70% of all financial sector assets – still remains an issue. Non-performing loans persist as a source of financial difficulties. The share of non-productive assets in the balance sheet of banks has increased and bank profitability has been steadily falling since 1998. Although the liquidity situation has been improving, this may also be an indicator of the substantial slowdown in new lending and banks' growing difficulties to find risk-adjusted, profitable investment opportunities. The difficulties described above are unfortunately not limited to the banking sector. Similar problems are also affecting the other groups of financial institutions, i.e. the financieras, the savings & loans societies, and the insurance companies.

A key factor behind the persistent weakness of Honduran financial institutions is undoubtedly the unfavorable evolution of the macroeconomic environment. The combination of a US economic slowdown and the sharp fall in the prices of major commodities, notably coffee, in the last two years has taken its toll on economic activity in Honduras. As a result, economic growth decelerated from about 4% in 1999 -2000 period to an estimated 2% in 2002, impacting the local financial institutions and their clients, especially those in or with large exposure to the agricultural sector, and exporters. However, three structural factors are also thought to play an (at least) equally important role in the deterioration of the situation in the financial sector:

(i.) **An excessive number of players competing for a limited market potential:** There is a certain level of fragmentation of the market, as in the banking sector the six largest institutions control about 71.2% of the market measured in terms of total assets, and the remaining

institutions typically have only a limited client base. Accordingly, Honduran banks exhibit the highest operational costs ratios in Central America (see table 2). Intermediation spreads also remain high in spite of the significant drop of nominal interest rates, both passive and active, over the past four years. An exit of the non-viable institutions from the financial market and a reduction in the number of institutions would allow the remaining institutions to reach economies of scale, improve their cost structure, and possibly restore profitability.

Table 2: Comparative Analysis of Cost Efficiency in Central American Banking Market

%		Administrative Expenses/ Assets
Central America	Average CA	4.7
	Costa Rica	5.9
	Guatemala	5.0
	Nicaragua	4.3
	El Salvador	3.0
	Panamá	0.9
	Honduras	6.4
Honduras	Medium Banks	7.9
	Small Banks	7.0
	Foreign Banks	5.9
	Big Banks	5.7

Source: Banco Central de Nicaragua, CNBS Honduras 2002

(ii.) **Weak legal / regulatory framework:** This is discussed at great length in the next section. At this stage, it should only be noted that an effective system of early warning indicators and an adequate resolution framework for troubled banks would have helped prevent weak institutions to accumulate more losses and thereby substantially increase fiscal contingencies.

(iii.) **Weak risk management practices:** Honduran banks lack business diversification, which is probably due to the limited size of the market. All banks display high levels of concentration in their loan portfolio and a number of institutions also have a substantial risk exposure to single sectors, for instance agriculture, without using adequate instruments to hedge the risks inherent in these activities such as weather and/or catastrophe insurance policies, or commodity risk hedging. Sophisticated risk management tools to assess liquidity risks, credit risk, interest rate and foreign exchange risk are underdeveloped.

b. Inadequate Framework for Financial Sector Supervision and Regulation

A recent analysis of banking supervision in Honduras revealed that compliance with the Basel Core Principles is relatively limited. The quality of the information produced based on on-site inspections and off-site analysis was also found to be in need of improvement. With respect to prudential regulation, the following areas were identified as those in most urgent need of improvement: (i) consolidated supervision, (ii) capital adequacy, (iii) loan classification and provisioning, (iv) corporate governance and risk management, and (v) framework for prompt corrective action. The introduction of consolidated supervision would especially allow the CNBS

to gain a more comprehensive view of the state of the financial system, and ensure a more satisfactory application of prudential norms and regulations.

Similarly, the legal and institutional framework for dealing with problem banks and bank resolution requires upgrading. Strengthening CNBS will ensure the timely/early identification of potential problem banks, while prompt corrective actions can become more effective. The timeliness of the emergency assistance under the "lender of last resort" can improve, while the deposit insurance system, which currently provides a blanket guarantee for all deposits in the system, necessitates alterations as well. As it stands, this blanked guarantee undermines market discipline and generates welfare losses for the economy.

In summary, the Honduran authorities can improve their capacity to (i) assess the level of risk in the financial system, and/or (ii) enforce existing prudential norms and regulations.

c. Structural Weaknesses in the Corporate Sector

The Honduran financial sector has been strongly impacted by the evolution in the corporate sector. Evidence up to 1999 suggested that Honduran companies exhibited very high leverage, with debts often reaching several multiples of equity endowment, modest profitability levels and decreasing return on equity (ROE).

Unfortunately, more recent information is not available to assess the financial soundness of the corporate sector. The credit bureau, launched by the CNBS a few years ago, provides incomplete information. Given the current situation of the Honduran financial system, such corporate sector information may be of vital importance for prudential oversight and any attempt to restructure the banking system. Nevertheless, the volume of non-performing loans held by banks seems to suggest that the Honduran corporate sector is weak and many companies are having difficulties to service their obligations. Broadly publicized defaults on bond payment obligations have already led the two Honduran exchanges to almost entirely dry-up as a source of new financing for the corporate sector.

The indebtedness problem also points to an inadequate framework for corporate bankruptcy. The availability of regulations concerning dissolution, liquidation, bankruptcy and suspension of payments has not prevented insolvent corporations and their creditors from almost never engaging in bankruptcy proceedings. This arises due to legislative, institutional and cultural factors. There is a widespread perception that said proceedings are very costly, complicated and time consuming. Importantly, a sound environment for out-of-court corporate restructuring negotiations and agreements ("workouts" and "prepackaged plans") does not exist at present.

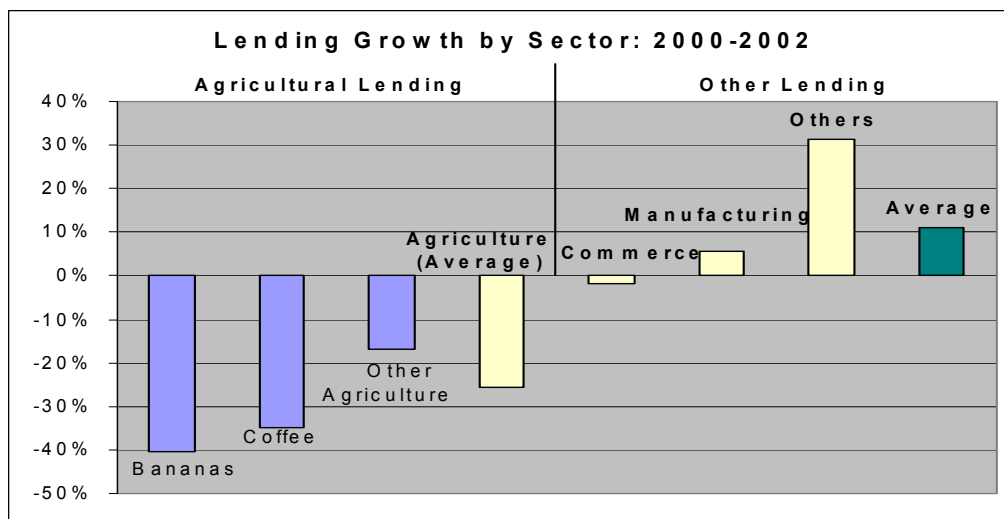
d. Systemic Risks related to Payments System Operation

Two payments systems were identified as systemically important in Honduras: the current banks-owned electronic check clearing house (CEPROBAN) and the funds transfer "system" associated with the accounts of financial institutions and the government at the Central Bank. The yearly value settled in the check clearinghouse represents approximately 215% of GDP. The yearly value settled in the funds transfer system represents approximately 125% of GDP.

A recent review by the IDA staff identified a number of structural shortcomings leading to an inadequate exposure to credit and liquidity risks, legal risks, operational risks, and custody and settlement risks for securities transactions.

e. Difficulties in Agricultural Lending

Lending to the agricultural sector has decreased over the past few years, having fallen in nominal terms by about 25% since 2000 and with the banana and coffee sectors being the worst hit. In comparison, lending has increased in all other sectors except in commerce, where a slight fall of about 2% was registered.



Source: CNBS

The shock of Hurricane Mitch and a recent drop in commodity prices resulted in a significant part of the non-performing loans of banks belonging to the agricultural sector. Almost all refinanced loans are from the agricultural sector. Consequently this resulted in a fall in agricultural lending. Interestingly, not all types of agricultural lending have fallen. Loans to some sub-sectors, such as fisheries and livestock production, have actually increased (30% and 21% respectively from 2000 to 2002). This seems to indicate that Honduran banks are also trying to diversify their agricultural portfolio, which in itself is a good development.

Given the social and political importance of the agricultural sector in Honduras, policy makers have undertaken several attempts to revive lending to the sector. After the devastation caused by Mitch, the Government passed regulations to subsidize affected loans and to allow the banks to refinance non-performing loans. Honduran authorities have recently approved another resolution to reactivate agricultural lending, but the details of this latest scheme have yet to be published.

Unfortunately, the promotion efforts made by the Government do not seem to have been very successful at raising the flow of credit to the agricultural sector. Honduran banks may be primarily interested in recovering their losses and may not have much appetite for agricultural lending at this time. The impact of the policies may have also been indirectly adverse for the

banking system. The nature of the government intervention could be fuelling the bad debt problem by increasing the level of moral hazard in the system and contributing to a deterioration of payment culture among borrowers. Moreover, it is questionable whether commercial banks should be given incentives to take on such additional risks, given the very nature of their current problems.

f. Government Strategy:

The new administration shares the assessment of IDA about the structural nature of the problems faced in the banking system and the need for a consolidation in the industry. The new Honduran authorities have demonstrated their willingness to act by intervening some weak institutions. Also, the authorities showed their readiness for complete openness with IDA by allowing a thorough diagnostic of its financial sector in the context of the joint WB – IMF Financial Sector Assessment Program (FSAP). Following these positive developments, IDA has initiated the use of PHRD grant resources to provide some critical technical assistance in preparation of the TA credit and a possible FSAC in FY04. The collaboration with the authorities has so far been very satisfactory in this regard. Whereas there is no doubt about the goodwill of the new administration to tackle the existing structural problems, its commitment to an uncompromising banking sector consolidation program is yet to be tested. In particular, uncertainties remain with respect to the administration's ability to withstand pressure from its main political constituencies on the issue of how to reactivate agricultural lending. Similarly, the proposed project will reach its critical phase in early 2005, when pre-electoral campaigning starts again in Honduras. It is hard to predict at this stage how this will affect the consolidation program.

3. Sector issues to be addressed by the project and strategic choices:

The proposed project will support the development of the institutional capacity to address the systemic vulnerabilities of the financial sector. The focus will be on banking sector consolidation and other areas regarded as critical for preventing the worst-case scenario of a major disruption of financial sector activity, which could undermine economic and social stability. In this logic, the credit will finance technical assistance to address the following issues:

a. Banking System Consolidation

As explained in section B.2.a., the Honduran banking sector accounts for about 70% of the financial sector in terms of assets. From the perspective of reducing systemic risks, a first priority should therefore be given to addressing the structural shortcomings affecting this particular sector and this should be done within the context of a well-thought out banking sector consolidation process.

b. Financial Sector Supervision

Given the fact that the IDB has just initiated a comprehensive technical assistance program, the proposed project will concentrate on those aspects of bank supervision perceived as being most critical for the success of the banking sector consolidation efforts: (i) the need for intense supervision of the weakest institutions, and (ii) the need for ongoing monitoring of the level of systemic risks in the banking sector.

The proposed project will also address the issue of anti-money laundering and combating the financing of terrorism (AML/CFT), which is not covered by the IDB. Honduras has enacted a regime to prevent and detect money laundering and terrorist financing that is relatively consistent with international standards, but the implementation of the new legal requirements needs support. CNBS examiners have recently begun the onsite inspections of banks for AML/CFT compliance, but the process is at an early stage and needs to be strengthened. Onsite examinations in other financial institutions have not yet begun.

The newly-created financial intelligence unit (FIU), which is part of the CNBS, receives, analyzes and disseminates to competent authorities financial information related to money laundering. However, its internal organization can be strengthened, alongside existing analytical capabilities. Further guidance on what constitutes suspicious transactions activities must also be provided to the financial sector, alongside AML/CFT training and the dedication of necessary resources.

c. Systemic Risks in Payments System

As indicated in section B.2.d., the Honduran payments system currently shows a substantial level of exposure to credit, legal, and operational risks. A comprehensive reform is needed to reduce and better manage these risks in order to prevent the worst-case scenario of a possible disruption in the system.

d. Monitoring of Corporate Sector

The initiation of some form of monitoring of the Honduran corporate sector would greatly contribute to properly assess, monitor and eventually reduce the level of risk in the banking system.

A reform of bankruptcy laws and regulations would facilitate corporate reorganization and provide a better protection of creditor rights. Such a reform should also include the initiation of a modern and safe registration system of property rights and securities, both for immovable and movable assets, as well as a review of the legislation on securities over movable and intangible assets. Under the current "book system" the deeds filed for registration take an average of two to four months to be recorded, due mainly to the heavy workload and the inefficient system of registrar analysis in place.

C. Project Description Summary

1. Project components (see Annex 2 for a detailed description and Annex 3 for a detailed cost breakdown):

Component	Indicative Costs (US\$M)	% of Total	Bank-financing (US\$M)	% of Bank-financing
Technical Assistance for Banking Sector Consolidation	4.66	42.4	4.19	42.3
Reform of Payment System	2.34	21.3	2.11	21.3
Improvement of Financial System Infrastructure	2.26	20.5	2.03	20.5
Project Administration	1.25	11.4	1.13	11.4
Unallocated Reserve	0.49	4.5	0.44	4.4
Total Project Costs	11.00	100.0	9.90	100.0
Total Financing Required	11.00	100.0	9.90	100.0

a. Technical Assistance for Banking Sector Consolidation

The objectives of this component are to (i) establish a conducive framework for an improved soundness of the Honduran financial system, (ii) facilitate the market exit of the weakest / non-viable banks, and (iii) contribute to the institutional strengthening of the CNBS. Given the inadequate legal framework and the shortage of crucial resources to Honduran authorities, it was agreed to adopt a gradual approach for the banking sector consolidation program (BCP) while a more conducive environment is being put in place. An incentive package will also be included to support the BCP because the low level of profitability at systemic level might discourage bank shareholders to invest more equity, especially when the authorities are still in the process of strengthening their enforcement capacity.

The process for the elaboration and implementation of the BCP will consist of three distinct phases with well-specified milestones preceded by a preliminary stocktaking exercise, as indicated below:

□ *Preliminary Phase: Basic organization of implementation framework & initial stocktaking of existing information*

Three prerequisites for the implementation of the credit will be completed during the preliminary phase. First, a high level Financial Sector Policy Committee (FSPC) will be formed to define the consolidation strategy, ensure political consensus around the strategy and coordinate its implementation. However, the FSPC will not take over the functions of the CNBS, but will rather act in a consultation capacity, ensuring approval of the overarching principles and purpose for the BCP, providing political backing to decisions taken in connection by the CNBS. Second, a Task Force Unit will be organized to design and carry out the required operational work on behalf of the Commission. This task force will consist of designated officials from the CNBS and the BCH, and will be part of the project coordination unit. Third, the banks will be classified by risk profile, identifying essential information gaps. The satisfactory completion of these tasks will be a condition of effectiveness for the project.

□ *Phase I: Short term preparatory actions for initiation of consolidation program*

Phase I comprises the short term preparatory actions for the initiation of the consolidation program. The FSPC is expected to define and formally adopt the core strategy, purpose and

principles, for the Banking Consolidation Program. Technical assistance will be provided to support this process, as well as to make the necessary legal amendments, including: (i) strengthening the legal framework in crucial areas such as: remedial actions and regularization, failed bank resolution, mixed financial-commercial groups, and enforcement; (ii) improving prudential norms on asset valuation, capital adequacy, and governance and risk management, including a gradual adjustment schedule for the banks towards best international practices; (iii) designing and requesting from all banks rehabilitation plans to adapt to the upgraded regulations and to assess their viability, supporting as well the institutional capacity of the CNBS to validate these plans, in order to identify troubled and unviable banks, and to impose precautionary holding actions; and (iv) improving emergency liquidity assistance processes, enabling better liquidity monitoring, and improving methods and criteria to summarize the supervisory risk assessments (SRA) of banks, to provide for consistent supervisory reaction, directing the BCP's actions in routing banks to predetermined treatment.

After validating the rehabilitation plans, and discussing them with the banks' boards, the CNBS will update its preliminary classification of banks, and adopt decisions on which case-by-case treatment will be followed for each institution.

□ *Phase II: Medium term consolidation actions*

Phase II comprises the medium term actions for initiating the execution of the consolidation program, including: (i) the in-depth review of selected banks of adverse SRA, as rated per the previous phase, after considering the feasibility of their rehabilitation plans; (ii) the design of the processes and vehicle for resolving non-viable banks to implement the new legal framework in this regard, (iii) the resolution of troubled institutions on a least cost resolution transactions; (iv) the initiation of an ongoing process of risk monitoring at system and individual bank levels; and (v) the initiation of a process of intensified supervision processes for high risk banks.

The bank classification from the Preliminary Phase will be updated according to the outcome of the ongoing diagnostics and the progress achieved in implementing the rehabilitation plans. In addition, a government funded capitalization scheme will be elaborated as an incentive scheme to facilitate viable mergers between sound institutions as well as other market-based mechanisms of banking sector consolidation.

The incentive package to be designed will also include technical assistance (on a cost-sharing basis) for the top five performers, in implementing the previously designed self rehabilitation plans, to hire reputable management consulting firms to advise on board, operations, risk management, and information and control systems.

□ *Phase III: Long term consolidation actions*

At the end of this phase, the BCP is expected to have significantly contributed to the institutional strengthening of the CNBS, alongside the enforcement of new prudential regulation to ensure adherence to "best practice standards". To avoid over-stretching the limited resources of the CNBS, it is designed to build upon the technical assistance program provided by the IDB.

The topics covered by this program are consolidated supervision, the reform of the credit bureau, capacity-building in on-site supervision through a series of assisted inspections, the strengthening of accounting and auditing standards as well as the redefinition of the role of external auditors in the supervision process. The assistance to be provided under the BCP should help expand the supervision focus from compliance inspections towards a more proactive and risk based supervisory approach. Furthermore, events will be organized on a periodic basis to disseminate best practices for the banking sector in selected areas such as corporate governance and risk management (including dealing with the exposure to natural disaster risks and environmental risks).

b. Reform of the Payments System

Under this component, the project will carry-out an upgrade of the current systems, including the launching of a special purpose large value payments system that will allow for the separation of large and low value payments and the establishment of a securities depository function. If the electronic clearinghouse becomes a low value payments system, more attention and dedicated resources could be devoted to improving payments system efficiency by developing other payments instruments such as direct debits and electronic transfers. Further, a depository function for securities settlement will be established to help mitigate risks and provide the necessary facility for the development of a collateralized interbank money market and the provision of liquidity by the Central Bank. The reform initiative will be accompanied by additional elements that will help set up an adequate legal, regulatory, and oversight environment.

c. Improvement of Financial System Infrastructure

The suggested component will focus on three aspects of the financial system infrastructure: (i) the institutional framework for Anti Money Laundering activities & Combating Financing of Terrorism (AML/CFT), (ii) the oversight of the corporate sector and effectiveness of insolvency proceedings, and (iii) the policy instruments used to facilitate access to finance by small agricultural producers.

With respect to AMF/CFT activities, advisory assistance will be provided under the project to the Honduran Financial Intelligence Unit (FIU) to strengthen its organizational structure and its analytical capabilities. It is also planned to build capacity within the FIU for on-site examinations for AML/CFT purposes. This will require training and support from similar institutions in other countries, which could take place through visits, staff exchanges and seminars. A limited number of computers and specialized software will be provided to ensure that the FIU has appropriate tools to carry-out its function. Further, the project will also fund capacity-building activities to raise more awareness on AML/CFT issues. Training will be provided for the financial community (i.e., employees, compliance officers, internal auditors and senior management from banks, insurance companies, money remitters, exchange houses, and other non-bank financial institutions), financial regulators, the FIU, prosecutors and judges. A pilot program will be designed with the Honduran Bankers Association (AHIBA), and some limited assistance could be provided for the purchase of licenses for specialized software. Training for prosecutors and judges could possibly be supplemented with consultations with prosecutors and judges from foreign countries.

With respect to corporate sector issues, activities will be initiated under this component to ensure that (i) a certain level of monitoring of major systemic risks emanating from the corporate sector is established, and (ii) areas related to property rights and security interests regulation and registration, as well as judicial and non-judicial mechanisms for corporate insolvency, are governed by a modern and workable legal framework and implemented through sound institutions. First, a unit will be constituted at the BCH to establish a system of ongoing analysis and monitoring of the structure, soundness and evolution of the Honduran corporate sector, as well as its ties with local financial institutions. Second, advisory assistance will be provided to review the current legal framework for (i) judicial and extra-judicial insolvency proceedings and corporate reorganization and liquidation to reflect internationally recognized best practices; and (ii) secured transactions on all kind of tangible and intangible assets. The project will provide advisory assistance to facilitate consultations between the various stakeholders, design the reform strategy, draft new laws and regulations and help with initiating the implementation of the new framework. Third, technical assistance will be provided to design a safe, efficient, modern and cost-effective registration method for property rights, licensing of rights and secured interests, on movable, immovable and intangible assets. The consultancy will also be expected to elaborate on the technical requirements (hardware and software) for suggested concept and implementation costs.

Finally, advisory assistance will be provided to (i) review the current instruments used by the government of Honduras to facilitate and reactivate lending to small agricultural producers, and (ii) identify possible options for improvement based on international best practices. The analytical work conducted during the project preparation will also be taken into account in the context of the initial assessment to be done. Once the government takes a decision regarding their reform strategy based on the recommendations made, experts will be hired to help prepare the implementation of this strategy.

d. Project Administration

Under this component, the project will finance the salaries of project staff, operational expenses (including audits, local transportation and travel, etc.), training and limited equipment. This should ensure an efficient implementation and adequate monitoring of the different project components, as well as compliance with the IDA financial management and procurement guidelines. The project staff mentioned above include the project coordinator (1 person), a procurement specialist (1 person), a financial management specialist (1 person), the members of the task force (at least 4 persons) provided by the CNBS and the BCH to implement the banking sector consolidation program, and one administrative assistant (1 person) provided by the CNBS. Some limited equipment will also be provided.

e. Unallocated reserve

An unallocated reserve of about 4.5% of the total project costs (US\$ 0.49 million equivalent) has been set to allow for a limited level of flexibility in project implementation. Experience clearly shows that the issues addressed by the project tend to have their own dynamics and such an unallocated reserve would serve as a risk management tool against unexpected funding requirements during the life of the project. The largest share of these funds is likely to be used for additional consultancy services.

2. Key policy and institutional reforms supported by the project:

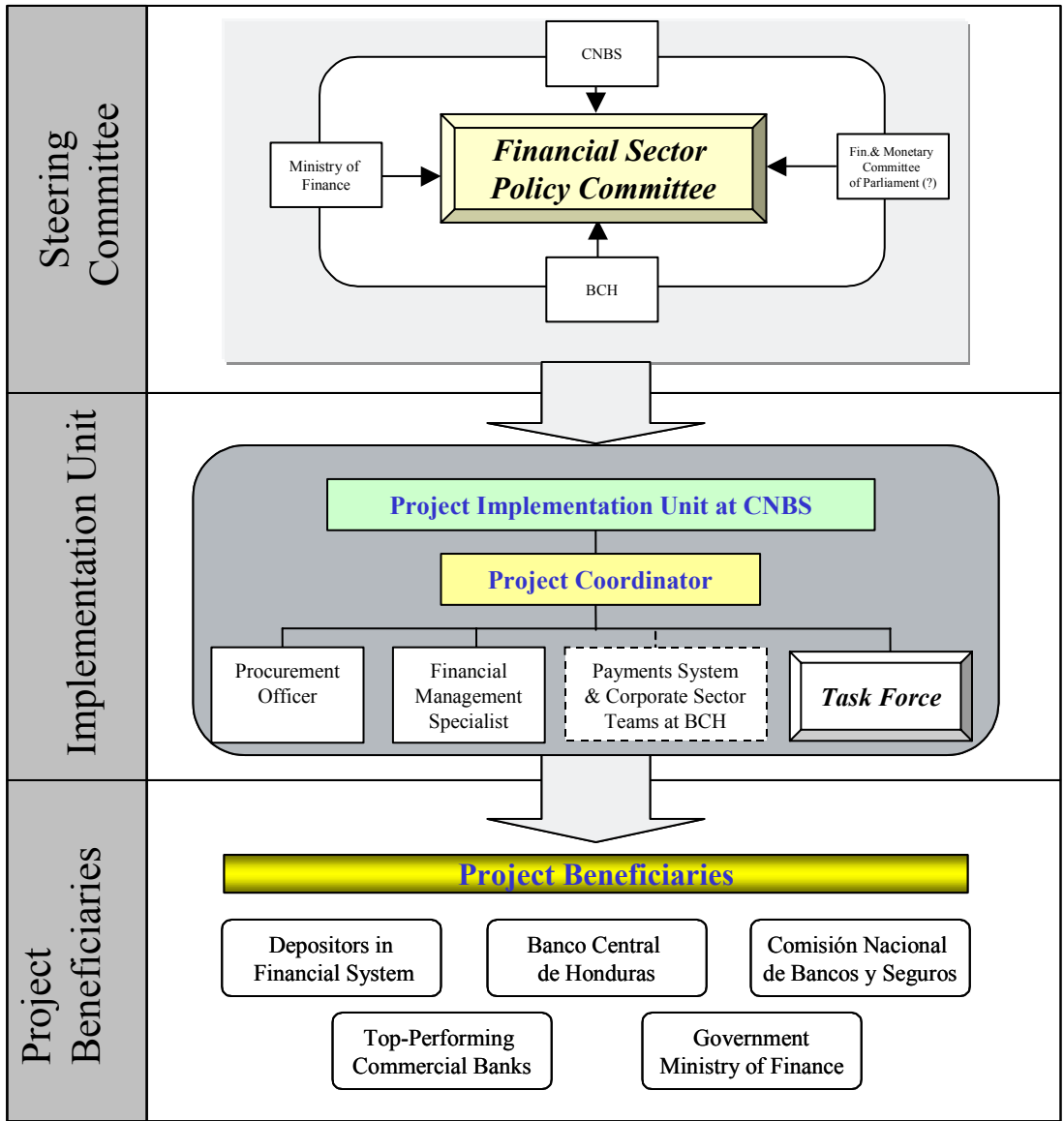
The proposed technical assistance credit will support the implementation of a financial sector reform program in Honduras, which involves: (i) a program of bank regularization that would help strengthen and recapitalize weak but viable institutions, promote the consolidation of the system through market-based mechanism such as mergers and acquisitions; (ii) a reform of the payments system to reduce risk and increase efficiency; and (iii) improvements to the overall financial system infrastructure. In this respect, the credit is expected to contribute to improve the effectiveness of the institutions responsible for the regulation and supervision of Honduras' financial sector, providing training to their staff, upgrading their IT infrastructure, and providing them with some of the technical tools needed to fulfill their goals. Recognizing that Honduras is vulnerable to money laundering activities, given the openness of its financial system and the large number of unregulated financial institutions operating in the country, the credit will also finance technical assistance to strengthen the institutions in charge of the prevention of money laundering, including the acquisition of specialized equipment and staff training. Since the situation in the banking sector is often just a "mirror image" of the state of the corporate sector, a system will be put in place to improve the information available to policy makers on systemically important Honduran corporations and develop a more conducive legal framework for corporate restructuring. Finally, this credit aims at strengthening (i) market discipline and corporate governance in the financial sector, (ii) the overall legal framework for debt collection and recovery, and (iii) the accounting rules and disclosure practices by bringing them into compliance with best international practices. All these reforms are expected to lay the ground for a possible IDA-supported financial sector adjustment operation in the near future, which would contribute to the sound and efficient development of the Honduran financial system, and improve access for the poor.

3. Benefits and target population:

The proposed TA credit would assist the Honduran authorities to implement a very ambitious program of legal, regulatory and institutional reforms aimed at strengthening the financial system. A sound financial system will also offer better savings, investment, and credit instruments to a larger segment of the population under competitive conditions; and, in the longer run, contribute to maintain macroeconomic stability and foster economic development. Ultimately, the proposed credit would benefit all users of financial services in Honduras, including depositors, creditors, investors, firms and households.

4. Institutional and implementation arrangements:

The government agencies beneficiaries of this credit would be the CNBS and the Central Bank of Honduras (BCH). The implementation arrangements are visualized in the diagram below and described at greater length in section E.4.



D. Project Rationale

1. Project alternatives considered and reasons for rejection:

Several alternatives were considered. They included: (i) the simultaneous execution of an adjustment and a technical assistance operation, (ii) a stand-alone adjustment operation; (iii) a technical assistance program with the immediate enforcement of all components of bank restructuring, and (iv) a technical assistance operation with a full-fledged corporate restructuring program.

The simultaneous execution of an adjustment and a TA operation is precluded by the Government's need to organize its institutional framework for banking sector consolidation. In addition, discussions on an IMF program are still ongoing and IDA cannot process a financial sector adjustment operation until they are successfully completed. By preceding the adjustment operation with a technical assistance credit, IDA will have the opportunity to get a confirmation of the government's resolve to address the issues in the financial sector prior to committing more resources.

A stand-alone adjustment operation was dismissed due to the lack of implementation capacity, which will be addressed by the proposed FSTAC. Another reason is the lack of an IMF program.

It is highly questionable whether a "big bang" approach to banking sector consolidation could be implemented given the existing constraints in terms of resources, skills and people that are needed for such a major restructuring task.

A full-fledged program of corporate diagnostics and restructuring measures was not included in the program because of the priority granted to address the short term risks in the banking sector, and the lack of skills and resources in Honduras to carry-out such a program at this stage. Moreover, there is a lack of a counterpart with legal authority (and the required political influence) to (i) request and process comprehensive diagnostics like in the banking sector, and (ii) organize larger-scale corporate restructuring. The creation of an official entity with legal authority to promote sound practices in the Honduran corporate sector and facilitate corporate reorganizations is crucially needed however, and it should be included in any future IDA-supported adjustment operation.

2. Major related projects financed by the Bank and/or other development agencies (completed, ongoing and planned).

Sector Issue	Project	Latest Supervision (PSR) Ratings (Bank-financed projects only)	
		Implementation Progress (IP)	Development Objective (DO)
Bank-financed			
Sector Analysis	Financial Sector Assessment Program (FSAP)		
Supervision and Regulations	PHRD Grant US\$0.695m		
Financial Sector Reform	Guatemala - Financial Sector Technical Assistance Loan, US\$5.0m	S	S
	Ecuador Financial Sector Technical Assistance Loan, US\$10 million	U	S
Other development agencies			
Financial Sector Strengthening	IDB, US\$2.4m		
CNBS Institutional Strengthening	IDB, US\$0.17m		
Possible Stand-by Program (FY 04)	IMF		
Technical Assistance to reform specific aspects of legal & regulatory framework as well as Lender of Last Resort function	IMF		

IP/DO Ratings: HS (Highly Satisfactory), S (Satisfactory), U (Unsatisfactory), HU (Highly Unsatisfactory)

3. Lessons learned and reflected in the project design:

Recent banking crises in other Latin American countries have been extremely costly. Their fiscal cost alone has represented on average 20-30% of a country's GDP, reducing future social spending and adding an enormous burden to public finances. Banking crises have caused major social setbacks, in particular because the real value of savings and investments declines rapidly during a crisis. Experience shows that financial authorities have frequently failed to prevent a crisis for several reasons, including a poor diagnosis of bank problems and existing losses, lack of a comprehensive strategy to deal with a crisis, weak implementation capacity, unwillingness to dismantle vested interests, inadequate legal and regulatory framework, among others.

The FSTAC has been designed taking these lessons into consideration to avoid this worst-case scenario. It focuses on capacity-building to ensure that Honduran authorities can implement the BCP and the new legal and regulatory framework to be created. Second, its sequential approach shows a certain level of pragmatism to ensure political consensus and broad support for the government's program. Finally, the operation is based on a comprehensive diagnosis of the problems and vulnerabilities of the Honduran financial sector carried out jointly by the IMF and the IDA very recently. It was formulated in order to maximize transparency in the use of public funds to support bank restructuring, minimize moral hazard problems by providing support only to the best-performers with their rehabilitation plan, forcing private shareholders to inject capital into their banks, speed up the resolution of assets, foster an orderly repayment of deposits, and solve the problems as rapidly as possible.

IDA experience with TA credits involving more than one beneficiary agency also shows the need for implementation arrangements that ensure the effective coordination of these agencies. To ensure effective coordination between BCH and the CNBS, the two beneficiary agencies of the FSTAC, it has been agreed that the PCU will operate under the oversight of an executive committee composed of high level representatives of both agencies. Moreover, the PCU will be working with the technical teams of the two agencies for the preparation of terms of reference, the selection of consultants, and the specifications for the acquisition of equipment and software.

4. Indications of borrower commitment and ownership:

The government of Honduras is strongly committed to carry out the financial sector reforms envisioned by this technical assistance operation. Senior government officials from Honduras have requested IDA to present the proposed project to the Board at the earliest possible date to help them in the drafting and implementation of the new laws, and to support its program of banking sector consolidation. The authorities have shown their commitment through full cooperation in the fast-paced preparation process for this FSTAC as well as for the FSAP.

There is clear recognition on the part of the Government that external financial and advisory assistance is required to implement the financial sector reform program. The authorities of BCH and the CNBS have contributed actively to the preparation of the project, providing inputs at all stages of the process.

Yet, some uncertainties remain with respect to the administration's ability to withstand pressure from its main political constituencies on the issue of how to reactivate agricultural lending. Similarly, the proposed project will be in a critical phase in early 2005, when pre-electoral campaigning starts again in Honduras. It is hard to predict at this stage how this will affect the BCP.

5. Value added of Bank support in this project:

The value added of IDA support for this project comes from IDA's international experience in the design of financial sector reforms and assistance strategies. IDA has already provided valuable assistance to the CNBS with a PHRD grant. Further IDA assistance through this FSTAC would contribute to the effective implementation of the new legal and regulatory framework and the establishment of a mechanism to handle the recapitalization and resolution of weak banks. Also, IDA support for Honduras' financial sector reforms is likely to strengthen international confidence in the Government's capability to manage the current difficulties in the financial system and implement effective anti-money laundering regulations.

E. Summary Project Analysis (Detailed assessments are in the project file, see Annex 8)

1. Economic (see Annex 4):

- Cost benefit
- Cost effectiveness
- Other (specify) NPV=US\$ million; ERR = % (see Annex 4)

Given the character of this operation, a quantitative economic and financial analysis would not be the appropriate tool to assess the significance of this project. The pace and depth of the reforms envisioned in this operation will determine the ultimate economic benefits of this credit.

In the course of project implementation, the credit will help the Honduran authorities to better assess the true dimension of existing non-performing loans and other issues in Honduras' financial system. If the project is carried out successfully, this project will contribute to restore the soundness of the financial system. A sound financial system would help to provide financial services to an increasing segment of households and enterprises in Honduras, resulting in higher economic growth and welfare in the medium and long terms.

2. Financial (see Annex 4 and Annex 5):

NPV=US\$ million; FRR = % (see Annex 4)

Same as above

Fiscal Impact:

3. Technical:

The technical merits of the project components have been reviewed by IDA, IDB and IMF staff and are considered to be sound. Technical assessment will continue throughout project preparation and implementation.

4. Institutional:

The borrower of the proposed credit will be the Republic of Honduras through the Ministry of Finance, and the implementing agencies will be the CNBS and the BCH.

4.1 Executing agencies:

The executing agencies of this credit are the CNBS and the BCH. A Project Coordination Unit (PCU) will be created at the CNBS to manage the credit. The Head of the PCU will work under the supervision of the president of the CNBS, but will also report to the Financial Sector Policy Committee (FSPC) to be constituted shortly, which will act as steering committee (i.e., decision-making entity) for the project. The structure of this steering is still being finalized, but it will include representatives of the Ministry of Finance, CNBS, BCH and possibly the Financial and Monetary Committee of Parliament.

4.2 Project management:

A Project Coordination Unit (PCU) will be established at the Comisión Nacional de Bancos y Seguros (CNBS) to manage the implementation process. The PCU will report to the President of the CNBS and soon to be constituted Financial Sector Policy Committee (FSPC), which will

act as the steering committee (i.e., decision-making entity) for the project. The Task Force created to implement the decisions of the FSPC will also be part of the PCU and the project coordinator will be the Head of this Task Force. Although the BCH will execute the payment system component and the corporate sector related sub-component, the procurement and financial management function will be centralized in the CNBS.

4.3 Procurement issues:

A Procurement Capacity Assessment was carried out at the CNBS to assess its ability to carry-out procurement under IDA guidelines. Considering the volume and complexity of the procurement actions to be taken during project execution, it was recommended that a Honduran procurement specialist with specific experience in IDA procurement rules and procedures be hired. Terms of reference have been given to CNBS. The appointment of the PCU coordinator, the procurement specialist and all the key posts in the PCU will be subject to IDA's prior approval. The procurement and disbursements arrangements are found in Annex 6. A summary of the actions to be completed in order to comply with IDA requirements is indicated below:

Recommendation	Responsible	Date for Compliance
Establish CNBS autonomy in relation to contracting decision making	CNBS	Appraisal
Finalize the Procurement Plan	PCU	Negotiations
Prepare the Project Operations Manual	PCU	Effectiveness
Hire a national procurement specialist	CNBS	Effectiveness
Training in Procurement	CNBS	Continuous
Prepare Standard Bidding Documents	PCU	Effectiveness
Define a secure area for record keeping	PCU	Effectiveness

The capacity assessment was approved by the Office of the Regional Procurement Advisor on May 14, 2003.

4.4 Financial management issues:

The PCU will be responsible for the project financial management arrangements including the flow of funds management for the entire project. Assistance is being provided to the PCU by IDA to address some of the weaknesses that were identified during the financial assessment of the Project and to ensure that sufficient capacity exists within the PCU to prepare the project financial monitoring reports (FMRs) by the Credit effectiveness. Consequently, the PCU, with successful implementation of the action plan, is expected to have in place, prior to Credit effectiveness, the institutional capacity required to carry out the financial management requirements of the project. The PCU will be under the direction of a Project Coordinator who will report to the President of the CNBS. Reporting directly to the Project Coordinator (PC) will be a Procurement Officer, a Financial Management Officer, and the Task Force members in charge of implementing the BCP. The project implementation teams for the payment system and corporate sector components will report primarily to the management of the BCH, but their work will be supervised by the PCU at the CNBS.

The PCU will establish and maintain a project Special Account (SA) to be opened at the Central Bank of Honduras. The PCU will also establish a project account to which the Borrower's counterpart funds will be deposited. Disbursements under the IDA Credit will be transactions based. The PCU will undertake monthly reconciliations of the balances in the special account and project account, as well as the project expenditures, the Borrower's contribution and IDA's disbursements. Financial Monitoring Reports (FMR) will be used for monitoring purposes only and not for disbursements. These FMR projections will themselves be based on the annual operational plans agreed with BCH and CNBS under the project. The PCU will then make payments to consultants and contractors on behalf of BCH and CNBS, based on documentation provided by them. Both the BCH and the CNBS will provide the PCU with the necessary documentation in a format compatible with PCU's chart of accounts and financial reporting framework, to enable the PCU to prepare the project FMRs. There will be only one special account and all project financial information will be maintained by the PCU to facilitate the auditing of the accounts and financial statements for the entire project from a single location. The audit opinion and periodicity would be in accordance with the new audit policy.

The following are the conditions of effectiveness specifically relating to the financial management of the project: (i) implementation of a Financial Management System; (ii) finalization of a project operation manual detailing financial procedures; and (iii) the appointment of an external auditing firm on the basis of terms of reference acceptable to IDA.

5. Environmental: Environmental Category: C (Not Required)

5.1 Summarize the steps undertaken for environmental assessment and EMP preparation (including consultation and disclosure) and the significant issues and their treatment emerging from this analysis.

N/A.

5.2 What are the main features of the EMP and are they adequate?

N/A

5.3 For Category A and B projects, timeline and status of EA:

Date of receipt of final draft:

5.4 How have stakeholders been consulted at the stage of (a) environmental screening and (b) draft EA report on the environmental impacts and proposed environment management plan? Describe mechanisms of consultation that were used and which groups were consulted?

N/A

5.5 What mechanisms have been established to monitor and evaluate the impact of the project on the environment? Do the indicators reflect the objectives and results of the EMP?

N/A

6. Social:

6.1 Summarize key social issues relevant to the project objectives, and specify the project's social development outcomes.

The measures to be supported by this operation would have important social implications, as they would reduce the probability of the worst-case scenario of a financial crisis in Honduras, such as those suffered by other developing countries in the last decade. Just a small reduction of the risks in the banking system would have a significant social impact in terms of reducing the potential negative effects on poverty that a banking crisis would produce, as evidenced by the negative effects of banking crises on poverty levels in other countries. A banking system less vulnerable to crisis is better able to sustain growth and, therefore, reduce poverty. Also, technical assistance will be provided to selected banks to diversify their business structure and improve their risk management. It is expected that this would ultimately help improve the access to financial services of currently marginalized segments of the population such as small and medium entrepreneurs. Greater access to credit by small and medium enterprises would in turn create more job opportunities, an important objective in a country with high rates of under-employment, one of the lowest per capita incomes in the region, and widespread poverty.

6.2 Participatory Approach: How are key stakeholders participating in the project?

Strategic decisions regarding the project will be made by the members of the Financial Sector Policy Committee, representing BCH, CNBS, Ministry of Finance and the Financial & Monetary Committee of Parliament. Due to confidentiality issues, broad participation of civil society is not considered.

6.3 How does the project involve consultations or collaboration with NGOs or other civil society organizations?

An involvement of civil society will be sought on specific activities such as in the context of the elaboration of a reform proposal for property registries.

6.4 What institutional arrangements have been provided to ensure the project achieves its social development outcomes?

N/A

6.5 How will the project monitor performance in terms of social development outcomes?

N/A

Does this project include any Community-Driven Development component?  (hidden when printed) No

7. Safeguard Policies:

7.1 Are any of the following safeguard policies triggered by the project?

Policy	Triggered
Environmental Assessment (OP 4.01, BP 4.01, GP 4.01)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Natural Habitats (OP 4.04, BP 4.04, GP 4.04)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Forestry (OP 4.36, GP 4.36)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Pest Management (OP 4.09)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Cultural Property (OPN 11.03)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Indigenous Peoples (OD 4.20)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Involuntary Resettlement (OP/BP 4.12)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Safety of Dams (OP 4.37, BP 4.37)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Projects in International Waters (OP 7.50, BP 7.50, GP 7.50)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Projects in Disputed Areas (OP 7.60, BP 7.60, GP 7.60)*	<input type="radio"/> Yes <input checked="" type="radio"/> No

7.2 Describe provisions made by the project to ensure compliance with applicable safeguard policies.

N/A.

F. Sustainability and Risks

1. Sustainability:

Past attempts by Honduran authorities to address the difficulties in the domestic financial system have clearly not yielded the expected results. This experience has convinced most of the key project stakeholders in Honduras of the need for consolidation in the banking sector. Moreover, several members of the current Honduran administration are from the banking sector themselves, in terms of professional background, and have a clear understanding of the nature of the difficulties faced by the industry. Differences of opinion may still remain as to the required scope for such a consolidation program, but an agreement in this regard is a prior requirement for the FSTAC to become effective. Another factor to take into consideration is the fact that the IMF and the IDB are both working with IDA to support the government's efforts to strengthen the Honduran financial sector. Both institutions have been involved in the discussions related to the design and scope of the proposed project, and are providing complementary technical assistance to address the other issues identified by the FSAP diagnostic.

2. Critical Risks (reflecting the failure of critical assumptions found in the fourth column of Annex 1):

Risk	Risk Rating	Risk Mitigation Measure
<p>From Outputs to Objective Lack of improvement of macroenvironment</p>	S	Detailed contingency plan will be prepared to handle further deterioration of financial sector soundness. Flexible credit design will ensure availability of resources to implement contingency plan. Project steering committee will be designed to ensure political consensus for Banking Consolidation Program. See above on contingency planning.
Lack of public buy-in to banking sector consolidation program	S	
External shock triggers run on bank deposits	M	
<p>From Components to Outputs Authorities' commitment to reforms is not sustained</p>	H	Government has shown a high level of commitment to advance the agenda for financial sector reform. Nevertheless, this risk remains and therefore IDA has sequenced its overall support to financial sector reform by first testing the ability of the Honduran authorities to put in place the required institutional capacity for reform with this TA credit prior to the preparation of an adjustment operation. The final design of the incentive component will be developed after discussions with representatives of the banking sector on the Banking Consolidation Program. The project will provide qualified advisory assistance to the financial sector policy committee in the area of communication policy. Also, see above on contingency planning.
Insufficient response of commercial banks to incentives offered under BCP	S	
Too many institutions found to be weak & their intervention affects depositors' trust in the BCP and triggers a run on existing banks	H	
Overall Risk Rating	H	IDA will ensure a close supervision of the project with well-elaborated project implementation reporting and frequent visits by specialist staff from Headquarters. IDA will also coordinate closely with the IDB and the IMF to keep the reform agenda prominent in the Government's strategy and development program.

Risk Rating - H (High Risk), S (Substantial Risk), M (Modest Risk), N (Negligible or Low Risk)

3. Possible Controversial Aspects:

One possible controversial aspect of the credit could be the proposed incentive package for the provision of technical assistance and recapitalization assistance for selected commercial banks in order to help them strengthen their institutional capacities and improve their profitability to achieve compliance with the new prudential framework being put in place by the CNBS (see

section C.1.a.). A well-elaborated communication campaign will be needed to ensure that such incentives are not misunderstood by the public. To mitigate this risk, the Government of Honduras is working on a strategy paper which will be officially adopted as the roadmap for the banking sector consolidation program after a broad political consensus is ensured. IDA is already providing technical assistance in this process, but the structure of the project steering committee (FSPC) should also facilitate the maintenance of this political consensus throughout the life of the project. IDA will also be closely involved in the definition of the criteria for eligibility of selected banks, which will be clear, transparent and easy to communicate and explain.

G. Main Loan Conditions

1. Effectiveness Condition

The following steps will need to be completed prior to credit effectiveness:

Project Design:

- (i) Establishment of Financial Sector Policy Committee (FSPC)
- (ii) Project Coordination Unit is fully established and staffed; including the CNBS/BCH Task Force to coordinate the implementation of the banking sector consolidation program
- (iii) Completion of official CNBS diagnostic and first-cut classification of banking system following the criteria satisfactory to IDA

Financial Management:

- (i) Implementation of a Financial Management System
- (ii) Finalization of a project operation manual detailing financial procedures
- (iii) Appointment of an external auditing firm on the basis of terms of reference acceptable to IDA

Procurement:

- (i) Preparation of project operation manual; including standard bidding documents and definition of secure area for record keeping
- (ii) Hiring of national procurement specialist (already included in PCU staff)
- (iii) Cooperation agreement between CNBS and BCH has been executed

2. Other [classify according to covenant types used in the Legal Agreements.]

H. Readiness for Implementation

- 1. a) The engineering design documents for the first year's activities are complete and ready for the start of project implementation.
- 1. b) Not applicable.
- 2. The procurement documents for the first year's activities are complete and ready for the start of project implementation.
- 3. The Project Implementation Plan has been appraised and found to be realistic and of satisfactory quality.
- 4. The following items are lacking and are discussed under loan conditions (Section G):

I. Compliance with Bank Policies

1. This project complies with all applicable Bank policies.

2. The following exceptions to Bank policies are recommended for approval. The project complies with all other applicable Bank policies.

Modibo Khane Camara

Team Leader

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M. Leipziger

Sector Manager/Director

Jane Armitage

Country Manager/Director

Annex 1: Project Design Summary

HONDURAS: Financial Sector Technical Assistance Credit

Hierarchy of Objectives	Key Performance Indicators	Data Collection Strategy	Critical Assumptions
<p>Sector-related CAS Goal: Accelerate equitable and sustainable economic growth to levels consistent with the poverty reduction targets</p>	<p>Sector Indicators: Sound macroeconomic fundamentals</p> <p>GDP growth</p> <p>Capacity to absorb internal and external shocks</p> <p>Sound and efficient financial system.</p>	<p>Sector/ country reports: Aggregate macroeconomic data</p> <p>Financial data produced by CNBS</p>	<p>(from Goal to Bank Mission) Stable political environment and strong commitment of authorities to continue the implementation of the PRSP</p> <p>Macroeconomic stability not jeopardized by catastrophic event (e.g., Mitch)</p>
<p>Project Development Objective: Capacity-building to assist Honduran authorities to address the systemic vulnerabilities of the financial system</p>	<p>Outcome / Impact Indicators: Compliance by all operating banks with capital adequacy norms</p> <p>Increased cost efficiency of the Banking Sector</p> <p>Increased efficiency of judicial and extra-judicial corporate restructuring</p> <p>Increased transparency and timeliness of information available to CNBS and BCH on bank soundness and corporate clients</p> <p>Reduced levels of non-performing loans from top 50 Honduran corporate borrowers</p> <p>Reduced legal uncertainty in payments system & improved risk management</p> <p>Improved effectiveness of special unit against money laundering at the CNBS</p>	<p>Project reports: CNBS progress Reviews</p> <p>Progress review to be prepared by new oversight unit at BCH</p> <p>Project Progress review</p>	<p>(from Objective to Goal) GDP growth</p> <p>Macroeconomic stability is not jeopardized by catastrophic event</p>

Output from each Component:	Output Indicators:	Project reports:	(from Outputs to Objective)
Banking sector consolidation to fewer, healthier and more efficient institutions	Market exit of all - or at least all systemically important - banks rated as non-viable and insolvent	Project progress reports, supervision missions and reporting, and evaluation reports.	Sustained confidence in success of consolidation program
	Enforcement of new prudential regulation to ensure adherence to "best practice standards"		Appropriate legal and institutional framework is in place for resolution of troubled institutions
	Early recognition of institutional failures		
	Duration & costs of troubled banks resolution process		
Modernization of Honduran Payments system and reduction of existing systemic risks	Reduced significance of checks as mean of payment		Successful coordination of existing payment system reform initiatives outside of Central Bank
	Better integration of existing elements of Honduran payments system		
	Adjustment to legal framework for payments system operation		
Improved financial system infrastructure leading to (i) effective monitoring system for detection of money laundering activities; and	Technical capacity of anti-money laundering unit		
	Increased volume and quality of on-site examinations		
Improved oversight and financial soundness of corporate sector	Current financial information is available for the 20 largest corporate borrowers (from a holding perspective)		BCH has authority to request financial information on corporate sector
Elaborated proposal for reform of Government rural finance strategy including use of innovative instruments	Better consideration of risks emanating from corporate sector for prudential oversight		Government is committed to a fundamental reform of its rural finance strategy.
Adequate implementation of the overall project	Concept paper for reform proposal is available		

	Timely, cost-effective and high quality delivery of all project outputs.	Progress monitoring reports of the Project Implementation Unit Annual review of procurement plans, financial audits and project progress reports	The Project Coordination Unit has sufficient: (i) staff; (ii) technical capacity, and (iii) political support required to manage and supervise all components and sub-components of the project.
<p>Project Components / Sub-components:</p> <p>I. Technical Assistance for Banking Sector Consolidation</p> <p>1) Improvement of Legal and Regulatory Framework 2) Diagnostics & Institutional Strengthening 3) Enhancing Management of Systemic Risks 4) Incentive Package for Self-Rehabilitation of Banks 5) Design of Effective Framework for Asset Liquidation</p> <p>II. Reform of Payments System</p> <p>1) Advisory Assistance for formulation of Reform Strategy & its Implementation 2) Initiation of New RTG System 3) Reform of Depository System</p> <p>III. Improvement of Financial System Infrastructure</p> <p>1) Strengthening Institutional Framework for AML/CFT 2) Strengthening Framework for Corporate Restructuring & Initiation of Public Oversight Function 3) Dissemination of Best Practices in Rural Finance</p> <p>IV. Project Administration</p>	<p>Inputs: (budget for each component)</p> <p>US\$4.66 million</p> <p>US\$2.34 million</p> <p>US\$2.26 million</p> <p>US\$1.25 million</p>	<p>Project reports:</p> <p>Periodic reports from implementing agency, BCH and CNBS</p> <p>Project supervision reports & Mid-term review</p>	<p>(from Components to Outputs)</p> <p>Government commitment to reform is sustained</p> <p>Sustained confidence in success of consolidation program</p> <p>Appropriate legal and institutional framework is in place for resolution of troubled institutions</p> <p>Adequate incentives are provided to commercial banks to participate to the program</p> <p>Commitment of CNBS leadership to reform is sustained Commitment of BCH leadership to reform is sustained</p> <p>Adequate coordination of all existing public and private initiatives to improve payment system</p> <p>Required regulatory reform package is approved by Parliament</p> <p>Adequate support from Honduran Authorities</p>

Annex 2: Detailed Project Description

HONDURAS: Financial Sector Technical Assistance Credit

By Component:

Project Component 1 - US\$4.66 million

Technical Assistance for Banking Sector Consolidation Program (BCP)

The basic conceptual framework of the BCP has been described in section C.1.a. The objective of this component is to help implement the program by providing technical assistance in the following areas:

(a) Improvement of the Legal and Regulatory Framework for Banking: Advisory assistance will be provided to the Financial Sector Policy Committee (FSPC) to draft essential amendments to (i) the financial institutions law, (ii) the law of the deposit insurance fund (FOSEDE), (iii) the Central Bank law and the law of the CNBS, (iv) the current prudential norms and regulations, and (v) norms and regulations related to bank corporate governance and risk management standards. These legal amendments should help create the appropriate environment and instruments for a more efficient resolution of troubled banks (including a new resolution vehicle), establish the authority of the CNBS and improve its enforcement capabilities, ensure a much more effective regulation and supervision of mixed financial-commercial groups, limit the risks arising from related parties' transactions, enforce better practices of corporate governance and management, and improve the approach to assessing asset quality, earnings and capital adequacy.

(b) Rehabilitation Planning and In-depth Diagnostics of Selected Banks: This sub-component has two objectives, which are (i) the design of an effective system for monitoring the restructuring efforts of commercial banks and (ii) the identification of non-viable institutions. The activities to be undertaken are as follows:

□ First, advisory assistance will be provided to help the CNBS design standardized templates and a financial projection model for the *rehabilitation plans* to be requested from the commercial banks. In these rehabilitation plans, banks will indicate their strategy for achieving compliance with the new prudential norms to be issued by the CNBS especially with respect to solvency and limits on related party-lending. They will also indicate the underlying assumptions for their rehabilitation strategy, as well as provide the business information needed by the CNBS to assess their respective plans. Detailed procedures will be worked out at the CNBS for the review of these plans, the validation of the underlying assumption on asset valuation and income performance, the benchmarking of the implementation performance, as well as for requesting revisions and setting conditions for approval. This should help to ensure consistency in the viability assessment of the various institutions and the feasibility of their recovery. The rehabilitation plans will also be used by the CNBS to validate its preliminary classification of banks and design of appropriate regulatory contracts, to ensure that a menu of differentiated holding actions is imposed on banks. These holding actions will establish the necessary prudential safeguards and a formal documentation of commitments by the incumbent boards of the banks, as well as the benchmarks that the boards will need to satisfy to until fully adhering to the new regulations and recovering full bank rehabilitated status.

□ Second, *fully fledged in-depth diagnostics of viability* will be conducted for selected banks subject to conditions such as (i) poor solvency in stock and flow terms, (ii) lesser probability of recovery or failure of current owners and directors to reasonably ensure full rehabilitation within an acceptable time-frame, (iii) high likelihood to become source of major systemic risks, (iv) indications of major governance and management weaknesses or abuse. These conditions will be determined on the basis of the preliminary classification, the review of rehabilitation plans, and the results of on-going assisted examinations and surveillance. The diagnostics will be done on behalf of the Commission following comprehensive terms of reference that ensure due diligence quality and responsibility in assessing: (a) full coverage of asset quality and related group lending activity; (b) the prospective and residual earn-out capacity of future pre-provision cash earnings; (c) the reliability and integrity of information and data processing systems; (d) the efficiency of operations (profitability of major business lines/products, cost absorption of delivery networks, and effectiveness of head-count), and effectiveness of credit processes; and (e) the treasury and liquidity-funding activities.

□ Third, advisory assistance will be provided for the *resolution of banks* rated as unviable following the in-depth diagnostics described above. Assistance will be provided to evaluate and structure the least cost resolution option on a case by case basis. The range of option should include, in addition to outright liquidation, also viable opportunities for transferring residual franchises using purchase and assumption (PA), as well as merger and acquisitions. In such cases, a specific evaluation will be conducted to assess the viability of the transaction, and the fitness and properness of the acquirers and the resulting banks. Commitment to specific benchmarks for increased cost efficiency and profitability will be required.

(c) Enhancing the Management of Systemic Risks: The goal of this sub-component is to complement the current supervision activities of the CNBS with an elaborated system for monitoring systemic risks and managing them more effectively. The activities to be undertaken are as follows:

□ First, technical assistance will be provided to design a *Contingency Plan* to enhance preparedness for a worst case scenario. The preparation of such a plan will involve both the BCH and the CNBS. It will include, among other things, (i) an agreement on clear roles and responsibilities, procedures and coordination channels to accelerate preventative measures, (ii) the review of the lender of last resort function at the BCH and simulation of various scenarios, and (iii) the definition of an appropriate communication strategy.

□ Second, support will be provided to the CNBS to establish an elaborated system of *ongoing diagnostics* at systemic and individual bank level. These diagnostics will include an evaluation of the current industry structure in terms of segments and services, including determining excess of physical structure and network redundancy, its effects upon cost performance, and the potential volume and trend of banking businesses and segments going forward. Similarly, available information from examination and other sources will be used to monitor the accumulation of risk across the industry and in individual institutions --including projecting the level and trend of stock and flow solvency, overseeing concentrations and related lending, suspected related parties, and progress in addressing major troubled debtors in the economy.

□ Third, similar support will be provided to the CNBS to design and implement a *specific program of intensified supervision* of adversely rated banks. The assistance will cover (i) the design of specific processes and procedures such as incremental reporting requirements to monitor the compliance with the specific holding actions imposed on the selected banks; (ii) specific onsite targeted examinations for banks and their major related parties including investigations on the source of recapitalization funds and those used for debt repayment by related parties; and (iii) the oversight of risk management measures and existing plans of debt recovery / work out of problem loans.

(d) Design & Implementation of Incentive Package for Self-Rehabilitation of Banks: As explained earlier, incentives will be provided under the BCP to assist eligible banks to strengthen their institutional capacities and improve their profitability in order to achieve compliance with the new prudential framework being put in place by the CNBS. Under this sub-component, advisory support will be provided to design an incentive package consisting of (i) technical assistance (on a cost-sharing basis) to the five top performers on the implementation of the previously designed self rehabilitation plans (excluding subsidiaries of OECD banks), and (ii) a Government funded capitalization scheme to facilitate viable mergers between sound institutions as well as other market-based mechanisms of banking sector consolidation. Subsequently, the project will finance the implementation of the directed technical assistance scheme with a maximum amount of co-financing of US\$500,000.- per eligible bank. These funds would be used to hire reputable management consulting firms to advise the selected banks on market strategy and business organization (e.g. credit risk management processes, approach to troubled debt restructuring, governance and management structures, etc.).

(e) Design of Effective Framework for Asset Liquidation: Advisory assistance will be provided to elaborate at least two different options for the design of a more efficient mechanism for the liquidation of assets of intervened banks and the foreclosed assets (*activos eventuales*) in the balance sheets of remaining institutions. After Honduran authorities take a decision regarding the solution to be selected, experts will be hired to help implement the selected design, the procedures and designated vehicles, as well as to identify the legal and regulatory amendments to be conducted.

Project Component 2 - US\$2.34 million Reform of Payment System

The objective of this component is to modernize the Honduran payments system and reduce the legal, operational, and credit risks affecting its current operations. The following activities will be supported:

(a) Definition & Implementation of Reform Scope and Strategy: Advisory assistance will be provided to formulate a reform strategy, define the scope of the reform and set-up adequate organizational arrangements. The scope of the reform will be decided by the authorities following in-depth discussions between the BCH, other regulators and private sector stakeholders. It will involve a combination of legal, regulatory, governance, procedural and system changes. A payments systems reform team will be constituted at the BCH to oversee the reform process on a day-to-day basis. The project will cover the costs of hiring a resident

specialist to coordinate the work of the BCH team for the duration of the project. It will also provide for technical experts on very specialized issues whenever required, as well as limited funding for training BCH staff and other project stakeholders. Once the strategic vision and the scope of the reform have been agreed upon by all project stakeholders, the BCH team will prepare a detailed implementation plan to be used as benchmark for project monitoring by the PCU.

(b) Initiation of new Real Time Gross Settlement System (RTGS): Under this component, the project will carry-out an upgrade of the current systems at the BCH to launch a special purpose large value payments system that will allow for the separation of large and low value payments. The initial investment will cover the costs of hardware (with back-up), software, tailoring, training, telecommunication encrypted services and, possibly, SWIFT set-up. Training on technical implementation issues for RTGS systems when implementation is provided by a contracted company (versus an in-house system) is likely to be provided also by this company included in a package offer.

(c) Implementation of a Central Securities Depository (CSD): A depository function for securities settlement will be established to help mitigate risks and provide the necessary facility for the development of a collateralized inter-bank money market and the provision of liquidity by the Central Bank. The project will cover the costs of purchasing and implementing the equipment, including training for the users.

Project Component 3 - US\$2.26 million

Improvement of Financial System Infrastructure

(a) Strengthening of Institutional Framework for AML/CFT :

□ **Strengthening the Financial Intelligence Unit (FIU):** The Honduran FIU is a unit within the organizational structure of the CNBS, which receives analyzes and disseminates financial information related to fighting money laundering. It is a recently created institution and its establishment pursuant to Honduras' 2002 AML law was an important step towards building an integrated AML/CFT regime. Under the project, advisory assistance will be provided to the FIU to strengthen its organizational structure (e.g., through definition of clear procedures) and its analytical capabilities. A staff training plan will be developed and implemented, supplemented by exchanges with other FIU's in OECD countries. It is also planned to build capacity within the FIU for on-site examinations for AML/CFT purposes. The CNBS had already begun conducting such examinations for banks but these compliance examinations are relatively weak and non-banks have yet to be examined. An agreement was reached with the CNBS to assign about 3 inspectors to the FIU, who will be trained as AML/CFT specialists and will cover banks and non-banks. Some limited equipment will also be provided.

□ **AML/CFT Awareness-raising and Training:** While the imposition of reporting and record-keeping requirements for financial institutions is important to any AML/CFT regime, it is critical to ensure that the financial community understands the risks of AML/CFT to the integrity of the Honduran financial system, and that competent authorities deal effectively with such cases. This sub-component will provide training for the financial community (i.e., employees, compliance officers, internal auditors and senior management from banks, insurance companies, money remitters, exchange houses, and other non-bank financial institutions), financial

regulators, the FIU, prosecutors and judges. The training would cover AML/CFT issues and would be designed and rendered in partnership with the private sector, possibly the Honduran Bankers' Association (AHIBA). Training for prosecutors and judges could possibly be supplemented with consultations with prosecutors and judges from foreign countries.

(b) Strengthening of Framework for Corporate Reorganization and Initiation of Public Monitoring Function: The thrust of this sub-component is to ensure that (i) a certain level of monitoring of major systemic risks emanating from the corporate sector is initiated, and (ii) areas related with property rights and security interests regulation and registration, as well as judicial and non-judicial mechanisms for corporate insolvency, are governed by a modern and workable legal framework and implemented through sound institutions. Its implementation will be carried-out by the BCH. Technical assistance will be provided for the following initiatives:

□ **Initiation of a monitoring unit for large corporate risks:** A unit will be constituted at the BCH to establish a system of ongoing analysis and monitoring of the structure, soundness and evolution of the Honduran corporate sector, as well as its ties with local financial institutions. Technical assistance will be provided in form of a full-time local expert who will coordinate the work of a BCH team for the duration of the project. The project will also provide for a high-level international expert to guide the local team in the establishment of the unit, the definition of its exact terms of reference, as well as the preparation of a “business plan with clear milestones”, and oversee the implementation of the project component through periodic technical visits. The project will also cover the cost of staff training and limited equipment. The local expert to be hired by the BCH will also be the task manager for all other corporate sector-related activities to be implemented by the BCH under this project.

□ **The Reform of Bankruptcy Regulation and Improvement of Creditor Rights:** Advisory assistance will be provided to review the current legal framework for insolvency proceedings to reflect internationally recognized best practices regarding the regulation of (i) court supervised insolvency proceedings (formal), including corporate reorganization and liquidation; (ii) out-of-court (informal) or minimally court supervised (quasi-formal) mechanisms for corporate restructuring negotiations and plans (“workouts” and “prepackaged plans”); (iii) secured transactions on all kind of tangible and intangible assets; and (iv) related laws, as necessary (e.g.: tax legislation relating to treatment of debt writeoffs).

□ **Advisory Assistance to Initiate the Implementation of the New Framework for Corporate Restructuring Mechanisms (judicial and extra-judicial):** The successful implementation of any reform of the legal framework for creditor rights and insolvency proceedings will require that the users of the system understand it and have proper incentives to adopt it. In this regard, judges will need to be trained on commercial law and related business issues. As for the out-of-court corporate restructuring mechanism, the following activities will need to be carried out: (i) developing materials and training required to implement the new process, including organization and funding of stakeholders workshops with the participation of local and international experts in corporate restructuring; (ii) contracting international expert consultants to provide technical expertise on operational aspects of the voluntary corporate restructuring mechanism (e.g., corporate restructuring facilitators/mediators); and (iii) developing and implementing an effective communications strategy to help disseminate

awareness of the process and advantages of the voluntary corporate restructuring mechanism to main stakeholders, including investors, creditors, users, as well as the general public.

□ **Elaboration of Reform Proposal for Property Registries:** Technical assistance will be provided to design a safe, efficient, modern and cost-effective registration method for property rights, licensing of rights and secured interests. The tasks to be performed include: (i) a review of the existing legal and institutional infrastructure, and the organizational aspects of the registration system in Honduras (including the Immovable Property Registry, the Public Registry of Commerce and any other existent Registry); (ii) evaluation as to whether the registration system should be privately administered with public supervision, or part of the public administration, with or without partial involvement of private sector institutions; (iii) evaluation of the costs and fees associated with the process of registration and search of data related with property rights, secured transactions, judicial orders affecting the debtor's assets, etc.; (iv) providing ideas for the reform process of the registration system and for the creation of modern linked registries, or a single unified registry, utilizing modern and computerized technologies; (v) evaluation of the needs and prospective costs of technical equipment (hardware and software) required to perform electronically the different steps of the registration process (filing, recording, searching, etc.); (vi) providing ideas for the design of the required legal regulation for a modern registration system; and (vii) the actions required to implement the new system, such as capacity building for the registries staff, and the development of appropriate guide and manuals to educate the public and users of the system. An integrated team of legal and technical consultants will be hired to carry-out this component.

(c) **Dissemination of Best Practices in Rural Finance:** Advisory assistance will be provided to (i) review the current instruments used by the government of Honduras to facilitate and reactivate lending to small agricultural producers, and (ii) identify possible options for improvement based on international best practices. The analytical work conducted during the project preparation will also be taken into account in the context of the initial assessment to be done. Once the government takes a decision regarding its reform strategy based on the recommendations made, experts will be hired to help prepare the implementation of this strategy.

Project Component 4 - US\$1.25 million

Project Administration

Under this component, the project will finance the salaries of project staff, operational expenses (including audits, local transportation and travel, etc.), training and limited equipment. This should ensure an efficient implementation and adequate monitoring of the different project components, as well as compliance with Bank financial management and procurement guidelines. The project staff mentioned above include the project coordinator (1 person), a procurement specialist (1 person), a financial management specialist (1 person), the members of the task force (at least 4 persons) provided by the CNBS and the BCH to implement the banking sector consolidation program, and one administrative assistant (1 person) provided by the CNBS. The equipment requirements of this team will include desktop and lap-top computers, fax, copiers, and ancillary office equipment. It is understood that over the period of the project, the interaction between the staff at the CNBS and the project unit will allow a transfer of skills to CNBS staff.

Project Component 5 - US\$0.49 million
Unallocated Reserve

An unallocated reserve of about 4.5% of the total project costs (US\$0.49 million) has been set to allow for a limited level of flexibility in project implementation. Experience clearly shows that the issues addressed by the project tend to have their own dynamics and such an unallocated reserve would serve as a risk management tool against unexpected funding requirements during the life of the project. The largest share of these funds is likely to be used for additional consultancy services.

Annex 3: Estimated Project Costs

HONDURAS: Financial Sector Technical Assistance Credit

Project Cost By Component	Local US \$million	Foreign US \$million	Total US \$million
A. Technical Assistance for Banking Sector Consolidation	0.00	4.50	4.50
B. Reform of Payments System	0.00	2.25	2.25
C. Improvement of Financial System Infrastructure	0.19	1.84	2.03
D. Project Administration	1.11	0.00	1.11
Unallocated Reserve	0.00	0.49	0.49
Total Baseline Cost	1.30	9.08	10.38
Physical Contingencies	0.00	0.00	0.00
Price Contingencies	0.16	0.46	0.62
Total Project Costs ¹	1.46	9.54	11.00
Total Financing Required	1.46	9.54	11.00

Project Cost By Category	Local US \$million	Foreign US \$million	Total US \$million
Services	1.39	5.92	7.31
Training	0.00	0.89	0.89
Goods	0.07	2.24	2.31
Unallocated		0.49	0.49
Total Project Costs ¹	1.46	9.54	11.00
Total Financing Required	1.46	9.54	11.00

¹

Identifiable taxes and duties are 0 (US\$m) and the total project cost, net of taxes, is 11 (US\$m). Therefore, the project cost sharing ratio is 90% of total project cost net of taxes.

Annex 4

HONDURAS: Financial Sector Technical Assistance Credit

Not Applicable

Annex 5: Financial Summary

HONDURAS: Financial Sector Technical Assistance Credit

Years Ending

	IMPLEMENTATION PERIOD						
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Total Financing Required							
Project Costs							
Investment Costs	1.9	6.0	1.3	0.7	0.0	0.0	0.0
Recurrent Costs	0.2	0.3	0.4	0.2	0.0	0.0	0.0
Total Project Costs	2.1	6.3	1.7	0.9	0.0	0.0	0.0
Total Financing	2.1	6.3	1.7	0.9	0.0	0.0	0.0
Financing							
IBRD/IDA	1.9	5.7	1.5	0.8	0.0	0.0	0.0
Government	0.2	0.6	0.2	0.1	0.0	0.0	0.0
Central	0.2	0.6	0.2	0.1	0.0	0.0	0.0
Provincial	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Co-financiers	0.0	0.0	0.0	0.0	0.0	0.0	0.0
User Fees/Beneficiaries	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Project Financing	2.1	6.3	1.7	0.9	0.0	0.0	0.0

Main assumptions:

Annex 6(A): Procurement Arrangements

HONDURAS: Financial Sector Technical Assistance Credit

Procurement

A. Procurement Arrangements: Procurement for the proposed project will be carried out in accordance with the World Bank "*Guidelines: Procurement Under IBRD Loans and IDA Credits*", published in January 1995 (revised January/August 1996, September 1997 and January 1999); and "*Guidelines: Selection and Employment of Consultants by World Bank Borrowers*" published in January 1997 (revised in September 1999, January 1999 and May 2002), and the provisions stipulated in the Credit Agreement. The objective of the Project is to support the development of the institutional capacity needed by the Honduran Authorities in order to address vulnerabilities of the financial system through capacity-building for dealing with weaknesses of the banking system, a prerequisite for sustainable growth and poverty alleviation. The project will achieve this objective by providing technical assistance for: (i) Technical Assistance for Banking Sector Consolidation, (ii) Reform of the Payments System, (iii) Improvement of Financial System Infrastructure, and (iv) Project Administration.

The Project is broken down into four components as follows:

1. Technical Assistance for Banking Sector Consolidation – (US\$4.50 Million): This component will focus on:

i) Improvement of Legal and Regulatory Framework for Banking includes the Review & Reform of Financial Institutions Law, Review & Reform of FOSEDE Law, Review & Reform of CNBS & BCH Laws, Review & Reform of crucial prudential regulations and the Adoption of Governance & Risk Management Standards. The procurement actions are in the form of individual consultancies.

ii) Rehabilitation planning & In-depth Diagnostics of selected banks includes Preparation and Assessment of Rehabilitation Plans, Special Diagnostic of Troubled Banks and Advisory Assistance for Resolution of Non-Viable Banks. The procurement actions are in the form of consultants services employing firms and individual consultants, both national and international.

iii) Enhancing Management of Systemic Risks include Detailed Contingency Planning, Ongoing Diagnostic and Intensive Supervision of High-Risk Institutions. The procurement actions are in the form of a) consultants services employing firms and individual consultants, both national and international; b) training including workshops, seminars, study trips and on-the-job training at similar institutions abroad; c) equipment such as desktops and lap-tops, a database interface, servers and examination and statistical software and licenses.

iv) Design & Implementation of Incentive Package for Self-Rehabilitation of Banks include the hiring of specialized companies to assist eligible institutions.

v) The design of an effective framework for assets liquidation by hiring a firm to carry out this function.

2. Reform of the Payments System – (US\$2.25 Million): This component involves advisory assistance for formulation of a reform strategy and its implementation, acquiring and implementing a Real Time Gross Settlement System (RTGS) and acquiring and implementing equipment for the

reform of the repository system. The procurement actions are in the form of a) consultants services employing individual consultants; b) training including workshops, seminars, study trips and on-the-job training at similar institutions abroad; and c) equipment (RTGS and Reform of Depository Systems).

3. Improvement of Financial System Infrastructure (US\$2.03 Million):

This component will focus on:

i) Strengthening Institutional Framework for AML/CFT includes Strengthening of the Financial Information Unit (FIU) and Awareness-raising and Training. The procurement actions are in the form of a) consultants services employing firms and individual consultants, both national and international; b) training including workshops, seminars, study trips and on-the-job training at similar institutions abroad; c) equipment such as desktops and lap-tops, a database interface, servers and analytical software and licenses.

ii) Strengthening Framework for Corporate Restructuring & Initiation of Public Oversight Function includes the creation of an Oversight Unit for corporate risks at the Central Bank, Reform of Bankruptcy Regulation and Improvement of Creditor Rights, Advisory Assistance for Implementation of new framework for corporate restructuring mechanisms (both judicial and extra-judicial) and Elaboration of a reform proposal for property registries. The procurement actions are in the form of a) consultants services employing firms and individual consultants, both national and international; b) training including workshops, seminars, study trips and on-the-job training at similar institutions abroad; c) equipment such as desktops, servers and licenses.

iii) Dissemination of Best Practices in Rural Finance. The procurement actions are in the form of a) consultants services employing firms and individual consultants, both national and international, and b) training including workshops, seminars, study trips and on-the-job training at similar institutions abroad.

4. Project Administration (US\$1.11 Million): This component is targeted at supporting the Project Consolidation Unit (PCU) in the CNBS to assure effective project management and coordination, and strengthen the capacity of this institution to implement and supervise the project. It includes the hiring of a project coordinator, a procurement specialist and a financial/accounting specialist. This will be done in accordance with the Bank's guidelines for selection of individual consultants.

5. Unallocated Reserve: US\$1.11 Million

Procurement methods (Table A)

The methods to be used for procurement are described below, and the estimated amounts for each method, are summarized in Table A. The threshold contract values for the use of each method are specified in Table B.

Procurement of Goods: Goods procured under this project will include desktops and lap-tops, a database interface, servers and examination and statistical software and licenses. The RTGSS and the Reform of Depository systems will be the most complex and expensive equipment to be procured. Special attention will be given to the preparation of the specifications. To the extent possible, contracts for these goods will be grouped into bidding packages of more than US\$150,000 equivalent and procured following International Competitive Bidding (ICB) procedures, using IDA-issued Standard Bidding Documents (SBDs). Goods estimated to cost between US\$25,000 and

US\$150,000, up to an aggregate not to exceed \$300,000 equivalent, may be procured using National Competitive Bidding (NCB) procedures and standard bidding documents agreed with IDA. Contracts for goods which cannot be grouped into larger bidding packages and estimated to cost less than US\$25,000 per contract, up to an aggregate not to exceed US\$150,000 equivalent, may be procured using Shopping (National /International) procedures based on a model request for quotations satisfactory to the IDA.

Selection of Consultants: Consulting Services will be procured using Bank Standard Request for Proposals.

Firms: All contracts for firms will be procured using QCBS except for small and simple contracts estimated to cost US\$100,000 equivalent or less that may be procured using LC or Consultants' Qualifications.

Individuals: Specialized advisory services up to an aggregate amount of US\$3,000,000 equivalent will be provided by individual consultants selected by comparison of qualifications of three candidates and hired in accordance with the provisions of paragraphs 5.1 through 5.3 of the Consultant Guidelines.

A) Prior review thresholds: The proposed thresholds for prior review are summarized in Table B.

B) Assessment of the agency's capacity to implement procurement: The Capacity Assessment was approved by the office of the RPA on May 14, 2003. Procurement activities will be carried out by the Project Coordination Unit (PCU). The PCU will be staffed by a Project Coordinator, a Procurement specialist and a financial/accounting specialist.

A Capacity Assessment of the PCU to implement procurement has provided the means to identify certain risks concerning the PCU. The issues, recommended actions and the deadlines for their completion are as follows:

Area	Actions	Deadline
(a) Procurement Cycle Management.	Finalize General Procurement Plan	By negotiations
(i) Procurement planning	Finalize a complete Operations Manual	By effectiveness
(ii) Preparation of documents	Prepare SBDs for all types of procurement	By effectiveness
(iii) Contract Administration	Define areas of responsibility	By effectiveness
(b) Organization and Functions		
(i) Organization of unit and functions	Hire a Procurement Specialist	By effectiveness
(ii) Internal manuals and instructions	Finalize Operations Manual	By effectiveness
(c) Support and Control Systems		
(i) Technical and administrative controls	Details must be included in Operations Manual	By effectiveness
(d) Staffing		
(i) Existence of experienced and capable staff	Hire experienced procurement specialist	By effectiveness
(ii) Clear written standards and delegation of authority	Must be included in OM	By effectiveness

Considering the nature and complexity of the procurement actions under the project and the fact that CNBS has no experience in World Bank financed projects, the overall project risk for procurement is considered to be HIGH.

C) Procurement Plan: A procurement plan has been developed in as much detail as the possible. The PCU will complete and finalize the procurement plan by negotiations. The task team and the staff at the PCU have provided the information required to determine the procurement methods (Table A). At the beginning of each calendar year, the Borrower will update the Procurement Plan with a detailed procurement schedule for the coming year.

D) Frequency of Procurement Supervision: It is recommended to carry out supervision missions every six months to provide advice in general procurement issues and to reassess the capacity of the PCU to carry out procurement in order to review the prior review thresholds.

Annex 6, Table A: Project Costs by Procurement Arrangements
(in US\$ Million equivalent)

Expenditure Category	Procurement Method ¹			Total Cost
	ICB	NCB	Other ²	
1. Consultant Services	0.00 (0.00)	0.00 (0.00)	5.86 (5.27)	5.86 (5.27)
2. Goods	1.97 (1.97)	0.13 (0.13)	0.06 (0.05)	2.16 (2.15)
3. Training	0.00 (0.00)	0.00 (0.00)	0.80 (0.80)	0.80 (0.80)
4. Audits	0.00 (0.00)	0.00 (0.00)	0.10 (0.09)	0.10 (0.09)
5. Operational Costs	0.00 (0.00)	0.00 (0.00)	0.97 (0.62)	0.97 (0.62)
<i>Unallocated</i>	0.00 (0.00)	0.00 (0.00)	1.11 (0.97)	1.11 (0.97)
Total	1.97 (1.97)	0.13 (0.13)	8.90 (7.72)	11.00 (9.90)

^{1/} Figures in parenthesis are the amounts to be financed by the IDA credit

^{2/} Other: Includes goods to be procured through national shopping, consultant services, services of contracted staff of the Project Coordinating Unit.

Annex 6, Table A1: Consultant Selection Arrangements
(in US\$ million equivalent)

Consultant Services Expenditure Category (*)	Selection Method						Total Cost
	QCBS	QBS	SFB	LCS	CQ	Other	
A. Firms	3.61 (3.25)	0.00 (0.00)	0.00 (0.00)	0.10 (0.09)	0.37 (0.33)	0.00 (0.00)	4.08 (3.67)
B. Individuals	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	1.87 (1.68)	1.87 (1.68)
Total	3.61 (3.25)	0.00 (0.00)	0.00 (0.00)	0.10 (0.09)	0.37 (0.33)	1.87 (1.68)	5.95 (5.35)

Note: QCBS = Quality- and Cost-Based Selection
 QBS = Quality-based Selection
 SFB = Selection under a Fixed Budget
 LCS = Least-Cost Selection
 CQ = Selection Based on Consultants' Qualifications
 Other = Selection of individual consultants.
 (*= Audit costs are included in the total consultants costs shown above.

Annex 6, Table B: Thresholds for Procurement Methods and Prior Review

Expenditure Category	Contract Value (Threshold)	Procurement Method	Contracts Subject to Prior Review	
	US \$ thousands		US \$ millions	
1. Goods	>150	ICB	All	
	>25 < 150	NCB	All contracts above \$50,000	
	<25	Shopping	Post-review	
2. Consultants				
	Firms	>100	QCBS	All
		< 100	QCBS, LCS, CQ	All
Individuals	All values	See Section V of Guidelines	All (TOR, contract, CV)	
Total value of contracts subject to prior review:			8.0	

Overall Procurement Risk Assessment has been rated as HIGH:

Frequency of procurement supervision missions proposed: One every 6 months.

Annex 6(B): Financial Management and Disbursement Arrangements HONDURAS: Financial Sector Technical Assistance Credit

Financial Management

1. Summary of the Financial Management Assessment

The Honduras Financial Sector Technical Assistance Project is expected to cost US\$11 million, of which the IDA Credit of US\$9.9 million equivalent will finance 90%. The remaining US\$1.1 million will be financed by the Government of Honduras. The overall responsibility for project implementation will reside with both Central Bank of Honduras (BCH) and Comisión Nacional de Bancos y Seguros (CNBS). A key component of the project will be undertaken by a joint CNBS/BCH task force, which will be part of the Project Coordination Unit (PCU) to be located at CNBS. The PCU will function under the supervision of the President of the CNBS and a Steering Committee comprising the representatives of the Ministry of Finance, CNBS, BCH and possibly the Financial and Monetary Committee of the Parliament.

The PCU will be responsible for the project financial management arrangements including the flow of funds management for the entire project. As a result of the financial management assessment undertaken during project preparation, certain weakness and gaps in the financial management structure of the PCU will need to be addressed in order to ensure that the PCU will have the capability to properly undertake the financial management of the project. The weakness related to the following financial management aspects include: (i) lack of a financial procedures manual to guide the recording and reporting of financial transactions; (ii) lack of adequate accounting norms and procedures for the setting up accounts, journals and ledgers to support proper financial statement preparation and documentation; and (iii) the lack of an on-going training program for accounting and financial staff. During preparation of the project a financial management plan of action was agreed with the PCU to address these weaknesses, prior to the effectiveness of the IDA Credit. This action plan will be finalized in consultation with IDA. IDA is assisting the PCU prepare the financial procedures manual. A chart of accounts of the PCU, consistent with chart of accounts of the Government, is also under preparation and a financial management and accounting system capable of producing financial management reports (FMRs) will be completed prior to Credit effectiveness. IDA will provide training for PCU financial and accounting staff and assistance to the PCU in hiring external auditors.

Staffing

The PCU is expected to have in place, prior to Credit effectiveness, the institutional capacity required to carry out the financial management requirements of the project. The PCU will be under the direction of a Project Coordinator who will report to the TSPC and to the President of the CNBS in the implementation of the decisions taken by the former. Reporting directly to the Project Coordinator (PC) will be a Procurement Officer, a Financial Management Officer, and the Task Force members in charge of implementing the BCP. The project implementation teams for the payment system and corporate sector components will report primarily to the management of the BCH, but their work will also be supervised by the PCU at the CNBS.

Flow of Funds

The PCU will establish and maintain a project Special Account (SA) to be established at the Central Bank of Honduras. The PCU will also establish a project account to which the Government's counterpart funds will be deposited. Disbursements under the IDA Credit will be transactions based. An authorized allocation will be advanced into the SA, based on the estimated IDA share of the expenses to be financed through the SA during the first four months of the project. The PCU will undertake monthly reconciliations of the balances in the special account and project account, as well as the project expenditures, the government's contribution and IDA's disbursements.

Project Financial Monitoring Reports, FMRs

The general format of the FMR will follow the one agreed with the Government of Honduras. The format will also be consistent with the financial reporting format being followed under the program of IDB assistance to the financial sector in Honduras. Both the BCH and the CNBS will provide the PCU with the necessary documentation in a pre-determined format to enable the PCU to prepare the project FMRs. The FMRs will provide information for monitoring the financial implementation and procurement progress of the project. The financial reports will indicate inflows of financial resources by sources and outflow by expenditure categories, both by reporting period and cumulatively. They will also include supporting schedules comparing planned versus actual expenditures. The financial reports, which will be prepared from accounts that are consistent with GOH chart of accounts, will also provide the basis for the preparation of the project audit reports. Reports to assist the monitoring of the implementation progress of the project will include project performance indicators that will link the financial information and implementation progress. Reports for monitoring progress in the acquisition of project facilities will include reports on the procurement of goods, works (if any), and services. The procurement progress reports will address issues relating to the compliance with IDA procurement guidelines, highlight key procurement issues and provide information on complaints, inadequate performance, if any, and major disputes.

Risk Analysis

The specific financial management risk to be considered during the implementation of the project is the capability of the PCU to properly manage the financial management aspects of the project and whether the PCU will be able to meet the requirements for utilizing reports (i.e. FMRs) based disbursement. The strengthening of the Finance and Accounting Unit of the PCU and the hiring of Financial Officer should substantially mitigate this risk. Furthermore the consultants will put in place a training program that will upgrade and maintain the skills of the Finance and Accounting Unit during project implementation. While the PCU currently does not have an established procedures manual, procedures are followed, and there is a high degree of awareness and application of what constitutes acceptable good practice. The production of an operations manual will also reduce the risk level of the project.

Conditions of Effectiveness

The following are the conditions of Effectiveness specifically relating to the financial management of the project: (i) completion of the Financial Management System; (ii) finalization of a project operations manual detailing financial procedures; and (iii) the appointment of an external auditing firm on the basis of terms of reference acceptable to the IDA.

2. Audit Arrangements

An external auditor, acceptable to IDA, will be contracted by the PCU to carry out an annual financial audit of the project, as required by OP/BP 10.02. The auditor will be selected in accordance with IDA's Guidelines for the Selection and Employment of Consultants by the World Bank Borrowers dated January 1997, revised in September 1997. The auditors should be hired at the project inception, and ideally renewed prior to the commencement of each project fiscal year thereafter, so that interim audits can be performed throughout each year of project implementation. The project financial statements, the Special Account, and Statements of Expenditures (SOEs) will be audited at the end of each fiscal year of project implementation. An audit report of the project financial statements should be sent to IDA within 4 months of the close of the fiscal year of the project. The Guidelines and Terms of Reference for Audits of Projects with financing by the World Bank in the Latin American and the Caribbean Region should be followed by the PCU when preparing the terms of reference for the audit and these guidelines should be provided to the auditors invited to submit proposals for undertaking the project audits.

3. Disbursement Arrangements

During project implementation, disbursements will be transactions-based (Statements of Expenditures, SOEs). Disbursements will be made on the basis of full documentation, provided in advance, for all expenditures above the prior review threshold. For all other eligible expenditures, disbursements will be made on the basis of SOEs for goods costing less than US\$50,000. Similarly, all expenditures for training and operational costs will be made on the basis of SOEs. The authorized allocation to the special account during the transactions based disbursement will be set at a level sufficient to cover approximately four months of estimated expenditures eligible for financing by the IDA up to a maximum allocation of US\$750,000. All supporting documentation authenticating the expenditures reported in the SOEs and FMRs will be maintained by the PCU and made available for review by independent auditors and by the IDA supervision missions. Disbursements against contracts for all consulting services will be on the basis of the full documentation.

Retroactive Financing

Retroactive financing may be made on account of payments made for eligible expenditures under the Project from June 1, 2003 (or 12 months from the date of agreement, whichever is later) through the effectiveness of the project in an aggregate amount not exceeding US\$0.5 million equivalent.

Use of Statement of Expenditures (SOE)

During the first year of project implementation, SOEs may be submitted for goods under contracts for expenditures for which no prior review is required, as well as training and operational costs.

Special Account

A separate project Special Account in US Dollars will be established at the Central Bank of Honduras. The PCU will be responsible for submitting appropriate disbursement applications to request transfer of funds to the Special Account. Replenishments of the funds under SOEs will be made on evidence of satisfactory utilization of previous advance (s) as evidenced by the documentation submitted in support of disbursement applications. Deposits into the Special account and its replenishment, up to the authorized allocation will be made initially on the basis of Applications for Withdrawals (Form 1903) accompanied with the supporting and other documentation specified in the Disbursement Handbook. Replenishment applications should be submitted regularly, preferably monthly, after monthly bank statements are received and reconciled by the project entity.

The project completion date will be March 31, 2007, with the Credit Closing date of September 30, 2007. The Credit proceeds will be disbursed against the following percentages of eligible expenditures: 90% for services; 88% for local goods and 100% for foreign goods; 98% for training and audits; and 64% for operational costs.

Allocation of credit proceeds (Table C)

Table C: Allocation of Credit Proceeds

Expenditure Category	Amount in US\$million	Financing Percentage
Services	5.27	90%
Goods	2.15	100% of foreign expenditures and 88% of local expenditures
Training	0.78	98%
Audit	0.09	90%
Operational Costs	0.62	64%
Unallocated	0.99	
Total Project Costs with Bank Financing	9.90	
Total	9.90	

Use of statements of expenditures (SOEs):

Special account:

Annex 7: Project Processing Schedule

HONDURAS: Financial Sector Technical Assistance Credit

Project Schedule	Planned	Actual
Time taken to prepare the project (months)		
First Bank mission (identification)		
Appraisal mission departure	05/19/2003	05/19/2003
Negotiations	05/22/2003	05/23/2003
Planned Date of Effectiveness	09/30/2003	

Prepared by:

Comisión Nacional de Bancos y Seguros, Banco Central de Honduras

Preparation assistance:

Japanese PHRD Grant TF025839 (US\$0.695 m)

Prepared with the assistance of consultants and IDA staff

Bank staff who worked on the project included:

Name	Speciality
Modibo Khane Camara	Sr. Financial Economist / Task Team Leader
Joaquin G. Gutierrez	Lead Financial Sector Specialist / Banking Consolidation Program
Juan Ortiz	Sr. Financial Sector Specialist / Banking Supervision
Mario Guadamillas	Sr. Financial Economist / Payments System
Pierre-Laurent Chatain	Sr. Financial Specialist / Prevention of Money Laundering
Aquiles A. Almansi	Sr. Financial Economist
Frank Baumgardt	Consultant
Helena K. Issa	Program Assistant
Pilar Gonzalez	Counsel
Rajeev Swami	Financial Management Officer
Emmanuel N. Njomo	Sr. Projects Officer
Adolfo Rouillon	Consultant / Bankruptcy Regulation & Credit Rights
Bess Johnson Michael	Sr. Financial Sector Specialist
Luis R. Prada Villalobos	Procurement Specialist
Ilias Skannelos	Junior Professional Associate
Cara Zappala	Operations Analyst
Astrid Manroth	Financial Economist

Annex 8: Documents in the Project File*

HONDURAS: Financial Sector Technical Assistance Credit

A. Project Implementation Plan

B. Bank Staff Assessments

Capacity Assessments for Procurement and Financial Management

C. Other

Memorandum of Understanding between the CNBS and IDA dated April 1, 2003
Aide-Memoire of Appraisal Mission (May 19 -20, 2003)

*Including electronic files

Annex 9: Statement of Loans and Credits

HONDURAS: Financial Sector Technical Assistance Credit

16-Apr-2003

Project ID	FY	Purpose	Original Amount in US\$ Millions					Difference between expected and actual disbursements ^a	
			IBRD	IDA	GEF	Cancel.	Undisb.	Orig	Frm Rev'd
P053575	2002	HN- HEALTH SYSTEM REFORM PROJECT	0.00	27.10	0.00	0.00	29.54	0.00	0.00
P057859	2002	SUSTAINABLE COASTAL TOURISM PROJECT	0.00	5.00	0.00	0.00	4.76	1.21	1.53
P060785	2001	HN ECONOMIC & FIN.MANAGEMENT PROJECT	0.00	19.00	0.00	0.00	13.34	13.53	0.00
P057538	2001	HN ROAD RECONSTRUCTION AND IMPROVEME	0.00	66.50	0.00	0.00	46.38	2.07	0.00
P064895	2001	HN FIFTH SOCIAL INVESTMENT FUND PROJE	0.00	60.00	0.00	0.00	27.55	-2.88	0.00
P073035	2001	Access to Land Pilot (PACTA)	0.00	8.00	0.00	0.00	6.57	2.93	0.00
P007397	2001	HN COMMUNITY-BASED EDUCATION PROJECT	0.00	41.50	0.00	0.00	39.85	12.89	0.00
P064913	2000	EMERG DISASTER MGMT (TAL)	0.00	10.82	0.00	0.00	7.88	-3.02	0.00
P057350	1999	PROFUTURO	0.00	8.30	0.00	0.00	4.21	-0.04	3.34
P044343	1998	GEF HN-BIODIVERSITY CONSERVATION	0.00	0.00	7.00	0.00	3.06	6.74	0.00
P007398	1997	RURAL LAND MGMT	0.00	34.00	0.00	0.00	4.07	-2.00	-1.99
P007388	1993	TRNSPRT SCTR RHB	0.00	65.00	0.00	1.12	0.22	-18.86	1.28
Total:			0.00	345.22	7.00	1.12	187.43	12.56	4.16

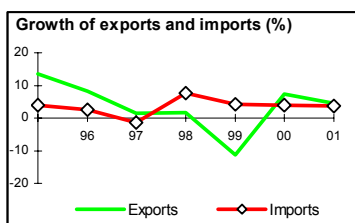
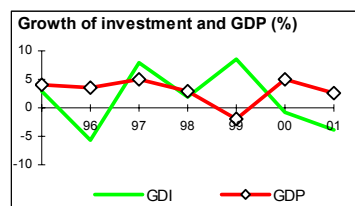
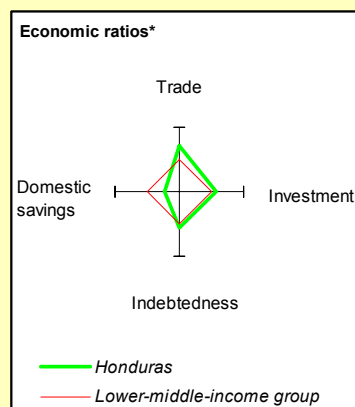
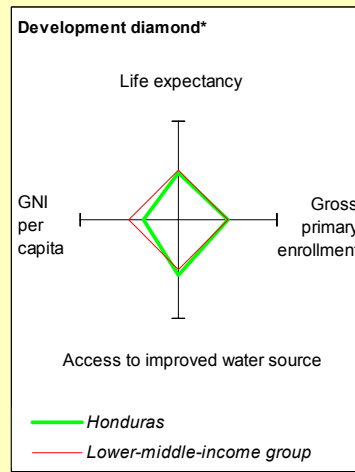
HONDURAS
STATEMENT OF IFC's
Held and Disbursed Portfolio
Jun 30 - 2002
In Millions US Dollars

		Committed				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1998	Camino Real Plaz	9.00	0.00	0.00	0.00	9.00	0.00	0.00	0.00
1995/98	Elcosa	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1986/99	Granjas Marinas	4.50	0.00	0.00	0.00	4.50	0.00	0.00	0.00
	Total Portfolio:	13.50	0.00	0.00	0.00	13.50	0.00	0.00	0.00
		Approvals Pending Commitment							
FY Approval	Company	Loan	Equity	Quasi	Partic				
	Total Pending Commitment:	0.00	0.00	0.00	0.00				

Annex 10: Country at a Glance

HONDURAS: Financial Sector Technical Assistance Credit

POVERTY and SOCIAL	Honduras	Latin America & Carib.	Lower-middle-income	
2001				
Population, mid-year (millions)	6.6	524	2,164	
GNI per capita (Atlas method, US\$)	890	3,560	1,240	
GNI (Atlas method, US\$ billions)	5.9	1,862	2,677	
Average annual growth, 1995-01				
Population (%)	2.6	1.5	1.0	
Labor force (%)	3.7	2.2	1.2	
Most recent estimate (latest year available, 1995-01)				
Poverty (% of population below national poverty line)	..	..	..
Urban population (% of total population)	54	76	46	
Life expectancy at birth (years)	66	70	69	
Infant mortality (per 1,000 live births)	35	29	33	
Child malnutrition (% of children under 5)	25	9	11	
Access to an improved water source (% of population)	90	85	80	
Illiteracy (% of population age 15+)	25	11	15	
Gross primary enrollment (% of school-age population)	108	130	107	
Male	107	131	107	
Female	110	128	107	
KEY ECONOMIC RATIOS and LONG-TERM TRENDS				
	1981	1991	2000	2001
GDP (US\$ billions)	2.8	3.1	5.9	6.4
Gross domestic investment/GDP	21.1	24.7	32.5	30.6
Exports of goods and services/GDP	30.8	33.0	42.1	38.3
Gross domestic savings/GDP	14.1	20.0	18.8	13.9
Gross national savings/GDP	10.0	15.3	23.5	20.3
Current account balance/GDP	-11.1	-9.2	-9.0	-10.3
Interest payments/GDP	3.4	4.8	2.6	2.1
Total debt/GDP	60.5	110.7	88.7	80.2
Total debt service/exports	25.6	27.6	14.8	13.2
Present value of debt/GDP	..	..	52.5	..
Present value of debt/exports	..	..	102.0	..
	1981-91	1991-01	2000	2001
<i>(average annual growth)</i>				
GDP	3.0	3.0	4.9	2.6
GDP per capita	-0.1	0.2	2.3	0.1
Exports of goods and services	1.4	1.7	7.3	4.6
STRUCTURE of the ECONOMY				
	1981	1991	2000	2001
<i>(% of GDP)</i>				
Agriculture	22.4	22.7	15.1	13.7
Industry	22.9	27.3	32.2	31.6
Manufacturing	14.4	16.9	20.0	20.3
Services	54.7	50.0	52.7	54.7
Private consumption	73.1	68.1	68.5	72.2
General government consumption	12.8	12.0	12.8	13.9
Imports of goods and services	37.7	37.7	55.9	55.0
	1981-91	1991-01	2000	2001
<i>(average annual growth)</i>				
Agriculture	3.1	1.7	9.5	-0.9
Industry	3.4	3.5	5.2	1.6
Manufacturing	3.9	4.1	5.5	5.2
Services	2.6	3.7	4.4	4.5
Private consumption	2.9	2.8	4.6	3.8
General government consumption	2.5	4.0	15.7	11.3
Gross domestic investment	6.2	5.0	-0.8	-3.9
Imports of goods and services	2.8	3.5	3.8	3.6

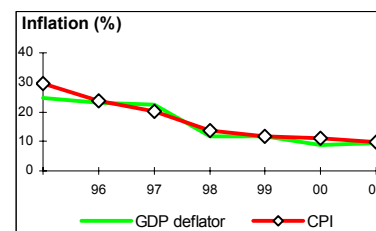


Note: 2001 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

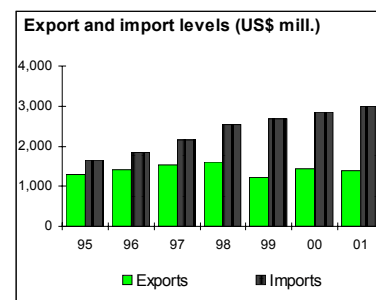
PRICES and GOVERNMENT FINANCE

	1981	1991	2000	2001
Domestic prices (% change)				
Consumer prices	..	34.0	11.0	9.7
Implicit GDP deflator	7.1	26.0	8.7	9.6
Government finance (% of GDP, includes current grants)				
Current revenue	13.5	18.2	18.0	18.2
Current budget balance	-0.6	-0.3	0.5	-0.4
Overall surplus/deficit	-9.5	-5.3	-6.8	-8.1



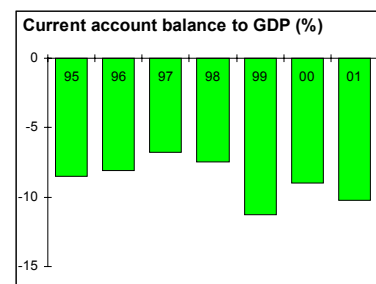
TRADE

(US\$ millions)	1981	1991	2000	2001
Total exports (fob)	784	835	1,426	1,379
Bananas	213	314	124	204
Coffee	173	146	339	161
Manufactures	..	..	..	..
Total imports (cif)	976	1,001	2,855	2,997
Food	160	140	470	480
Fuel and energy	163	150	384	402
Capital goods	216	188	722	867
Export price index (1995=100)	..	92	98	90
Import price index (1995=100)	..	79	131	133
Terms of trade (1995=100)	..	117	75	68



BALANCE of PAYMENTS

(US\$ millions)	1981	1991	2000	2001
Exports of goods and services	884	997	2,497	2,447
Imports of goods and services	1,061	1,139	3,313	3,512
Resource balance	-177	-142	-816	-1,064
Net income	-153	-192	-165	-141
Net current transfers	18	53	447	550
Current account balance	-313	-281	-534	-656
Financing items (net)	239	350	554	736
Changes in net reserves	74	-69	-20	-80
Memo:				
Reserves including gold (US\$ millions)	..	198	1,285	1,386
Conversion rate (DEC, local/US\$)	2.0	5.3	14.8	15.5



EXTERNAL DEBT and RESOURCE FLOWS

(US\$ millions)	1981	1991	2000	2001
Total debt outstanding and disbursed	1,705	3,396	5,255	5,121
IBRD	176	551	152	125
IDA	77	126	838	901
Total debt service	236	307	450	410
IBRD	20	88	48	36
IDA	1	2	8	10
Composition of net resource flows				
Official grants	25	549	292	344
Official creditors	172	121	316	195
Private creditors	61	5	16	-72
Foreign direct investment	-4	52	262	186
Portfolio equity	0	0	0	0
World Bank program				
Commitments	0	91	154	66
Disbursements	42	78	38	98
Principal repayments	6	45	35	27
Net flows	37	33	3	71
Interest payments	15	45	21	19
Net transfers	22	-12	-18	52

