ICR Review
Operations Evaluation Department

Report Number : ICRR11428

1. Project Data:		Date Posted : 05/09/2003		
PROJ ID:	P070640		Appraisal	Actual
Project Name :	First Programmatic Financial Sector Adjustment Loan (FPF-SAL)	Project Costs (US$M)	404.04	404.04
Country:	Brazil	Loan/Credit (US$M)	404.04	404.04
Sector(s):	Board: FSP - Banking (43%), General finance sector (38%), Payment systems securities clearance and settleme (13%), General industry and trade sector (6%)	Cofinancing (US$M)		
L/C Number:	L7053			
		Board Approval (FY)		01
Partners involved :		Closing Date	03/31/2002	03/31/2002
Prepared by :	Reviewed by :	Group Manager :	Group:	
John H. Johnson	Alice C. Galenson	Kyle Peters	OEDCR	

2. Project Objectives and Components

a. Objectives

To support a program of broad-based and comprehensive fundamental financial sector reform, as a means for consolidating growth with stability and the reduction of poverty.

b. Components

1. To increase the efficiency of, and access to, financial services;

   (a) Strengthen Central Bank Risk Center;
   (b) Improve debtor information among banks;
   (c) Strengthen contract enforcement;
   (d) Send proposals for bankruptcy reform to Congress;
   (e) Amend banking regulations to encourage delivery of services to under -served population and facilitate the creation of banking coops.

2. To enhance the soundness of the banking system and its safety net;

   (a) Strengthen supervisory methods;
   (b) Raise capital adequacy requirements;
   (c) Start work on a bank rating system;
   (d) Start upgrade of the deposit insurance system;
   (e) Prepare draft resolution to fix bank exit framework.
   (f) Prepare a blueprint for Central Bank crisis management.

3. To enhance the efficiency and safety of the banking clearance and settlement systems;

   (a) Pass legislation reforming the payments system;

4. To strengthen the regulatory framework for, and oversight of, securities markets .

   (a) Submit a revised law on corporate governance to Congress;

(b) Issue good governance guidelines to stock exchange, the federal development bank, and pension fund managers.
(c) Submit legislation strengthening the enforcement powers of the securities exchange commission;
(d) Issue new securities regulations requiring greater disclosure and investor protection;
(e) Agree on principles of a draft Central Bank/financial systems law.

c. Comments on Project Cost, Financing and Dates

This programmatic loan, in the amount of US$404.04 million, was fully disbursed a little over one month after approval. It is the first of three programmatic loans contemplated to support reform of the financial system.

3. Achievement of Relevant Objectives:

All components intended to support the intermediate objective of financial reform were fully implemented prior to Board approval, measurably improving some, but not all, constraints on achieving strong and efficient financial and capital market institutions. However, the anticipated higher-order benefits of stable growth and poverty reduction have yet to materialize.

4. Significant Outcomes/Impacts:

(a) Creditors' rights over the repossession of collateral and the execution of guarantees have been significantly strengthened;
(b) The banking system is covered by a stricter, internationally-sanctioned set of capital adequacy and asset management regulations;
(c), Depositors enjoy improved legal and financial protection of their savings from the effects of bank failure;
(d) Banks have access to more extensive and up-to-date information on debtors;
(e) Underserved populations in rural and poorer areas have wider access to bank branches in post offices, supermarkets, lottery points, local retailers, and coops.
(f) Although not a stated objective of the FPF-SAL, the restructuring, liquidation, and/or privatization of the state-owned banks occurred during the period immediately preceding loan approval, and could properly be considered an integral, and highly significant, achievement of the financial reform program of the late 1990s-early 00s.

5. Significant Shortcomings (including non-compliance with safeguard policies):

Some factors identified as major causes of high banking spreads were not addressed by this operation, with the result that spreads remain high, and access to credit and equity finance remains restricted.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Satisfactory	Although largely achieved, the FPF-SAL objectives were mainly intermediate in character, and have yet to generate tangible high-level development benefits in the form of improved private sector access to credit at lower costs.
Institutional Dev.:	Modest	Substantial	The rating upgrade reflects the significant improvements in the financial rules of the game and in lower-income client access to financial services supported by this operation. The ICR rating may have referred only to the organizational changes resulting from these reforms, but, even here, it is arguable that the increases in the powers of the Central Bank and the Securities Exchange Commission were substantial.
Sustainability:	Likely	Likely	
Bank Performance:	Satisfactory	Satisfactory	
Borrower Perf.:	Highly Satisfactory	Satisfactory	Executive Branch support was unstinting and exemplary, but key pieces of legislation remain in limbo in the Congress.
Quality of ICR:		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

1. Programmatic lending, with its enhanced emphasis on partnership and flexibility, may be a more palatable form of policy lending for Borrowers zealous of their independence.
2. Early in-depth Bank analysis and technical assistance on financial sector issues provided under a previous loan accelerated preparation of the FPF-SAL.
3. A partial approach to addressing the underlying causes of high bank spreads was unlikely to yield tangible reductions. The next programmatic loan needs to address the remaining causes, such as high bank administrative overhead and explicit and implicit financial taxes, if borrowers and the economy are to receive meaningful benefits.
4. Likewise, measures such as improving minority shareholder protection, are necessary, but not sufficient, to bring about improved enterprise access to reasonably-priced equity finance as well as compellingly attractive investment vehicles to investors.

8. Assessment Recommended? ● Yes ○ No

Why? This is one of the early incarnations of a programmatic loan, and may eventually form part of a cluster of three. Since doubts have been expressed about the expected impact of this new instrument, an audit would be beneficial, once all relevant programmatic operations have closed.

9. Comments on Quality of ICR:

The ICR does well in placing this operation in the context of an expected set of three programmatic financial sector adjustment loans. The emerging impact of the FPF-SAL might have been more clearly identified, had the ICR supplied a longer timeline of data on trends in bank spreads, credit volume to private borrowers, and improved low-income access to credit, keyed to specific FPF-SAL interventions which would facilitate before-and-after comparisons. In this regard, Annex 1 provides some useful supporting data, but over a relatively short time period. For example, the graphic on interest rate spreads (Annex Figure A1.2) begins in January 1999, and ends in October 2001. It would have been more useful if the graph had started, say, a decade before loan approval, so as to afford some perspective about spreads historically. Similarly, data could have been provided after October 2001, since the ICR was not published until December 2002. While it is understood that the impact of the supported actions will only be gradual, that a second programmatic loan was approved in 2001, and that there have been a number of intervening exogenous impacts on the economy, in our view, no purpose is served by circumscribing the presentation of data to the lifetime of the operation under evaluation (Note: Even by this standard, the ICR could have done better, since the FPF-SAL closed in March 2002, six months beyond the data horizon presented in Annex 1.) Why does this matter? Because, if one were to measure the reduction in bank spreads only from the moment of PFP-SAL approval, then one could conclude, on the basis of the information presented in the ICR, that the loan's impact has been disappointing, since Brazil's bank spreads remain among the highest in the world. However, such a conclusion is probably not correct, since the actions supported by this loan were completed prior to approval, and, presumably, should receive some of the credit for the reduction in spreads which occurred between, say, 1999 and 2001. Moreover, attribution is further clouded by the fact that a follow-on programmatic financial loan has disbursed, and by the impact of a variety of exogenous effects likely to affect bank spreads. But, without longer timelines and refinements in data analysis and presentation, it will remain difficult to gauge what impact these operations have had on reducing bank spreads. For the next loan in this series, it is recommended that the ICR document focus greater attention on making the case for the promised high-level development benefits of these operations having materialized in whole or in part.