

Project Name Mexico-Savings and Credit Sector (@)...
Strengthening and Rural
Microfinance Capacity Building

Region Latin America and Caribbean Region

Sector Institutional Development; Financial
Sector Development

Project ID MXPE70108

Borrower(s) UNITED MEXICAN STATES

Implementing Agency

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1. Country and Sector Background

The Savings and Credit SectorThe non-bank financial sector, and savings and loan institutions in particular, has a significant and growing presence in areas and among clients not traditionally served by banks in Mexico. Non-bank financial intermediaries in Mexico include a multiplicity of formal and informal, regulated and unregulated institutions which mobilize deposits from and/or extend credit to the public. Among formal non-bank intermediaries (i.e., licensed under a law) are those which are regulated as financial institutions, including Sociedades de Ahorro y Préstamo (SAPs) and Credit Unions, and those which are not, including Cajas Populares, Cooperativas de Ahorro y Crédito , Cajas Solidarias, NGOs and others. Savings and credit institutions (SCIs), in this document, refer to both of these types of formal intermediaries. Informal intermediation, on the other hand, which is unregulated and not legally sanctioned, includes rotating savings and credit associations (tandas), money lenders, savings groups and other personal savings and loan arrangements, which are not dealt with in this document.It is estimated that the SCI sector, comprised of more than 650 institutions, extends savings and loan services to approximately 2.6 million people or (about 6 percent of the economically active population) and has assets of more than US\$1.8 billion (or approximately 1 percent of banking sector assets). The SAP network alone includes nearly 400 retail outlets with 500,000 members in 31 states. For many of these SCIs, full reliance on mobilized deposits

to support their loan portfolios protected them from the 1995 currency crisis, as they had practically no foreign-currency liabilities. In addition, it gave the savings and loan societies an advantage vis à vis the banking system, as they were able to lend when banks were drastically contracting credit flows. Well-functioning savings and credit institutions were thus able to attract new members and grow in scale when most of the rest of the financial system was shrinking. While the relative stability and extension of the SCI sector towards lower-income and rural clients has provided for alternative access to financial services where commercial and development banks have not been successful, the lack of effective regulation and supervision until the passage of new legislation last year has meant that these institutions and their depositors are exposed to significant risks. These risks have been made apparent by several SCI failures, some of them openly fraudulent, which have seriously undermined public confidence in these institutions, especially among small depositors. Restoring client confidence, and enhancing the ability of financial intermediaries to reach more people thus became critical objectives of the Mexican administration. Against this background, Government has embarked on a strategy to strengthen financial intermediaries active among all market segments, including banks and non-bank institutions. The banking sector has benefited from a strengthening process supported by the Bank Restructuring Facility. Moreover, the recent Bank/Fund FSAP mission has outlined additional strengthening measures, including a framework for the rationalization of public development banks. In order to increase access to services and enhance the reliability of those services among lower-income households, which traditionally do not benefit from banking services, the Government has devised a strategy towards strengthening and effectively supervising SCIs. This strategy aims at further developing the capacity of these intermediaries, modernizing their services, substantially improving their image among the general public and increasing their overall outreach, especially in rural areas. To this end, key government entities concerned with financial sector issues, the Secretariat of Finance and Public Credit (SHCP), the National Banking and Securities Commission (CNBV) and the Central Bank of Mexico (BANXICO), with Bank collaboration, developed a new legal and regulatory framework for savings and credit institutions and organizations (instituciones de ahorro y crédito popular), perceived to hold a high potential to expand institutional outreach to under-served sectors of the population. In reality, the diverse range of non-bank financial institutions operating in Mexico serves a continuum of clientele, from the relatively wealthy to poor, marginalized households in rural and urban areas alike. (See Section C.3. for details on SCIs and client profiles). The Ley de Ahorro y Crédito Popular was passed on April 30, 2001 and became effective on June 4, 2001. It provides for the incorporation of all savings and credit (non-bank) financial institutions into a legal framework that covers the range of their intermediation activities. The law recognizes two types of retail intermediaries authorized to mobilize deposits from the general public: Savings and Credit Cooperatives (Sociedades Cooperativas de Ahorro y Crédito), and Popular Savings Associations (Sociedades Financieras Populares). After a period of two years from the date of the law's effectiveness, only those institutions which are able to demonstrate their financial viability, which subject themselves to regulation and supervision and which purchase private deposit insurance will be authorized to remain in operation. Regulation and supervision will be tailored to four different categories

of SCIs, depending on the scale and types of liabilities and assets, number of shareholders or clients, number of branches, geographic coverage and technical operating capacity. More developed institutions will be granted authorization to provide a greater range of services and products, while being subject to stricter standards than less developed ones. The institutional framework prescribed by the legislation will require affiliation in Federations, which will monitor and oversee SCI activities and status according to CNBV guidelines and under its overall sector monitoring. The CNBV, per mandate of the new law, becomes the sole regulatory and supervisory authority for non-bank entities providing savings and credit services and has the responsibility of issuing all rules and regulations associated with the new law. In this manner, the law aims at eliminating the opportunities for regulatory arbitrage that have thus far characterized the Mexican legal framework. The regulatory and supervision framework for "popular savings and credit" institutions has thus been designed to be consistent with the laws mandating prudential norms and governing the activities of banks and other financial institutions. While the CNBV is in charge of SCI supervision, the newly created BANSEFI has been charged with the responsibility of developing the capacity of and preparing SCIs for their integration into the new system, and overseeing the formation and strengthening of the Federation(s) of SCIs and their associated auxiliary supervisory bodies (Comités de supervisión) which will assist CNBV in its supervisory role. BANSEFI, as successor of the Patronato del Ahorro Nacional (PAHNAL) will continue to provide secure savings instruments to low-income clients and to educate and encourage savings habits among the public, but in addition to PAHNAL's retail savings services functions, BANSEFI will arrange the provision of technical support to savings and credit institutions, provide second tier central banking services, excluding on-lending of funds, and will coordinate the Government's programs to develop the SCI sector. On the practitioners's side and as a reaction to the legal reforms, the numerous entities in the sector created (in March 2001) the Consejo Mexicano de Ahorro y Crédito Popular (COMACREP), which encompasses all major second-level organizations (such as that of the SAPs, AMSAP, of the Uniones de Crédito, AMUCSS, and of the non-cooperative microfinance institutions, PRODESARROLLO, among others). The COMACREP, thus claiming at least 80 percent of the SCI sector by any measure of scale (clients, assets, deposits), is carrying the dialogue with the official entities involved, notably CNBV and BANSEFI, on both regulatory and developmental issues. The Government of Mexico has requested Bank assistance to prepare SCIs for incorporation into the system and to build capacity among sector institutions to effectively provide supervision, monitoring and institutional strengthening functions. In addition to the SCI sector stabilization, integration and supervision program, the Government has sought Bank support for the preparation of a program to increase the outreach of savings and credit institutions and organizations in rural areas, as well as to provide technical assistance and training in poor, rural communities interested in increasing formal savings. Financial Services in Rural Areas Rural Finance in Mexico suffers at present two main consequences of past government strategies: (i) rates of participation in formal financial transactions for rural entrepreneurs and households lower than those in countries with one-half of Mexico's per capita GDP; and (ii) a severe scarcity of viable or potentially sustainable financial institutions with a significant presence and outreach among low-income households, particularly in rural areas. Directed credit at subsidized

interest rates, subsidized credit guarantees, and debt forgiveness and restructuring characterized rural credit in Mexico during the 1980s and early 1990s. Key public rural finance institutions, namely the Banco Nacional de Crédito Rural (BANRURAL) and the Fideicomisos Instituidos en Relación con la Agricultura (FIRA) were the main means of intervention. In addition, the Aseguradora Nacional Agrícola (ANAGSA, closed in 1990) insured most of BANRURAL loans at subsidized premium rates. These interventions created heavy fiscal outlays, estimated in the period 1983-1992 at approximately US\$28.5 billion (an annual average of about 13 percent of agricultural GDP), of which US\$23.1 billion (81 percent) were associated with subsidized interest rates. The government began introducing reforms in rural credit policies in the early 1990s, intended to reduce transfers to the sector and improve efficiency of its rural finance institutions. It reduced interest-rate subsidies, made transfers to institutions more transparent and closed or reorganized inefficient government entities. The exchange-rate crisis of early 1995 induced further closings of rural branches by struggling banks, thus diminishing the already dwindling presence of financial institutions in rural areas (then limited to less than one third of the country's municipalities, including offices of development banks). Subsequent Bank dialogue with government focused on providing an environment conducive to increasing the outreach and sustainability of formal financial intermediaries in rural areas, as opposed to the traditional direct intervention. Specifically, a Rural Finance Technical Assistance loan was approved in 1996 with the objective of reviewing Government participation in the sector; and developing a package of appropriate financial products, lending technologies and incentive schemes to provide sustainable financial services to low income populations through private, commercial banks. The project was not successfully implemented due, in part, to the financial crises and controversial rescue package provided by the Banking Fund to Protect the Saver (FOBAPROA), which induced commercial banks into much more conservative approaches. Banks chose the pursuit of profitable opportunities in their existing urban markets over experimentation and the substantial investments in infrastructure and staff training needed to move into less understood rural markets. Moreover, a collusive attitude among commercial banks and a struggle between Government offices for control over the initiative hampered the project viability and resulted in its closing in late 1999. Currently, the Secretariat of Agriculture, Livestock, Rural Development, Fishing and Food (SAGARPA), and the Secretariat of Finance (SHCP) are concerned with increasing the presence of reliable financial intermediaries in rural areas as an essential base for a healthy development of savings and other microfinance activities, and a restoration of rural people's confidence in the financial sector. In addition, SAGARPA is encouraging the establishment of adequate linkages mechanisms between emerging rural community funds (usually formed among producers that benefit from SAGARPA's transfer programs) and sustainable intermediaries that conform to the new law. The Secretariat requested Bank support to substantially re-structure and re-design a support program initiated in 2000 (the Programa de Asistencia Técnica para el Microfinanciamiento Rural, PATMIR, which had no Bank support in 2000). This request provided an opportunity to ensure that activities under this program are fully consistent with the new legal reform and regulatory framework, and that institutional development approaches are coherent with those to be applied for the implementation of this new framework.

2. Objectives

The proposed project builds upon and enhances the Bank's overall program of strengthening Mexico's financial sector, and providing targeted assistance to the rural poor. The project's main objective is to contribute to the integration of low-income people into the national economy and to the realization of their income generating potential by increasing their access to financial services. To this end, the project aims at improving the financial stability and outreach capacity of savings and credit institutions (SCIs) nationwide, and especially at expanding financial services in rural areas. The project also builds upon the recent legal and regulatory reforms the Government of Mexico (GOM) has enacted to restructure and strengthen the savings and credit sector, a much needed action given the state of this sector and especially the loss of confidence in the financial system among the poor. Most notable among these reforms are the "Popular Savings and Credit Law" (Ley de Ahorro y Crédito Popular, June 4, 2001), and the law that creates the "National Savings and Financial Services Bank" (Banco del Ahorro Nacional y Servicios Financieros, BANSEFI, June 1, 2001, see section B.2). Specifically, the project would support the strengthening of the SCI sector through specialized assistance to the retail institutions, enabling these intermediaries to reach more clients with improved services in a sustainable manner, and through improving the supervisory capacity of the Comisión Nacional Bancaria y de Valores (CNBV) to oversee the SCIs as mandated by the Ley de Ahorro y Crédito Popular. In addition, as a targeted element of this generalized financial sector strengthening, the project would support actions to improve the access of low-income rural communities to sustainable financial services. Lastly, the project would include studies and actions designed to increase understanding of the constraints affecting the extension of financial services to lower-income clients, monitoring the effectiveness of current policy and programs and developing new financial techniques adapted to Mexico.

3. Rationale for Bank's Involvement

The Bank has been actively involved in stabilizing and strengthening the financial sector and in improving access to productive opportunities in poor and rural areas in Mexico over the last decade, supporting operations and sector work in banking, pensions, insurance and capital markets, as well as rural development and municipal services projects in various regions. The proposed project will help provide the required multi-year continuity to the policy reforms and capacity building efforts initiated under BANSEFI, CNBV, SAGARPA and SHCP auspices. Given the non-additionality of Bank lending in Mexico, the value-added of Bank lending consists primarily in the technical guidance the Bank can contribute to the implementation of the new institutional and policy framework for SCI sector development in general, and outreach expansion in rural areas in particular. The World Bank's international expertise in rural finance and microfinance, in legal and regulatory framework issues, in payments systems, and its increasing experience in institutional capacity building operations are already being brought forth in its existing dialogue with government and practitioners in Mexico. The proposed project provides a long-term horizon to this dialogue.

4. Description

The project supports the Government's efforts to strengthen the SCI sector, which serves the poorer segments of the market, so that sector

institutions are able to provide secure and expanded services, and over time, increase their coverage. In addition, because rural areas are seriously underserved and because of the intrinsic problems in serving clients in this market, the project includes programs aimed at improving access of rural communities to sustainable financial services. The main components of the project are summarized below.

Component 1: Consolidation of the Savings and Credit Institutions Sector

The project supports a program to strengthen eligible institutions and liquidate institutions which are not sustainable, to improve SCI sector infrastructure, and to enhance sector supervision. As per its mandate, BANSEFI will manage the technical assistance programs. CNBV will be in charge of certification of institutions for lawful operations.

1.1 Strengthening SCIs Support to Institutions. The project will support an assessment of existing SCIs to determine whether these qualify for certification by CNBV, require technical assistance either to strengthen or to restructure them (mergers with other institutions), or need to be liquidated. Evaluation criteria have been prepared by a team led by CNBV, and consisting of national and international specialists. It is expected that 365 institutions with 1.7 million members or 75 percent of total sector membership) will participate in the program. Preliminary analysis shows that some 90 percent of institutions would meet the capitalization requirements for certification provided they take measures to strengthen their financial performance and operations. This estimate excludes the Cajas Solidarias network, where it can be expected that a higher percentage will have viability problems and will need to be merged or closed down.

The project will support the preparation and implementation of plans to strengthen institutions which can be strengthened or restructured and which have agreed to carry out plans to gain CNBV certification. It is anticipated that the institutional strengthening plans will last between one and two years, depending on the size of the institution. BANSEFI will recruit institutions which are specialized in the provision of these services (referred to as technical assistance providers) to carry out the initial assessment using CNBV guidelines, and to prepare and implement the institutional strengthening plans. The technical assistance providers will enter into formal agreements with the participating SCIs and their corresponding Federations spelling out the program and the performance standards to be met in a designated time period. BANSEFI will monitor the results of the technical assistance program and will review progress on a semi-annual basis. BANSEFI intends to suspend assistance to institutions which do not achieve the agreed semi-annual targets. In addition, CNBV intends to verify on a sample basis the accuracy of the classification given at the outset to the institutions participating in the program. The CNBV will conduct its own evaluation of the institutions when the technical assistance program is completed, and decide independently whether the institutions are to be authorized under the law. The project will also support, as required, the liquidation of institutions which have been determined unviable and present risks to deposit-holders. As the legal status of sector institutions is very diverse, support for liquidation will be determined on a case-by-case basis. Technical assistance providers will be selected from among specialized institutions with demonstrated experience in the field. The providers will support all institutions in a Federation which are willing to enter into specific agreements. The Government, with financing by the Bank, will pay for the costs of the technical assistance program. The beneficiaries will contribute some logistical support to the consultants. The participating institutions will also pay for the full

cost of the Federations which are being established as required by law. The loan does not include financing to shore up the capital, which may be required in the case of a few institutions. The contracts will cover the costs of the international and national specialists required to carry out the institutional development plans as well as expenses directly associated with their work, including equipment and materials. No vehicles will be financed; if vehicles need to be purchased, these will be paid by the Government. Providing SCI Information Infrastructure and Services. The project would support the design and establishment of an information system for the sector as part of an integrated effort aimed at strengthening the SCIs, their federations and the sector at large. The information system will enable sector institutions to provide required financial reports to the CNBV as their supervisor, and to other relevant government agencies. It will also have the capability to maintain accounts and financial information, and to provide other operational, control and reporting services, upon request by the institutions. The core system will reside and will be operated at BANSEFI. The SCIs will link to the system with equipment, software, technical assistance and training provided by the project contractors. This component would support the design and development of the basic system infrastructure and software, and the provision of services to about 40 SCIs that represent approximately 1000 points of service (SCI branches). The Government will pay, with Bank financing, for the system development costs. A fee-for-service cost recovery mechanism will gradually be put in place that will have as an objective the full recovery of operating costs by the fifth year of system operations. The requisite telecommunications infrastructure exists in Mexico. Prior to loan effectiveness, BANSEFI will have confirmed interest from data communications providers to participate in bids for provision of services to the information systems to be set up by BANSEFI. Training program for SCI staff. The project will support the implementation of a training program for SCI management and staff. The program will include modules in the areas of finance, accounting, risk management, credit analysis and governance and will be offered in six regions. The training, which will be available to all participating institutions, will be carried out by specialized consultants (for accounting) and training institutes for the other subjects. It will be implemented over a two year period. Some 800 members of participating institutions are expected to participate in the training. The Federations and member institutions will provide the physical facilities for the courses and will pay for the transportation and living expenses of its participants in the courses.

1.3 Strengthening SCI Supervision. The project will provide support to CNBV to strengthen its supervision procedures and competencies. To this end, it will provide training to CNBV staff on supervision practices and procedures for microfinance institutions and technical assistance to CNBV to develop and adapt regulations as needed. In addition, CNBV will engage the advice of recognized international experts in systems of auxiliary supervision (e.g., Germany, Canada, Spain) on a regular, semi-annual basis. The project will also provide technical assistance to strengthen the Supervision Committees (Comités de supervisión) at the Federations, specifically charged with the auxiliary supervision functions. It will also provide support to the Confederations that group them. This support aims at ensuring clear definition of the functions of the Federations (and the Confederation that will group them), and specifically a demarcation between the auxiliary supervision role and other functions. The support

to CNBV and the sector will seek to establish rules and procedures that ensure professional and transparent handling of entry and exit, and address and mitigate risks of conflict of interest, adverse selection and other issues that may emerge in the process of implementing the supervisory mechanism. The loan will finance technical assistance and training required to carry out the activities.

Component 2: Expanding Financial Services in Rural AreasThis component aims at expanding the supply of financial services the marginal areas, and builds upon work initiated under the marginal areas programs. The project will cover the marginal areas in some eleven states. Activities under this component will be carried out by specialized international technical assistance providers under contract with the implementing agency.

2.1 Expanding Institutions and Services in the Marginal AreasThe component aims at increasing outreach, ensuring financial sustainability, and improving and diversifying the financial services offered by existing intermediaries that serve the marginal areas. In areas where no intermediaries exist, new institutions will be established using proven methodologies and which will fully comply with existing legislation. Participating institutions will be selected on the basis of their track record in terms of outreach and sustainability, and their expansion plans. Institutions supported under this component are likely to be regional institutions, as these are the most inclined to serve the target clientele. The participating institutions would enter into agreements with the technical assistance providers committing to performance targets which will be closely monitored. Program activities will encourage commitment and ownership at the local level while setting up institutional policies and structures that encourage efficiency and profitability. The process will take time because new habits and skills will need to be developed. All participating SCIs will join or will be assigned to a Federation, as mandated by the law, and will meet the requirements for certification by CNBV. The program does not include a line of credit, and it is expected that most of the credit given by participating institutions will be from members' savings.

The marginal areas will be grouped into regions for developmental purposes. The population of the marginal areas covered total some 17 million people. The program will be implemented in six of the following seven regions: (i) Chiapas, (ii) Huasteca (marginal areas in the states of Hidalgo, San Luis Potosi and Veracruz), (iii) Oaxaca, (iv) Veracruz excluding the Huasteca (iv) Guerrero (and adjacent marginal areas in the state of Morelos), (v) Michoacan (and adjacent marginal areas in the State of Mexico), (vi) Puebla and (vii) Sierra Gorda (marginal areas in the states of Querétaro and Guanajuato). The municipalities covered by the program appear in a document prepared by SAGARPA which is based on the classification of the CONAPO for levels of marginality. The regions have been selected taking into account the demand for services identified in market studies, and the willingness of institutions or groupings of clients in the region to enter into performance agreements with the technical assistance providers. The sequencing of the regional programs has also been determined on the basis of the studies, although this order may be modified if developments justify advancing a region ahead of others. The technical assistance providers will be selected following World Bank procedures. The process of selection of the technical assistance provider which will implement the program in Chiapas is complete and the program will be initiated this month. The process of selection of the technical assistance provider for the Huasteca Region is well advanced, and work should start later this year. At the end of five

years of the project, some 60,000 families will be served in the six regions where the program will have been initiated. This figure takes into account that some of the regional programs would only be in their third year of operation. Given that the regions served under the program have few existing institutions, much of the expansion of services will come through the establishment of new branches or new institutions. Some 15-20 new branches (or local institutions) should be established in each of the marginal areas covered. The contracts will cover the costs of the international and national specialists required to carry out the regional development plans as well as expenses directly associated with their work, including equipment and materials. The loan will also finance the purchase of one computer and basic software per branch established. No vehicles will be financed; if vehicles need to be purchased, these will be paid for by the Government.

2.2 Community Training Programs (Social intermediation)The project will provide training to the poorer segments of the population in the marginal areas on basic principles of household finance and participation in financial transactions. In some cases, the program will assist communities to set up simple record-keeping for indigenous savings organizations, and introduce them to formal institutions where they could set up formal accounts. Activities under this sub-component will be organized by the same technical assistance providers that will provide services under sub-component 2.1.

Component 3: SCI Sector Studies, Monitoring and Information DisseminationActivities under this component include studies on financial intermediation in rural areas and other underserved areas of Mexico with a view to defining new methodologies which are adapted to local conditions. In addition, the component includes dissemination programs, including workshops and information campaigns, to inform SCIs, their clients and other stakeholders of the sector consolidation program, and to disseminate lessons from experience in the area of microfinance. The project will also support the introduction of systems to monitor sector development progress and the impact of the government's development programs. The sector studies and monitoring function will be carried out at five different levels: (i) SCI supervision mechanism; (ii) SCI performance; (iii) federation/network performance; (iv) social impact; and (v) fiscal impact. Lastly, the component will also support periodic external evaluations by national and international consultants, including technical and financial audits of the rural microfinance institutions supported under the project, and expert advice to the project management team. The project will finance consulting services under this activity and information materials prepared by BANSEFI.

Component 4: Project Management BANSEFI is conscious of the importance of a strong project implementation team to coordinate and supervise the work the consultants contracted to carry out the project activities, and has assembled a strong team for this purpose. The project will support the operations of the technical unit which has been set up to carry out project management and implementation follow up, including monitoring and evaluation of the activities.

1. Consolidating the Savings & Credit Institutions Sector
2. Expanding Financial Services in Rural Areas
3. SCI Sector Studies, Information Dissemination & Monitoring
4. Project Management

5. Financing

	Total (US\$m)
BORROWER	\$13.50
IBRD	\$64.60
IDA	
INTER-AMERICAN DEVELOPMENT BANK	\$3.50
LOCAL SOURCES OF BORROWING	
COUNTRY	\$4.60
Total Project Cost	\$86.20

6. Implementation

BANSEFI will be responsible for implementation of the project, including the project's financial management and procurement. Key activities under the project will be subcontracted by BANSEFI to technical assistance providers with demonstrated experience in the implementation of programs similar to those envisaged under the project. The arrangements between BANSEFI and SAGARPA, which prepared the Marginal Areas component, and CNBV, which will provide technical oversight to the supervision component are described in the sections relating to executing agencies and project management in Part E of this report. The project is innovative and ambitious as it seeks to support a major reform in the sector in a relatively short period of time. Because of its nature, priority is being given to monitoring activities. A mid-term review will be carried out in late 2003 to review progress on implementation of the SCI legislation, progress in the technical assistance programs to participating SCIs and to approaches and schedules as required.

7. Sustainability

The focus of the project is to strengthen the SCI sector as a whole and develop financially sustainable mechanisms for improved provision of financial services nationwide and especially in targeted rural communities. Technical support capacity will be developed through the transfer of training and TA technology to entities responsible for SCI sector development and supervision and to local organizations through partnerships with the contracted international and national firms. The evaluation and supervision mechanisms the CNBV is putting in place in consultation with the sector and with specialized technical assistance (notably from Canada, Germany and the USA) enhance the probability of long run sustainability for the savings and credit institutions.

8. Lessons learned from past operations in the country/sector

The proposed project relies on lessons from experience in financial sector development and rural and microfinance outreach expansion projects both in Mexico and internationally. International experience and best practice strongly indicate the need for an effectively regulated and supervised non-bank sector as a precondition for the sound growth and development of these financial intermediaries. Lessons have been drawn from the Canadian and German systems of delegated supervision as a means for providing cost effective prudential oversight for numerous intermediaries, as is the case in Mexico. The Rural Finance TA Loan closed in late 1999 also provided several important lessons regarding the development of more broadly accessible financial services in Mexico, which serve as inputs into the design of the proposed project. First, the project now closed was focused solely on encouraging large, commercial banks to extend their presence in rural areas, which represented a significant investment in new

infrastructure and staff and the development of knowledge of rural economic activities. Partly as a result of the financial crisis, but also due to the pursuit of alternative, profitable opportunities, the interest of the commercial banks was much less than expected. The proposed project will work instead with those financial intermediaries which are already working with clients from a broad range of income groups and geographic areas, including poor and rural households, and for whom the incremental costs of extending client outreach are lower. The focus will be on improving management systems, staff productivity and design of appropriate products which will permit increased leverage of the institutions' existing investments in infrastructure and staff. Second, the previous project sought to convince commercial banks that investment in rural banking was a profitable opportunity. By contrast, the design of the marginal areas outreach expansion component of the proposed project is based on the expressed demand of institutions already working in these areas. Third, experience elsewhere has demonstrated that to reach low-income households where literacy rates are low and functional literacy is practically nonexistent, important efforts need to be made in the area of social intermediation. This is particularly important given that the history of subsidized credit and lax financial discipline practiced by government agencies impairs the ability of rural entrepreneurs and households to knowingly and responsibly enter into financial transactions. Awareness raising and assistance at the community level, provided for in this project, are therefore essential to improve the likelihood of successful rural finance. Finally, most previous efforts have excluded the non-bank sector, with the notable exception of CGAP's investment in the NGO Compartamos, perhaps the only "success story" in microfinance in Mexico. This project builds upon and applies to non-bank financial institutions a model of specialized assistance and advice similar to the one used in Compartamos, in Financiera Calpia (El Salvador), Bancosol (Bolivia) and Banco del Estado (Chile) to name a few in LAC, which offers a reasonable likelihood of success for rural Mexico. Several lessons related to provision of TA to develop village and institutional capacity for financial intermediation have been identified and incorporated into the project design. These lessons are consistent with the general lessons which emerge from technical assistance projects:ñ TA should be demand driven;ñ Beneficiaries of the TA should be involved in the design of the TA product as well as the delivery mechanism;ñ Access to TA should be based on expressions of interest either through payment or technical requirements;ñ Existing institutional environment should be well understood and inform TA program design;ñ Program should have a core set of quantitative and qualitative performance indicators which are monitored regularly and providers held accountable;ñ TA program design should be flexible to permit modifications in response to feedback from M&E;ñ TA suppliers have to be well qualified and sensitive to local environment;ñ External TA providers have to provide strong supervision and management oversight of subcontracted staff;ñ Supervision of large and complex TA contracts require sufficient and qualified staff in the project management units.

9. Program of Targeted Intervention (PTI) Y

10. Environment Aspects (including any public consultation)

Issues : None

11. Contact Point:

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12. For information on other project related documents contact:

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Note: This is information on an evolving project. Certain components may not be necessarily included in the final project.

This PID was processed by the InfoShop during the week ending May 31, 2002.