1. Country and Sector Background

Overview of Access to Financial Services. Access to financial services in Mexico is limited and costly. Penetration rate is low, with 74% of its municipalities, supporting 22% of its population, having no bank branch. Regional variations are intense with south/south-east and central regions having 87% and 77% of their municipalities without any bank branch. About 75% of Mexico is urban; yet 85% of the adult population in the urban areas (metro-cities) have had no dealings with the formal financial sector institutions. Participation rates in formal financial markets are below those in other Latin American countries of lower per capita income (e.g., Colombia, Peru). These are particularly low for both rural agriculture and non-agriculture enterprises, and very low for individual entrepreneurs and farmers, with household participation rates in the single digits for both savings and credit services.

The low level of formal financial services entails high transaction costs for the unbanked, particularly in areas relating to payments for utility services, remittances from abroad, cashing of checks by non-bank accounts holders (including transfer payments under government social programs, such as Procampo and Oportunidades), high interest rates on alternative credit, and low earnings on savings.

Almost 75% of Mexico City homeowners have borrowed funds for housing investment. Also, savings are maintained in informal avenues by a large proportion of both banked and unbanked segments. There is a demand for financial services with client-oriented features. Offer of such financial services from alternative sources such as Banco Azteca, providing unsecured loans at relatively high rates, and savings options with small deposit amounts at relatively low interest rates have been hugely successful notching up almost 2 million clients in two years of operation.

Clearly, there is an underserved but bankable population, and poverty is not the only factor resulting in low levels of access to financial services. Supply side factors such as inadequate points-of-service network, inappropriate financial products, cumbersome procedural issues relating to opening of accounts, minimum balance required in the accounts, among others, are equally important constraints.

Industry Structure and Reform Program. Institutional factors underlying the limited and costly access to financial services were a severe contraction of the banking system following the 1995 currency crisis, and until recently a non-bank savings and credit sector which, for the most part, was weak and unsupervised. Against this background, Government embarked on a strategy to strengthen all types of financial intermediaries, bank and non-bank.
The commercial banks reform resulted in significantly stronger banks following a vigorous consolidation phase. However, despite a 50% increase in assets over the last five years, deposit and lending activity actually declined, most banking products offered are for high-income clients, savings products offered by almost all banks would result in loss in value to a middle/low-income client, and bank branch location has clustered around business and high-income residential areas. The reasons for such a scenario are understandable: target clientele perceived to present special risks and challenges - informality, low capacity to generate bankable projects, lack of collateral, volatile income, low savings, high transaction costs - and servicing such clientele is perceived as risky and costly. The reform process did not facilitate the expansion of financial services to the underserved urban and rural population.

A number of legal and regulatory reforms were also initiated to improve the efficiency and transparency of development banks’ operations, notably, to orient them toward developing rural financial markets, limiting their capacity to provide subsidies, taking them out of deposit taking, and moving them toward a second-tier lending role. BANRURAL, the main rural and agriculture bank with first-tier lending is now liquidated, and FIRA, the second major player in rural and agriculture sector lending, is mainly a second-tier lender operating through commercial banks and SCI segment. Clearly, in terms of outreach and access to financial services, the impact of the reforms in the development banking segment is limited, since this segment operates mainly through commercial banks’ and the SCI branch network.

Government Strategy to deepen access to financial services. The existing SCI sector has a comparative advantage in expanding outreach since the sector is widely dispersed: only a small number of entities have a national presence; the great majority of institutions have a local presence. The sector, however, consists of about 600 institutions: not all are authorized to mobilize savings; not all are regulated and supervised; and they have various legal forms (cooperatives and associations, credit unions, among others). The sector is also characterized by deficiencies in accounting, governance and self-regulation aspects.

Creating a regulatory environment, and leaving the SCI sector to resolve its deficiencies over time could take an extraordinarily long time with high social, economic and political costs. The government launched a comprehensive strategy that combines legal and regulatory reforms with a substantial public investment in creating and strengthening capacity of the SCI institutions and the regulatory agencies for supervision. The total one-time sector upgrade investment is expected at about US$150 million.

Key legal and institutional reforms were initiated: Ley de Ahorro y Crédito Popular in April 2001 (which became effective on June 4, 2001), and the creation in the same year of the Banco del Ahorro Nacional y Servicios Financieros (BANSEFI), as legal successor of the Patronato del Ahorro Nacional, and with an enhanced development role vis á vis the SCI sector, acting as the nodal bank to channel and coordinate government assistance for sector strengthening. The Comisión Nacional Bancaria y de Valores (CNBV), already the regulator for banks and capital markets, became the sole regulatory and supervisory authority for the SCI entities, having the responsibility for issuing all regulations associated with the new law.

BANSEFI strategy to assist the SCI sector. Existing institutions face a deadline of June 2005 to meet the legal requirements for certification, which include adopting one of the two acceptable legal forms, purchasing private deposit insurance, having an accounting and financial management system that meets CNBV standards, regular reporting and supervision, demonstrated financial viability, and effective governance structures. Only those institutions which qualify will be authorized to remain in operation. The legal aspects (certification requirements, operational classification, supervision, reporting, and liquidation) are detailed in Annex 15.

Left to themselves, a very large number of potentially certifiable SCIs would probably not be able to meet the requirements for certification, and would have to be liquidated. To maintain a reasonably robust sector size, which is crucial to achieve the objective of deeper penetration, and a wider access to financial services, BANSEFI launched a sector strengthening initiative in 2002, with support from the World Bank - Savings and Credit Sector Strengthening & TA Services.
Project (“on-going project”). This project is in line with the proposed government strategy, and consists of: (a) providing specialized technical assistance to the institutions to ready them for certification, or in a worst case scenario, for liquidation; (b) training sector staff in key areas of accounting, risk management, credit analyses, governance, and management; (c) developing capacity within the sector for regulation and auxiliary supervision; (d) testing a small pilot technology platform; (e) providing assistance to institutions in marginal areas to deepen outreach; (f) providing basic training and numerical literacy to poor, marginal and vulnerable communities; and (g) carrying out sector wide studies, and installing a strong M&E system to inform sector development policy. BANSEFI is administering this government investment off-balance sheet.

Challenges facing the SCI sector. Since the launching of the BANSEFI initiative over the last 12 months, several new challenges have emerged. These are detailed in Annex 1, and can broadly be grouped as follows:
(a) a higher than expected demand for the technical assistance program under the on-going project to assist entities with certification;
(b) a need for second generation legal requirements to be put in place: accounting, deposit insurance, regulatory reporting, among others;
(c) a need to address the longer term financial viability of assisted entities in the sector: identifying solutions to reduce transaction costs, enhance incomes, improve management and portfolio quality, and sector integration, particularly through technology upgrade; and
(d) a logical follow-up to reinforce entity certification with initiatives to achieve the objective of deepening sector penetration to reach out to the underserved population, partly through technology and partly through a portfolio of financial products which is responsive to the needs of the underserved population, including field-testing some products for refinement and wider adoption.

2. Project Development Objective and Indicators
Project Development Objective. The project will help the government of Mexico develop a robust SCI sector, consisting of a large number of entities which are compliant with the law, financially viable, operationally effective, managerially sound, technologically upgraded, and having an enhanced level of outreach and access to financial services by the underserved Mexican population.

Key performance indicators are as follows:
• About 195 entities assisted under the project certified by CNBV to operate as independent or merged entities, or identified for liquidation; and an additional 40 entities with appropriate plans and/or implemented strategy to deepen penetration and outreach;¹
• Procedures for liquidation of unviable entities initiated by the government (could be about 10% of the universe of 420 entities assisted under this and the on-going project)²;
• Deposit Protection Fund established for at least one Federation/Confederation;
• At least 45% market penetration for the Technology Platform achieved (about 100 of the 240 entities in the resulting consolidated sector adopt the platform);
• At least 90% of the participating entities show satisfactory outcomes in accounting and governance aspects (internal controls), as evaluated in the process of auxiliary supervision implemented by the CNBV and the supervision committees at federation level; and
• Clients of the sector increased from 4 million to about 9 million.

¹ The consultant carries out the diagnosticts and classifies the entity into one of the four groups: A: Institution ready for certification; B: Institutions that will have to implement a stabilization program before they will be eligible to apply for authorization; C: Institutions that require overhaul and financial support to strengthen their capital. This includes institutions that will require a merger, spin off, or major reorganization process; and D: Institutions that are incapable of meeting the minimum requirements for certification, and will have to be liquidated or dissolved.
² The on-going project supports TA for about 375 entities; about 150 of these entities require more intensive and in-depth TA for which funds are not available under the on-going project. These are being supported under this project. About 40 of the 375 entities are ready for more strategic inputs focusing on improving access and outreach, for which too funds are a constraint under the on-going project. These entities will be supported under this project. About 45 entities have indicated their desire to seek TA for the first time.
³ About 40 entities are expected to be liquidated in total, about 20 under each project.
The National Development Plan of Mexico envisions the Mexican economy to demonstrate, among others, the two key attributes of human development and competitive growth. These two attributes are represented in the three objectives of: (a) increasing and expanding competitiveness; (b) promoting balanced regional development that includes all population segments; and (c) increasing equity and equality of opportunity. The 2004 Country Assistance Strategy (FY 2005 through FY 2008) supports the Mexican government’s efforts to achieve these three objectives through initiatives under the two broad themes of: (a) reducing poverty and inequality; and (b) increasing competitiveness.

Reducing poverty and inequality. The CAS highlights incidence of acute poverty in rural areas, and a skewed regional development. It suggests improving access to financial services to enhance the poor’s ability to save, invest and manage risks. It also recommends that sustainable poverty reduction should go beyond mere human capital development, and suggests economic empowerment of the poor by helping them to build physical and financial assets that would provide a means to better cope with economic shocks.

Increasing competitiveness. The CAS also indicates that a broad-based financial sector is crucial to enhanced competitiveness, and suggests access to financial services for individuals, entrepreneurs, small and medium enterprises, and the agriculture sector to achieve: (a) competitiveness with increased employment opportunities and improved income distribution; and (b) a more regionally balanced development.

The proposed operation clearly supports the 2004 CAS objectives. It will: (a) deepen the outreach of the non-bank financial sector, and widen access to financial services by the underserved Mexican population, particularly in rural areas; (b) promote “bancarization” of hitherto unbanked segments of the population and economic units, integrating them into the global economy; and (c) facilitate monetization of physical assets, contributing to financial empowerment. It builds on the financial sector strengthening objectives embodied in the Bank Restructuring Facility Projects (Number 67491 and 71323), the Rural Finance Development Structural Adjustment Loan Project (Number 74655), and the on-going Savings and Credit Sector Strengthening & TA Services Project (Number 70108). It also complements the other proposed financial operations identified in the 2004 CAS to reform the development banking institutions, and is in line with the suggestions emanating from recent sector work studies.

3. Rationale for Bank Involvement

Innovativeness of the government policy. The government strategy has a number of very innovative features. It is holistic, and covers a range of issues relating to prudential oversight, auxiliary supervision, deepening outreach, legal reform, institutional reform, technical assistance at the SCI entity level, strengthening regulatory and supervision capacity. It blends public sector action and private initiative, focusing on sustainable and profitable SCIs. It attempts to improve the financial viability of small SCIs by centralizing services that offer economies of scale at BANSEFI and the federations/confederation level. In this sense, the policy approach seeks a balance between cooperation and competition. Moreover, the approach also seeks to enhance the social policy program implementation, by linking social transfers (Oportunidades and Procampo) to "bancarization" of the poor (opening bank accounts to effect such transfers), mainly through the technology platform. It is an initiative worth partnering with the government of Mexico.

On-going Bank support to implement the policy. The Bank has endorsed its support to this sector development policy through interventions under the on-going project. The Bank had also agreed during the preparation of the on-going project that the requirement of technology upgrade would be addressed in a parallel/follow-on project. The rationale for this project is justified on two grounds: (a) to complement the technical assistance program initiated under the on-going project to ensure that the objective of having a robust number of certified entities in the sector is achieved; (b) to invest in “public good”, namely, technology, to have minimum standards of accounting and reporting in the sector entities through homogenous accounting and financial management systems, to improve the credibility and cost-effectiveness of regulatory supervision, to make the sector more efficient, cost-effective, integrated, and inter-linked, and to achieve the broader development objective of enhanced outreach and access to financial services.
The technical assistance program is a once-and-for-all "smart" subsidy. Given the initial diverse financial health of the SCIs, a reimbursable technical assistance approach could have excluded potentially certifiable SCIs willing to, but unable to, afford these services required to meet certification standards. Developing the technology platform represents a public good investment for orderly sector development, which will be offered for adoption by the entities as a “fee-for-service” proposition. In the absence of this public-good investment, the technology needs could be met by individual entities but at varying levels of quality and cost, compromising: (a) system credibility; (b) possibility of improved financial performance; (c) economies of scale in procurement; and (d) the objective of deepening outreach.

Comparative advantage of the Bank. There are three value propositions which place the Bank in a position of comparative advantage to operate in partnership with the government of Mexico in its effort to reform the SCI sector: (a) a good understanding of the Mexican financial sector; (b) considerable international experience on various aspects relating to this sector; and (c) a portfolio of completed and on-going projects in this sector in Mexico.

Understanding of the Mexican financial sector. 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, pension, insurance and capital markets, as well as rural development programs. The Bank has also done considerable sector work notably the 2002 FSAP (joint with the IMF), the Rural Finance Savings Mobilization study (Report 21286-ME, 2001), the Mexico Policy Notes, Finance (2000), and the on-going, Mexico City-Access to Financial Services for the Poor. The project capitalizes on the Bank’s reservoir of Mexican financial sector knowledge.

International experience in financial sector aspects. The Bank has: (a) an in-depth knowledge of regulatory, supervision, legal and banking environment elsewhere in the world, including other countries in this region; (b) accumulated considerable international experience in working with banks on payments systems, automation of operations, and the technology associated with extensive service networks; (c) international experience in rural and micro-finance sector and related institutions; and (d) an understanding of the deposit insurance and institutional capacity building needs in the financial sector elsewhere in the world.

Portfolio of projects in Mexican financial sector. The Bank has assisted with several projects. These include: the completed Bank Restructuring Facility projects, the Savings and Credit Sector Strengthening & TA project, the Rural Finance Development SAL (supporting the liquidation of BANRURAL and the concomitant creation of the Financiera Rural), and a loan in support of reforms in housing finance market. All of these projects have assisted, or are assisting, with the strengthening of the financial sector, including SCI segment, to deepen outreach, and expand access of financial services to the underserved Mexican population. This project will promote Bank portfolio synergy in this sector.

4. Project description
The project is expected to cost US$160 million (Bank share: US$75.5 million, including a US$1.5 million contingency, and a US$0.75 million front-end loan processing fee; Government of Mexico share: US$14.6 million; stakeholder/entity share: US$69.9 million), and have a duration of 4.5 years, starting July 1, 2004. The project has four main components: (a) strengthening sector institutions; (b) developing a technology platform; (c) monitoring and evaluation, studies, and information dissemination; and (d) project management. Each component is discussed below briefly.

Component 1: Strengthening sector institutions. This is expected to cost US$13.0 million (Bank share: US$10.8 million), and consists of the following main sub-components:
(a) continuation of technical assistance to institutions due to an increase in the number of institutions offering themselves for certification, classification of a relatively large number of already assessed institutions in “C” and “D” categories, requiring a more focused technical assistance package to ready them for certification, and the longer time required for
the classification exercise due to the range of accounting practices being followed by the institutions. The project will finance technical assistance to about 45 additional institutions (including an outreach and a communication strategy, where these entities are situated in the identified marginal areas), and to about 150 institutions already being assisted under the ongoing project; 

(b) technical assistance to about 40 institutions expected to be classified in categories “A” and “B”, requiring little or no assistance with certification, but which may need strategic inputs to go “beyond certification”, improve their efficiency and effectiveness, and push the sector objective of deepening outreach and access to financial services. These better managed institutions will comprise a critical mass of institutions to field-test new financial products developed under the project to address access-related aspects; 

(c) technical assistance and guidance on aspects relating to the creation and functioning of the Deposit Protection Fund at the federation/confederation level; 

(d) quality assurance, including a consultancy to manage and monitor this component which will become increasingly complex with the number of diagnostics and work plans increasing with a peaking of the classification effort, and maintaining consistency in application of classification guidelines across entities and service providers; and 

(e) training of sector staff (BANSEFI, CNBV, federations, SCIs), which will consist of accounting and financial management (to migrate from existing accounting systems to CNBV prescribed systems), and other topics such as portfolio management, risk management, credit analysis, governance aspects, market analysis and understanding, and management of SCIs at the federation level. It will also include developing capacities in institutions adopting the technology platform-based accounting system.

Component 2: Developing a technology platform. This is expected to cost US$136.9 million (Bank share: US$56.2 million, and consists of the following sub-components: 

(a) hardware, comprising establishing technological capacity at the branches of BANSEFI and the assisted SCIs, data center, and virtual private network (VPN) for connectivity; 

(b) software, comprising development of the applications package, licensing of the software from the supplier for an initial three-year period for assisted entities by which time the platform would have reached a “stable” state for BANSEFI to charge reasonable rates, data warehouse, ERP, and internet banking; 

(c) technical assistance, consisting of quality assurance of the applications package, hardware/data center/VPN modules, a strategy and an organizational plan for BANSEFI’s IT support service, a verification and validation exercise including regression testing to support the maintenance function requirement, and operations support; 

(d) consultancy, consisting of services from an external service provider to manage and monitor the national roll-out of the technology platform in the participating entities and federations; and 

(e) contributions by the entities towards installation and operating costs of the platform.

Component 3: M&E, Studies and Information Dissemination. This is expected to cost US$7.5 million (Bank share: US$6.2 million), and consists of the following sub-components: 

(a) extending the M&E study under the on-going project to include a “sample filling” arrangement which would make up for the households lost in the sample survey through attrition. This will enlarge the sample and improve the credibility and confidence level associated with the data and its interpretation. A second area will be to provide assistance for consultancies to ensure that the various datasets are consistent, and to interpret the household survey data; 

(b) evaluation of the outcomes of specific project interventions through clearly focused studies; 

(c) refocusing the content of the on-going advertising campaign from the need to comply with the law to informing about the change in the complexion of the SCI segment to instill confidence in the existing and potential clients, marketing the benefits of financial intermediation through a certified entity, and disseminating the range of new financial

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4 A pilot has been initiated under the on-going project. The total cost of the technology upgrade is about US$85 million, US$19 million towards the pilot under the on-going project, and US$66 million under this project.
products which the renewed institutions will be offering with the adoption of the technology platform;
(d) conducting studies and workshops, relating to development of new savings and financial products, technology platform pricing study for cost recovery, sector issues related studies, and other topics related to sustainable development more generally; and
(e) disseminating the findings of the M&E outcomes, including any other reports and studies that may be of relevance to the sector. This would essentially take the form of participatory workshops and seminars.

Component 4: Project Management. This is expected to cost US$1.9 million (Bank share: US$1.4 million), and will cover the following two main areas of assistance:
(a) incremental operating costs relating to the BANSEFI IT team which are directly attributable to the scaling-up of the pilot IT initiative; and
(b) incremental operating costs relating to the BANSEFI Core Team, from the date of the closure of the on-going loan to the date of closure of the proposed operation.

5. Financing
Source: ($m.)
BORROWER 14.69
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT 75.5
PARTICIPATING ENTITIES 69.86
Total 160.05

6. Implementation
Project duration, execution and oversight. The project will have a duration of 4.5 years. BANSEFI will be the executing agency for the project. Project oversight will be provided through a Core Team, already created and operational under the on-going project. The Core Team is headed by the Director General of BANSEFI, and consists of representatives from the departments of Planning & Evaluation, Information Technology, Social Communication, and the International Finance Unit. The Core Team will meet every month to assess project implementation performance, identify issues impeding implementation, agree on measures to expedite implementation, address coordination aspects, and provide overall guidance to the departmental teams managing the assigned project activities.

Project implementation and management. All of the project activities will be implemented through consultants and hardware service providers, and managed/coordinated through appropriate departmental teams within BANSEFI. These teams have already been strengthened to handle the additional project work load. Procurement and financial management, including accounting, disbursement, financial reporting, and auditing will be the responsibility of the department of Accounting & Finance, under the overall guidance of the Finance Director.

Accounting and financial management (FM) system. Most project financial management processes will handled within BANSEFI’s normal operations. However, a small unit (International Financial Unit) exists to specifically handle certain project aspects, staffed by a Sub-director, a Financial Manager, and a Procurement Officer. The role of the latter two officials is primarily to gather information prepared in other units, in order to maintain project-specific records and manage project-specific processes such as the preparation of financial reports, disbursement requests, and procurement-related communication with international financiers. Project FM is not fully automated, and BANSEFI is considering procuring an integrated accounting and financial management package to further upgrade the project accounting and information system. FM issues are discussed in more detail in Annex 7 of the PAD.

The counterpart funds arising from the entities are user fees that will be paid by these entities to BANSEFI. As such they are not "in kind" contributions, but cash fees to be paid to, and accounted

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5 In making payments for example, 10 out of 14 procedures are carried out by BANSEFI’s main units, with the other 4 carried out by a project-focused team (Subdirrecion de Financiamiento Internacional-SFI).
Auditing arrangements. The financial audit of the existing project expenditures will be carried out as per the country-wide Terms of Reference for all loan-financed projects in Mexico. The Terms of Reference, and the appointment of the auditor, are the responsibility of the government’s internal auditor, Secretaría de la Función Pública.

For the project, a separate financial audit report will be required to be submitted for every year of project implementation. Since the project has incurred expenditures during FY2003 which are eligible for retroactive funding, it was agreed to have these expenditures audited as part of the FY2003 audit. The appointment of the auditor for the FY2003 audit for the on-going Bank-assisted project has been completed, and as recommended by the Bank, the same auditor has been appointed for the new operation, to avoid duplication in effort, since the same accounting and financial management systems serve both projects.

Disbursement. The project will have a Special Account in a commercial bank. The authorized allocation for the project is US$4.0 million, but the initial deposit into the Special Deposit Account will be limited to US$2.5 million, which would be increased to US$4.0 million after disbursement under the loan aggregates US$10.0 million, should BANSEFI so desire.

Retroactive financing will be allowed for eligible expenditures (expenditures relating to project activities, and for procurements following project-specific procurement procedures agreed with the Bank) incurred after June 1, 2003, but in no case earlier than 12 months prior to the Signing of the Loan, which would be disbursed by the Bank upon declaration of loan effectiveness, limited to US$7.5 million (10% of the loan amount). These expenditures relate to goods for the technology platform (applications package), consultancies for TA (institutional strengthening and the technology platform management), non-consultant services (hardware for the technology platform, data center, VPN), and incremental operating costs (relating to the technology team).

Expenditures relating to TA for institutional strengthening, technology platform, social communication (advertising campaign), and household surveys for evaluation will be financed out of the proceeds of this loan only after categories relating to similar expenditures have been fully committed or disbursed under the loan relating to the on-going project.

Disbursements under the project will be made following the Bank’s transaction-based disbursement procedures. Direct payment method will be used for very large contracts (for applications package and hardware services procurement).

7. Sustainability
Appropriate mechanisms have been built into the project to ensure that benefits emanating from the project interventions are sustained beyond the project period.

Institutional and SCI entity sustainability. The focus of the project is to strengthen the SCI sector and develop sustainable mechanisms for improved financial services provision. Entities are being supported through technical assistance to develop and implement work plans for their long-term financial sustainability. In addition, through the technology platform, the financial viability of the institutions will be further strengthened by reducing transaction costs, improving revenues, and enhancing the quality of management through better MIS and reporting. Supervision capacity will be improved both at the federation and CNBV level which will enable early warning signals to be provided in case of weak entities. Support is also being provided through international experts on the establishment and operationalization of a Deposit Protection Fund. These measures, together with the prudential regulations issued by CNBV, and regular auxiliary supervision by the federations, enhance the probability of long-term sustainability of the SCI entities.

Financial sustainability. The financial sustainability of the entities will be achieved as discussed above. The initial investment in technology provision to the entities is being funded by the project, including the licensing fees for the first three years before the intervention reaches a “stable state”.

for, by BANSEFI. The precise accounting and reporting of these amounts will be confirmed in a visit by a Bank Financial Management Specialist in early May 2005.
All operating expenses will be financed by the entities through a “fee-for-service” scheme based on terminal/transaction hybrid mechanism. An analysis of the incremental financial implications for the entities shows that the technology service will generate enough revenues for the entities to meet the operating costs, and still be a financially rewarding option to be sustained in the longer-term. BANSEFI will embrace this service as a future business proposition.

**Technical sustainability.** This relates to the technology intervention. The core technology platform is appropriate from the technical and operational perspective. The arrangements for hardware, data center, VPN, and connectivity will all be based on “service level” adherence by the service providers to ensure a high level performance. The fee-for-service structure will provide adequate funding for the technical maintenance of the platform. Appropriate support services will be available to assure all participants of technical back-stopping using a combination of skilled implementation support and continuous full-service helpdesk personnel, from federations, BANSEFI and external service providers.

BANSEFI has already established a team of IT professionals to support the design, management, implementation, and maintenance of the platform. This team will gradually expand and get transformed into a business unit, as the technology platform is implemented on a larger scale, to provide a pool of central technical experts, for the entire SCI sector, to monitor the performance of the project technology intervention, review its relevance periodically, and plan and initiate measures for its upgrade in the future.

**8. Lessons Learned from Past Operations in the Country/Sector**

International experience and best practice indicate the need for an effectively regulated and supervised non-bank sector as a precondition for sound growth of these financial intermediaries. Lessons have been drawn from the Canadian and German systems of delegated supervision to provide cost-effective prudential oversight for the large number of SCI intermediaries.

The Rural Finance TA Loan which closed in late 1999, and some on-going projects in Mongolia and Vietnam provide important lessons regarding the development of more broadly accessible financial services: (a) collaborate 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; (b) design the technical assistance component based on the expressed demand of institutions; (c) market the institutions to the clients to engender confidence in the sector and the system; and (d) develop financial products responding to specific client needs. The project design incorporates all these features.

Finally, financial viability of the institutions is crucial to ensuring that no future funding is required to sustain them. In this regard, technology has been identified as an important intervention to improve efficiency, reduce operational costs, deepen the outreach of the institutions, and enhance income streams. Two key considerations (apart from technological integrity) are as follows: (a) the facility needs to be provided on a centralized basis to obtain economies of scale, and be offered to all requesting entities in a spirit of “cooperation and competition”; and (b) the entities should meet all operating expenses as a full-cost recovery strategy to sustain this intervention in the post-project period. The project design incorporates both these features.

**9. Safeguard Policies (including public consultation)**

| Environmental Assessment (OP/BP/GP 4.01) | Yes | No |
| Natural Habitats (OP/BP 4.04) | | X |
| Pest Management (OP 4.09) | | X |
| Cultural Property (OPN 11.03, being revised as OP 4.11) | | | |
| Involuntary Resettlement (OP/BP 4.12) | | | |
| Indigenous Peoples (OD 4.20, being revised as OP 4.10) | | | |
| Forests (OP/BP 4.36) | | | |
| Safety of Dams (OP/BP 4.37) | | | |
Projects in Disputed Areas (OP/BP/GP 7.60) [X] | Projects on International Waterways (OP/BP/GP 7.50) [X]

Provisions made by the project to ensure compliance with applicable safeguard policy. The only policy applicable to the project is OD 4.20: Indigenous Peoples. Under the ongoing project, simplified IPDPs have been prepared for six identified marginal regions, which are identical to the marginal regions in this project. These IPDPs are an input into the Social Development Model (SDM) which uses consultations with identified groups to ascertain their perceptions on savings, credit, and also improvements in mechanisms to better achieve their participation in the project. The outputs of the simplified IPDPs and the SDM are used by the consultants to formulate appropriate strategy at the entity level, focusing particularly on communication and outreach aspects. This approach is already being implemented under the ongoing project.

Safeguard Action Plan. Actions are proposed for this project at four levels: (a) since the marginal regions are identical across the ongoing project and this operation, the same simplified IPDPs and the SDM approach will be adopted by those of the expected 45 additional entities which are situated in the identified marginal regions to address indigenous and vulnerable peoples’ issues; (b) the Terms of Reference of the technical service providers will include focus on this specific aspect, in addition to providing classification and certification support; (c) the component management consultant supporting the Planning and Strategy department at BANSEFI, which will be managing this component, will provide a staff with appropriate expertise and experience in these aspects; and (d) there will be a clear indication of incorporating these aspects in the entity strategy, and regular reporting by the technical service providers on the outcomes.

10. List of Factual Technical Documents


Bank Staff Assessments
- Financial Management Capacity Assessment Report, January and March 2004
- Procurement Capacity Assessment Report, March 2004

Technical Notes Prepared by BANSEFI (November 2003)
- Strategic Aspects of the BANSEFI-based Policy to Increase Access to Financial Services
- Formalization and Consolidation of Savings and Popular Credit Institutions: Entry, Monitoring, and Phasing Out of Institutions
- Costs, Benefits and Evaluation of Viability
- Information Technology Needs, Procurement and Implementation Strategy

Project Implementation Plan for the Technology Platform Component (April 2004)


Updated Operational Manual (April 2004)

Draft Agreement between BANSEFI and Participating SCI Entity relating to the Technology Platform (April 2004)

Draft Procurement Plan for First Year of the Project (April 2004)


* By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas.
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