ICR Review
Operations Evaluation Department

Report Number : ICRR11157

1. Project Data:		Date Posted :	05/30/2002	
PROJ ID:	P067491		Appraisal	Actual
Project Name :	Bank Restructuring	Project Costs (US$M)	505.1	505.1
Country:	Mexico	Loan/Credit (US$M)	505.1	505.1
Sector(s):	Board: FSP - Banking (77%), General finance sector (11%), Central government administration (6%), General industry and trade sector (6%)	Cofinancing (US$M)	0.0	0.0
L/C Number:	L7003			
		Board Approval (FY)		99
Partners involved :		Closing Date	06/30/2001	06/30/2001

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2. Project Objectives and Components

a. Objectives

Supporting the first stage of a program to: (a) resolve the situation of banks which remained insolvent after the 1994-95 crisis, (b) introduce a series of financial sector reforms aimed at preventing a repetition of the banking crisis, and (c) facilitate the resumption of prudent lending to the private sector .

b. Components

(i) Legal reforms to improve incentives in the banking system, including a phase -out of the universal deposit insurance scheme, a streamlined law on bankruptcy, and phase -out of publicly-financed debtor relief initiatives.

(ii) Regulatory reform to improve the capitalization and soundness of the banking system .

(iii) Mergers, acquisitions, and closures of failed banks under supervision of a newly -created Bank Deposit Insurance Institute (IPAB).

(iv) Disposal of certain bank assets under IPAB's control .

c. Comments on Project Cost, Financing and Dates

This programmatic loan was disbursed in three tranches -- US$200 million upon effectiveness in February 2000 in support of up-front reform measures already completed by the Borrower (see Section 3 below), and two floating tranches of US$150 million each disbursed against milestones involving the closure or merger of specified troubled commercial banks in June and December of 2000.

3. Achievement of Relevant Objectives:

All policy reform measures supported by this loan received final passage in law within a year of loan approval :

(i) Congress approved, and the President signed, laws in 1999 to: phase out the universal deposit insurance scheme over a five-year period, replacing it with one mandating limited coverage; facilitate speedier remedies to repossess debtor assets in bankruptcy proceedings; and provide one last publicly -financed subsidy of debtor obligations.

(ii) In September 1999, the regulatory authorities promulgated reforms raising minimum standards of bank capitalization and soundness, to be phased in between 2000 and 2003.

(iii) A December 1998 law granted IPAB enhanced authority to restructure, force mergers and acquisitions, or close insolvent or troubled banks.

(iv) IPAB was given authority under that same law to dispose of assets which had accumulated under its discredited predecessor through transfer to specialized asset management companies under a defined timetable .

4. Significant Outcomes/Impacts:

(i) The new legislation enabled the Government of Mexico to make explicit the cost of the bank clean -up, and to fund it in sustainable and permanent fashion.

(ii) Insolvent banks holding 23% of total banking sector assets were sold to strong banks .

(iii) IPAB successfully auctioned eight packages of goods, loans, and real estate it had inherited from its predecessor, FOBAPROA.

5. Significant Shortcomings (including non-compliance with safeguard policies):
(i) The new legislation delays removal of the universal insurance on individual deposits until January 2005, prolonging the period of risk to public finances.
(ii) The new legislation provides for a terminal ceiling on insured individual deposits estimated at US$ 130,000 equivalent, high by developing, and even most developed, country standards, thereby leaving in place a diminished, but still excessive, liability of the public sector.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Highly Satisfactory	Satisfactory	ICR outcome rating inconsistent with ICR ratings of Bank and Borrower performance. Moreover, the terminal ceiling on deposit insurance, at more than 13 times average per capita income in Mexico, exposes the public fisc to excessive liability, even after the reforms, while raising additional concerns about the inequitable subsidy provided to large depositors.
Institutional Dev.:	Substantial	High	The reforms supported by this loan have resulted in a major restructuring of incentives, regulation, and competitive conditions in Mexico's banking sector.
Sustainability:	Highly Likely	Highly Likely	
Bank Performance:	Satisfactory	Satisfactory	
Borrower Perf.:	Satisfactory	Satisfactory	
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:
(i) Bank funds should be disbursed to the main agency in charge of implementing policy reforms, in order to strengthen the incentives to work in close collaboration with the Bank.
(ii) Restructuring operations should disburse against the completed resolution of specific bank cases on the basis of specified eligibility criteria.
(iii) An exchange of bad loans for Government paper, by itself, is insufficient to wind up troubled banks facing major cash flow difficulties. The "least cash solution" is often not the "least cost solution".

8. Assessment Recommended? ● Yes ○ No

Why? This was the first of a cluster of programmatic loans approved during 1999-2001, and should be considered for a cluster audit, once the last loan in the series has closed.

9. Comments on Quality of ICR:
An otherwise exemplary ICR would have benefited from more editing. Text is marred by occasional incomplete sentences, as well as by unclear and confusing passages. Borrower comments in spanish should also have been translated.