ICR Review
Operations Evaluation Department

Report Number : ICRR11405

1. Project Data:		Date Posted :	12/23/2002	
PROJ ID :	P040560		Appraisal	Actual
Project Name :	Financial Sector Structural Adjustment Loan	Project Costs (US$M)	300	260
Country:	Ukraine	Loan/Credit (US$M)	300	260
Sector(s):	Board: FSP - Banking (83%), Central government administration (17%)	Cofinancing (US$M)		
L/C Number:	L4391			
		Board Approval (FY)		98
Partners involved :		Closing Date	12/31/1999	02/15/2001

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2. Project Objectives and Components

a. Objectives

The FSSAL's objectives were to:
1. support the balance of payments and budget financing needs for 1998-99
2. strengthen the financial sector as one component for private sector development
3. mitigate the direct budgetary costs of financial sector reforms
4. provide a framework guiding technical assistance from other donors .

b. Components

The FSSAL was to be disbursed in three tranches : the first expected to be in March 1998, the second in December 1998, and the third in June 1999.
The loan's three main components had several sub-components each. They were:
1. Improvements in banking laws
2. Improved banking regulations, including better accounting
3. Restructuring problem banks, including the large Savings Bank

c. Comments on Project Cost, Financing and Dates

The FSSAL was approved after the Russian defaults and followed two $ 300m Sector Adjustment Loans to Ukraine in 1996 (Agriculture and coal). The FSSAL accompanied the Fund's Stand-By Arrangement and the planned Extended Fund Facility and was supported by the technical assistance included in the second Enterprise Development Adjustment Loan. A Financial Services Project was expected to follow the FSSAL, but this did not happen.

The financial sector reforms were based on sector work (the Financial Sector Review) completed in 1995, and updated subsequently.

3. Achievement of Relevant Objectives:

The FSSAL attained its objectives. The Bank's $260m disbursement (after the third tranche was reduced) helped the country maintain macro-economic stability. The first tranche was disbursed in September 1998 and the second in September 1999 (the associated conditions were demanding), but the third tranche was delayed until 2001 and restructured because three of the six associated conditions were not met . One was the law on banking (the other two related to deposit insurance and the Savings Bank restructuring where there were no substantive disagreements with the Bank), which was almost ready and was considered crucial to resolve Bank Ukraine's situation . Since preparations had begun on a Programmatic Adjustment Loan, the Board approved the reduction of the FSSAL's third tranche from $100m to $60, and move the conditions on deposit insurance and the Savings Bank to the PAL that was approved in spring 2001.

Specifically, by the loan's components,
1. The central bank (NBU) law passed in mid-1999 confirmed its powers, although the NBU's supervisory council could compromise its autonomy (other articles mitigate the danger in the Bank's view). The banking law was passed at the end of 2000 and although the deposit insurance law was not passed before the loan closed, it was approved in

September 2001. A Presidential Decree established a Deposit Insurance Fund in 1998, and the law of September 2001 (after the FSAL closed) will govern its operations.
2. International accounting standards were introduced in all banks, and loan classification and provisioning have improved. Banking supervision is headed now by an NBU Vice-Governor, and USAID and EU-Tacis funded technical assistance has helped improve on-site examination. All commercial banks are examined annually under the CAMEL system. Licensing criteria have improved.
3. The agricultural bank (Bank Ukraine) was not in compliance and is being liquidated, and Savings Bank is operating under a modified forbearance regime. The NBU's large bank unit is working with the Savings Bank managers to rationalize its branch network and to resolve bad debts.

4. Significant Outcomes/Impacts:

Banks are being put on a sound footing, and the reforms are headed in the right direction. The loan helped establish the central bank as an effective banking regulator, and improvements in the commercial banks are well underway.

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

The poor coordination between the central bank and other government bodies wasted efforts, and the Financial Sector Policy Board was established at the end of 2000 to avoid this. The Savings Bank restructuring has been disappointing partly because the government still sits on the bank's supervisory council, thereby politicizing some decisions.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Satisfactory	
Institutional Dev.:	Substantial	Substantial	
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:

1 Loans based on sound sector work are more likely to succeed even in a difficult economic and political environment.
2. The shared view within the government is needed for reforms to succeed.

8. Assessment Recommended? ○ Yes ● No

9. Comments on Quality of ICR:

An excellent description of the situation in banks and how the loan dealt with it. It would have been helpful to have a short description of the macro-economic outcomes, especially since financing the balance of payments and budget deficit was an objective of the loan.