



RESTRUCTURING PAPER
ON A
PROPOSED PROJECT RESTRUCTURING
OF
PACIFIC REGIONAL CONNECTIVITY PROGRAM 2:FSM CONNECTIVITY PROJECT
(FORMERLY, PACIFIC REGIONAL CONNECTIVITY PROGRAM 2: PALAU-FSM CONNECTIVITY PROJECT)
APPROVED ON DECEMBER 17, 2014
TO THE FEDERATED STATES OF MICRONESIA

DIGITAL DEVELOPMENT

EAST ASIA AND PACIFIC

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ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
C&MA	Construction and Maintenance Agreement
DOFA	Department of Finance and Administration
DTCI	Department of Transport, Communication and Infrastructure
EMC System	East Micronesia Cable System
FSM	Federated States of Micronesia
FSMTC	FSM Telecommunications Corporation
HANTRU-1	Hannon Armstrong Cable System
ICT	Information and communication technology
IRU	Indefeasible Rights of Use
OAE	Open Access Entity
RP	Restructuring Paper
TRA	Telecommunication Regulation Authority



BASIC DATA

Product Information

Project ID P130592	Financing Instrument Investment Project Financing
Original EA Category Partial Assessment (B)	Current EA Category Partial Assessment (B)
Approval Date 17-Dec-2014	Current Closing Date 30-Nov-2022

Organizations

Borrower Federated States of Micronesia	Responsible Agency Department of Transport, Communication and Infrastructure, Telecommunication Regulation Authority, Federated States of Micronesia Telecommunications Cable Corporation
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Project Development Objective (PDO)

Original PDO

The development objective of the Project is to reduce the cost and increase the availability of ICT services needed to support social and economic development in the Recipient's territory.

Summary Status of Financing

Ln/Cr/Tf	Approval	Signing	Effectiveness	Closing	Net Commitment	Disbursed	Undisbursed
IDA-D1880	31-May-2017	19-Sep-2017		30-Nov-2022	16.20	0	16.61
IDA-D0040	17-Dec-2014	06-Mar-2015	11-Mar-2015	31-Jan-2020	47.50	32.42	12.43

Policy Waiver(s)

Does this restructuring trigger the need for any policy waiver(s)?

No



I. PROJECT STATUS AND RATIONALE FOR RESTRUCTURING

A. Project status

1. The parent project was approved by the Board on December 17, 2014, for an amount of SDR 32,100,000, which was IDA financed. The Financing Agreement between the Recipient and the Association was signed on March 6, 2015, as amended on September 19, 2017. The Project is the FSM portion of a series of IDA interventions in the Pacific Region that aim to reduce the cost and increase the availability of information and communication technology (ICT) services needed to support social and economic development for some of IDA's most remote clients. The Project's development objective is to reduce the cost, and increase the availability of, ICT services needed to support social and economic development in the Recipient's country. The Project provides financing for new international connectivity infrastructure (\$44.5 million) in the form of submarine fiber optic cable connectivity for Yap (subcomponent 1A) and Chuuk (subcomponent 1B), and a one-time partial purchase of international bandwidth for Kosrae (subcomponent 1C). The Project also provides support for technical assistance and project management.
2. An additional financing for the Project in an amount equivalent to SDR 12,000,000 was approved by the Board on May 31, 2017. An Agreement Providing for the Additional Financing and the Amendment and Restatement of the Financing Agreement ("Agreement") (Grant Number D004-FM and Additional Financing Grant Number D1880-FM), dated September 19, 2017, as revised through a corrigendum dated May 22, 2018, was executed by the Recipient and the Bank. The additional financing supports the Project and finances the costs associated with the restructuring and scaling up of the original Project as follows: (a) modification of Component 1C of the Project to finance the costs to the FSM of its share of the proposed East Micronesia Cable (EMC) system that will connect Kiribati (Tarawa), Nauru and FSM (Kosrae) to Guam via the existing HANTRU-1 cable system and landing point in FSM (Pohnpei), including ancillary works and facilities; (b) scaling up of Component 2 of the Project to provide additional technical assistance to FSM for Project advisory services; and (c) scaling up of Component 3 of the Project to support additional Project management and administrative support services to strengthen the capacity of the Government of FSM to deliver these new and additional activities.
3. The additional financing also effected a Level 1 restructuring to the original Project comprising of the following amendments: (a) revision of the Project Development Objective; (b) modification of activities under Component 1C of the Project and scaling up of activities under Component 2 and Component 3 of the Project; (c) revision of the implementation covenants of the Project to reflect the proposed restructuring and additional financing, and the recent development of the FSM's ICT sector; (d) deletion of Category 1(b) of the withdrawal table in Section IV.A.2 of Schedule 2 to the Financing Agreement for the Project and reallocation of funds under such Category, which was never disbursed, to Category 1(a); (e) revision of the results framework to measure the outcomes associated with the revised PDO, revised scope of activities and the extended Project duration; (f) revision to apply the World Bank Procurement Regulations for Investment Project Financing (IPF) Borrowers, dated July 2016, to the procurement activities required under Component 1C, Component 2 and Component 3 of the Project; (g) revision of the name of the Project from "Pacific Regional Connectivity Program Phase 2: Palau-FSM Connectivity Project" to "Pacific Regional Connectivity Program Phase 2: FSM Connectivity Project"; and (h) extension of the closing date of the original IDA grant (IDA Grant No. D004-FM) from January 31, 2020 to November 30, 2022.



4. The overall Implementation Rating is Moderately Satisfactory (MS) in the most recent Implementation Status and Results Report. The overall disbursement rate for the Project, including the additional financing which is not yet effective, is 52%. Disbursements under the parent project (IDA-D0040) is 71%. The Withdrawal Conditions for withdrawals under Category 1(a) and Category 3, as set out in Section IV.B.1(b) and Section IV.B.1(d), respectively, of Schedule 2 to the Financing Agreement, have been satisfied. The FSM Open Access Entity (OAE) and Telecommunication Regulation Authority (TRA) have both been established and made operational. The installation process for the Cable System for Yap is complete and the cable entered into service on June 28, 2018. Installation of the Cable System for Chuuk is also complete and the cable entered into service on April 27, 2019. The terms of the collaboration between FSM, Kiribati and Nauru for the supply, installation and operation of the EMC system have also been agreed, pursuant to a Construction and Maintenance Agreement (C&MA) and IRU Deed signed by the responsible implementing entities for each of the three countries on April 15, 2019. Draft procurement documents for the supply and installation of the EMC system have been prepared and submitted to the Association and the ADB for review.
5. The effectiveness conditions for the additional financing have not yet been satisfied and therefore the additional financing and restructuring of the Project is not yet effective. The conditions of effectiveness, as listed in Sections 2.01(a) to (q) of the Agreement, and their status, are described in Section IV of this RP. In the period since the additional financing was signed, the Recipient has made substantial progress towards meeting the effectiveness conditions. The only remaining effectiveness conditions not yet satisfied are Sections 2.01(j), (k) (m) and (q) of the Agreement. The receipt and adoption of Project Operations Manuals by the Recipient and the Project Implementing Entities is a dated covenant in the Amended and Restated Financing Agreement, pursuant to Section I.G.1 of Schedule 2. This covenant was complied with on June 5, 2019.
6. A first extension was processed to extend the Effectiveness Deadline of the Agreement from June 19, 2018 to October 19, 2018. A second extension was subsequently processed to extend the effectiveness deadline until June 30, 2019. This would be the third restructuring of the Project.

B. Rationale for restructuring

7. Effectiveness of the additional financing needs to be met urgently. Without these additional funds, the Recipient has insufficient resources to implement the Project. In addition, it will have significant regional implications as the additional financing is necessary to enable FSM to participate in the regional EMC system which includes the Republic of Kiribati and the Republic of Nauru. This regional corporation provides an opportunity for Kiribati and Nauru and Kosrae State (FSM) to be connected through a cable system. If any one country were unable to participate in the EMC system, the financial, economic and technical assumptions underpinning the Project would change. Any remaining partners would be required to provide additional financial resources which may not be available. Kiribati's participation in the EMC system is financed by the Association under the Kiribati Connectivity Project (P159632). Nauru's participation is being financed by the ADB.
8. The EMC parties expect to launch the bidding process by the end of June 2019 and FSM needs to be actively engaged in this process. The C&MA provides that all parties must agree unanimously before the bidding process can be launched or a supplier selected to install the EMC system. Until the additional financing is effective, FSM will be unable to approve the publication of the bidding process and will need to delay the EMC parties. A delay of six months or more would likely trigger a redesign of the project by Kiribati and Nauru, potentially in favor of exploring alternative route(s) at substantially increased costs to those parties.



9. This RP seeks to amend the effectiveness conditions to align them to the current context and risk. While Government has made considerable progress towards satisfying Sections 2.01(j), (k) (m) and (q) of the Agreement, there is insufficient time to complete these actions prior to the effectiveness deadline on June 30, 2019. Due to the overall timing pressures under the collaboration with Nauru and Kiribati on the EMC system, it is neither practicable nor necessary for the achievement of the PDO to seek a further extension of the effectiveness deadline. Any risks related to financing for Kiribati and Nauru under Sections 2.01(j) and (k) are addressed through the C&MA and the procurement processes for procuring a supplier(s) for the EMC system under Component 1. The linkages between the satisfactory fulfillment of Section 2.01(m) and 2.01(q) and the achievement of the PDO can be secured by including new dated covenants to ensure timely completion of all other implementation arrangements required for Part 1 (Section 2.01(m)) and the TRA making rules pursuant to the Telecommunications Act (Section 2.01(q)).

Sections 2.01(j) and (k)

10. The Recipient has made substantial progress on meeting the effectiveness conditions. There is no longer any need to carry over the conditions imposed under Sections 2.01(j) and (k). The legal agreements for the provision of the Kiribati IDA Financing and Nauru ADB Financing have become effective and while all conditions to the disbursement of the funds have not yet been satisfied, the C&MA provides that no decision to select a supplier or proceed with the installation of the EMC system can proceed without the unanimous consent of all three parties, including Kiribati and Nauru. This requirement may not be abridged or amended without prior review by the World Bank and the ADB. The procurement of the EMC system under category one also cannot proceed without prior review and no objection by the World Bank and ADB. Completion of these requirements by Kiribati and Nauru is expected by the end of June 2019. The ADB has advised that it has not imposed any cross-conditionality on Nauru similar to Section 2.01(k).

11. There is a very low risk of nonperformance by Kiribati or Nauru, as evidenced by: (a) financing agreements entered into by the World Bank and Kiribati and by the ADB and Nauru providing grant financing for these activities; and (b) the agreement of all the parties to the C&MA and EMC IRU Deed setting out the terms of the collaboration among the parties for the installation and operation of the cable system. However, if either Kiribati or Nauru were unable to satisfy the withdrawal conditions imposed by World Bank or ADB, or secure alternative financing, it may trigger a request by the Recipient for a further restructuring of the Project. However, such event would not impact the ability of the Recipient to achieve the PDO.

Sections 2.01(m) and (q)

12. Satisfaction of Sections 2.01(m) and (q) are significantly delayed, but on track for completion by March 31, 2020. These remaining actions pertain to the domestic regulatory environment in FSM and its readiness to support new private sector investment. Satisfactory fulfillment of these conditions are not prerequisites to the launch of the bidding process for the EMC system under Category one. The Recipient has demonstrated its commitment to fulfilling these requirements. The TRA is moving quickly to complete those actions needed to give effect to the Telecommunications Law of 2014. Draft licensing rules will be released publicly for consultation in June 2019. These rules are expected to be finalized and promulgated by Q4 2019. An information memorandum and marketing materials to encourage new private sector investment in FSM is expected to be released publicly by the end of 2019. A presentation to international operators marketing the FSM telecom sector as “open for business” is planned for January 2020 at the PTC annual event in Honolulu.

13. In addition to restating these obligations Sections 2.01(m) and (q) as dated covenants to be complied with by no later than March 31, 2020, any residual risk of backsliding on the commitment of the Recipient to promote



competition and new private sector-led investment can be dealt with through the inclusion of conditionality under the proposed Phase 2 Digital FSM Project (P170718) which is proposed for approval in FY20. Delaying the effectiveness of the additional financing would not increase the likelihood of success, but political support for the Project overall may weaken if FSM cannot participate in the EMC.

14. The date of the midterm review is currently indicated as not later than February 1, 2019. This will be revised to be completed by not later than November 30, 2019.

15. The Recipient remains committed to the Project. No other changes to the Project are needed to ensure its viability.

II. DESCRIPTION OF PROPOSED CHANGES

16. The following changes are proposed:

- a. Revise the language in Section 2.01 of the Agreement to delete Section 2.01(j), Section 2.01(k), Section 2.01(m) and Section 2.01(q).
- b. Insert a new provision in the Amended and Restated Financing Agreement which would provide that the Recipient shall, by no later than March 31, 2020, provide evidence satisfactory to the Association that all other implementation arrangements required for Part 1 of the Project, satisfactory to the Association and as agreed with the Recipient, have been completed.
- c. Insert a new provision in the Amended and Restated Financing Agreement which would provide that the Recipient shall by no later than March 31, 2020, provide evidence satisfactory to the Association that the Office of the Regulator has, pursuant to the Telecommunications Act, made: (a) licensing rules for communications networks and services; (b) spectrum licensing rules; and (c) interconnection and access rules, including wholesale prices and pricing principles to guarantee open and nondiscriminatory access to bottleneck facilities and the provision of wholesale services, satisfactory to the Bank.

17. No other changes are proposed.

I. SUMMARY OF CHANGES

	Changed	Not Changed
Legal Covenants	✓	
Other Change(s)	✓	
Implementing Agency		✓
DDO Status		✓
Project's Development Objectives		✓
Results Framework		✓



Components and Cost		✓
Loan Closing Date(s)		✓
Cancellations Proposed		✓
Reallocation between Disbursement Categories		✓
Disbursements Arrangements		✓
Disbursement Estimates		✓
Overall Risk Rating		✓
Safeguard Policies Triggered		✓
EA category		✓
Institutional Arrangements		✓
Financial Management		✓
Procurement		✓
Implementation Schedule		✓
Economic and Financial Analysis		✓
Technical Analysis		✓
Social Analysis		✓
Environmental Analysis		✓

IV. DETAILED CHANGE(S)

LEGAL COVENANTS

Loan/Credit/TF	Description	Status	Action
IDA-D0040	Finance Agreement :Competitive Framework-FSM (1) Description :Ensure implementation of the Telecommunications Act of 2014, in particular those aspects which support a competitive ICT sector, including licensing, wholesale access, guarantees around open access to international communications infrastructure & the creation & operationalization of an independent regulatory authority to oversee market	Not complied with	No Change



	activities--Financing Agreement (FA) Sch 2.I.D. Frequency :CONTINUOUS		
IDA-D0040	Finance Agreement :Competitive Framework-FSM (2) Description :For FSM Open Access Entity: appoint directors, mgmt., staff; adopt by-laws & governance arrangements, business & marketing plan, organizational plan; put in place financing arrangements ensuring adequate capitalization & operational financing including to address contingencies-FA Sch 2, I, B, 2. Frequency :CONTINUOUS	Not complied with	No Change
IDA-D0040	Finance Agreement :Competitive Framework-FSM (3) Description :Ensure that FSM Open Access Entity & FSMTC shall not compete against each other in the supply of connectivity services utilizing satellite or submarine fiber optic cable(s); where FSMTC owns or controls capacity rights on HANTRU1 between Pohnpei and Guam, it shall supply such services to FSM Open Access Entity free of charge, including system access, on terms as may be demanded- Sch 2, I, B, 4(h) Frequency :CONTINUOUS	Not complied with	No Change
IDA-D0040	Finance Agreement :Project Coordinator Description :The Recipient shall appoint, by not later than three months after the Effective Date, and thereafter maintain throughout the period of Project implementation, a Project coordinator within DTCL, with qualifications and experience and under terms of reference acceptable to the Association, to be responsible for supporting DTCL, DoFA and the Project Implementing Entities-FA Sch 2.I.A.3. Frequency :CONTINUOUS	Complied with	No Change
IDA-D0040	Finance Agreement :Financial management specialist Description :The Recipient shall, by not later than three months after the Effective Date, appoint or assign, and thereafter maintain, throughout the period of Project implementation, a financial management specialist within DoFA, with qualifications and experience and under terms of reference acceptable to the Association, to support DTCL with financial management and	Complied with	No Change



reporting for the Project-FA Sch 2.I.A.4. Frequency :CONTINUOUS			
IDA-D0040	The Recipient shall by Mar 31 2020 furnish satisfactory evidence demonstrating that TRA has pursuant to the Teleco Act made (a) licensing rules for comms networks and services; (b) spectrum licensing rules; and (c) interconnection and access rules, incl. wholesale prices and pricing principles guaranteeing open non-discriminatory access to bottleneck facilities and provision of wholesale services.	Not yet due	New
IDA-D0040	The Recipient shall, by not later than March 31, 2020, ensure, or take all measures required or necessary on its part to ensure, that all other implementation arrangements required for Part 1 of the Project, as satisfactory to the Association and agreed in writing with the Recipient, have been completed.	Not yet due	New



Name	Description of Condition	Status	Proposed change
2.01 (a)	The execution and delivery of the Agreement Providing for the Additional Financing and the Amendment and Restatement of the Financing Agreement on behalf of the Recipient have been duly authorized or ratified by all necessary governmental and corporate actions; and a legal opinion attesting such matter has been received by the Association.	Complete.	None.
2.01 (b)	The FSM Open Access Entity has been established and made operational for the implementation of Part 1 of the Project; and a legal opinion attesting that the establishment of the FSM Open Access Entity complies with the Recipient’s laws has been received by the Association.	Complete.	None.
2.01 (c)	The FSM Open Access Entity Project Agreement has been entered into; and a legal opinion attesting such matter has been received by the Association.	Complete.	None.
2.01 (d)	The FSM Open Access Entity Subsidiary Agreement has been entered into; and a legal opinion attesting such matter has been received by the Association.	Complete.	None.
2.01 (e)	The FSM OAE has obtained all licenses, rights, permits and approvals required for the operation and supply of international and domestic wholesale communication services in the Project areas; and a legal opinion attesting that the FSM OAE has obtained all such required licenses, rights, permits and approvals in accordance with the Recipient’s laws has been received by the Association.	Complete.	None.
2.01 (f)	The FSM Open Access Entity has entered into, or otherwise acquired rights under, one or more Landing Party Agreements in relation to Part 1 of the Project; and a legal opinion attesting such matter has been received by the Association.	Complete.	None.



2.01 (g)	The FSM OAE has entered into an agreement with the FSMTC granting indefeasible rights of use in dark fiber, active wave circuits landing station spaces and other matters required for the operation and supply of international and domestic wholesale communication services in the Project areas, in form and substance satisfactory to the Association; and a legal opinion has been received by the Bank.	Complete.	None.
2.01 (h)	The FSM Open Access Entity has entered into an agreement to secure adequate capacity for the cable serving Yap, Chuuk and the EMC, including Kosrae, to connect to the global telecommunications network; and a legal opinion attesting such matter has been received by the Association.	Complete.	None.
2.01 (i)	The FSM OAE has entered into the Construction & Maintenance Agreement (C&MA), satisfactory to the Association, with Kiribati and Nauru (directly or through their respective designated cable operator) and the C&MA has become effective (except for the effectiveness of this Agreement, if it is a condition of effectiveness in the C&MA); and a legal opinion has been received by the Bank.	Complete.	None.
2.01 (j)	The legal agreements for Kiribati IDA Financing have become effective and all conditions to the disbursement of funds allocated to the construction of the EMC under such legal agreements have been satisfied (except for the condition in Section 2.01 of the Agreement Providing for the AF, if it is a condition of effectiveness or disbursement in the financing agreement for Kiribati IDA Financing).	Not complete. Kiribati IDA Financing is effective. C&MA signed in form satisfactory to the WB. All withdrawal conditions have not yet been satisfied. Project and Subsidiary Agreements, and Legal Opinion, not yet complete.	Delete



2.01 (k)	The Cofinancing Agreement has become effective and all conditions to the disbursement of funds allocated to the construction of the EMC under the Cofinancing Agreement have been satisfied (except for the condition in Section 2.01 of the Agreement Providing for the AF, if it is a condition of effectiveness or disbursement in the Cofinancing Agreement).	Not complete. Nauru ADB Financing Agreement is effective. C&MA signed in form satisfactory to the ADB. Subsidiary Grant Agreement and Legal Opinion and not yet complete.	Delete
2.01 (l)	The Association and the ADB have entered into a memorandum of understanding setting forth the joint arrangements implementation of Part 1(c)(i) of the Project.	Complete.	None.
2.01 (m)	All other implementation arrangements required for Part 1 of the Project, satisfactory to the Association and as agreed with the Recipient, have been completed.	Not complete. Expected by mid 2019.	Delete. Insert new dated covenant requiring completion of this action by no later than March 31, 2020.
2.01 (n)	The Office of the Regulator has been established (in accordance with the Telecommunications Act) and made operational.	Complete.	None.
2.01 (o)	The Office of the Regulator Project Agreement has been entered into; and a legal opinion attesting such matter has been received by the Association.	Complete.	None.
2.01 (p)	The Office of the Regulator Subsidiary Agreement has been entered into; and a legal opinion attesting such matter has been received by the Association.	Complete.	None.



2.01 (q)	The Office of the Regulator has, pursuant to the Telecommunications Act, made: (a) licensing rules for communications networks and services; (b) spectrum licensing rules; and (c) interconnection and access rules, including wholesale prices and pricing principles to guarantee open and nondiscriminatory access to bottleneck facilities and the provision of wholesale services, satisfactory to the Bank.	Not complete. Expected by end 2019 or early 2020.	Delete. Insert new dated covenant requiring the Recipient to, by no later than March 31, 2020, furnish to the Association evidence satisfactory to the Association to demonstrate that the Office of the Regulator has completed this action.
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