

Bank

Summary of the Operation Performance Evaluation Review

July 2004

THE PROJECT

The client bank (the Company) was established in May 1994. After a series of mergers it became the second largest bank in this country of operations. The Company has been a client of the EBRD since 1995, when the Bank provided a line of credit equivalent to €8.5 million, which was fully repaid in 2002. In July 1997, a 10-year housing loan facility was signed. It has been fully disbursed and is expected to be repaid in July 2007.

This Operation Performance Evaluation Review (OPER) considers two projects which focus on supplying long term funds to the Company. These funds were allocated in an economic environment where term financing was not available, either locally or on the international financial markets. The first project is a 10-year subordinated loan for €5 million equivalent, extended by the Bank in January 1998. The loan was repaid early in March 2003. The second project is a bank-to-bank loan of €20 million equivalent, in the form of a line of credit approved in April 1998. This loan had a maturity of seven years and was part-syndicated.

PROJECT RATIONALE

The EBRD's goal in this country of operations has been to support selected banks which have the capacity to develop into leading banks in terms of capital, asset quality and management. The EBRD has provided these banks with financial tools to serve their traditional clients and to acquire new customers.

The two projects under review were consistent with the Bank's aim to provide support to a leading player in the financial sector. In late 1997, transition countries were subject to much economic uncertainty. Extending the subordinated loan during that period had the additional benefit of demonstrating that the EBRD had confidence at the institutional and systemic level, at a time when other financial institutions were reluctant to remain engaged.

ACHIEVEMENT OF OBJECTIVES

Subordinated loan

The subordinated loan extended in January 1998 had three main operational objectives: to enable the Company to increase its long-term lending to private sector enterprises; to enhance competition in the country's banking market; and to improve capital adequacy.

To prevent the economy from overheating, and to ensure adequate capitalisation of banks at a time of international uncertainty, the Central Bank tightened financial regulations. The EBRD's loan enabled the Company to meet the new requirements while continuing to offer its clients a full range of banking services. The other objectives were also achieved. The first loan under review formed a buffer in the Company's capital base. The second loan increased the level of sub-borrower exposure the bank could consider. This strengthened the Company's competitive position in the market.

Line of credit

The credit line had two aims. First, to meet the Company's need for long-term financing for private sector clients. Second, to encourage international banks to extend the maturity of their

lending to the Company, and other banks, by syndicating an amount of the loan. (Syndication would be in the form of a B loan to at least one participating bank.) The loan was fully disbursed to 23 sub-borrowers. The syndication objective was successfully accomplished. Notwithstanding the prepayment of the subordinated loan, the OPER team considers that the project merits a **Good** rating for fulfilling its objectives.

OVERALL ASSESSMENT

Based on its independent assessment of the project's performance, PED assigned a **Successful** overall performance rating. This rating takes into account transition impact, achievement of objectives, environmental impact, additionality and company and project performance.

The overall transition impact has been rated **Satisfactory**, both at corporate and industry level, taking into consideration the fact that the projects were part of the overall Bank strategy in the country of operations. PED believes that each project should be considered in the context of its contribution to creating and maintaining a competitive financial sector. The subordinated loan and the credit facility formed part of this overall strategy, by encouraging the recipient banks to improve their competitiveness in order to remain leaders in the market. As local banks' requirements became more sophisticated, they were able to influence changes in the business behaviour of their borrowing clients.

The Bank's additionality is **Verified at Large**. The Company needed funding at a time when the country's status was not high on the financial markets. By adding the syndication feature to the loan, the EBRD succeeded in bringing it to the international market at a difficult time.

TRANSITION IMPACT AND THE BANK'S ADDITIONALITY

PED assigned a transition impact rating of **Satisfactory** to the syndicated loan and credit line. There was limited opportunity for skills transfer with these two projects. The Company made regular efforts to improve management practices, policies and operational procedures, utilising the expertise of external consultants. Due diligence concluded that the Bank did not require technical assistance for the prudent and effective implementation of the credit line. The Company was already managed and operated to international standards. No support was required or envisaged for the subordinated loan or the credit line. Nevertheless, through implementing the loans, the Company's staff gained experience of working with an international lender, particularly in respect of compliance requirements.

Transition impact at an industry level has been stronger. The loans under review helped the Company to take its business further in a new direction, providing investment finance to corporate clients and providing short-term loans to finance working capital requirements. The loans helped foster competition by enabling the Company to provide medium and longer term financing to corporate customers. There are indications that having a greater supply of loans translated into more competitive pricing for these loans and a higher standard of customer service.

The Bank's additionality is rated **Verified at Large**. The subordinated loan came at a time when the country's stock exchange suffered a dramatic decline. A falling stock market and the repercussions of financial crisis closed off the long term international market for the country, which lacked a domestic bond market.

BANK HANDLING

The Bank responded to the Company's request to increase the amount of its subordinated debt in order to satisfy the Central Bank's new capital adequacy rules. Subsequently the Company asked the EBRD to provide a line of credit for on-lending to private sector clients who needed larger loans with longer term maturities. The PED has assigned a rating of *Good* for bank handling, reflecting the Bank's willingness and capacity to take appropriate decisions in response to rapidly changing circumstances.

MAIN ISSUES AND LESSONS LEARNED

By continuing to work with existing clients during periods of economic uncertainty, the Bank can preserve and increase transition impact. Subject to meeting the Bank's credit requirements, such projects can help countries in their transition towards a market economy by building institutions and by making funds available for on-lending to the real sector in difficult times.

While it is not appropriate to press technical cooperation (TC) on an unwilling recipient, the Bank should be proactive in assessing a client's training needs and in explaining the benefits to the client. In the present case, TC for training was offered during negotiations but declined by the client who expressed scepticism about the benefits. In retrospect, this scepticism may have been rooted in a lack of confidence rather than a careful analysis of training needs. Subsequently, the client acknowledged the benefits of training that took place at a later date as part of another project with the Bank. These benefits may have accrued earlier if the Bank had presented the case more persuasively when negotiating the earlier project.