ICR Review
Operations Evaluation Department

Report Number : ICRR11135

1. Project Data:		Date Posted :	01/29/2002	
PROJ ID :	P055755		Appraisal	Actual
Project Name :	Banking Reform Asst.	Project Costs (US$M)		
Country :	Indonesia	Loan/Credit (US$M)	20	11.01
Sector(s):	Board: FSP - Banking (94%), Law and justice (3%), Central government administration (3%)	Cofinancing (US$M)	0	0
L/C Number :	L4255			
		Board Approval (FY)		98
Partners involved :	None	Closing Date	09/30/2000	07/31/2001
Prepared by :	Reviewed by :	Group Manager :	Group:	
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2. Project Objectives and Components

a. Objectives

The objectives were to assist the Indonesian Government in the resolution of the financial crisis and implement a bank restructuring program.

b. Components

The loan had four components: (i) the evaluation of the rehabilitation plans of financially troubled, but viable, private banks; (ii) the implementation of a program to restructure the state banks; (iii) the strengthening of the examination, supervision and regulatory functions of BI; and (iv) the diagnostic review of the legal and institutional infrastructure for financial sector development.

c. Comments on Project Cost, Financing and Dates

At the time of board approval, the project components were relatively open and had not been fully discussed with or agreed upon by Indonesian counterparts. Only 55 percent of the original loan amount of US$20 million was utilized. Components 1 and 2 accounted for 89% of the amount disbursed. Component 3, modified to support institutional build-up and capacity building of IBRA (who assumed some of the BI activities originally planned to receive technical assistance) accounted for 11 percent of the amount disbursed. No funds were disbursed for component (iv).

3. Achievement of Relevant Objectives:

Components (i) and (ii): Assisted in diagnostic planning, investigation of suspected illegal activities and asset tracing involving a major private bank, financial analysis and bank evaluation. Under diagnostic planning, terms of reference were finalized for diagnostic reviews ("Agreed upon Due Diligence Procedures or ADDPs) conducted by international audit firms for public and private banks, requests for proposals were drafted for diagnostic reviews, and proposal were reviewed and evaluated. Under investigative activities, a consultant conducted corporate and personal asset tracing, gathered evidence and compiled recommendations for possible civil and criminal action against violators of regulations or laws in private banks. Under financial analysis and evaluation, the consultant assisted IBRA by assessing the ADDP reports for both public and private banks and in creating summary reports to support the decision making process for determining and implementing resolution options.

Component (iii): BRAP provided technical assistance for the establishment of IBRA, provided IBRA and IBRA banks with training on sound loan review, classification and provision criteria as well as diagnostic review procedures. Legal advice on laws covering banking regulation, supervision and enforcement capabilities and legal counsel services to assist IBRA were also provided. Components that were prepared but not fully implemented were an operational and governance reviewed and forensic and asset tracing program.

4. Significant Outcomes/Impacts:

Under component (i), the ADDPs assisted IBRA in the evaluation of 37 banks and provided IBRA with an independent report, by international auditing firms, on the asset quality capital position and recapitalizing needs of each bank. The level of insolvency of each bank and the nature of past lending practices, were used by the authorities as the basis for recapitalization or closure (achieved in 5/1999), and for the preparation of investment and management contracts for the recapitalized banks. The recapitalization process was driven by a multilevel, interministerial committee process using transparent and consistent measures on medium -term viability. Consensus was reached between BI, MOF and IBRA on the closure or merger of more than fifty banks and effective nationalization of at least a dozen others.

Under component (ii), the state banking sector was consolidated significantly. Performance contracts established a core strategy in each bank, defining ways to improve their credit practices, risk management and internal controls. Under (iii), IBRA capacity was strengthened.

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

Agreement on a financial sector reform strategy, design of the Banking Reform Assistance Project (BRAP) and specific selection of project components was precluded by frequent changes of key government counterparts, particularly the Minister of Finance (MOF), the Chairman of the Indonesia Bank Restructuring Agency (IBRA) and key members of Board of Governors in Bank Indonesia (BI).The financial health of recapitalized private banks remains fragile and some are not likely to meet BI's year end 2001 capital adequacy requirement of 8 percent. In the state banks, the delays in the recapitalization and extended period of high interest rates has exacerbated their financial health because during recapitalization they received fixed -interest rate bonds. Further decisive measures will be needed for four state banks representing over 50% of banking assets in the system, to bring them to full operational and financial viability.

IBRA's ability to perform its tasks has been hampered by frequent changes in leadership. Its internal control procedures and its independence from external interference remain a serious concern. IBRA's progress in disposal of its assets has been slow.

The Bank fell short in providing IBRA with sufficient direct support in procurement and financial management related issues. While Bank's procurement rules and procedures are well established and suited for investment lending processes, they are not conducive for rapid procurement of highly specialized professional advice. The task manager of the project, as well as the rest of the Special Financial Operations Team (created to deal with the crisis), had no previous experience in supervising Bank operations and had modest knowledge of internal Bank procedures.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Unsatisfactory	Unsatisfactory	
Institutional Dev.:	Modest	Modest	
Sustainability:	Unlikely	Unlikely	
Bank Performance:	Unsatisfactory	Unsatisfactory	
Borrower Perf.:	Unsatisfactory	Unsatisfactory	
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. Provision of complex crisis related technical assistance is difficult within the framework of policies and procedures that were originally created for large investment operations. In a crisis, flexibility in design and rapid and timely delivery are essential and may require a different set of policies and procedures. The interpretation of Bank rules on areas related to the level of fees, conflict of interest, confidentiality and downstream work lengthened the procurement process and delayed the timely provision of assistance. 2. The Special Financial Operations unit created to respond to the crisis contributed to the speed and quality of restructuring efforts, but this type of operation has not proven sustainable within the Bank's organizational structure.

8. Assessment Recommended? ○ Yes ● No

9. Comments on Quality of ICR:

The ICR is of satisfactory quality. It presents a good description of achievements under the various components and the context in which the operation was approved. However, since the ICR dwells at length on the achievements (para 4) of the project, the unsatisfactory rating for outcomes, unlikely rating for sustainability and unsatisfactory Bank performance in the ICR appear to be less than fully supported.