

## TECHNICAL ASSISTANCE COMPLETION REPORT

Division: ECRD/ECGF

<b>TA No. and Name</b> TA 3208-MON: Strengthening Restructuring of the Banking System			<b>Amount Approved: \$220,000</b>	
<b>Executing Agency:</b> Bank of Mongolia (BOM)		<b>Source of Funding:</b> TASF	<b>TA Amount Undisbursed</b> \$5,172.92	<b>TA Amount Utilized</b> \$214,827.08
<b>Date</b>			<b>Completion Date</b>	
<b>Approval</b>	<b>Signing</b>	<b>Fielding of Consultants</b>	<b>Original</b> 31 March 2000	<b>Actual</b> 29 February 2004
17 June 1999	28 July 1999	4 August 1999	<b>Closing Date</b>	
			<b>Original</b> 31 March 2000	<b>Actual</b> 30 April 2004
<b>Description</b>				
<p>At the time of TA approval, the banking system in Mongolia was in a precarious situation, with a number of commercial banks facing liquidity and solvency problems. This was caused by continued Government interference in bank lending, weak prudential regulations, inadequate accounting standards, and the absence of effective debt recovery and bank liquidation framework. ADB's Financial Sector Program Loan<sup>1</sup> (FSPL) represented the first comprehensive policy reform initiative that sought to restore the health of the banking system. The reforms under FSPL included both short-term measures to restore public confidence in the financial sector, as well as medium-term measures to develop legal, regulatory, and institutional infrastructure conducive to the development of the banking sector.</p> <p>Despite the support provided under the piggy-backed TA<sup>2</sup> and TA Loan<sup>3</sup> there were delays in compliance with outstanding FSPL bank restructuring conditions. Problems included resistance to tough restructuring actions and lack of accountability on the part of the commercial banks. These delays in turn resulted in further deterioration in banks' asset quality and financial position. Under these circumstances, the Government of Mongolia requested ADB support for the operational and financial restructuring of three banks: Agriculture Bank (AB), Bank for Investment and Technological Innovation (BITI), and Reconstruction Bank (RB). These three banks jointly accounted for 23% of total assets of the banking system, and over 70% of its nonperforming portfolio.</p> <p>The TA was therefore consistent with Government's priority, and complemented ADB's other activities in Mongolia at the time.</p>				
<b>Objectives and Scope</b>				
<p>The objective of the TA was to develop a restructured and viable banking system in Mongolia. The TA had two key components. The first component was to provide advisory support to the Bank of Mongolia (BoM) for the effective restructuring of AB, BITI, and RB. This included support for (i) developing a restructuring strategy for AB, BITI, and RB; (ii) streamlining operations under the restructuring strategy; and (iii) facilitating the sale, merger, and/or liquidation of the banks. The second component was to provide support for banking supervision development and training, including on-site and off-site activities.</p> <p>The TA design was relevant at the time and the two components complementary. Fundamental restructuring of commercial banks and an improved supervisory framework to prevent further deterioration of bank assets was critical for the successful implementation of FSPL. As the country's financial regulator, the BoM was the appropriate choice for executing agency. The TA was formulated in close consultation with the Government and a number of other donors that were active in the financial sector.</p> <p>The scope of the TA was broadened subsequently. In November 1999, BoM requested that the services of a legal specialist be provided to review the draft Bank Insolvency Law that BoM had prepared. As this law would have direct implications for TA outcomes, it was important that ADB was closely involved in its finalization. A short-term international consultant was recruited for this purpose. In June 2000, as there was substantial savings under the TA (\$81,998), the Government requested assistance for drafting implementing regulations for the newly passed Law on Non-Bank Financial Institutions (NBFIs). Improved regulation of the non-bank sector including savings and credit cooperatives (SCCs) was considered to be critical for the diversification of the financial system as well as to mitigate any risks of contagion between banks and NBFIs. Therefore, the coverage of NBFIs complemented the TA's original objectives.</p> <p>Both the changes to the TA scope were therefore justified, and fully in line with the TA objectives.</p>				

<sup>1</sup> Loan 1510-MON: Financial Sector Program, 1996.

<sup>2</sup> TA 2720-MON: Strengthening the Supervisory and Restructuring Capacity of Bank of Mongolia, 1996.

<sup>3</sup> TA Loan 1510-MON: Upgrading the Skills and Systems of Commercial Banks, 1996.

### Evaluation of Inputs

The TA was well formulated, and reflected the prevailing situation in Mongolia. The terms of reference (TOR) was in line with the TA scope. However, the expectation that one consultant (Banking System Reform Specialist) could effectively fulfill all the activities outlined in the TOR was not realistic. Due to the difficulties in finding a suitable long-term specialist, two short-term Bank Restructuring Advisors were engaged. The changes in TA scope described above also required recruitment of three additional international consultants (Legal Specialist, NBF Specialist, and Regulatory Expert). All 5 consultants completed their tasks in a satisfactory manner.

BoM's support as the Executing Agency was satisfactory. There is no record of fact-finding and inception missions, and only one review mission was fielded. However, ADB had been closely involved in Mongolia's financial sector during the implementation of FSPL and TA implementation was closely monitored during the processing of, and review missions for, the Second Financial Sector Program Loan (FSLP II)<sup>4</sup>, and through regular dialogue with the Government and the consultants recruited under the TA.

TA implementation was delayed significantly, and the TA completion date was extended six times amounting to a cumulative extension of 48 months. Initial delays were largely due to the difficulties in locating appropriate consultants. The savings of \$81,998 under this TA were used to finance some of the consulting services that would otherwise have been financed under FSPL II. However, delays in the loan effectiveness led to significant delays in determining the exact scope of services to be provided under the remaining budget.

### Evaluation of Outputs

The TA outputs contributed significantly to the TA objectives. The main outputs included (i) a detailed restructuring plan for the banking sector, (ii) a revised bankruptcy law, and (iii) a comprehensive report on NBFIs.

The restructuring plan proposed both immediate actions to stabilize the banking sector and a longer-term strategy for developing a viable banking sector. The recommendations formed the basis for the orderly liquidation of BITI and RB and for the successful restructuring and privatization of AB. The bank insolvency law prepared under the TA was in line with international standards and incorporated country-specific considerations. While a separate law on bank insolvency was not adopted, its recommendations were used to make appropriate amendments to the existing bankruptcy law. The consultants' initial report on NBFIs was unsatisfactory and required an additional six months' work to bring it an acceptable standard. The final report included a comprehensive review of the NBF sector and recommendations for the regulation and supervision of NBFIs and SCCs. Under this component, a 5-week training session on risk-based supervision was also conducted.

Due to time constraints and other supervision difficulties facing the BoM at the time, the Restructuring Expert was not able to provide bank supervision training as called for in his terms of reference. With this exception, all other outputs envisaged under the TA were attained.

### Overall Assessment and Rating

The TA is rated as successful.<sup>5</sup> Both the original and revised design were relevant. The delays in TA implementation did not significantly affect the achievement of TA objectives. The TA contributed to the successful implementation of FSPL, as intended, and more generally helped advance the Government's financial sector reform agenda. Its benefits are sustainable.

### Major Lessons Learned

A key lesson that emerged from this TA is that effective coordination among donors is crucial. Several donors including the IMF, World Bank, USAID, and GTZ were actively engaged in the Mongolian banking sector during the design and implementation of this TA. ADB expended considerable efforts into donor consultation and coordination thereby ensuring that different donor activities were consistent and complementary.

Notwithstanding the significant achievements under the TA, the TA objectives would likely have been enhanced with more careful drafting of the consultant TOR. While the TOR was detailed and fully in line with the TA objectives, it was unrealistic to expect that one consultant could effectively fulfill the wide range of tasks that the TA required.

### Recommendations and Follow-Up Actions

The NBF report prepared under the TA includes a detailed analysis of Mongolia's non-bank financial sector and specific recommendations for the regulation and supervision of NBFIs. It is recommended that the planned Third Financial Sector Program Loan which will focus on the development of the non-bank financial sector in Mongolia incorporate the findings and recommendations of the NBF report.

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<sup>4</sup> Loan 1743-MON: Second Financial Sector Program, 2000.

<sup>5</sup> Using OED's criteria for overall performance based on relevance, efficacy, efficiency, sustainability, institutional development and other factors outlined in Guidelines for the *Preparation of Project Performance Audit Reports, September 2000*.