

## TECHNICAL ASSISTANCE COMPLETION REPORT

Division: SAGF

<b>TA No. and Name</b> TA 3580-NEP: Strengthening Corporate and Financial Governance (Technical Assistance Cluster)			<b>Amount Approved:</b> \$3,300,000	
			<b>Revised Amount:</b> \$2,250,000	
<b>Executing Agency:</b> The Ministry of Finance		<b>Source of Funding:</b> Technical Assistance Special Fund (TASF)	<b>Amount Undisbursed:</b> \$268,757	<b>Amount Utilized:</b> \$1,981,243
<b>Date</b>			<b>Completion Date</b>	
<b>Approval</b> 14 Dec 2000	<b>Signing</b> 25 Jul 2001	<b>Fielding of Consultants</b> Various	<b>Original:</b> 31 Dec 2004	<b>Actual:</b> 31 Dec 2006
			<b>Closing Date</b>	
			<b>Original:</b> 31 Dec 2004	<b>Actual:</b> 25 Jul 2007
<b>Description</b>				
<p>The goal of the technical assistance (TA) on Strengthening Corporate and Financial Governance (the TA cluster) was to facilitate financial sector reform and increase the efficiency of financial intermediation for equitable economic growth for Nepal. The immediate objectives of the TA cluster were (i) increased competition for improved financial resource mobilization and intermediation, (ii) reduced information transaction costs to increase the effectiveness of financial intermediation, (iii) improved transparency and disclosure as a basis for sound financial sector risk analysis, and (iv) improved corporate sector governance with an effective enforcement and dispute resolution mechanism. The TA cluster was piggybacked to the Corporate and Financial Governance Project<sup>1</sup> and included six sub TA projects: Sub TA 1: Streamlining Financial, Corporate, and Commercial Legislation; Sub TA 2: Improved Accounting and Auditing Standards in the Public Sector; Sub TA 3: Institutional Strengthening of Nepal Rastra Bank (NRB)-the central bank-for Regulation and Supervision of Rural Finance; Sub TA 4: Developing Nepal's Payment System; Sub TA 5: Financial and Operational Review of Agricultural Development Bank Limited (ADBL) and Nepal Industrial Development Corporation (NIDC); and Sub TA 6: Developing Insurance, Pensions, and Contractual Savings. The TA cluster was to be completed in December 2004. However, after detailed review of each sub TA, the Government and Asian Development Bank (ADB) agreed on the extension of the TA cluster and an addition of two sub TAs utilizing the savings from other sub TAs. The two sub TAs were Sub TA 7: Coordination of Financial Sector and Legislative Reform, and Sub-TA 8: Developing Commercial Small and Medium Enterprise (SME) Finance.</p>				
<b>Expected Impact, Outcome, and Outputs</b>				
<p><b>Sub TA 1</b> was to support the Government in streamlining corporate, commercial, and financial sector legislations to incorporate international practices. Specific outputs included (i) a diagnostic study of corporate laws and legislations, (ii) guiding principles and policy objectives to be addressed through legislations, (iii) drafting support for new legislations, and (iv) recommendations to improve the law enforcement.</p>				
<p><b>Sub TA 2</b> was to assist the Government for improved accounting and auditing standards in the public sector based on the internationally accepted standards. Planned outputs included (i) a transitional plan for adopting international accounting and auditing standards, (ii) capacity development for adopting new standards, (iii) a design of training program for training of trainers, (iv) training of key staff of the Office of the Auditor General, (v) establishment of an independent accounting and auditing standard boards, and (vi) a manual on public sector accounting and auditing practices.</p>				
<p><b>Sub TA 3</b> was to improve the regulatory environment and upgrade NRB's enforcement capacity in supervision and regulation of rural finance institutions (RFIs). Key outputs were (i) a review of the prevailing policy framework for RFIs, and NRB's capacity for supervision and enforcement in RFI regulation, (ii) drafting prudential norms and rules for RFI regulation, (iii) seminars on policies and supervisory frameworks for RFI regulation, and (iv) an assessment and installation of basic information technology requirements in NRB.</p>				
<p><b>Sub TA 4</b> was to upgrade Nepal's payment system for reduced transaction costs for private sector businesses. Expected outputs included (i) policy, operational guidelines, and institutional arrangements for the NRB clearing house; (ii) recommendations to upgrade the payment system; (iii) training for NRB clearing house staff; and (iv) an institutional and operational plan to establish the Nepal Payment Association.</p>				
<p><b>Sub TA 5</b> was to provide detailed audits of the financial and operational positions of ADBL and NIDC for fundamental institutional reforms of those institutions. Planned outputs included (i) assessments of the financial positions and performances, (ii) a review of the existing and potential clientele and market environment, (iii) organizational review and management audit, (iv) credit policies and procedures, and (v) strategic plans for restructuring of ADBL and NIDC (restructuring plans).</p>				

<sup>1</sup> 2000. ADB. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to Nepal for the Corporate and Financial Governance Project*. Manila.

**Sub TA 6** was to facilitate expansion of insurance, pension, and other forms of contractual savings. Expected outputs were (i) recommendations for regulating insurance, pension, and other forms of contractual savings; (ii) draft legislations; (iii) a review of the 1992 Nepal Insurance Act; (iv) an assessment of the operational and financial performance of the National Insurance Company; (v) a review of the financial and operational information on private pension funds and the Employee Provident Fund; (vi) draft amendments to the existing law for private pension funds; and (vii) training for staff in charge of pension and provident funds.

**Sub TA 7**, which was not in the original scope of the TA cluster, was added in July 2001 to coordinate the complex financial sector reform agenda and support the implementation of the TA cluster.

**Sub TA 8** was also added in April 2005 to enhance access to financing of SMEs. Key outputs were a market study, an awareness program to disseminate international good practice on SME finance, and customization of the approach to the conditions in Nepal.

#### **Delivery of Inputs and Conduct of Activities**

The total TA cluster cost was estimated at \$3.3 million from the ADB TA special fund resources to finance approximately 84 international and 132 domestic consultants. The original cost comprised of (i) \$250,000 for sub TA 1, (ii) \$250,000 for sub TA 2, (iii) \$800,000 for sub TA 3, (iv) \$400,000 for sub TA 4, (v) \$850,000 for sub TA 5, and (vi) \$750,000 for sub TA 6. During the implementation, savings were identified from sub TAs and reallocated to the additional sub TAs 7 and 8 for \$173,000 and \$150,000, respectively. By the TA cluster completion, ADB financed the total \$1,981,243 for foreign exchange and local currency costs. The balance of \$268,757 out of the revised TA amount (\$2,250,000) was cancelled and returned to the TA special fund upon the closure of the TA cluster.

During the implementation, ADB missions reviewed the sub TAs at least semi-annually and had substantial interactions with the consultants, Government agencies, and other stakeholders through meetings and workshops. ADB missions were proactive in making recommendations to make revisions in sub TA designs when originally planned approaches were no longer effective. ADB's performance in supervising the TA cluster was considered satisfactory. The quality of the consultants' inputs was also generally satisfactory. They dealt effectively with the constraints to accommodate difficulties derived from the political changes during the TA cluster implementation.

#### **Evaluation of Outputs and Achievement of Outcome**

The implementation was affected by the emergence of insurgency and political instability in Nepal since November 2001. There were three caretaker Governments and the state of emergency during the TA implementation period. The political instability reduced the Government's ability to manage reforms, and affected financial sector reform outcomes of the TA cluster. Specific outcomes of each sub TA are:

**Sub TA 1** was to assist in drafting economic legislations. Assurances under the loan Project (footnote 1) resulted in the promulgation of four legislations: Company Ordinance (2005), Insolvency Ordinance (2005), Secured Transactions Ordinance (2005), and Securities Ordinance (2005). Given the passage of those legislations, Sub TA 1 focused on promoting better understanding of the legislation among the stakeholders with exposure visits and training programs. However, expected outcomes in other areas, especially in improvement of law enforcements, were limited. Sub TA 1 was considered partly successful and completed in December 2006.

For **sub TA 2**, the consultants prepared a draft framework for improving public sector accounting standards and implementing a controlling unit concept for public sector accounting. However, the Office of the Auditor General did not accept the proposed approach stating it was not confirming Nepal's constitution. ADB proposed to redesign sub TA 2 to meet the constitutional requirements. However, the effort was unsuccessful as the executing and implementing agencies were unable to provide adequate commitment and support to the proposal. Subsequently, sub TA 2 was terminated in March 2004. Sub TA 2 was unsuccessful.

**Sub TA 3** involved an evaluation of NRB's regulatory policies and capabilities to regulate RFI. It supported the development of prudential norms, supervision guidelines, operational policies and procedures, and supporting information systems for NRB on RFI regulation. The outputs of sub TA 3 provided a basis for the rural finance regulatory reform agenda for the Rural Finance Sector Development Cluster Program,<sup>2</sup> which was approved in October 2006. Sub TA 3 was successful and completed in March 2005.

**Sub TA 4** aimed to enhance institutional participation, safety of payments, reliability and cost efficiency of the payment system. NRB and other stakeholder agreed to establish a private clearing house company by October 2006. However, the establishment of the clearing house did not materialize and other activities were insufficiently implemented due to the lack of strong commitment by NRB and other stakeholders. The sub TA was closed in December 2006 with little outputs. The outcome of sub TA 4 was considered unsuccessful.

<sup>2</sup> ADB. 2006. *Report and Recommendation of the President to the Board of Directors to Nepal for the Rural Finance Sector Development Cluster Program*. Manila.

**Sub TA 5** produced a financial audit of ADBL and NIDC as well as strategic plans for restructuring those institutions. The consulting services were successfully completed in October 2003 and the Government officially adopted the restructuring plan of ADBL in 2006. The plan for NIDC was not adopted by the Government as it recommended a politically sensitive liquidation option. The ADBL restructuring plan became the framework for the Rural Finance Sector Development Cluster Program (footnote 2), which supports the implementation of the restructuring plan of ADBL as well as other key RFIs. The outcome of sub TA 5 was successful. The sub TA was completed in October 2003.

**Sub TA 6** was to support the development of the enabling policy, regulatory, and supervision framework for insurance, pension funds, and other forms of contractual savings and linked to the subloan 1: Corporate Governance and Capital Markets of the piggybacked loan Project (footnote 1). Sub TA 6 was unable to be implemented because the expected reform actions under the subloan 1 of the Project did not take place. Sub TA 6 was cancelled in September 2005. The sub TA was unsuccessful.

**Sub TA 7** provided necessary administrative and logistical support for the implementation of the TA cluster. However, the consultant was less effective in liaising among the executing, implementing agencies, and ADB. Sub TA 7 was continued until December 2006 and partly successful.

**Sub TA 8** involved a market study and awareness building of financial institutions for a commercial approach to SME finance. The consultants have submitted to the Government a well designed project proposal in January 2006 and held a series of seminars on recommendations to improve SME finance as part of the project design for the planned SME sector Development Program. The sub TA was closed in December 2006 and considered successful.

#### **Overall Assessment and Rating**

The TA cluster's focus on contributing to the acceleration of equitable economic growth through an efficient financial sector was consistent with the Government's strategy (Ninth Plan 1997-2001)<sup>3</sup> and ADB's country assistance plan (2000-2001).<sup>4</sup> The TA cluster was relevant. Although five out of the eight sub TAs were unable to fully yield the expected outcomes, the TA cluster led to several important outcomes including the promulgation of major corporate legislations and adoption of restructuring plan of a key RFI, which laid the foundation for the continued financial sector reform in Nepal after 2002.<sup>5</sup> The TA consultants yielded outputs in line with the expectations. However, some sub TA activities were not matched with appropriate responses by the executing and implementing agencies. The TA cluster was assessed less efficient. Lasting impact varies depending on a sub TA and the sustainability of the TA cluster overall is considered less likely. In terms of overall rating, while some sub TAs failed to meet the expected goals, those were considered to be over ambitious in Nepal's financial sector context at that time and affected by various external factors. The TA cluster as a whole produced important benchmarks for the financial sector reform such as a regulatory framework for NRB, and restructuring plans for major RFIs, in balance, the TA cluster is rated partly successful.<sup>6</sup>

#### **Major Lessons**

The design of the TA cluster well identified sub-sector reform needs for the financial sector in Nepal. The implementation was affected by the changing political environments and Government's policy swing on the financial sector reforms. However, the limited success can also be attributed to the "overdesign" of the TA cluster by involving highly complex components and overly ambitious output targets without due regards to the institutional strengths and implementation capacity of the country. Also, the TA design process lacked a realistic assessment of Nepal's political context at that time, in which there was already the conflict with high likelihood of further instability. Time and efforts required for coordinating with various stakeholders under the cluster modality was also underestimated, resulting in insufficient mutual understanding and cooperation among the Government agencies and ADB.

Those indicate that, when a cluster TA is designed, it should be thoroughly reviewed that the needs and rationale of the cluster modality justify the cost and effort to implement the multiple sub-sector objectives and targets. Target outputs and outcomes shall be rationalized based on sufficient understandings of the executing and implementing agencies' willingness to accept reforms and capacity to carry out planned activities. A contingency plan for possible political instability is also recommended. There is a growing concern by the Government about the overuse of resources for international consultants. The TA budget was over estimated mainly due to the excessive international consultant inputs, which resulted in the cancellation of approximately 40% of the total TA amount. A TA design should include international consultants prudently, and whenever possible, try to maximize the use of local experts.

<sup>3</sup> The Government of Nepal. 1997. *Ninth Plan (1997-2001)*. Kathmandu.

<sup>4</sup> ADB. 1999. *Country Assistance Plan Nepal 2000-2002*. Manila.

<sup>5</sup> The Government adopted the Financial Sector Strategy in 2002 and addressed the reform agenda in Tenth Plan (2002-2007). The agenda included (i) restructuring and privatizing state-owned banks, (ii) improving auditing and accounting standards, (iii) strengthening NRB's monitoring and regulatory functions and capacity, (iv) strengthening the monitoring framework for effective loan recovery, and (v) improving loan quality and banking discipline.

<sup>6</sup> The overall rating of the TCR follows OED's *Guidelines for Preparing Performance Evaluation Reports for Public Sector Operations* (January 2006). According to the Guidelines, the numerical rating score of the TCR is 1.2, which is in the range of partly successful (greater than or equal to 0.8 and less than 1.6).

**Recommendations and Follow-Up Actions**

The constituent assembly election in April 2008 finally led the country into the phase of reconstruction and development of the economy. While the direction of the financial sector reform under the new Government is yet to be announced, the elected policy makers indicated an economic policy orientation with continued reforms and private sector participation. While the financial sector reform made some progress over the last few years, the sector still remains with structural problems including over dominance of the Government in the ownership and management of financial institutions, weak supervisory and regulatory capacity of NRB especially for RFIs, and high nonperforming loans in state-owned financial institutions. In its Three Year Interim Plan (2007-2010),<sup>7</sup> the Government confirmed its commitment to accelerate the broad-based financial sector reform. To support the fragile transitional economy of Nepal, a solid financial sector is necessary and ADB's continued engagement in this sector is highly recommended. Based on the experience of the TA, simple and focused interventions such as in insurance, contractual savings, and/or RFI regulations will be worthwhile to pursue.

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<sup>7</sup> The Government of Nepal. 2007. *Three Year Interim Plan 2007-2010*. Kathmandu.