TECHNICAL ASSISTANCE COMPLETION REPORT

Division: SAPF

TA No., Country and Name			Amount Approved: $1,700,000	
TA 4421-SRI: Implementing Products and Services for the Domestic Debt Market			Revised Amount: Not applicable	
Executing Agency: Ministry of Finance and Planning		**Source of Funding** TASF and Others	**Amount Undisbursed:** $669,694	**Amount Utilized:** $1,030,306
TA Approval Date: 26 October 2004	**TA Signing Date:** 08 December 2004	**Fielding of First Consultant:** 20 June 2005	**TA Completion Date** Original: 31 March 2006 Actual : 31 Dec 2009 **Account Closing Date** Original: 31 March 2006 Actual: 25 Feb 2010	

Description

On 26 October 2004, the Asian Development Bank (ADB) approved the Technical Assistance (TA) project on Implementing Products and Services for the Domestic Debt Market to Sri Lanka for the total amount of $1.7 million, out of which $1.2 million was provided by the Swedish International Development Cooperation Agency (Sida), and $0.5 million by ADB. The project's purpose was to strengthen the domestic debt market through deepening the first-generation financial reforms included in Sri Lanka's policy and regulatory framework; and implementing relevant financial products and services to support the development of a stronger and more competitive financial market. The project was expected to complement (i) Sida's collaboration between Riksbanken (Central Bank of Sweden) and the Central Bank of Sri Lanka (CBSL); (ii) ADB's Private Sector Development Programs[1] and the Small and Medium Enterprise Sector Development Program;[2] (iii) International Monetary Fund (IMF) financial recommendations;[3] and (iv) the World Bank's work in restructuring contractual savings institutions, including pension, and provident fund.

Expected Impact, Outcome, and Outputs

The expected impact of the project was two-fold: (i) deepened financial reforms included in the country's policy and regulatory framework, and (ii) adaptation of relevant financial products and services to support the development of a stronger and more competitive financial market. These goals, as originally stated, were to be the product of seven outcomes (in themselves an ambitious endeavor), including supporting the bond market in asset and risk management, capacity building to introduce securitized bonds, and public awareness campaigns for use of derivatives. There were also seven outputs to yield the outcomes, making the project rather complex in design. They included, among others: (i) introduction of relevant products and services for the debt market; (ii) provision of additional financial products and services, (iii) reduction of overall capital cost and financial risk to the Government and private sector, and (iv) strengthening of financial institutions. The project's primary aim was to provide capacity building assistance in these and other areas.

Delivery of Inputs and Conduct of Activities

The scope of the project work, which clearly impacted the delivery of inputs, was rather broad (the relevant project officers themselves in their BTORs have said as much). By all accounts, the delivery of inputs by the lead consulting firm, Maxwell Stamp, seems to have been acceptable. However, while the Swedish National Debt Office (NDO) was to provide relevant services as part of the partnership, a minor change in scope was effectuated mid-way through the project so that the ex-head of NDO could serve as an individual consultant rather than the NDO itself as a firm provide the services. Maxwell Stamp's work was implemented in 2 phases: (i) phase 1 focused on skills development and training activities on asset and risk management, securitized home mortgage bonds, bond derivatives, and public debt management; and (ii) phase 2 focused on, among others, different activities in areas such as strengthening the curriculum on debt securities, developing a complete reference book on the debt securities market in Sri Lanka, etc. The consulting firm asserted in its final report that by September 2006, close to 2,000 people had participated in training on subjects such as risk management, securitized bonds, bond derivatives, etc. However, there were no baseline target figures to measure whether this could be considered a realistic achievement. The satisfaction rate of such training was said to be 85%, but once again there are no benchmarks to put this in proper perspective).

Towards the end of the original project period, the government requested–and ADB and the co-financing entity (Sida)

[1] ADB. 2000. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for Private Sector Development Program.* Manila; and ADB. 2003. *Technical Assistance to Sri Lanka For Preparing the Private Sector Development Program (Subprogram II)*. Manila.

[2] ADB. 2001. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Democratic Socialist Republic of Sri Lanka for Small and Medium Enterprise Sector Development Program.* Manila.

[3] IMF 2004. *IMF Country Report No. 04/68.* Washington, D.C.

agreed–that the scope, and, therefore the inputs and activities as well, of the project had to be extended. The initial extension of 9 months (due to delays in work) was further increased by 24 months in light of the changes in the project scope largely resulting from the government's adoption of the recommendations of the issues paper on national debt strategy that highlighted the need for more policy-oriented work. The project was further extended to 2009-end, i.e., almost four years after the original closing date. The records on file reveal that several activities were indeed carried out in full, while others were not.[4]

Non-disbursement of a fair amount of project funds (approximately 40%) was an issue. Records show that almost 50% of Sida funds and 20% of ADB funds were not disbursed, even after the long extension of the project period. Of this, the budget item on training had the greatest variance in budgeted vs. disbursed figures.[5]

During a review mission in December 2006, the government requested to refocus the project outputs more on public debt management from training to policy orientation. A debt policy issues paper was prepared (and accepted) focusing on outputs in key strategic areas, including: (i) preparing an integrated framework for domestic and foreign debt management; and (ii) developing investment policies of the large state-owned banks (i.e., People's Bank (PB) and Bank of Ceylon [BOC]), and the Employees' Provident Fund (EPF) to improve their asset and risk management.

With the broader mandate of the project to assist capital market development, it was agreed in mid-project period to re-orient the actual work program toward assisting the Securities Exchange Commission (SEC) on its urgent issue of building a sustainable approach to educate market participants and promote financial literacy to the public on investments. In this regard, the project provided support to the Financial Services Academy in designing a professional certification program for financial sector professionals, and development of detailed contents and curriculum on equity securities. The work of the Academy continues in good stead to this day.

Evaluation of Outputs and Achievement of Outcome

Overall, work on the project outputs can be considered only partially satisfactory. The design of the project itself was weak, with considerable confusion existing between outputs, outcomes, and activities, which further meant that focus on inputs tended to be seen as the primary product or intended outcomes of the project. In this respect, the TA does not seem to have adhered to applicable DMF guidelines.

The key initial objective of the project, excluding the infrastructure bond component, was to develop knowledge and skills in theory and applications of debt securities. In this regard, only 3 out of the 6 components were adequately met relating to: (i) developing skills and training programs to strengthen and upgrade asset and risk management; (ii) strengthening the capacity of the public debt department; and (iii) implementing skills enhancement programs and a training plan for MOF. Towards meeting this objective, skill development programs were designed after taking into account the specific needs of the Sri Lankan market and its participants. Considerable efforts were made in implementing the training programs under the project (although the fact that more than $0.2 million training funds remained unused during the entire project period shows that more could have been done in this area). Furthermore, the records show–and confirmation has been received from project consultants–that the scope of the training outputs was ambitious and could have been made more relevant to the participants' daily work.

The other components related to: (i) developing skills programs to introduce home mortgage securitized bonds; (ii) conducting an awareness campaign and various skills development programs to develop a bond derivative market; and (iii) creating an infrastructure credit insurance guarantee bond to finance a pilot project, were not achieved mainly as a result of change in project focus from training to more output driven policy work, including support of the Treasury and Debt Departments in managing the debt through a debt policy and action plan. The deviation in project focus was said to have been warranted at that time given that regulators still lacked the capacity to move forward with the creation of an enabling regulatory and economic environment for developing a securitized debt market. Given the nascent stages of development of capital market in Sri Lanka, the pre-conditions for developing bond derivatives remain weak and virtually non-existent, and the country needs to develop an efficient and liquid market with sufficient depth in various bond sectors before any meaningful market-based derivatives contracts can be introduced. Whilst the project started the process, there remains a substantial need for further upgrading the expertise of these institutions not only in the area of securitized debt but also in all capital market related areas.

As a result of the project, CBSL has managed to properly address issues related to public debt management and addressing key issues with regard to the pension portfolio of the EPF, which was underperforming largely due to concentration of investment portfolio in low-yielding government securities. Similarly, both BOC and PB still continue to be faced with a similar set of issues regarding debt and investment policies that are largely affected by government borrowing practices and interventions. This is not surprising given the policy situation in Sri Lanka at the time of project implementation when there appeared to be greater need for resources to finance renewed efforts to respond to the

[4] For example, work on the infrastructure bond component for the Colombo South Harbor of the Sri Lanka Ports Authority (SLPA), which was the entity selected for the bond component, was halted pending a decision by the SLPA on the various financing options presented by the consulting team, and it was subsequently removed from the project outputs.

[5] Of the almost $670,000 remaining in the project, approximately $207,000 of funds meant for training, $163,000 for contingency, $130,000 for equipments, and $129,000 for miscellaneous administration and consulting expenses still remained to be disbursed.

conflict and conditions became unfavorable to implement public debt guidelines.

Overall Assessment and Rating

The project is rated as only partially successful. While work on some outputs proceeded more or less on target, the scope and intended outcomes were ambitious to adequately meet capital market development and public debt management objectives, particularly given the lack of firm policy basis for reforms in project-specific areas and the lukewarm government commitment to the project's overall objectives.

The change in the focus of the project, although warranted, seemed to undermine the overall achievement of the original objectives of the project to a large extent. Still, it was able to lay the essential foundation for the development of the domestic debt market in Sri Lanka, and helped in strengthening ADB's work in the country, particularly on the ongoing reforms under the Financial Markets Program for Private Sector Development (FMPSD).[6] The Government benefited from the recommendations under the policy papers on formulation and implementation of a debt market and management strategy that addressed issues related to the overall financial sector. Such recommendations were taken as policy actions under the FMPSD, and the project helped seek a consensus in the design and establishment of a Debt Management Office at CBSL. While the Office did not get the degree of autonomy proposed in the program, the project did provide valuable support in strengthening it and transforming it into a more operationally effective entity.

It is possible that the overall assessment of the project could have been improved had the project not had several project officers at ADB implementing it over the years. Given the length of time of implementation, this may be considered to be an unavoidable risk; yet it seems to have contributed to a degree of discontinuity in project implementation.

Major Lessons

There are several lessons that can be drawn from the implementation of the project:

1. Major changes in project scope (as was the case here in March 2007 while still broadly relevant to the original project objectives) should merit a more fundamental review of the degree of political commitment and the suitability of incorporating the new focus in an existing project just for purposes of administrative and operational efficiency. In any event, renewing a project for almost four years beyond its original closing date (and not for mere administrative purposes) demonstrates that some consideration could at least have been accorded to a new project altogether).

2. The project remained relevant but its impact is yet to be fully evident, other than in a few areas such as the work of the Financial Services Academy. Although the training programs were highly relevant, the MOFP still lacks capacity to use the training obtained. It has yet to have a dedicated division and staff resources to handle capital market development, policy and regulation activities. This demonstrates that training staff members from various functional departments does not necessarily translate into practical use of such knowledge or yield immediate productivity improvements.

3. A valuable lesson of the project is that in work in this sector, any project should coordinate, and align its work, with that of other development partners; in this respect, this project was spot on. It was also well aligned to the planned financial sector portfolio of ADB for the country.

4. It is imperative that any project be properly designed with measurable indicators and targets (including baseline data) specified in the DMF (this was a major lapse in the project at the design stage itself; and indeed the issue had been identified in the interdepartmental feedback although no remedial actions seem to have been taken by the staff).

Recommendations and Follow-Up Actions

Based on the lessons the TA: (i) it is highly desirable that the MOFP have a dedicated capital markets division in charge of development, regulation, as well as domestic and external debt management; (ii) it is necessary to continuously monitor the progress of the policy actions under the FMPSD in order to complement the work achieved under the TA; and (iii) on the administration and financial closure of the TA, it is recommended that the unutilized fund of $669,693 be allocated back to Sida ($580,000) and the ADB TA Special Funds resources ($89,000) at the earliest.

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[6] ADB. 2004. *Report and Recommendation of the President to the Board of Directors for the Proposed Loans – Financial Markets Program for Private Sector Development.* Manila.