

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PARAGUAY

SECTOR FACILITY FOR INSTITUTIONAL STRENGTHENING

**PROGRAM FOR INSTITUTIONAL STRENGTHENING OF THE
NATIONAL CREDIT UNION ADMINISTRATION
(INCOOP)**

(PR-L1011)

LOAN PROPOSAL

This document was prepared by the project team consisting of Felipe Gómez-Acebo (RE1/FI1, Team Leader; Joaquín Domínguez (COF/PR); Alejandro Escobar (SDS/MSM); Dana Martin (LEG); Luis Humberto Ramírez, Luis Porto, and Miguel Ángel Rojo (consultants); and Jorge Ordóñez (RE1/FI1).

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EXECUTIVE SUMMARY

Borrower:	Republic of Paraguay	
Executing agency:	Project Executing Unit for Programmatic Public Banking Operations	
Amount and source:	IDB (OC/IFF):	US\$3,600,000
	Local counterpart:	<u>US\$1,350,000</u>
	Total:	US\$4,950,000
Terms and conditions:	Currency:	U.S. dollar from the Single Currency Facility
	Amortization period:	25 years
	Grace period:	60 months
	Disbursement period:	60 months
	Execution period:	60 months
	Interest rate:	Adjustable
	Inspection and supervision:	0%
	Credit fee:	0.25%
Kind of Operation:	Operation of the Sector Facility for Institutional Strengthening (document GN-2085-2)	
Objectives:	The objective of the program is to contribute to the long-term sustainability of the credit-union sector, thus helping to strengthen financial and production systems overall. The purpose of the program is to have appropriate up-to-date credit union regulations, with an effective system of supervision.	
Components:	1. <i>Update and improve the regulatory framework.</i> This component would: (i) review and improve the sector regulatory framework by preparing technical suggestions as a basis for INCOOP's general pronouncements; and (ii) consequently, provide training to INCOOP personnel on the regulatory changes that are introduced.	
	2. <i>Strengthen supervision and oversight.</i> This component would: (i) propose a model for supervision of sector activities,	

including onsite, offsite, and complementary supervision, as well as support services; and (ii) provide INCOOP with a central credit office, a remote monitoring system, and the necessary training for staff.

3. *Establish a safety net.* This component would: (i) design the structure, functions, operations, scope, and conditions of a Deposit Guarantee Fund; and (ii) create a Stabilization Fund and design its structure, functions, operations, scope, and conditions.
4. *Strengthen the administrative structure.* This component would optimize INCOOP's organizational structure to satisfy regulatory requirements and to conform to the supervision and oversight model proposed for the program.
5. *Create a system for statistical data gathering and dissemination.* This component would create a reliable and timely statistical data system that gives an overview of the sector, to permit policy decision-making and effective regulation and supervision.

**Special
contractual
conditions:**

Three special contractual conditions are envisaged:

- a. As conditions precedent to the first disbursement of the financing, the program executing unit (PEU) must present to the Bank: (i) a work plan with a schedule for carrying it out, showing the main activities including the operational indicators and means of verification proposed for each activity; and (ii) evidence that an agreement has been entered into between the borrower and INCOOP, whereby the former is bound to fulfill its obligations under the program.
- b. Program funds will be used solely for the Stabilization Fund: (i) in a *pari passu* arrangement with the credit union sector; and (ii) to a maximum of US\$800,000.
- c. Insofar as institutional agreements are implemented to make available funds originally intended for the creation and strengthening of the nonbanking oversight agency (envisaged in nonreimbursable technical cooperation operation ATN/MT-7926-PR): (i) such funds would be applied proportionally to components 1 and 2; and (ii) funds released from these components would be allocated to the Stabilization Fund.

The Bank's country and sector strategy:

The Bank's strategy with Paraguay centers on efforts to address the principal challenges to development, as a means of fostering sustainable growth and poverty reduction. The present operation is consistent with this strategy, since it promotes competitiveness and conditions conducive to sustainable economic growth. To this end:

- a. From a financial perspective, the Bank approved the Programmatic Public Financial Reform Operation in 2005, which included two single-tranche policy-based loans (PBLs). The purpose of the first PBL was to restructure second-tier public financial institutions and the purpose of the second was to streamline first-tier public financial activities. The present operation supports the first PBL operation and, given the significance of the credit union sector and the troubles it is facing, will play an essential part of that operation.
- b. From a social perspective, the operation is consistent with the "Building opportunities for the majority" initiative as it targets population groups not at the apex of the economic pyramid that are excluded from participating fully in national economic activity.

Coordination with other multilateral organizations:

This operation fits in with the agreement between the Government of Paraguay and the IMF under the 2003 Stand-by agreement and its May 2006 follow-up. The regulatory strengthening of the credit union sector is vital, due to the size of its deposits, and the role it plays in channeling long-term funding to production.

Environmental and social review:

The operation is not expected to have any direct environmental effects, since the actions envisaged are limited to institutional and regulatory reforms.

Benefits:

The program would contribute to: (i) improving the credit union sector, fostering its stability, growth, competitiveness, transparency, and integrity, and contributing to a greater deepening of the nonbanking financial system; (ii) channeling long-term funding to the productive sector, thus contributing to the country's growth and development; and (iii) expanding financial services to include low-income individuals and people in rural areas.

Risks:

The risks the project faces are adequately mitigated and are concentrated in the following areas: (i) *macroeconomic*, where changes can affect the performance of the credit union and financial sectors; (ii) *political*, where external factors, such as changes in legislation or a lack of political will on the part of the government may hinder the program; (iii) *institutional*, where approvals can be delayed, new regulations related to this project may not be passed, or

institutions involved may not receive timely and reliable information; (iv) *other*, where the credit unions may not understand the program's benefits and show no interest in providing economic support for the safety net or timely and reliable information.

Poverty-targeting and social sector classification:

The operation would not be targeted to poverty reduction (PTI); nor would it qualify as a social-equity enhancing project (SEQ). Nevertheless, it would benefit the population groups targeted in the Bank's new strategy, "Building opportunities for the majority."

Procurement plan::

The PEU may use the single-source selection method in accordance with the Bank's policies for selection and contracting of consultants (document GN-2350-7), if justified and requested by INCOOP, and provided that the technical quality of the outputs would be equivalent to that achieved through a regular selection process. Depending on the nature of the consulting services to be provided and the contributions each eventual collaborator has already made to INCOOP, the PEU may engage: (i) the *World Council of Credit Unions* (WOCCU), for updating prudential regulations; (ii) *Desjardins*, for Auxiliary Supervision and establishment of the Stabilization Fund; (iii) *Deutscher Genossenschafts- und Raiffeisenverband* (DGRV), for the central credit office, financial monitoring system, and remote monitoring system; and (iv) the Swedish Cooperative Center, for training areas.

Disbursement schedule:

Disbursement Schedule						
Source	Year 1	Year 2	Year 3	Year 4	Year 5	Total
IDB	1,263,390	1,424,484	388,901	347,231	175,994	3,600,000
Local	391,493	244,482	299,690	294,949	119,386	1,350,000
Total	1,654,883	1,668,966	688,591	642,180	295,380	4,950,000
%	33%	34%	14%	13%	6%	100%

Performance indicators and monitoring guidelines:

1. *Aim.* Credit unions maintain the level of services provided to the lowest income groups (baseline 700,000 members) and channel funds to the productive sector. This would be verified through reports from INCOOP based on financial and annual reports from the credit unions and the Financial Agency for Development (AFD).
2. *Purpose.* 60 months into the project, type A and type B cooperatives and production cooperatives are fully incorporated into and supervised under an appropriate regulatory framework (only 9 of the 45 type A credit unions are incorporated and none of the type B or production

cooperatives). This would be verified through INCOOP statistics, credit union financial statements and reports, and the program quarterly management reports and midterm evaluation.

3. *Component.* After the conditions precedent to the first disbursement have been fulfilled, the following activities will be carried out by the deadlines specified:
 - a. *Regulatory framework:* (12 months into the program) there will be a consistent and consolidated legal framework, the Standards Department and General Counsel will be functioning, and staff will be trained. Verification will be done through a review of documentation reflecting regulatory changes, implementation plans, and training certification.
 - b. *Supervision and oversight:* (30 months into the program) INCOOP will have a general supervision model (onsite and offsite) designed and running with the respective models for complementary supervision, the central credit office, the remote monitoring system, the institutional filing system, and the personnel training system. Also, methodologies will be established for certifying external audits and opening regional offices. Monitoring will be performed by means of progress reports, operating reports, and operating manuals for each of the systems in place, as well as INCOOP resolutions approving the introduction of proposals.
 - c. *Safety net:* (60 months into the program) INCOOP and the credit union sector will have designed and established a Guarantee Fund and a Stabilization Fund. Verification will be based on final reports outlining the design and structure of these funds, the resolution creating the Stabilization Fund, and the joint *pari passu* disbursements from the fund.
 - d. *Administrative structure:* (48 months into the program) INCOOP will have a new organizational structure, human resources management system, operating technological infrastructure, and an internal control system. Monitoring will be carried out by means of INCOOP's and the consultants' final reports on the proposed organizational structure, the extent to which implementation plans have been fulfilled, and human resources management. Monitoring will also be performed on the basis of

contracts for procurement of technological resources and related invoices.

- e. *Statistical data gathering and dissemination:* (60 months into the program) INCOOP will have a fully operational statistical data system on its website, as well as a historical database and data collection methodology. This will be verified by means of progress and final reports while the systems are being developed and ultimately by their performance when they are introduced.

**Monitoring and
evaluation
reports:**

In accordance with the procedures for sector facilities set out in document GN-2085-2, the Bank's general program monitoring and supervision procedures would apply. The executing agency will prepare a semiannual report describing the rate of advance of the program, the progress made, and the activities scheduled for the following period. Also, within 120 days after the end of each financial year and after the deadline for the last disbursement of financing, the PEU must present to the Bank the financial statements for project PR-L1011, in accordance with the terms of reference previously agreed upon with the Bank. The financial statements must be audited by an independent auditing firm acceptable to the Bank.

A final report must be presented to the Bank upon completion of the operation, outlining the reforms carried out under the program and any future reforms that may be needed.