FINANCIAL SECTOR PROGRAM

(GY-0032)

EXECUTIVE SUMMARY

BORROWER AND GUARANTOR:	The Cooperative Republic of Guyana
EXECUTING AGENCY:	The Ministry of Finance will be the agency responsible for the overall execution of the Program. The Ministry of Legal Affairs will be the executing agency for the Bankable Property Rights sub-program and the Bankers' Association will be the entity responsible for the Rural Finance sub-program.
AMOUNT AND SOURCE:	IDB: US$38 million
FINANCIAL TERMS AND CONDITIONS:	Amortization period: 40 years Disbursement period: 3 years Interest rate: 1% p.a. for first 10 years, 2% p.a. thereafter Inspection and supervision: 1% Credit fee: 0.50%
OBJECTIVES:	The objective of the Program is to create a financial system capable of supporting the increased private sector activity that is needed to develop Guyana. This will be achieved by: improving the safety and soundness of the financial system and increasing its competitiveness; strengthening selected government banks; privatizing three other government-owned banks, and; improving the delivery of financial services to the rural sector. The Government has already taken several important measures to implement the Program. A ministerial order has been given enabling the Bank of Guyana to approve licenses for two new commercial banks. The Government has sold its shares in the Guyana Bank for Trade and Industry to a private investor. It has drafted three important financial laws and Parliament has passed one of them -- the Financial Institutions Act. A Ministerial order has been given which will lead to the merger of the Guyana National Cooperative Bank (GNCB) and the Guyana Cooperative Agricultural and Industrial Development Bank (GAIBANK). And the Cabinet has approved the action plan for the merger of these two banks and the institutional

strengthening of the resulting entity. The IDB provided advice and financial support for these measures during project preparation.

DESCRIPTION: The Program will: lead to the enactment of modern financial legislation that will increase the scope and quality of bank supervision; create an independent central bank and facilitate access to credit by smaller borrowers; support the merger of GAIBANK and GNCB and the strengthening of the resulting institution; promote the sale of the Government's shares in two other financial institutions, and; improve the flow of credit to small farmers and businesses.

The loan will provide fast-disbursing balance-of-payments support of US$38 million. The loan will be disbursed in three tranches upon the fulfillment of financial sector policy conditions contained in the policy matrix and the policy letter. The first tranche of US$12 million will be disbursed after the operation is approved by the Bank. The second tranche is for US$16 million, and the final tranche is for US$10 million. The Government will place part of the first disbursement in an account at the Bank of Guyana to be used to fund the technical support program. The Bankable Property Rights and the Rural Finance sub-programs are expected to be supported by the MIF.

ENVIRONMENTAL CLASSIFICATION: The Environmental Management Committee, at its meeting of May 19, 1993, classified this as a Category II operation.

RISKS: The greatest risk to the success of the reform program is the possibility that the strengthening of the institution created by the merger of GAIBANK and GNCB will not be successful. These two banks have incurred large losses over the past few years and increased competition from the private sector banks is putting more pressure on them. To be successful, the action plan for strengthening the merged bank must be executed promptly and efficiently.

The success of the Program also depends on the continued existence of macroeconomic stability. Guyana has only recently returned to macroeconomic stability and must continue to exercise a cautious monetary and fiscal policy to ensure its continuance.

THE BANK'S COUNTRY AND SECTOR STRATEGY: The Bank's strategy for Guyana is set out in the Country Programming Paper approved in March, 1991. This strategy identifies the financial sector as an

important priority. Accordingly, this operation is consistent with the Bank's strategy. A new strategy is being discussed with Guyana and will be reflected in a Country Paper that is expected to be prepared in May, 1995.

SPECIAL CONTRACTUAL CONDITIONS:

The Program will be governed by a loan contract. The special conditions of the contract are set forth in Annex IV.

EXCEPTIONS TO BANK POLICY:

Two exceptions to the Bank's policies are being requested. An exception to the Bank's procurement policies is being sought in respect of purchases of petroleum and petroleum products, to enable Guyana to enter into purchases for amounts greater than US$5 million without requiring International Competitive Bidding (ICB). An exception is also being requested to waive the Bank's normal limitation of six months on retroactive financing, to permit expenses incurred during the previous twelve months to be financed by the proceeds of the loan.

I. INTRODUCTION

1.1 Since adopting a more participative democracy in the late 1980s, Guyana has taken measures which have led to a return to economic growth and which have laid a foundation for the overall development of the country. Many of these measures were contained in the Economic Recovery Program (ERP), which began in mid-1988. As a result of the ERP, and of the efforts of a support group led by Canada, arrears with the multilateral institutions were cleared; controls on prices, interest rates and the foreign exchange market were eliminated or substantially reduced; a privatization program was began; and new investments began to be made in Guyana. These steps have had a positive effect -- economic growth has been rekindled, while inflation has been reduced and the depreciation of the exchange rate slowed. However, important obstacles remain that are discouraging the private sector from making the investments needed to ensure the continuation of this growth process.

1.2 Many of these obstacles are in the financial sector. Financial legislation and bank regulation are out-of-date and do not cover the activities of many deposit-taking institutions. The two main Government-owned banks are poorly managed and technically bankrupt, presenting a risk to the whole banking system. The privately-managed banks have been overly cautious, investing most of their funds in treasury bills. Consequently, the productive sector receives little support from the financial system while the national treasury suffers large losses from covering the deficits of the government banks. Other obstacles include deficiencies in the laws and in the administrative procedures that govern the giving of collateral in support of loans. As a result of these factors, the Government of Guyana has requested the Bank to provide a financial sector operation to support a program of reforms directed at these problems.

1.3 The program described in this document will: promote modern financial legislation and create an independent central bank; support measures to improve systems for creating "bankable" property rights; support the merger and institutional strengthening of the two largest government banks; and provide for the privatization of three other banks (one of which has already been sold); and establish a program of training and assistance designed to increase the flow of credit to the rural sector. In this way a strong foundation will be laid to support private sector growth and to increase capital formation.

1.4 This program of reforms is being coordinated by the Interamerican Development Bank (IDB), the Multilateral Investment Fund (MIF), the International Bank for Reconstruction and Development (IBRD), the International Monetary Fund (IMF), and the International Fund for Agricultural Development (IFAD). Support from all of these institutions will be provided during a three-year period, with closely coordinated policy reforms and technical assistance

programs. Through these coordinated programs Guyana will receive substantial support for balance of payments purposes and for the modernization of the country's financial infrastructure.

1.5 The amount of the proposed operation is US$38 million. The loan will be at concessionary rates financed from the Bank's Fund for Special Operations (FSO). It will be disbursed in three tranches. Upon meeting conditions described in this Loan Document, the loan will be presented to the IDB Board of Executive Directors. A first tranche of US$12 million will be disbursed upon fulfillment of the agreed conditions. A further US$16 million will be disbursed upon meeting the conditions of the second tranche, and the final disbursement of US$ 10 million will be made when the conditions for the third tranche are met. The World Bank operation, which will also be made on concessionary terms using funds from the International Development Association (IDA), is expected to be for US$21 million (including IDA reflows), and will be accompanied by reimbursable technical assistance funds of US$3.5 million. It will be released in three tranches, over a somewhat longer period. The IMF facility is for the equivalent of approximately US$75 million, spread over a three-year period. The assistance from the MIF and from IFAD is under discussion, and their contributions are expected to be formalized in July, 1995.

1.6 The Government has agreed to finance the technical support for this Program by placing US$3 million in an account at the Bank of Guyana to be used to hire consultants and purchase equipment. The Government and the Bank will agree on the terms of reference for the work to be done as set out in Annex III.

II. FRAME OF REFERENCE

A. Macroeconomic Framework

2.1 Until 1988, Guyana pursued a model of economic development that it called "cooperative socialism", which was characterized by heavy state intervention in the economy. The critical sugar and bauxite sectors were nationalized, government banks were created and government ownership was extended even to consumer goods retailing. Prices and interest rates were controlled and foreign exchange was rationed. As a result, much of Guyana's investment capital fled the country for a more welcoming home abroad or was destroyed as neglected maintenance led to a crumbled infrastructure and Guyana entered a protracted period of economic decline. The effects of these policies were not limited to the destruction of investment capital -- they had an equally damaging effect on the country's stock of human capital. In 1991, GDP was less than it was eight years earlier and so many citizens left Guyana for better prospects abroad that the population actually fell during this period.

2.2 With the economic decline came large public sector deficits, high inflation and a growing reliance on foreign borrowing. New investments were made by the public sector in industry and the bill for imported oil grew to become the single largest debt of the Government. In the early 1980s, the Government began to suspend payments on external debts, both to official and private lenders, and these arrears continued to mount during the decade. By 1990, debt was almost 500% of GDP. The Government made some attempt to deal with these problems in the mid-1980s, but these efforts did not have much impact.

2.3 In 1988 a support group was formed to help Guyana reinsert itself into the international community. The group was led by Canada and the IDB played an important role in this effort. The results of the group's efforts were the clearing of arrears with official agencies and the launching of the Economic Recovery Plan (ERP). The main accomplishments of the ERP were the elimination of price controls and the freeing of interest and exchange rates; the privatization of fourteen companies including the sale of part of the Government's shares in two commercial banks; and a return to monetary and fiscal discipline.

2.4 This program was successful. Although real GDP continued to fall through 1990, the economy turned around nicely with a 8% real rate of growth in 1991 and in 1992 followed by a 13% growth rate in 1993 and approximately 8.5% in 1994. Inflation was brought down from a peak of 102% to around 16% last year. The liberalization of the exchange and interest rate regimes halted the de-monetization of the economy -- banking system liabilities grew rapidly beginning in late 1991 and continued to grow in 1992 and 1993. During this time, the foreign exchange rate stabilized while interest rates (as

measured by the average yield on 90-day treasury bills) fell from 31% in 1991 to 17% in March 1995, and there was a sharp increase in gross international reserves to US$247 million at the end of 1994.

2.5 Despite these successes, total external debt has remained very high at about US$2 billion in recent years as repayments, reschedulings and forgiveness have roughly matched new borrowings to finance public-sector capital investment. About 40% of total debt is owed to multilateral institutions, and about 50% of the debt is bilateral. About US$400 million is owed to Trinidad and Tobago for oil purchases. The elimination of commercial bank arrearages took place in 1992 through a buy-back arrangement financed by a grant from the IDA Debt Reduction Facility at a cost of US$9 million.

2.6 Since 1990, the macroeconomic policy framework has been supported by two successive IMF Enhanced Structural Adjustment Facilities (ESAF) and a World Bank Structural Adjustment Credit. Under these programs the Government has instituted rigorous monetary programming, controlled the level of public expenditures, and restructured the stock of external debt. The World Bank facility has been fully disbursed. The second IMF ESAF is disbursing at a rate that approximately matches repayments owed to the IMF.

2.7 On June 16, the IMF presented its midterm review under the ESAF program and its revised macroeconomic targets for 1995 to the IMF Board of Directors. Under the review, the Fund concluded that macroeconomic performance was not only satisfactory but stronger than envisaged under the Program. In many areas Guyana exceeded its macroeconomic targets. As a result, $13 million of balance of payments support will be disbursed. The next review of the program will be undertaken in March 1996. The Program expires toward the end of 1996, and the Government is expected to start negotiation for a follow-on program next year.

B. Obstacles to Economic Growth

2.8 Although the ERP has helped to restart the process of economic growth, and to begin the process of reinsertion of Guyana into the international community, it has not been sufficient to reverse the effects of twenty years of economic mismanagement. Furthermore, some momentum has been lost, since until recently, there had been few substantive economic reform measures taken since the early years of the ERP. This momentum should be recovered and the gains from opening up the economy that resulted from the ERP should now be consolidated in order to lay a firm foundation to support continued growth and development.

2.9 Three of the most pressing requirements are: a rationalization of the tax system, the implementation of improved systems to collect import tariffs, and the development of a sound financial sector. The World Bank have recently negotiated a Private Sector Development Adjustment Credit (PSDAC) that has sub-programs to: improve customs administration; simplify the income tax regime; and

create a "one-stop shop" for investors in Guyana. Additionally, the PSDAC has a financial sector sub-program with measures that are similar to those contained in this operation.

2.10 The financial sector of Guyana has the following composition:

COMPOSITION OF THE FINANCIAL SYSTEM OF GUYANA

TYPES OF INSTITUTION	PERCENT OF TOTAL SYSTEM ASSETS (%)
Seven commercial banks[1/]	76
Four trust companies	4
A mutually-owned savings bank	6
Six insurance companies	7
The National Insurance Scheme	3
Private pension funds	4
TOTAL	**100**

1/ GAIBANK, the government-owned development bank, is scheduled to be merged into GNCB, the largest government-owned bank, during 1995. Its assets are included in the total given above for the seven commercial banks.

2.11 The legal and regulatory framework of the financial sector is deficient. Prudential regulation is inadequate, and the Bank of Guyana (BOG) lacks the independence necessary to perform its functions. The large government-owned banks, Guyana National Cooperative Bank (GNCB) and Guyana Cooperative Agricultural and Industrial Development Bank (GAIBANK), have performed badly, wasting scarce public funds and, in the case of GNCB, threatening the health of the banking system as a whole. Government involvement in other financial institutions stifles innovation and ties up public funds that could otherwise be used for providing social services. Guyana's small and informal market for shares is not playing a significant role in capital formation. The National Insurance Scheme (NIS) is in need of institutional strengthening to control waste and to enable it to fulfill its role as the country's social security system. The Financial Sector Reform Program is directed at all of these areas except the NIS. By focussing on the most important deficiencies in the financial sector, the Government wishes to achieve rapid results, while recognizing that Guyana's absorptive capacity for reform measures is constrained.

C. Bank Strategy in Guyana

2.12 The Bank's strategy for Guyana is set out in the Country Programming Paper (CPP), approved by the Programming Committee in March, 1991. (A new strategy is being discussed with the authorities and is expected to be approved later in 1995.) The CPP identifies the following areas as priorities: the agriculture sector and sea defenses, electrical energy, road transport, the financial sector and the social sectors (water, urban, and Social Impact Amelioration Program (SIMAP). Investments in the industrial, mining, forestry sectors and in urban rehabilitation are identified as complementary to the priorities mentioned above.

2.13 The project set out in this Loan Document is directed at the financial sector, in fulfillment of the strategic goal in that area. Improvements in the financial sector will support economic growth by facilitating capital formation in all sectors. The operation also contains specific measures to improve the flow of finance to the agricultural sector. The operation will contribute to the other strategic goals indirectly by reducing amounts spent on periodically recapitalizing the government-owned banks, by increasing government revenues from privatization and by contributing to a more active economy from which the Government will be able to harvest larger tax revenues. The funds so saved or obtained can be invested in the other public or social sector targets that form part of the Bank's strategy in Guyana.

D. Relations with Other Multilateral Organizations and External Creditors

2.14 Since 1988 the Government has managed its external debt well. Most of the debt is owed to official lenders. Although the total amounts owed to foreign creditors has remained constant at about US$2.0 billion, the conditions of the debt service have improved. Concessionary lending has replaced debt previously contracted on commercial terms, and several bilateral debt write-offs have been negotiated. This process continues but it is not enough. The debt burden of $2400 per-capita remains crushing, third highest among the Bank's borrowing members.

2.15 The International Monetary Fund approved a second Enhanced Structural Adjustment Facility (ESAF) in June, 1994. The staff report recommending the second ESAF showed that Guyana had performed well with respect to the macroeconomic goals contained in the earlier Facility but that the country had fallen short on the implementation of the structural goals. A mid-term review of the new ESAF by IMF staff was presented to their Board on June 16, 1995, recommendy a tranche disbursement of US$ 13 million.

2.16 The World Bank restarted its activities in Guyana in 1990. It has a portfolio of US$212 million outstanding in Guyana, and an additional US$77 million committed but undisbursed. The World Bank has a pipeline of new operations equal to US$65 million through

1998. The pipeline has operations in sugar, rice, water supply, secondary education, primary health and bauxite mining. Economic policy reform was supported by a Structural Adjustment Credit approved in June, 1990, whose last disbursement of $17 million was made in December 1993.

2.17 The efforts of the major donors are being closely coordinated. Joint missions of the IDB, the World Bank, and the IMF have been held. The financial policy conditions proposed in this operation are very nearly the same as those contained in the World Bank's PSDAC, and all three multilaterals have assisted in the preparation of Guyana's Policy Framework Paper (PFP). The bankable property rights segment of the legal and regulatory framework sub-program have been generously supported with grant aid from the Canadian government. Grants from Japan and Great Britain have supported the privatization process. Grants and loans from the MIF and IFAD are expected to provide support to the Bankable Property Rights and Rural Finance sub-programs.

III. THE SECTOR PROGRAM

3.1 The main objective of the Program is to create a framework for financial system development that will enable the system to grow to the point where it can support the private-sector development that is needed in Guyana. Modernized banking legislation will improve the safety of the system and make it more competitive. Simpler sounder systems for creating bankable property rights would enable more businesses and individuals to provide the collateral that is usually required to obtain financing. Merging the two largest government-owned banks and strengthening the resulting institution will reduce and hopefully eliminate the fiscal costs of covering their losses. Privatizing three other banks will send a positive signal to the business community while raising badly needed revenue for the Government. And measures to increase the flow of credit to the rural sector will increase productivity and reduce poverty in rural areas.

3.2 The Program has four parts. The largest sub-program is directed at introducing new financial legislation. A Financial Institutions Act (FIA) will be enacted to improve the regulation of the system. A new Bank of Guyana Act will improve that institution's functioning by making it into an independent central bank. Legislation governing the creation and execution of security interests will be consolidated into one modern law called the Moveable Property Security Act (MPSA). The office in which security interests are registered will be strengthened. Other laws that are affected by these changes will be amended to bring them into harmony with the new laws. And finally, the Laws of Guyana will be consolidated by incorporating all of the amendments that have occurred since 1976 into the texts of the original laws, enabling the Government to issue an updated set of the Laws of Guyana. The second part of the Program is the merger of GNCB and GAIBANK and the strengthening of the merged institution. The third part of the Program is the sale of the Government's holdings in three other financial institutions. The final component is a program of training and technical assistance to enable financial institutions to lend more to rural areas.

A. <u>Macroeconomic Framework</u>

3.3 The Program requires a stable macroeconomic environment. In March 1995, the IMF undertook a midterm review of its ESAF Program and presented it to its Board of Directors in June 1995. The IMF's assessment of macroeconomic performance was positive since it exceed the defined targets in many areas. During the execution of the Program, the Bank will monitor the macroeconomic performance of Guyana and the Fund's subsequent evaluations with respect to the targets set out under the ESAF program in order the assess the continued stability of the macroeconomic environment.

B. Legal and Regulatory Framework in the Financial Sector

3.4 The legal framework for the financial sector is provided by the Banking Act, the Bank of Guyana Act, and, for most government-owned institutions, the Co-operative Financial Institutions Act (COFA). This framework is affected by a number of other laws which set out the rules for establishing security interests in collateral. These laws are out-of-date and inadequate to protect the health of a banking system in which private sector institutions operate in a market-based, competitive environment.

1. Banking Legislation

3.5 The scope of coverage of the existing Banking Act is very narrow--the Act covers only institutions that take demand deposits. Other important bank-like institutions are not regulated at all, even though they take time deposits from the public. Several institutions routinely take advantage of this loophole by calling themselves "trust companies" instead of banks, while taking time deposits and transforming these into "demand deposits" through an artifice similar to money market funds. They then lend these resources and engage in other "banking" activities. Some of these institutions are related to industrial or commercial groups who may be financing their own activities with the deposits their financial arms gather, rather than reducing the depositors' risks by investing in more diversified portfolios. The public trust is put at risk by these unsupervised institutions, and ultimately, the national treasury is exposed.

3.6 The standards for capitalization and for risk provisioning for banks are insufficient. The capital required by the Banking Act to start a new bank is G$1 million. Devaluation has reduced this amount to the equivalent of about US$8,000. Regulations regarding the background and experience of the shareholders and managers of new banks are deficient. Furthermore, standards of conduct for bank owners, officers and directors do not exist.

3.7 The BOG lacks the legal independence to effectively manage monetary policy and to supervise the financial system. The directors of the BOG are named by the Ministry of Finance (MOF) and the Governor of the BOG reports to the Minister. There are no restrictions on the financial relations between the Central Government and the BOG. Furthermore, many important decisions, e.g., the issuance and enforcement of prudential regulations, the granting of new banking licenses and even the opening of new branches of existing banks, all require the approval of the MOF.

3.8 During the preparation of this project, a joint mission of the Bank, the IMF and the World Bank visited Guyana to analyze the legal foundation of the financial services sector. The mission developed specific recommendations for the reform of Guyana's financial sector laws. These recommendations were elaborated into a body of draft financial legislation that would remedy the

deficiencies mentioned above. The drafts and support material were delivered to the Government in July 1993. As an interim measure, the three institutions also helped the Government draft a ministerial decree that raised, to the equivalent of US$2 million, the level of capital required to start a bank, and which set out selection criteria to be used in judging applications for new banking licenses. This decree was issued in July 1993 and the criteria set out in it were used by the BOG and the MOF to review applications for new banking licenses. As a result, two new licenses were granted during 1994, increasing the population of commercial banks by 40%, while adding US$4 million to the capital of the banking system. The effects of this increased competition are already being seen. The banks are more aggressive, they are providing better services and are lending more to the productive sectors of the economy.

Proposed Action

3.9 The legislative reforms consist of a Financial Institutions Act (FIA), a new Bank of Guyana Act, and selected amendments to the COFA Act, the Dealers in Foreign Currency (Licensing) Act and the Companies Act. The FIA extends the coverage of regulation to include all institutions that take deposits from the public, including the presently unregulated trust companies and the institutions regulated by the COFA Act. Other provisions in the draft FIA would create managerial and integrity standards for officers and directors of financial institutions; confer more extensive regulatory enforcement authority on the Bank of Guyana; require audits and management reviews of licensed institutions by competent external auditors; and establish a process for the voluntary and involuntary winding-up of licensed financial institutions.

3.10 The COFA act is to be amended to eliminate its regulatory functions, since these will be taken over by the Bank of Guyana once the FIA is enacted. The Government will consider, in the future, the complete elimination of COFA and the COFA Act. The Foreign Exchange Dealers act would be amended to give the BOG the ability to request information and conduct inspections of foreign currency dealers. The Companies Act would be amended to cede the jurisdiction for the registration and regulation of financial institutions to the FIA.

3.11 During 1994, the FIA was discussed with the financial community, and some technical changes made. The legislation was passed by Parliament in January 1995. In order for the FIA to be enacted into law, the appropriate order must be issued by the MOF. Once the conforming amendments mentioned in paragraph 3.10 are approved by Parliament, the Ministry will issue the order. **Enactment of the FIA is a condition of presentation of this operation to the Bank's Board of Executive Directors.**

3.12 The new Bank of Guyana Act is designed to create an independent central bank. The new Act will focus the BOG's objective on domestic price and monetary stability, and will confer the powers and resources necessary to allow the BOG to exercise a considerable degree of independence in its central banking and bank supervisory functions. To achieve these objectives, the Act contains provisions to: adopt a monetary policy based on market principles; promote an arms-length relationship between the BOG and the Government; strengthen the capital and reserves of the BOG; and change the way the BOG's directors are appointed by requiring staggered terms of office. The BOG is completing the draft Act, in order to deliver it to the Ministry. **Presentation of the Act by the BOG to the Ministry is a condition for presentation to the Executive Board. The Act must be approved by Cabinet before the disbursement of the second tranche and the Act should be regulated before the third tranche.**

2. "Bankable" Property Rights

3.13 A healthy, growing economy relies on financial institutions to act as intermediaries between savers and borrowers. In their role as intermediaries, these institutions have the responsibility to safeguard their depositor's funds, and collateral plays an important role in providing such safeguards. Furthermore, since easy-to-value collateral simplifies the task of analyzing the capacity of a debtor to service the debt, institutions can process many more transactions when they are able to rely partially on the collateral than they could if they had to gain an expert-level understanding of, for example, each industrial borrower's ability to transform raw materials into revenues and profits.

3.14 Collateral is given when a borrower cedes a property right, such as a land title or an automobile title, to a lender. Hence the term "bankable property rights". Commercial assets, such as inventory, or the right to receive the proceeds of the sale of goods or services, can also be used to secure a loan, when the law and the administrative procedures are clear on these points. Where systems for establishing collateral are cumbersome, banks will lend less and target what lending they do to wealthier clients with established capacities for servicing debt. A legal system that enables borrowers to easily provide lending institutions with collateral, and for a lending institution to easily ascertain its priority, register its interest in that collateral and enforce default remedies, is necessary to promote growth and development and to give smaller borrowers access to the formal financial system.

3.15 In Guyana, the process of securing an interest in collateral and, if necessary, taking action upon default, is time consuming, expensive and unreliable. This is due to problems with the laws themselves -- they are an awkward combination of Roman-Dutch law and British statutory and common law -- and to administrative

problems in the Deeds Registry, the government office in which the rights to collateral (called security interests) are registered. Lastly, there is a more general problem that affects the entire legal foundation of the society. The laws of Guyana have not been edited to reflect amendments made since 1976. Some laws have been amended dozens of times, and the perception of the full text of a law is often a function of the number of the amendments the interested parties have in their possession.

3.16 All of these things make the creation, granting and execution of security interests difficult. The amount of credit provided by the financial system reflects this. At the end of December 1994 deposits in private banks totaled US$292 million, but lending to the private sector was only US$99 million. A more normal ratio is close to one to one, so it is easy to see that if these problems were remedied, the positive effects on lending and on economic growth could be significant.

3.17 During the preparation of this project technical assistance was provided to: (i) review the existing legislation and practices governing security interests, and to make recommendations for a new system; (ii) review the operations of the Deeds Registry Office, and make recommendations to modernize this office and; (iii) conduct a pilot program to update the commercial laws of Guyana and to create a system that can be used to update all of the Laws of Guyana. This effort has left the Ministry of Legal Affairs with:

- the draft text of a Movable Properties Security Act (MPSA),
- recommendations on the modernization of the Registry Office,
- the compiled version of the commercial laws of Guyana, including all of the amendments that have been made over the past twenty years;
- a methodology, using modern desktop publishing techniques, for compiling the rest of the Laws of Guyana, and for keeping them up-to-date in the future.
- the hardware and software necessary to keep the laws up-to-date.

Proposed Action

3.18 The Ministry of Legal Affairs will discuss the draft MPSA with Cabinet, with members of the judiciary and the bar, and with lenders and other affected parties in order to develop the technical adjustments to the draft that may be necessary. Technical assistance will be allocated to facilitate this process through training sessions for these constituencies. The legislation will be presented to Parliament before the target date of July 1996.

3.19 Technical assistance to strengthen the Deeds Registry will be provided. The hardware and software that are used in modern

registry offices to provide an efficient and secure service will be installed, and the staff of the Deeds Registry trained in its use.

3.20 Finally, this project will provide technical assistance to the Ministry of Legal Affairs to bring the remaining laws, ie the non-commercial laws of Guyana, up-to-date. The desktop publishing technology that was provided to the Ministry during project preparation, will be used to create a definitive master copy of the compiled Laws of Guyana. The compiled laws will be checked for accuracy by the Law Review Commission, a government body in the ministry, and these compiled laws will become the new Laws of Guyana once the Law Review Commission approves them. This is expected to be completed before the end of 1995.

3.21 In addition, a simple technology for maintaining the laws up-to-date will be designed. The existence of these laws on easy-to-update computer disks at the Ministry and in law offices will help to insure that they do not fall out-of-date again.

C. Guyana National Cooperative Bank (GNCB) and Guyana Co-operative Agricultural and Industrial Development Bank (GAIBANK)

3.22 Both of these institutions are wholly-owned by the Government. Together they account for 24% of total assets in the financial system. Both have serious financial problems deriving from uncollected loans. As a result, GAIBANK has been a large drain on Guyana's limited fiscal resources and GNCB will be, once it is recapitalized to cover past losses. Together, they are a risk to the entire financial system, which only very recently has returned to normalcy.

3.23 GNCB is the second largest bank in Guyana, after the National Bank for Industry and Commerce. It operates as a commercial bank, taking deposits from the public and making loans and short-term liquid investments. It has twelve branches, many more than any other commercial bank. Customers can also deposit with GNCB through the postal system. This access to deposits through the branch system and the postal system has enabled the bank to increase its deposits significantly over the years, and thus avoid a liquidity crisis or run. In the meantime, the Government's liability to depositors continues to grow.

3.24 GNCB's main problem is bad debts. Of total loans and advances of US$43 million, US$28 million have been provisioned by the end of 1993. Officials of the bank have indicated that much lending was done for political reasons. In many cases, loan documentation is insufficient to stand up in court. Bank rules and procedures for the registration of collateral have been routinely ignored. Attempts to collect on these debts have not produced satisfactory results, although there is evidence of some recent recoveries.

3.25 The bank reported total assets at December 31, 1994 of approximately US$79 million and net worth of US$3 million. However, if a proper accounting is made of the non-performing Guyanese government bonds held by GNCB, the institution would show negative net worth of approximately US$9 million. There is also some evidence that additional provisioning may be required to more accurately reflect the portion of the loan portfolio that can be expected to be collected.

3.26 GNCB is regulated by the COFA Act and the Banking Act. The COFA Act explicitly requires the Government to cover the losses of the institutions governed by it. In 1991 an attempt was made to recapitalize GNCB to cover losses that were already apparent then, but the Government failed to pay in any cash or interest-bearing government bonds to effect the recapitalization. Rather, an account receivable from the treasury was recorded, and this entry was used to make the balance sheet balance. Subsequently, the Government has not performed under the agreement evidencing the receivable, making neither the interest nor capital payments that are due periodically. As a result of this, and the continued bad performance of the loan portfolio, the losses have continued at GNCB.

3.27 GAIBANK, Guyana's development finance institution, is the country's third largest bank. It funded itself with lines of credit from donor agencies (including the IDB) until these sources dried up in 1994, and from the Government. Loans were made to industrial, commercial and agricultural borrowers. GAIBANK was meant to be regulated by the Co-operative Financial Administration, but this regulation was never effective. Since this regulation was not effective, the Government decided that the expenses of the COFA were not justified, and COFA was disbanded, GAIBANK has not been regulated at all for the past two years.

3.28 GAIBANK's track record is characterized by large and continuing losses caused by poor administration and by a lending process that has been affected by political influence. Approximately 60% of the loans on GAIBANK's books are past due. During a recent twelve-month period, 80% of interest payments falling due were not received. Furthermore, the quality of the collateral that GAIBANK holds against loans is poor. There is a lack of clear policy on classifying and estimating collateral worth; inconsistency in the types of collateral demanded for large loans; and the absence of a program to preserve the physical condition and value of collateral.

3.29 It is difficult to get an accurate picture of GAIBANK, because generally accepted accounting procedures are not always followed. Since the bank has been unable to service its debts, many of these payments have to be made by the Government out of the national treasury. This assumption of debts by the central government has been recognized in part through contracts in which the Government has officially taken over the debts, and thereby lifted these liabilities from GAIBANK's balance sheet. As a result of this, and

as a result of under-provisioning for loan losses, GAIBANK's own books show it to be profitable. However, by under-provisioning, it is recognizing more income than it receives, and by passing much of the obligation for its debt service to the Ministry of Finance, it is avoiding one of its largest expenses.

3.30 Several alternative solutions to remedy the problems of GNCB and GAIBANK were considered.

- To continue operating both institutions as public-sector banks.
- To liquidate one or both of the banks.
- To merge the banks and strengthen the resulting entity.
- To merge and strengthen the banks, and to privatize the resulting entity.

3.31 To continue operating both institutions would not solve the problems described above. Liquidation of either bank is not politically feasible at this time. The Government is selling most of its holdings in the financial sector (see paras 3.37 to 3.41). If it were to liquidate either GNCB or GAIBANK it would go from holding a dominating position in the financial sector to holding only a very small one or even no position at all. This is too dramatic a change in the present circumstances. There is much duplication of staff and geographical coverage, and the two institutions' problems mirror one another. There is some scope for savings, and so the Government has decided that the merger/institutional strengthening alternative was preferred. The Government will also consider privatizing the resulting entity if there are interested buyers. The effect of the merger will be to considerably reduce the combined size of the two banks, thereby reducing the exposure of the Government to the liabilities of the public sector banks.

3.32 A full GNCB/GAIBANK merger is not feasible. The bad loans of both institutions would be too heavy an anchor, preventing the merged institution from being able to focus on competing in the new private-sector-dominated banking environment. Although there would be some savings in operational costs from sharing facilities, this would be the only identifiable benefit, and these efficiencies are not material compared to the financial and operational problems that would need to be solved in order to fully merge the two institutions.

3.33 A partial merger is feasible, however, one in which the non-performing loans of both institutions are hived off to a government collection company while the performing loans are concentrated in the surviving entity. (It will not be possible to sell the non-performing loans to a private-sector collector, because these loans are already several years past due and the documentation backing them up is poorly drafted.) In this way, the surviving entity would be strengthened and could concentrate its efforts on achieving a sustainable profitability. Ultimately, the institution

might even be privatized, if a buyer could be found (see para 3.41).

3.34 It will be necessary for GNCB to be recapitalized in order to be able to operate profitably on a sustainable basis. Presently, a large amount of the bank's assets are in the form of non-performing government debt. These assets are supported by liabilities, mainly deposits from the public, that carry a high interest or administrative cost. This imbalance between income generating assets and cost incurring deposits makes it unlikely that GNCB could ever return to profitability on a sustainable basis without a substantial recapitalization.

3.35 The first step in the recapitalization plan is to measure the capital deficiency. When this gap is known, the Government, with the assistance of the Bank of Guyana, the IDB and the IMF, will determine how much of the recapitalization will come in the form of cash injections, how much will be contributed in the form of marketable treasury bills and how much in longer-term government securities. At this time, a schedule for the recapitalization will also be determined that is designed to fit the cost of the recapitalization into the 1996 budget and the IMF program. The IMF advises that the contributions can be substantially accomplished in 1996 without violating the fiscal program guidelines.

Proposed Action

3.36 The Government is proceeding with the merger of GNCB and GAIBANK and the strengthening of the merged bank. An action plan to accomplish this has been approved by Cabinet and a Ministerial order has caused this process to begin. The action plan has three main components: (i) the Government will contract with an experienced team of advisers to help manage GNCB through the merger and strengthening process; (ii) the bad loans of both institutions will be identified and transferred to a government-owned collection company, and; (iii) the merged entity will be recapitalized by replacing the government debt used to recapitalize GNCB in the past with marketable interest-bearing government securities. **Agreement of the action plan, a condition of negotiations, has already been met. Satisfactory execution of the plan would be a condition for presentation to the Executive Board, and for the second and third tranches of the loan.**

D. State Ownership in the Financial Sector

3.37 The Government has equity participation in four major financial institutions. It owns GNCB and GAIBANK outright. In addition, the Government owns 51% of the shares of the National Bank for Industry and Commerce (NBIC), and all of the shares of GNCB Trust. Until the last quarter of 1994, it also owned 30% of the shares of Guyana Bank for Trade and Industry (GBTI).

3.38 NBIC is a profitable bank run much as it would be if it were a completely private institution. The Government would like to sell its participation in NBIC for a variety of reasons. Firstly, by doing this they will free up resources that can be redeployed to other activities that are more appropriate for the Government, such as the providing more social services, paying down government debt or rehabilitating infrastructure. Secondly, since NBIC is already a well-run institution, the Government's shares in it can probably be sold without putting the bank through a time-consuming restructuring process. Lastly, if NBIC is majority-owned by private-sector investors, management will be in a better position to raise new capital and make it grow.

3.39 The Government has prepared a statement of its privatization policy, which sets out its intent to divest itself of the companies named in the document. In addition, the privatization policy statement established an inter-ministerial commission to oversee the process, and a Privatization Unit. This unit was staffed in December 1993. During 1994, the Privatization Unit assisted in the sale of the Government's shares in GBTI.

Proposed Action

3.40 In NBIC the Government intends to sell the 30% investment it holds directly, and in this way transfer control to the private sector. It will retain the 23% that it holds through the NIS on the grounds that these shares are an appropriate holding for a pension fund.

3.41 Until an institution is specifically identified by Cabinet as a priority for privatization,the Government prefers to express its commitment to privatization goals for financial sector institutions in terms of a percentage of their total holdings, instead of in terms of named institutions. This is in order to retain some flexibility over the order of the sales and to be consistent with undertakings made with the World Bank and the IMF. With the sale of its shares in GBTI, the Government has already met the privatization goal for presentation of the loan to the Executive Directors. With the sale of its shares in NBIC, the goal of selling an additional 40% of its holdings in the sector by the second tranche will be met. With the sale of the appropiate holding in one of the remaining institutions, it will meet the condition for the third tranche. Since it is not at all certain that a buyer or buyers could be found for GNCB, the condition for the third tranche reflects this reality and is slightly milder than the Government's own goal. **The conditions are, therefore, that the Government will sell an additional 30% of its holdings in the financial sector before the second tranche,** and that by the third tranche the financial institutions still owned by the Government will constitute no more than 25% of its holdings, as measured with reference to the end-1993 reference point.

COMBINED ASSET VALUES OF THE GOVERNMENT
HOLDINGS IN THE FINANCIAL SECTOR

(as at December 31, 1993)

INSTITUTION	Total assets in G$ billions	PERCENT OF COMBINED ASSET VALUE
GAIBANK	5.56	% 12.14
GNCB	10.76	23.49
GNCB TRUST	1.19	2.60
NBIC	18.42	40.21
GBTI	9.51	20.75
GOMFB	0.06	0.13
GCIS	0.31	0.68
COMBINED ASSET VALUE	45.81	100.00

E. Rural Finance

3.42 Sugar and rice are the predominant crops, with sugar produced by a state-owned monopoly. Except for one large government-owned mill, rice is in the hands of private farmers, millers and exporters. Problems in the export market for rice, particularly the potential loss of preferential access to European Union (EU) and CARICOM markets, make the business of rice farming fundamentally risky and cause the banks to take a conservative attitude toward financing rice growing, milling and trade.

3.43 These risks and problems plus those mentioned in section B above concerning bankable property rights, have resulted in very low levels of bank finance being provided to the agriculture sector. At the end of December 1993, lending to the agricultural sector was only US$11 million. At current production levels, crops in the field represent an investment of about US$64 million, most of which is being self-financed through personal savings. With the privatization of the rice sector and the significant expansion that has occurred over the past 2 years, medium and small farmers have experienced liquidity problems. One frequent problem occurs when rice exporters delay payments to the farmers for up to four months after having received the rice from them. This leaves the farmers without sufficient funds to plant their next crop.

3.44 GAIBANK is meant to be one of the main lenders to agriculture but has not fulfilled this role. Most of its lending has gone instead to industrial loans and to finance heavy equipment in the sugar and rice sectors. Only US$1.4 million of its US$30 million loan portfolio has been lent directly to agriculture. As explained above, the Government is in the process of merging GAIBANK with GNCB (effectively closing GAIBANK).

Proposed Action

3.45 To help farmers and small rural businesses gain access to the formal system, the FSRP will provide technical support to commercial banks (including GNCB), suppliers and small borrowers to develop the private-sector linkages needed for a more efficient rural sector. Alternative initiatives will be examined to increase the flow of credit and to lower lending margins by taking advantage of the presence and local knowledge of traders, millers, selected local individuals, through incentives for prompt repayment, through training and through improvements in the quality of information about borrowers and lenders. The proposed changes to the laws on secured transactions referred to in paragraphs 3.13 to 3.21 are also likely to improve the flow of credit to small rural borrowers and small urban enterprises.

3.46 One initiative, involving the suppliers of heavy equipment was developed during project preparation. These suppliers are in a good position to assist the banks in deciding who would be a good loan risk for purchasing such equipment. They are also in a better position to repossess the equipment, recondition it and find other buyers in the event of default. Several heavy equipment suppliers and commercial banks have agreed to develop such a collaborative arrangement. The equipment suppliers have agreed to give a 25% guarantee on loans extended to farmers to purchase such equipment. The IDB has been the initiator of this dialogue between the suppliers and the banks, and continues to work with these groups to produce the documentation required for these types of loans.

3.47 Other initiatives are less advanced and will be developed during execution. Starting with small pilot projects and expanding as the results merit, this project will work with financial institutions, farmers, suppliers and other key rural participants to develop a commercially viable rural financial system serving small farmers and businesses. A Project Implementation Unit will be established within the Bankers' Association to formulate and execute new initiatives to expand financial services to a wider range of rural clients. The key elements of the project are as follows:

- Group lending with cross guaranties.
- Training of community bank liaison officers and group leaders.
- Promoting credit sales by input suppliers.
- Develop a local credit reference data base in the bank.
- The examination of leasing as an alternative means of financing activities in the sector.

3.48 The MIF has expressed interest in participating with the Bank in this sub-program. Before presentation to the Board of Executive Directors, this will be discussed further with the MIF in order to determine the likelihood that they will be able to support this component.

IV. PROGRAM FINANCING AND IMPLEMENTATION

A. The Borrower and the Executing Agency

4.1 The Borrower will be the Cooperative Republic of Guyana and the Ministry of Finance will be the primary executing agency. The Ministry of Legal Affairs will be the executing agency for the Bankable Property Rights sub-program and the Bankers Association will be the executing agency for the Rural Finance sub-program.

B. Disbursement, Procurement and Retroactive Financing

4.2 Proceeds from the loan will finance the FOB cost of eligible imports, or the CIF cost, when freight is eligible. Disbursements of the tranches will be made against import documentation provided by the MOF. The usual restrictions contained in a negative list will apply, excluding local currency expenses, guns and other goods used by the armed forces, luxury items, and imports financed through medium and long-term loans.

4.3 The MOF will, if necessary, retain a consultant to prepare the information required for the purposes of releasing the first disbursement. Because of technical assistance the Bank is presently providing to the customs agency, the task of gathering the import records in the form the Bank requires is likely to become substantially easier, therefore it should not be necessary for the Government to have to retain someone permanently for this function. The Country Office and the Project Team should be able to assist the Government in the documentation for the release of the second and third tranches. It will not be necessary, therefore, to create a Project Executing Unit for this operation.

4.4 Procurement of goods with funds provided by the loan will be carried out in accordance with standard Bank procedures. For amounts above US$5 million, International Competitive Bidding (ICB) will be required. In the case of petroleum and petroleum products, imports above US$5 million from individual suppliers do not always follow the letter of Bank procedures. However, they follow acceptable commercial practices, and are effectively done at market prices. This situation is comparable to those faced by the Bank in other sector adjustment operations. Based on the recommendations made by the Country Office in its experience in administering a previous sector loan (876/SF-GY Agriculture Hybrid Loan) the requirement for ICB in contracts above US$5 million should be waved for imports of petroleum and petroleum products, provided these imports are from Bank member countries and the payments take place within the period established by the loan contract.

4.5 For amounts smaller than US$5 million, procurement by the public sector will be done in accordance with established national procedures, provided they are consistent with the Bank's

procurement policy. Procurement of smaller amounts by the private sector will be done in accordance with applicable commercial practices and, whenever possible, on the basis of quotes from suppliers from at least two Bank member countries.

4.6 One issue related to disbursements under the proposed loan refers to the limited amount of eligible imports that the country would be able to claim for reimbursement under the first tranche. This could occur if the World Bank's Private Sector Development Adjustment Credit, and this operation are disbursed within a short time of one another. This limitation could be attenuated by providing more flexible conditions to the Bank's retroactive financing procedures. In accordance with established Bank policy for sector loans, eligible expenditures are recognized for the purpose of retroactive financing, up to six months prior to the loan contract date. In view of the above, a waiver of Bank policy will be requested to extend the period of retroactive financing to twelve months prior to the loan contract date. Nevertheless, total retroactive financing will be limited to 50% of the total loan amount. The date of the expenditure for the purpose of applying this condition would be the value date of the remittance to the foreign payee.

C. The Technical Support Program

4.7 The Government will support the implementation of the reforms contained in the FSRP with up to US$3 million. Allocations will be made to the four sub-programs. An application will be made to the Multilateral Investment Fund (MIF) to fund the rural finance sub-program for up to US$1 million and to fund the Bankable Property Rights sub-program for up to US$700,000. If these are approved, the contribution of the Government to the technical support program will be correspondingly reduced. A plan for the technical support program is presented in Annex III.

4.8 The technical support contracts will be coordinated between the Government and the Bank. Terms of reference for the hiring of consultants will be drafted with inputs from both parties. The Government will draw up a short list of candidates for each contracting, which will be given to the Bank for its approval.

D. Records, Audit and Control

4.9 For each disbursement, the Executing Agency will provide documentation showing the goods imported during each period, the country of origin, and the date and value of the transaction. For purposes of accounting and control of those transactions, the Borrower shall open a special account in the Central Bank, keep accounting records of the project, prepare and forward the applications for disbursements, present lists of the transactions considered eligible and maintain all relevant supporting documentation. The Borrower shall present to the Bank, within 90 days following the disbursement of each tranche, a statement of

account for such tranche, prepared in accordance with terms of reference agreed with the Bank and certified by a firm of independent public accountants designated by the Borrower and accepted by the Bank.

4.10 Funds for the technical support program will be deposited in a separate US dollar account at the Bank of Guyana, and used to pay for goods and services in accordance with a memorandum of understanding to be negotiated with the Government. This memorandum will reflect the program set out in Annex III.

E. Environmental Impact of the Operation

4.11 The environmental brief for the Financial Sector Loan was considered by the Environmental Committee on May 19, 1993. The operation was classified as a category II, since it has no immediate direct or indirect environmental impact. As such, no environmental study or report was requested beyond the Environmental Brief. Nevertheless, the Environmental Committee suggested that, if actions significantly affecting the role of GAIBANK are contemplated, the CMA should be informed as to any anticipated environmental consequences. As GAIBANK's role will be reduced and its operations folded into the GNCB/GAIBANK merged institution, it is considered that no new environmental consequences will result from this merger.

V. PROBLEMS AND RISKS

A. Social impact

5.1 The social costs of an unstable banking sector to a developing country are enormous. These costs are reflected in investments not made, because the banking system could not finance them, and in public funds wasted, when the government is required to take over the obligations of failed institutions. When investments are not made because a too-small or a non-competitive banking sector is not able to finance its part, jobs are not created and poverty increases. Similarly, the wasting of fiscal resources on bank bailouts increases poverty. In a developing country like Guyana, whose ability to increase government revenues by raising taxes is very limited, the funds for bailing out a bank must come from other sources. Often, the only sources are cut-backs in social services, even basic social services like health and education. Ultimately, schools and hospitable beds are the currency of societies whose tax bases are so limited as to offer few alternatives. Naturally, when these basic services are reduced, as they markedly have been in Guyana, poverty is increased.

5.2 This operation has measures to improve the safety and soundness of the banking system and so can be expected to reduce poverty in both of these ways. Measures already taken have enabled the Government to approve two new banking licenses. The impact of this has been more or less immediately to create twenty new high-paying jobs, and the presence of two new competitors has revitalized the banking sector. The private-sector banks are now offering more services than before, including more lending to the productive sector, which has the effect of creating jobs and reducing poverty.

5.3 Finally, the rural finance sub-program will reduce poverty in that sector by increasing agricultural investment and productivity.

B. The Risks of the Program

5.4 The satisfactory execution of the Program requires a stable monetary policy, continued fiscal discipline and free and open foreign exchange and money markets where prices are determined by the interaction of market forces. Presently, these conditions exist in Guyana. However, there are some signs of deterioration in this macroeconomic stability which could compromise the goals of the Program. The value of the Guyanese dollar has fallen from 134 to 144 during the last twelve months after holding steady for two years. Presently, the foreign exchange market is functioning sporadically. Dollars, which had been freely available until recently, are now sometimes unavailable following efforts by the Government to hold the rate steady.

5.5 To be successful the institutional strengthening of GNCB will require the concerted action of GNCB, its board of directors, and

its advisers. This task is made more difficult because the Government is not in a position to pay in the needed capital from this year's budget. Thus, GNCB must be made to survive until 1996, when the recapitalization will begin.

5.6 Lastly, the Government has adopted a consensus-building approach to the determination and execution of policy. As a result, it has not been quick to take advantage of its parliamentary majority nor of the "honeymoon" period that the Government could have enjoyed during its first two years of office. This, combined with an absorptive capacity for policy reform that is constrained by institutions that have been weakened by years of neglect, present serious risks to the success of this Program.

5.7 To compensate for these risks, several important reforms are required to be accomplished before board presentation. Some of these measures have already been taken. Two new banking licenses have been approved. Three financial laws have been substantially drafted and one of them, the FIA, was passed by Parliament in January. The sale of the Government's shares in GBTI took place last year. Also, a ministerial order has been given regarding the merger of GNCB and GAIBANK, which will result in the legal merger taking place before June 1, 1995. And an action plan for the institutional strengthening of the merged bank has been approved by Cabinet. In this way, a track record is being built that will reduce the risks of the FSRP while providing a platform for the measures that are to be taken during execution.

GUYANA - FINANCIAL SECTOR LOAN

POLICY MATRIX

I

CTIVE	ACTIONS TAKEN	BEFORE NEGOTIATIONS	BY BOARD PRESENTATION	SECOND TRANCHE	THIRD TRAN
ONOMIC FRAMEWORK					
mic compatible eform	Second three-year IMF ESAF began in June, 1994. IMF staff review currently under way.	Satisfactory macroeconomic performance consistent with the objectives of the program.	Satisfactory macroeconomic performance consistent with the objectives of the program.	Satisfactory macroeconomic performance consistent with the objectives of the program.	Satisfactory macroeconomic performance cons with the objecti the program.
AND REGULATORY FRAMEWORK					
ize the ework of g system and n, and to fficiency ition.	In June 1993, MOF decreed an increase in required capital of banks to the equivalent of US$ 2 million. IMF and WB sponsored specialists are providing technical assistance in bank supervision. In 1993, IMF, IDB and WB sponsored team advised the GOG on the drafting of new financial legislation. In January 1995, a new Financial Institutions Act(FIA) was passed by Parliament. The FIA will become effective upon Ministerial order.	Submission to Parliament of conforming amendments to the COFA Act and related financial Acts. Along with the FIA this legislation would, inter alia: i. strengthen the independence and the regulatory authority of the Bank of Guyana(BOG), ii. establish BOG regulation of all major deposit-taking institutions, iii. mandate satisfactory capital and provisioning requirements, and iv. establish prudential standards including lending concentration and related party lending limits.	Passage and implementation of Financial Institutions Act and conforming amendments to COFA Act and related Acts. Promulgation by BOG of an action plan for the issuance of prudential regulations of the FIA.	Regulations of the Financial Institutions Act issued in the following areas: i. licensing of new and existing entities, ii. capital adequacy standard, following the Basle standard and capital build-up program, iii. permissible activities, iv. loan classification and provisioning, v. limitations on large exposures and related party transactions, and vi. financial disclosure requirements.	Evidence that th regulations are fully applied.

GUYANA - FINANCIAL SECTOR LOAN

POLICY MATRIX

E

CTIVE	ACTIONS TAKEN	BEFORE NEGOTIATIONS	BY BOARD PRESENTATION	SECOND TRANCHE	THIRD TRAN
e the ce of the nk.	In July 1993, a new Bank of Guyana Act was drafted.		Draft Act analyzed by BOG and delivered to MOF with BOG recommendation. Draft to include provisions that: i. provide for an independent central bank, ii. define preservation of monetary stability as the BOG's main goal, iii. provide for the election of the directors of the BOG on staggered terms that do not coincide with the government's period of office, and iv. prohibit the BOG from financing the Government.	Approval by Cabinet of draft Bank of Guyana Act containing provisions for central bank independence, the preservation of monetary stability, the election of directors on staggered terms, and prohibit the BOG from financing the Government.	Regulation of Ba Guyana Act.

GUYANA - FINANCIAL SECTOR LOAN

POLICY MATRIX

E

CTIVE	ACTIONS TAKEN	BEFORE NEGOTIATIONS	BY BOARD PRESENTATION	SECOND TRANCHE	THIRD TRAN
NATIONAL CO-OPERATIVE BANK (GNCB) AND GUYANA COOPERATIVE AGRICULTURAL & INDUSTRIAL DEVELOPMENT BANK (GAIBANK)					
ture GNCB ost to ate the t of he losses e al & t Bank	Consulting report delivered recommending the restructuring and privatization of GNCB. Consulting report delivered recommending the liquidation of GAIBANK.	Complete Action Plan acceptable to the Bank covering the merger of GNCB and GAIBANK, and the institutional strengthening of the new bank (New Commercial Bank, (NCB)). Action Plan to include: (i) spinoff of problem loans to a collection company, (ii) appointment of a team of experienced professionals to advise on the execution of the action plan, (iii) recapitalization of NCB to meet FIA requirements, (iv) entering into a rehabilitation program with the BOG to comply with prudential regulations. (iv) staff rationalization and salary increases to competitive levels.	Public announcement of merger and strengthening plan for GNCB/GAIBANK. Appointment of advisory team under TORs and contract acceptable to the Bank.[1] Identification of non-performing loans in GNCB and GAIBANK to be passed to govt-owned collection company. Establishment of govt-owned collection company.	Satisfactory execution of the action plan, including: (i) transfer non-performing portfolios to collection company, (ii) transfer GAIBANK's performing assets to GNCB in exchange for assumption of part of GAIBANK's liabilities. Transfer GAIBANK's other liabilities to GOG. Liquidate GAIBANK's other assets, (iii) complete staff rationalization for both banks, and (iv) substantially complete merger and restructuring program.	Satisfactory exe of the action pl

dition to be met prior to first disbursement of the loan.

GUYANA - FINANCIAL SECTOR LOAN

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POLICY MATRIX

CTIVE	ACTIONS TAKEN	BEFORE NEGOTIATIONS	BY BOARD PRESENTATION	SECOND TRANCHE	THIRD TRAN
OWNERSHIP IN THE FINANCIAL SECTOR					
the role te in the sector.	In August 1993 the Government issued a Privatization Policy Framework to restart the privatization process which was halted in November 1992. The Policy establishes the Privatization Unit and Privatization Board. The members of the Board have been appointed and the GOG has selected the head of the Unit. In 1994, GOG's remaining shares in GBTI sold to private investor.	GOG to announce detailed objectives of privatization program. Objectives should include: (i) policy for workers' participation; (ii) sequence and timing of entities to be divested; (iii) details and timing of public awareness campaign and issuance of "privatization booklet";	Complete Action Plan acceptable to the Bank for the privatization of Institutions in the financial sector. Action plan to include provisions for: (i) an evaluation of the value of the GOG's holdings the sector, (ii) the sale of at least 65% of the GOG's holdings in the sector, (iii) a public invitation to tender, (iv) the vetting of potential buyers according to provisions of the FIA, (v) the adjudication of the offers, and (vi) the award of the shares to the highest qualifying bidder.	Satisfactory execution of the action plan.	Satisfactory exe of the action pl
CAL SUPPORT					
the sures in the			GOG to open account in the BOG to finance the program implementation, as described in the Technical Support Action Plan.	Satisfactory execution of the technical support program.	Satisfactory exe of the technical program.

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GUYANA
FINANCIAL SECTOR REFORM PROGRAM
POLICY LETTER

Mr. Enrique V. Iglesias, President
Inter-American Development Bank
Washington, D.C. 20577

Dear Mr. Iglesias:

The Government of Guyana is undertaking a program of economic reforms that are designed to create a strong foundation for growth. This Program is based on market principles, and it will lead to a stronger and more competitive private sector. The purpose of this letter is to describe the Program to you and to place it in the context of our achievements and our goals for the future.

Several important measures have already been taken. We would like to formally request your good institution's assistance in carrying out the measures that remain, while acknowledging your assistance in those already taken.

Background

The Government launched a Structural Adjustment Programme to promote economic growth, eliminate domestic and external imbalances in the economy, bring the informal sector into the formal economy, and to normalize Guyana's relations with its external creditors. The objectives were set out in the Policy Framework Paper of 1989-91 and were supported by an IMF Enhanced Structural Adjustment Facility (ESAF) from 1990-1993 and a Structural Adjustment Credit from the International Development Association.

These efforts were taken further and consolidated through the second three-year ESAF (1994-1997) signed with the IMF in July 1994. More specifically, the fiscal deficit has been reduced through conservative fiscal policy and tax reform, capital outlays enhanced, the trade regime liberalized further, and the free-functioning exchange regime and macroeconomic stability have facilitated considerable growth in the foreign exchange market. Moreover, the incentive framework for the private sector has been improved, impart through major modernization of capital and financial sector legislation. Throughout this adjustment, the Government has instituted and strengthened its social programes for the most vulnerable citizens.

The macroeconomic results from strong stabilization and structural

reform efforts have been impressive. Real GDP growth averaged over 8% between 1992 and 1994, and inflation has been lowered. The exchange rate has remained stable and gross reserves increased. However, serious constraints remain - principally a very heavy foreign and domestic debt burden and deteriorated infrastructure. These problems will require an increased role for the private sector, working in partnership with Government. The Financial Sector Reform program will be a key element in ensuring continued growth and long-term stability.

THE FINANCIAL SECTOR REFORM PROGRAM

The Government is committed to a program to modernize the financial sector in order to expand the financial services available to business, Government and to individual citizens, and to reduce the cost of these services. Our program has three parts. Firstly, we have undertaken a program to modernize the legal and regulatory framework in the financial sector. Then, to stem the losses of the official banking sector, we will merge two institutions and considerably strengthen the merged entity. We will further reduce the state's participation in the financial sector, by selling our participations in two important institutions. And finally, we will develop a program to eliminate some of the market impediments that prevent financial services from reaching the rural sector.

1. **Modernization of the Legal and Regulatory Framework.** Presently, the legal framework of the financial system consists of The Banking Act and The Bank of Guyana Act, and related laws and regulations. This framework is considerably out of date and requires the Bank of Guyana to seek the approval of the Ministry of Finance before taking action in many areas. The BOG therefore lacks the independence that is required in the management and execution of monetary policy and in carrying out its supervisory and regulatory functions. The BOG's authority extends only to the commercial banks, it does not extend to other suppliers of financial services, nor even to the trust companies, even though they take deposits from the public. Prudential standards concerning lending limits and capital requirements either do not exist or are deficient.

Much work has been done to correct these deficiencies. A completely new Financial Institutions Act (FIA) has been drafted, discussed by its constituencies, and passed by Parliament and enacted by ministerial order. The FIA should be fully regulated by the first quarter of 1996. This regulation will include the setting of reserve requirements that are the same for all deposit-taking institutions. In the meanwhile, we have continued our efforts to improve bank supervision by taking on a second international expert to help conduct the inspections and train the staff of the BOG.

We have also drafted a substantially new Bank of Guyana Act, principally to address the issue of central bank independence. It defines the preservation of price stability as the BOG's main goal; provides for the Bank's directors to be named for terms that are staggered and do not coincide with the Government's period of office; prohibits the BOG from financing the Government, and brings the language

of the Act into harmony with that of the FIA. The amended BOG Act is being analyzed by the BOG, who will shortly present it to my Ministry with their recommendation. The Ministry will conduct its own review and consult with the Cabinet and with the affected parties before submitting it to Parliament sometime after the FIA is approved. It is our expectation that it should be passed into law during the first three months of 1996.

Bankable Property Rights. The second part of our sub-program to reform the legal and regulatory framework of the financial sector is directed at an area that we call "bankable property rights". The provision of credit depends on the ability of individuals and companies to convert evidence of ownership, such as the titles to land or equipment and bills of sale and warehouse receipts, into security interests to support the loans. These security interests are, in effect, the lubrication of a financial system--to the extent that the systems for their creation and registration work well, the system is well oiled and credit flows normally to the productive sector.

In Guyana, the system has not worked well and, as a result, the amount of capital created by our financial system has been limited. Many of the laws governing the creation of security interests are antiquated--some of these date back to the Dutch colonial period--and the Deeds Registry lacks the necessary systems for ensuring the integrity of titles and for giving a speedy response to inquiries. We are amending existing legislation and drafting a new law to correct these deficiencies. The Attorney General received a draft of this legislation in February, 1995, which will go through the normal review process in order to be submitted to Parliament before the end of 1995. In addition, we are reforming the Deeds Registry with the technical support of the FSRP.

The review that has been made of the legislation concerning bankable property rights has provided us with the opportunity to solve another serious problem related to the law. In Guyana, the laws have not been compiled since 1977. Many laws have been amended many times yet the text of the original laws have not themselves been changed to reflect these amendments. With the passing of time, people have forgotten which version of the laws or amendments are currently in force, and this has seriously compromised the Government in its efforts to provide society with a stable legal framework. Consequently, we are undertaking a review of all of our laws, and recompiling them to reflect the amendments that have occurred over the last twenty years. This effort is half done. It will be continued with the technical assistance included in the requested loan. The compilation of all of the Laws of Guyana should be completed by August, 1995 and it is our hope that the updated Laws of Guyana will be approved by the Law Review Commission before the end of 1995. This will give us the firm foundation that a modern civil society based on law requires. In addition, as a result of the generosity of the Government of Canada, we will have the technology to keep the laws updated in the future.

2. **Guyana National Co-operative Bank (GNCB) and Guyana Co-operative Agricultural and Industrial Development Bank (GAIBANK).** These institutions have not performed well and as a result, the Government has been obliged to cover their periodic losses. We have decided to merge the two banks, in order to eliminate duplications and use their resources more efficiently. Additionally, we will strengthen the merged institution to ensure that it remains profitable.

As part of the merger, the loan portfolios of the institutions will be reviewed to determine which loans are performing and which are not. The non-performing loans will be transferred to a separate collection company, where the proper attention can be given to them. It will be necessary to establish a government-owned collection company, since these loans are too old and too poorly documented to attract the interest of a private-sector collector. To ensure that this company does not itself become a drain on the treasury, the Government will monitor its performance closely, and a report on its performance will be provided to the IDB by the end of each April during the execution of the Program.

Additionally, measures will be taken to rationalize the bank's staff and improve their pay, and the bank will be recapitalized by replacing accounts receivable from the Consolidated Fund with marketable government securities. Finally, the bank will enter into a rehabilitation program with the BOG to ensure compliance with the prudential regulations that are contained in the new Financial Institutions Act.

An action plan detailing these actions has been prepared in coordination with the IDB and the World Bank. During the first half on 1995, advisers will be appointed to assist the management of the new institution in executing the plan. Also during the first half, we will announce this plan, identify the non-performing loans and establish the entity that will collect these loans. The loans will be transferred to this entity; the staff rationalization will be completed and the merger and restructuring program will be substantially completed by March, 1996.

We are confident that the bank's management, working with the advisers, can return the institution to financial health and profitability. Nonetheless, in the event that this does not occur, the contingency plan of the Government contains further measures, notably appointing two turnaround specialists to occupy the posts of CEO and CFO, until the new bank becomes profitable on a sustained basis.

3. **State Ownership in the Financial Sector.** To create a financial system that is driven by the signals of the marketplace, it is important to reduce the State's participation in the financial sector. The first steps towards this goal were taken during 1992, with the sale of part of the Government's position in Guyana Bank for Trade and Industry (GBTI) and the National Bank for Industry and Commerce (NBIC). Since then these institutions have been permitted to operate without interference from the Government, and they have been managed successfully according to private-sector goals and incentives. More recently, the Government sold the

remaining 30% position that it held in GBTI. The Government is committed to selling additionally holdings in the sector so that those still held by the end of June, 1997 will constitute no more than 25% of the combined asset value of our holdings as at end-1993. No new investments will be made in financial-sector firms, nor any new ones started by the Government until, at the earliest, one year after the final disbursement under the loan.

4. **Rural Finance.** The last part of the Financial Sector Reform Program is one of the most important--a program to increase the flow of credit to the rural sector. Only an incidental amount of credit is provided to the rural economy. Partly this is due to deficiencies in the area of bankable property rights, mentioned above. The reforms described there will help, but security interests are not the only problem. Farmers have problems in obtaining timely payments from the rice millers, they lack sophistication in using credit and the banks do not have adequate skills in appraising projects and pricing loan risks. The reform program will provide technical assistance in these areas for which funding will be requested from the Multilateral Investment Fund. In this way, we will be able to build on the agricultural expansion we have had during the last few years, and avoid the marginalization of this important segment of our society.

Final Considerations. During the execution of this program, the Government will maintain the reforms already implemented to date, including the elimination of price controls, the elimination of interest rate controls, and the establishment of a free and open foreign exchange market. In order to carry out the Program, the Government has budgeted up to US$3 to be used to pay for consulting services and equipment required to fully implement the measures of the program. To fund this work, the Government will deposit US$2 million from the first disbursement of the loan into a special account that it has opened at the Bank of Guyana for this purpose. Finally, the Ministry of Finance will act as the executing agency for this program, with the exception of the sub-program on bankable property rights, which shall be executed by the Ministry of Legal Affairs, and the Rural Finance sub-program, which will be executed by the Bankers' Association.

Jagdeo

Mr. Bharrat Jagdeo
Senior Minister of Finance

GUYANA
TECHNICAL SUPPORT FOR THE
FINANCIAL SECTOR REFORM PROGRAM

I. INTRODUCTION

1.1 Financial assistance from a variety of sources supported the measures that have been taken to date to reform the financial sector. Donor funds from Japan, Canada, Great Britain, the IDB and the World Bank were used to draft laws, provide advice and provide small amounts of equipment. This has resulted in the passing of the Financial Institutions Act, a first draft of the Bank of Guyana Act, the first draft of the Movable Properties Securities Act (MPSA), the compiling of the commercial laws of Guyana, some advice on the establishment of a capital market, a diagnostic study on the National Insurance Scheme, and two diagnostic studies of the government banks.

1.2 During execution, it will be necessary to maintain this momentum in order to meet the goals of the Program. To do this, the Government will require up to US$3.0 million to finance the contracting of consulting services, the procurement of equipment, and for other tasks that may be required in order to implement the policy reform measures and the other actions of the Program. The funding for these activities is contained in the proposed loan. However, the authorities are concerned with Guyana's high foreign debt and prefer to fund technical assistance with grant resources. Consequently, if Guyana become eligible for the MIF, an application will be made to the MIF to provide support for the Bankable Property Rights sub-programs and for the sub-program in rural finance mentioned in the main text of the Loan Proposal.

1.3 The support described in this annex will enable the Government to: (i) finish the drafting of the MPSA, and run seminars on its use and implementation; (ii) strengthen the operation of the Deeds Registry; (iii) finish the compiling of the laws of Guyana; (iv) and strengthen GNCB; (v) provide support to the Loan Recovery Unit, and; (vi) strengthen the Bank of Guyana.

1.4 The Ministry of Legal Affairs will be the executing agency for parts i, ii, and iii, the Ministry of Finance will be responsible for executing part iv and v; and the Bank of Guyana will be responsible for vi.

II. DESCRIPTION

2.1 The following areas will receive support under the program:

1. <u>The Moveable Property Securities Act(MPSA)</u>

2.2 The Ministry of Legal Affairs must take a number of decisions or express its preferences in a number of areas before the draft MPSA can be discussed with Cabinet. Decisions should be taken on how registry services will be provided to areas outside Georgetown, on the method of registry, on the nature of sanctions for fraud, and on transition provisions. Additionally, it is important to explain the MPSA to members of the bench and bar, and to other constituencies, so that the benefits of the new system are fully understood. A consultant will be hired to edit the draft MPSA to reflect these decisions and to run courses to explain the nature and use of the new rules.

2. Strengthening the Deeds Registry

2.3 Related to the above is the office where claims to security are registered. The Deeds Registry is not providing the level of service that is required to enable security to play the important role that it should in helping to make credit flow. Assistance will be provided in training in modern methods of registry office management and in supplying the office with the necessary hardware and software.

3. Updating the Laws of Guyana

2.4 The pilot project has developed a technology for updating the laws. This technology will be used to compile the rest of the Laws of Guyana so that the Law Review Commission can review, comment on, and ultimately approve the new version of the Laws of Guyana. A specialist will be hired to complete the compiling, and another to assist the Ministry of Legal Affairs in editing the results.

4. GNCB\GAIBANK Merger and Institutional Strengthening

2.5 Technical assistance is being provided by the World Bank to hire advisers to assist in the merger/strengthening. These funds are sufficient to last about twelve months. Since it will not be possible to turn the bank around in that short period -- the task is expected to require one or two years more than provided for in the World Bank loan.

5. Supporting the Loan Recovery Unit

2.6 This important part the strategy for strengthening GNCB is just now being set up. There is no funding for its set-up costs and first year's costs in the Guyana's budget.

6. Strengthening the Bank of Guyana

2.7 The Bank of Guyana will need to be continually strengthened in order to perform the expanded duties required of it by the new legislation. The areas of bank supervision and monetary policy are particularly critical. In the past, experts have been provided by the World Bank and the IMF but the funds are no longer available.

It is important for macroeconomic stability and for the safety and soundness of the banking system that the BOG continues to receive some help in these areas.

III. COST AND FINANCING

3.1 The cost of the this assistance is estimated at US$2.6 million. The operation will be financed by the Government, from the proceeds of the Financial Sector Reform Loan, and possibly by the MIF.

3.2 The Borrower, through the various participating entities, will be responsible for providing the executing agencies with logistical support for the consultants in carrying out their respective tasks. Funds from this technical support component of the loan will be disbursed to an account at the Bank of Guyana and these will be disbursed as needed to pay for the services provided. The table below summarizes the estimated budget by principal categories:

TECHNICAL SUPPORT PROGRAM SUMMARY			
AREA OF REFORM	**OBJECTIVE**	**BUDGET ESTIMATES**	**$TOTAL**
1. **MPSA**	Provide support leading to the passing of the MPSA.	1. Advisory and drafting assistance-(2 weeks, $25,000) 2. Training courses-(2 weeks, $25,000). Possible MIF funding.	$50,000
2. **Deeds Registry**	Strengthen the operation of the Deeds Registry.	1. Adviser expert in the operations of registry offices (4 visits of 2 week each, $100). 2. Computer adviser-1 month, $25,000). 3. Hardware and software-$300,000. Possible MIF funding.	$425,000
3. **Compiling the Laws of Guyana**	Provide support leading to the adoption of a compiled version of the Laws of Guyana.	1. Legal editor in MLA-(6 months, $150,000). 2. Specialist to compile the laws-(4 months, $100,000). 3. Hardware and software-($100,000). Possible MIF funding.	$350,000
4. **GAIBANK/GNCB merger and strengthening**	Complete the merger and lead the merged bank to sustainable profitability.	1. Senior advisers-(2 for 12 months each, $800,000). 2. MIS adviser-(4 months, $100,000). 3. Training courses, hardware, software. ($300,000)	$1,200,000
5. **Supporting the Loan Recovery Unit**	Provide the operating environment systems and procedures to collect the loans that are transferred to the LRU.	1. General manager (12 months) 2. Training ($50,000) 3. Hardware and Software ($200,000)	$400,000
5. **Bank of Guyana**	Provide advice in the area of monetary policy and assistance in the training of bank supervisors.	1. One bank supervision adviser/trainer for 12 months, (150,000) 2. One adviser for monetary policy for 12 months, (150,000)	$300,000
TOTAL			$2,725,000

SPECIAL CONTRACTUAL CONDITIONS

GUYANA
FINANCIAL SECTOR PROGRAM
(GY-0032)

Set forth below is a list of conditions which are to be fulfilled by the Borrower to the Bank's satisfaction prior to the release of the second and third tranche of the loan:

A. **Conditions to be fulfilled prior to the release of the second tranche**

1. **Macroeconomic framework**

(a) A satisfactory macroeconomic performance consistent with the objectives of the program.

2. **Legal and Regulatory Framework**

(a) Regulation of the Financial Institutions Act have been issued covering the following areas:

(i) licensing of new and existing entitie
(ii) capital adequacy, following the Basle standards, and capital build-up program for undercapitalized institutions,
(iii) permissible activities,
(iv) loan classification and provisioning,
(v) limitations on large exposures and related party transactions, and
(vi) financial disclosure requirements.

(b) Approval by Cabinet of a draft Bank of Guyana Act containing provisions for central bank independence, the preservation of monetary stability, the election of directors on staggered terms, and the prohibition of the BOG from financing the Government.

3. **Guyana National Co-operative Bank (GNCB) and Guyana Cooperative Agricultural & Industrial Development Bank (GAIBANK)**

(a) The satisfactory execution of the Action Plan covering the merger of GNCB and GAIBANK and the institutional strengthening of the resulting entity, including the execution of following sub-components of said action plan:

(i) the transfer of non-performing portfolios to a collection company;

(ii) the transfer of GAIBANK's performing assets to GNCB in exchange for the assumption of part of GAIBANK's liabilities; the transfer of GAIBANK's other liabilities to the Government of Guyana; and the liquidation of GAIBANK's other assets;

(iii) a complete staff rationalization for both banks; and

(iv) the substantial completion of the merger and restructuring program.

4. **State Ownership in the Financial Sector**

(a) The satisfactory execution of the Action Plan for the privatization of institutions in the financial sector;

5. **Technical Support**

(a) The satisfactory execution of the Technical Support Program.

B. **Conditions to be fulfilled prior to the release of the third tranche**

1. **Macroeconomic framework**

(a) A satisfactory macroeconomic performance consistent with the objectives of the program.

2. **Legal and Regulatory Framework**

(a) Evidence that the regulations of the FIA are being fully applied.

(b) Full regulation of the Bank of Guyana Act.

3. **Guyana National Co-operative Bank (GNCB) and Guyana Cooperative Agricultural & Industrial Development Bank (GAIBANK)**

(a) The satisfactory completion of the execution of the Action Plan covering the merger of GNCB and GAIBANK and the institutional strengthening of the resulting entity

4. **State Ownership in the Financial Sector**

(a) The satisfactory execution of the Action Plan for the privatization of institutions in the financial sector;

5. **Technical Support**

(a) The satisfactory execution of the Technical Support Program.

PLAN OF ACTION FOR THE INSTITUTIONAL STRENGTHENING OF THE GUYANA NATIONAL COOPERATIVE BANK

March 16, 1995

The board of directors of GNCB and the Ministry of Finance have developed a plan of actions that are designed to implement the merger of GAIBANK and GNCB and to substantially strengthen the merged entity, (which in this document will retain the name GNCB). The steps in the plan are explained below and the plan itself is appended.

THE LEGAL FRAMEWORK

The legal framework in which GNCB operates is established by the company's by-laws, the recently passed Financial Institutions Act(FIA), the Cooperative Financial Administration Act(COFA), the Bank of Guyana Act, and other statutes which are directed at or contain articles which are directed at financial issues. These laws are being substantially amended or, in some cases, completely rewritten, to provide a firmer foundation for the increasing level of financial activity that is occurring in Guyana.

The FIA establishes the Bank of Guyana(BOG) as the regulator of the financial sector, of which GNCB is an important part. In order to implement the FIA, the Ministry of Finance will issue the appropriate order once Parliament passes conforming amendments to the BOG Act, the COFA Act, and the Dealers in Foreign Currency Act which are necessary to bring them into harmony with the FIA. Later on, the BOG will complete the drafting of a new Bank of Guyana Act that creates an independent central bank and improves the BOG's ability to control inflation and supervise financial institutions. GNCB will register under the FIA and under the Companies Act, and the authority of the Cooperative Financial Administration to regulate GNCB will be removed by amending or eliminating the COFA Act. The completion of these steps will establish the BOG's regulatory authority over GNCB. Following this, GNCB will enter into a rehabilitation program with the BOG to bring it in line with the FIA's capitalization and prudential lending limits in the time frame contemplated in the FIA.

With the development of a more competitive market for financial services, and the passing of the FIA and the elimination of COFA authority over the activities of GNCB, the bank's by-laws are out of date. They will be evaluated and amended to reflect these developments. This modification will vest in the management of the bank the full authority to manage the institution, in accordance with the framework established by the board of directors, and it will remove the board from the day-to-day affairs of the bank.

ACCOUNT RECONCILIATION AND CAPITALIZATION

Reliable baseline financial information is an essential starting point in any bank restructuring. Accordingly, one of the first steps in the plan is to take certain actions that ensure that this important information will be obtained at the outset and on an ongoing basis thereafter. Firstly, the fixed assets of GNCB, including those inherited from GAIBANK, should be revalued to accurately reflect the market values of these assets. The accounts for year-end 1994 for GNCB and GAIBANK will be produced by the management of the banks. An international auditing firm will be retained to review the loan portfolio of the two banks to recommend proper provisioning of the loan portfolios and to identify the loans to be transferred to the Loan Recovery Company(LRC). With the fixed assets revalued and the portfolios reviewed and provisions established, much of the work leading to a full audit of the accounts of the two banks and the production of the opening balance sheet of the merged entity will be done. The firm will also prepare financial projections for the next three years.

An important result of these actions will be to measure the true net worth of the merged entity. Once the true position is known, a capitalization plan will be produced that over time will replace the account receivable due from the Consolidated Fund with interest-bearing marketable government securities. There are no funds in the current budgetary year for this capitalization, so it will begin in 1996, and be completed during 1997. By this time, this plan of action will be substantially implemented, and GNCB will be a much stronger institution.

TRANSFER OF PAST-DUE LOANS TO THE LOAN RECOVERY COMPANY

A central feature of the strengthening of GNCB is the transfer of the bank's portfolio of past-due loans to a loan recovery company(LRC) reporting to the Ministry of Finance. The LRC was created by ministerial order in February, 1995. The board and management of the LRC will be named soon, and an organization chart established, along with systems and procedures of operation. To ensure that there are sufficient incentives in place for management and staff to collect the loans, a compensation system will be established that provides for bonuses to be paid for meeting and exceeding collection targets.

Later on, the LRC will be staffed and the loans transferred from GNCB and GAIBANK to this company. Simultaneously, a budget for the company will be drawn up, and an allocation made of counterpart resources to fund the LRC. Finally, a system will be put in place to transfer "dividends" periodically to the Consolidated Fund, representing the proceeds of the loans collected by the company, less the administrative cost of running the company.

The management of the LRC will produce its financial statements by March 31st of each year, and these accounts will be audited by the Auditor General by the end of June of each year.

MANAGEMENT

GNCB has not had a chairman, general manager or a financial manager since October, 1994. These positions will be filled as a matter of urgency. Simultaneously, two experts will be hired to advise management, the board and the Government on the strengthening of GNCB. The advisers are expected to be retained for a period of up to two years, although the contractual arrangements will be for shorter periods to provide the flexibility to change the advisers if this becomes necessary. Lastly, the Government will make some changes in the composition of the board of directors to ensure that the board contains a balance of members from the private and public sectors with the experience to oversee the merger and transformation of GNCB and return to profitability in the new competitive environment. In the event that this does not occur, the contingency plan of the Government contains further measures, notably the appointment of two turnaround specialists to occupy the posts of chief executive officer and chief financial officer, until the new bank becomes profitable on a sustainable basis.

One of the first tasks of the managers and advisers ("the management team") will be to evaluate the bank's work flow and the reporting obligations within the institution. This will lead to measures to improve the efficiency of the bank and it will serve as an important input for an evaluation of the bank's organizational structure. Based on this evaluation, GNCB will adopt a new organizational structure more appropriate to the merged entity.

BRANCH AND STAFF RATIONALIZATION

The merged bank will have 23 branches. Many of these branches are quite close to each other, and therefore represent a cost that is not producing additional revenues for the bank, nor services for the customers. The branch network will be evaluated and recommendations made to close and dispose of the unnecessary branch offices. In most cases, the activities carried out in the closed offices will be transferred to other branches.

In conjunction with this exercise, an evaluation will be made of skills and salary levels of GNCB's staff, including the staff transferring over from GAIBANK. On the basis of this, the staff will be reassigned to areas or functions that best utilize their skills. It is expected that a reduction in staff will also be required, in order to bring costs down to levels that are competitive with the other banks.

Many of the best qualified staff have left GNCB for higher paying positions in other institutions. This is having serious consequences, as the quality of the services provided by GNCB has not kept pace with those provided by other banks, and their is evidence of frequent fraud in GNCB. In order to stem the loss of qualified staff members, attract new staff and reduce temptation, an evaluation of salary levels will be conducted, and recommendations made and adopted to increase salaries to levels that are competitive with those paid for similarly qualified employees at other banks. At the same time, the differences in pay and benefits between staff members who came from GNCB and those who came from GAIBANK

will be eliminated in order to promote a transparent and fair environment that provides attractive employment opportunities to all of the members of staff, no matter where they came from.

CREDIT POLICY-ASSET/LIABILITY MANAGEMENT

To ensure that the mistakes of the past are not repeated, good policies must be established for the lending process and for the pricing of the risks that the bank will assume. Credit policies and practices will be evaluated, as will asset/liability management. As part of this process, the procedures manuals for these functions will also be evaluated and recommendations made to bring the manuals up-to-date.

New policies will be adopted in these two areas and these policies will include prohibition against taking on foreign exchange risks. Until the bank has been fully capitalized and until it has returned to profitability on a sustainable basis, no loans with a maturity greater than five years will be made and all loans with greater than a one-year maturity will be priced on a floating-rate basis. Finally, since the granting grace periods for interest payments is widely recognized as a bad developmental and commercial banking practice, no such grace periods will be granted.

INTERNAL AUDIT AND CONTROL PROCEDURES

The other important elements of risk management are effective internal audit function and financial controls. Early in the restructuring, the management team will evaluate the accounting system, including the chart of accounts, in order to determine their adequacy. Starting at the same time, internal audit policies and practices, financial control policies and practices and the procedures manuals for accounting, financial control and internal audit will be evaluated. Following that, the manuals will be edited to reflect the recommendations, and the new manuals will be adopted by the management of the bank. Similarly, revised internal audit, financial control and accounting policies will be adopted by management.

MANAGEMENT INFORMATION SYSTEMS

In order to be able to provide the basic accounting and business information that is required to guide management and provide information to the bank's constituencies, GNCB's management information systems must be thoroughly evaluated and redesigned. An expert will be retained to evaluate the existing system, recommend changes in it and to draw up a plan of action to implement the recommendations. Management will consider the recommendations, and adopt and execute the plan of action to bring MIS up to the required level.

DEVELOPMENTAL ACTIVITIES WINDOW

Since the ultimate goal is to sell a significant part of the restructured GNCB to the public, and since developmental lending has lead to significant losses for the Government in the past, these activities will not be conducted by GNCB. However, given the importance of providing

this kind of assistance, the Government wishes to use part of the physical and administrative infrastructure of GNCB to provide assistance to small farmers and businesses. This will be done through the figure of a "developmental window" at GNCB, which will intermediate Government fiscal resources or possibly donor resources to these sectors. Recognizing that these kinds of activities carry a considerably higher risk than commercial banking, and that it would be unfair for depositors to bear these risks, these activities will be carried out in the name of and for the account of the Government. In no case will GNCB itself be exposed to these risks and the assets and liabilities resulting from these activities will not appear on GNCB's balance sheet.

PRIVATIZATION

Many of the activities in this action plan are the same strengthening activities that would have to be executed to prepare the bank for privatization. Once the bank has been recapitalized and begins to demonstrate some significant earnings potential, it should be possible for the Government to recoup part of its investment through the sale of all or part of the shares of GNCB to private sector investors. The Government has the goal of bringing GNCB to the point of sale before the third tranche of the loans, in accordance with the agreements undertaken in the PFP.

GUYANA: Private Sector Development Adjustment Credit
Proposed GNCB Restructuring Program
March 16, 1995

	Negotiations	Board Presentation or, for IDA, June 30, 1995	September 30, 1995	December 31, 1995	Second Tranche	September 30, 1996	Third
	Drafting of Financial and Operational **Plan of Action** for the Restructuring of GNCB.	Adoption by the Government and by the Board of Directors of GNCB of the Plan of Action agreed-to with IDA and IDB.	Compliance with the interim targets indicated in the plan.	Compliance with the interim targets indicated in the plan.	Compliance with the interim targets indicated in the plan.	Compliance with the interim targets indicated in the plan.	Compli the inte targets in the p
k n	o Ministerial order issued transferring GAIBANK's assets and liabilities to GNCB, and dissolving GAIBANK.**(done)**	o Ministerial order implementing FIA. o Register GNCB under the Financial Institutions Act and Companies Act. o Eliminate COFA authority over GNCB (through modification to COFA Act). o Evaluate GNCB's by-laws, with particular reference to the delegation of powers and to their adequacy for a bank operating in a competitive environment. o Draft plan to amend by-laws in accordance with evaluation.	o Enter into rehabilitation program with Bank of Guyana to comply with prudential and capitalization regulations. o Adoption by the Government of new by-laws and other revisions to Board and management responsibilities respectively.	o Compliance with interim targets for rehabilitation program with Bank of Guyana. o Satisfactory evidence that the Board of Directors and Management Team is operating in accordance with their respective authorities as indicated in the Program.	o Compliance with interim targets for rehabilitation program with Bank of Guyana. o Satisfactory evidence that the Board of Directors and Management Team is operating in accordance with their respective authorities as indicated in the Program.	o Compliance with interim targets for rehabilitation program with Bank of Guyana. o Satisfactory evidence that the Board of Directors and Management Team is operating in accordance with their respective authorities.	o Full com with prud regu capi requ o Evid satis IDA that of D and Man Tean oper acco with resp auth

GUYANA: Private Sector Development Adjustment Credit
Proposed GNCB Restructuring Program
March 16, 1995

	Negotiations	Board Presentation or, for IDA, June 30, 1995	September 30, 1995	December 31, 1995	Second Tranche	September 30, 1996	Third T
d ion	o Management accounts received for year-end 1994 for GNCB and GAIBANK.**(done?)**	o Revalue fixed assets. o Begin review of loan portfolio by external auditors, leading to recommendations for provisions and identification of loans be transfered to Loan Recovery Company(LRC). o External auditors to produce audited balance sheet of merged institution showing true net worth position. o Agreement to replace the receivable from the Consolidated Fund with cash injection and/or the issue of marketable government securities and to bring capitalization of bank up to FIA standards.	Auditor General's report on GNCB's and GAIBANK's 1994 accounts received.	o Agreement for the timing, amount and kinds of govt obligations to be issued to replace receivable from Consolidated fund and otherwise bring capitalization of bank up to FIA standards. o Management accounts received for first half, 1995.	o First contributions to capital made. o Audited accounts received for 1995.	Additional capital contributions made.	Final ca contribu made, b capital p into con with rehabilit plan wit
nit	o Ministerial order creating LRC.**(done)** o Allocation of counterpart resources as budgeted for LRC. o Naming of board and CEO for LRC. o Adoption of organization chart for LRC. o Adoption of operating procedures for LRC.	o Appointment of management and staff of LRC. o Office space and equipment obtained. o Transfer of non-performing loans to LRC. o Implementation of operating procedures for LRC.		Periodic payment of dividends from LRC to GOG.	Periodic payment of dividends from LRC to GOG.	Periodic payment of dividends from LRC to GOG.	Periodic of divide LRC to

GUYANA: Private Sector Development Adjustment Credit
Proposed GNCB Restructuring Program
March 16, 1995

	Negotiations	Board Presentation or, for IDA, June 30, 1995	September 30, 1995	December 31, 1995	Second Tranche	September 30, 1996	Third T
nt of		o Appointment of new CEO and CFO. o Appointment of two advisers.[1] o Appointment of new board, including experienced professionals from the private and public sectors. o Evaluation begun of GNCB's work flow, reporting obligations and organization chart. o Recommendation presented from evaluation of work flow, reporting obligations and organization chart. o Development and adoption of plan of action in event of a run.	Adoption of recommendations, including new organization chart.		Satisfactory performance of action plan, including substantially improved performance. In the event this has not been achieved, GOG to strengthen its intervention by contracting with experienced turnaround positions and appointing them to CEO and CFO positions to turn bank around.		
l-			o Plan for branch rational-ization, including interim reevaluation. o Management and board adoption of first phase of branch rationalization plan, including plans to close selected branches.	Selected branches would have been closed.	Development of post-merger rationalization and improvement plan.	Implementation of post-merger plan.	

lition to be met prior to first disbursement of the loan.

GUYANA: Private Sector Development Adjustment Credit
Proposed GNCB Restructuring Program
March 16, 1995

	Negotiations	Board Presentation or, for IDA, June 30, 1995	September 30, 1995	December 31, 1995	Second Tranche	September 30, 1996	Third T
-		o Evaluate staff levels, skills, position descriptions and criteria for filling positions from pool of GAIBANK and GNCB staff. o Evaluate salary levels, compared to private sector banks.	Evaluations of staff levels, skills and position descriptions, criteria for filling positions and salary levels completed.	o Adoption of revised salary levels according to evaluation. o Adoption of planned staffing levels according to evaluation. o Implementation begun for revised salary schedules and staff reductions in accordance with plans adopted.	Conclusion of staff rationalization plan.		
t- gt.		o Evaluate credit policies and practices. o Evaluate loan appraisal & loan administration manuals. o Evaluate asset/liability mgt.	o Adoption of revised credit policy. o Adoption of asset/liability policies, including: (i) no foreign exchange exposures, (ii) no fixed rate loans greater than one year maturity, and (iii) no grace periods for interest payments. o Begin editing of loan appraisal & administration manuals.	o Implementation of revised credit policies. o Adoption of edited loan appraisal and administration manuals.			

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March 16, 1995

	Negotiations	Board Presentation or, for IDA, June 30, 1995	September 30, 1995	December 31, 1995	Second Tranche	September 30, 1996	Third
s		o Evaluate accounting system including the chart of accounts and accounting procedures manual. o Evaluate internal audit policies and practices, and procedures manual. o Evaluate financial control policies and practices, and procedures manual.	o Establishment and staffing of internal audit unit. o Adoption of revised internal audit procedures. o Adoption of internal control procedures. o Begin editing accounting, internal audit and financial controls manuals.	o Implementation of revised internal audit and control procedures. o Finish editing accounting, internal audit and financial controls manuals.	o Satisfactory evidence that the internal audit and control procedures are sufficient to ensure the prudent management of the bank. o Adoption and implementation of revised accounting, internal audit and financial controls manuals.		
nt n			o Mgt. team to decide whether to hire MIS adviser or use in house staff. o Evaluate MIS hardware, software and staffing and develop action plan to improve systems.	Execution of action plan.	Execution of action plan.	Execution of action plan.	
nt			o Draft action plan for the establishment of a window to intermediate GOG budgetary and bilateral donor resources (at market rates) for developmental lending and investment purposes. This activity may be carried out using some of the administrative infrastructure of GNCB, but will be done in the name of and for the account of a wholly-owned GOG entity and will not appear on GNCB's balance sheet. o Implementation of action plan.				

GUYANA: Private Sector Development Adjustment Credit
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March 16, 1995

	Negotiations	Board Presentation or, for IDA, June 30, 1995	September 30, 1995	December 31, 1995	Second Tranche	September 30, 1996	Third T
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APENDICE

PROPOSED RESOLUTION

GUYANA. LOAN /SF-GY TO THE COOPERATIVE REPUBLIC OF GUYANA
Financial Sector Program

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such Representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Cooperative Republic of Guyana as Borrower, for the purpose of granting the latter a financing to cooperate in the execution of a Financial Sector Program. Such financing will be for the amount of up to US$38.000.000, or its equivalent of in other currencies, except that of the Cooperative Republic of Guyana, which are part of the Fund for Special Operations of the Bank, and it will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.