

STRENGTHENING OF THE CREDIT UNION SYSTEM

(TC-93-08-15-8)

EXECUTIVE SUMMARY

EXECUTING AGENCIES: Ministry of Finance (MHCP) and Confederation of Colombian Cooperatives (CONFECOOP)

BENEFICIARIES: Banking Superintendency, Superintendency of Cooperative Associations (SES), and CONFECOOP

OBJECTIVES: To help preserve the financial cooperative system as a leading provider of financial services to micro-enterprise and small business as well as to low-income urban and rural communities. The specific objective is to support the establishment of a sound supervision system for Colombia's credit unions and other financial co-ops, referred to herein generically as cooperative financial institutions (CFIs).

DESCRIPTION: The project consists of the following activities: (i) strengthening of the CFI supervision apparatus within the Banking Superintendency and SES, and (ii) support for consolidating the CONFECOOP auxiliary self-monitoring system. The focus of these activities will be the transfer of specific supervisory know-how, information systems development, and employee training.

FINANCING:

Modality:	Grant - Facilities I and II
Recipient:	US\$ 945,000
MIF:	US\$ 750,000 Facility I
	<u>US\$ 665,000</u> Facility II
Total:	US\$2,360,000

IMPLEMENTATION TIMETABLE:

Execution:	24 months
Disbursement:	30 months

SPECIAL CONDITIONS: As conditions precedent to the first disbursement for each subcomponent of component I, the Ministry of Finance would be required to: (i) execute subsidiary project-implementation agreements with the Banking Superintendency and SES, delegating to those agencies the rights and responsibilities that would fall to them for the project, and (ii) appoint a project coordinator for component I.

EXCEPTIONS TO POLICIES: None.

I. COUNTRY ELIGIBILITY

- 1.1 The Donors Committee declared Colombia eligible for all modes of Multilateral Investment Fund (MIF) financing on December 14, 1993. The operation proposed herein is eligible for funding under Facilities I and II, inasmuch as it would support the strengthening of regulatory and oversight structures for Colombia's financial cooperative sector by way of training and technical cooperation.

II. BACKGROUND

- 2.1 Colombia's financial cooperative sector 1/ has been one of the most dynamic in the region. Though there are no official statistics about this segment of the economy, estimates by cooperative associations put the total number of cooperative financial institutions (CFIs) nationwide at about 1,200, with over 2.1 million members, or 6% of the country's total population. The sector controls aggregate assets of some US\$6.646 billion, equivalent to about 10% of the total assets of Colombia's financial system. The lion's share of its funds are from deposits of members and the general public. Traditionally, the sector's assets have been heavily concentrated in a handful of institutions, and most credit unions and co-ops are relatively small. Nevertheless, the sector is a major provider of financial services for low-income clients, microenterprises and small businesses. In rural communities particularly, CFIs are often the sole formal financial-services option.
- 2.2 Colombia's CFIs have been growing quickly in recent years, outpacing growth in the other subsectors of the national financial system. However, because this expansion on the financial front has not been accompanied by consolidation of the institutional apparatus of these cooperative institutions, they lag behind in terms of development of human resources, operating systems and procedures, and internal controls. Compounding the effects of this rapid growth with weak institutional setups has been the absence of a sound regulatory and oversight framework. The National Department for Cooperative Institutions (DANCOOP), the government agency in charge of promoting this sector and of the authorization, registration, regulation, and monitoring of cooperatives, 2/ has not had, for the most part, the funding or technical resources it needs to perform its mandate effectively, and there have been ongoing conflicts of interest among those functions.

1/ Cooperative banks, upper-tier cooperatives, financial co-ops, and credit unions, the latter being the most numerous.

2/ The sector takes in about 2,070 financial institutions and over 8,300 nonfinancial cooperatives.

- 2.3 The financial crisis which buffeted a number of CFIs in mid-1997 pointed up the danger of the system's very rapid growth and of lax State regulation. Huge losses of government funds that had been placed in some CFIs and the subsequent withdrawal of public funds fueled depositors' growing lack of confidence in the sector's stability. A run on deposits unleashed a systemic liquidity crisis in the sector, which to date has seen about 54 institutions placed under government control - 22 of them being currently in liquidation, affecting more than 500,000 depositors and US\$27.5 million in assets.
- 2.4 In the wake of this crisis the government redoubled efforts to overhaul the financial cooperative sector, and specifically to bring in a sound regulatory and oversight framework. 3/ The first steps were taken toward an institutional restructuring of the sector, to separate promotion and oversight functions, culminating in the passage of Law 454 in August 1998. Two provisions of that law are the conversion of DANCOOP to the National Administrative Department for Cooperative Associations, and creation of a new Superintendency of Cooperative Associations (SES). Under the new supervisory arrangement, the Banking Superintendency will oversee about 60 of the country's 1,200 CFIs; 4/ the rest will be supervised by the SES. At this writing, however, neither of the two superintendencies has an institutional structure sufficiently developed to perform its new mandate, or human resources with expertise in CFI supervision and compliance monitoring or information systems.
- 2.5 Since 1996 the Confederation of Colombian Cooperatives (CONFECOOP) has been developing an auxiliary self-monitoring system, as an aid to the supervisory authorities in gathering, screening, and analyzing CFI financial information. To that end CONFECOOP has signed subsidiary cooperation agreements with the Banking Superintendency and DANCOOP. The system also has been designed as an early-warning mechanism at the service of cooperatives, to signal potential risks and structural problems in CFIs. As further support, the system will work closely with CFI external and internal auditors, and there will be on-site audits by specialized personnel. Efforts to develop this system thus far have focused on initial design of the databases, data capture and validation mechanisms, and the first reports. However, budget constraints have kept CONFECOOP from completing the system's development and implementing it fully. CONFECOOP also recognizes that the CFIs

3/ Decree 619 provides for co-ops which deal in specialized financial intermediation to be supervised now by the Banking Superintendency; Decree 2896 establishes a Cooperative Institutions Office within that Superintendency; Decree 1840 institutes prudential standards for CFIs.

4/ Cooperative banks, upper-tier co-ops, and financial co-ops, as well as some large multipurpose cooperatives.

will need technical support to adapt their operating systems and procedures to comply with new prudential standards to be issued by government regulators and the self-monitoring system.

III. PROJECT OBJECTIVE AND COMPONENTS

- 3.1 The project's general objective is to help preserve the financial cooperative system as a leading provider of financial services for microenterprises and small businesses as well as for low-income urban and rural residents. The specific objective is to support the establishment of a sound supervision system for credit unions and comparable financial co-ops, referred to herein as cooperative financial institutions (CFIs). To that end, the project has been divided into two mutually complementary components: (i) strengthening of CFI oversight structures within the Banking Superintendency and the SES, and (ii) support for consolidating the CONFECOOP auxiliary self-monitoring system. Both components will focus on the transfer of specific supervisory know-how, development of information systems, and staff training.

A. Component I: Strengthening of the Banking Superintendency and SES
(MIF: US\$665,000; counterpart: US\$474,000)

Banking Superintendency (SB) - Cooperative Institutions Office
(MIF: US\$435,000; SB: US\$334,000)

- 3.2 The project would support the SB in strengthening and consolidating its Cooperative Institutions Office, by way of the transfer of know-how on co-op oversight, training, and design and implementation of information systems. The following activities would be financed: (i) specialized services of consultants in the areas of portfolio audits, compliance monitoring and inspection, and systems; (ii) hardware and software procurement; (iii) in-house training seminars for staff; and (iv) dissemination and off-site training activities. Technology transfer will be the central focus of the component. Advisory support to the SB would be arranged in close coordination with the activities planned for the SES and with CONFECOOP. The plan is to have the SB and SES share some of the consultant services working with systems and CFI auditing and risk analysis.

Superintendency of Cooperative Associations (SES)
(MIF: US\$230,000; SES: US\$140,000)

- 3.3 The project would help the SES become established and build a sound institutional base, through the transfer of technology, staff training, and design and implementation of information systems. Specifically, this component would finance: (i) services of consultants specializing in portfolio audits and risk analysis,

organization and systems; (ii) hardware and software procurement; and (iii) initial staff training. Because this is a new agency, the project would concentrate on support for the acquisition of information systems and on institutional design. Apart from the consulting services intended for the SES specifically, the plan is that it would benefit also from the work being done by consultants at the SB.

B. Component II: Consolidation of the CONFECOOP self-monitoring system

(MIF: US\$700,000; CONFECOOP: US\$471,000)

- 3.4 The project would support CONFECOOP as it consolidates and expands the self-monitoring system, and in making its rules and requirements known to CFIs. The core actions planned will help continue development of information systems, alongside technology transfer activities. This component would fund: (i) specialized consulting services to help design and implement information systems, perform financial and institutional analysis of CFIs, and devise CFI inspection and compliance monitoring mechanisms; (ii) training of CFI staff in prudential standards and supervisory regulations, and in financial administration and risk analysis; and (iii) hardware and specialized software to gather, analyze, and disseminate financial information from CFIs. This work would be closely coordinated with efforts planned at the SB and SES to ensure that the systems put into place and methods adopted are uniform and compatible.

IV. PROJECT IMPLEMENTATION, BENEFICIARIES, AND SUSTAINABILITY

A. Implementation arrangements

- 4.1 The project will have two executing agencies: the Ministry of Finance (MHCP) representing the SB and the SES, for component I, 5/ and CONFECOOP for component II. The two agencies would execute separate grant agreements for the specific amount established for each component, and would be fully accountable to the MIF for implementation of the respective component, including the local counterpart contribution. The MHCP would enter into subsidiary project-implementation agreements with the SB and the SES (see Annex IV, technical files), delegating responsibility for component I to those two agencies and delivering the funds earmarked for each subcomponent. The Ministry would also appoint a project coordinator to expedite implementation of component I and coordination with CONFECOOP and the Bank. The SB, SES, and

5/ The SB and SES do not have the budget autonomy to serve as executing agencies.

CONFECOOP would engage consultants and procure goods as provided in each component, adhering to IDB/MIF contracting and procurement rules. Annex III (technical files) contains the preliminary terms of reference for the proposed consultants. Contracting of these services would be expected to begin toward the end of the first quarter of 1999 at the latest.

- 4.2 The SB, SES, and CONFECOOP are the best agencies to implement the proposed project. They have the necessary institutional and legal mandates and the requisite technical and institutional capacity. The SB and SES are the agencies to which the government has commended the oversight of the financial cooperative sector; CONFECOOP is the sole federation-level agency representing the Colombian cooperative sector, with 32 second-tier member organizations. Funded largely through member contributions, CONFECOOP is financially and institutionally stable. It is firmly positioned at the heart of the co-op sector, and the Colombian people and government authorities recognize its stature at the head of the sector. The proposed activities to be conducted simultaneously by the three agencies, working in concert, would be expedited by the planned implementation arrangements and the fact that the SB and CONFECOOP have already executed a memorandum of understanding. CONFECOOP signed a similar memorandum with DANCOOP, which can serve as a basis for the cooperation with the SES.
- 4.3 In the project team's estimation, participation by the SB, SES, and CONFECOOP in the proposed operation would be a solid base for its rapid implementation. Furthermore, the coordination and communication arrangements established between the MHCP and the superintendencies in the course of the project's preparation will expedite the delegation of responsibilities for its implementation.
- 4.4 The Bank's Country Office in Colombia would supervise the project's implementation, which is expected to be take 24 months. The project would be considered completed when all the funds allocated have been disbursed, the executing agencies have presented project completion reports, and the final evaluation of the project has been done.

B. Beneficiaries

- 4.5 The project's direct beneficiaries would be the SB, SES, and CONFECOOP; benefiting indirectly would be credit unions and like institutions in the financial cooperative system. However, the ultimate beneficiaries would be credit union and co-op depositors, who would see their investment risks decline once a regulatory and supervision system comparable to those in place elsewhere in the financial system is instituted in the cooperative sector.

C. Sustainability

- 4.6 The funding proposed for this project would be used for systems design and implementation and for the initial transfer of know-how for effective supervision of cooperatives, that is, it would defray startup costs, not recurrent expenditures of institutions taking part in the project. Once the basic technical conditions for the supervisory system were in place, sustainability of CFI inspection and oversight services would be assured by the availability of the executing agencies' own funds to cover recurring costs.

V. COST AND FINANCING

- 5.1 The total estimated project budget is US\$2,360,000, of which the MIF would fund US\$1,415,000 and US\$945,000 (40%) would be the local counterpart contribution. Of the total, US\$1,139,000 would be for component I and US\$1,171,000 for component II; the balance would pay for two evaluations of the project. MIF funds for each component would be disbursed pari passu with local-counterpart disbursements. The following summary budget shows cost items for each component (see itemized budget in Annex II, technical files).

Budget (US\$000)			
Cost item	Local	MIF	Total
COMPONENT I			
Consultants	144	434	578
Training	125	25	150
Software and hardware	100	150	250
General support	95	0	95
Contingency	10	56	66
Subtotal	474	665	1,139
COMPONENT II			
Consultants	216	330	546
Training	125	180	305
Software and hardware	70	140	210
General support	50	0	50
Contingency	10	50	60
Subtotal	471	700	1,171
Evaluations	0	50	50
Grand total	945	1,415	2,360

VI. RATIONALE AND RISKS

A. Rationale

- 6.1 The proposed project is a pressing priority in light of the current crisis in the CFI sector, in that it will address the structural roots of the problem and help rebuild depositor confidence. It likewise would strengthen prudential supervision systems covering a sizable segment of the country's financial system, bringing it under rules and standards comparable to those governing other institutions in the national financial system. This would bolster that national system generally, and more specifically it would make the savings of middle- and low-income depositors more secure, particularly in rural communities. Given the large number of CFIs in operation, the organization of an auxiliary supervision system is being proposed, whereby part of the responsibility for gathering and verifying CFI financial information would be delegated to CONFECOOP.

B. Risks

- 6.2 The most serious risk facing the proposed project is that it would be carried out at a juncture in which the public has deep misgivings about the stability of the CFI system. On an operational level, however, the project risks would be minimal, inasmuch as the government recognizes the severity of the crisis and the need to move forward with reform of the system. Legislative reforms, creation of the Cooperative Institutions Office and the SES, and support for setting up an auxiliary oversight apparatus all attest to the government's commitment. For their part, the co-op system and CONFECOOP have shown a strong commitment to the project, prompting pledges of considerable resources from the sector.

VII. EXPECTED OUTCOMES AND EVALUATIONS

- 7.1 Expected outputs and outcomes of the project are: (i) more technical know-how regarding economic and financial analysis of CFIs instilled in staff of the SB's Cooperative Institutions Office, the SES, and CONFECOOP, particularly with respect to portfolio audit and risk appraisal; (ii) new computerized information systems to gather, compile, and verify financial information from CFIs; (iii) a CFI oversight system implemented in the SB and SES; (iv) a system of cooperation and delegation of functions among the SB, SES, and CONFECOOP in place, as part of an auxiliary supervision system framework. Project funds have been budgeted for two evaluations of the operation, both of them to be commissioned by the Bank, the first 12 months after the first disbursement of MIF funds and the second when the project is complete. Both evaluations would be commissioned by the Bank. One element of the evaluations will be the project performance benchmarks shown in the attached Logical Framework (Annex I).

VIII. EXCEPTIONS TO POLICIES

- 8.1 None.

IX. SPECIAL CONDITIONS

- 9.1 As conditions precedent to the first disbursement for each subcomponent of component I, the Ministry of Finance would be required to: (i) execute subsidiary project-implementation

agreements with the SB and SES, to delegate rights and responsibilities for the project to those agencies; and (ii) appoint a project coordinator for component I.

CONDENSED LOGICAL FRAMEWORK

THE PROGRAM	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
GENERAL OBJECTIVE			
To help preserve the credit union/ financial cooperative system as a leading provider of services to microenterprise and small business and to low-income urban and rural communities.	<p>Number of cooperatives offering financial services.</p> <p>Supply of financial products for the target group.</p> <p>Supervision structures instituted in SB and SES.</p> <p>Institutionalization of the auxiliary supervision structure via CONFECOOP.</p>	<p>Financial reports of SB, CONFECOOP, SES.</p> <p>Consultants' reports.</p>	<p>Crisis in the cooperative sector is allayed.</p> <p>Government continues to support the process of prudential regulation and oversight of financial cooperatives.</p> <p>Cooperative sector and regulatory agencies work in concert.</p>
Components and activities			
Component I: Strengthening of supervision structures in SB and SES			
Develop and implement specialized methodologies to assess lending portfolios of cooperatives that will come under SB and SES supervision, by way of portfolio audits, and design restructuring plans.	Documented methodologies for portfolio-assessment, institutional diagnoses, restructuring plans.	Consultants' reports.	<p>There are firms in the market that have the expertise needed for this work.</p> <p>SB and SES work closely together and coordinate efforts.</p>
Transfer and instill know-how about on-site and off-site supervision, compliance monitoring, and inspection of cooperative financial institutions.	Staff trained; 60 on-site and off-site audits (SB); 50 on-site audits and 250 off-site inspection and compliance reports (SES).	Inspection reports.	There are firms in the market that have the expertise needed for this work.
Develop and implement information systems to gather, process, assess, and disseminate statistics and financial data on the supervised cooperatives.	Systems acquired and implemented; software developed and in place.	<p>Information outputs.</p> <p>Hardware and software inventories.</p>	Computer hardware and software procurement adheres to the project timetable.
Design and implement SES organizational structure and procedures.	<p>Satisfactory SES operation.</p> <p>Positions identified.</p>	Organization chart and procedures manuals.	There are firms in the market that have the expertise needed for this work.

CONDENSED LOGICAL FRAMEWORK

THE PROGRAM	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
Develop and deliver in-house and off-site training programs on applying principles of supervision and prudential standards.	15 workshops for staff of SB, SES, CONFECOOP, cooperatives, and auditors. Training groups.	List of courses. Programs. Reports.	Training program is designed and delivered as per the project timetable.
Component II: Strengthening CONFECOOP self-monitoring and oversight structures			
Support to CONFECOOP to consolidate and expand the self-monitoring system, through development and implementation of:			
(i) Specialized methodologies for assessing cooperatives' loan portfolios and devising restructuring plans.	Documented methods for portfolio assessment, institutional diagnoses, restructuring plans.	Financial reports of SB, CONFECOOP, SES.	There are firms in the market that have the expertise needed for this work.
(ii) Know-how about supervision, compliance monitoring, and on-site and off-site inspection of cooperative financial institutions.	Staff trained; 50 on-site audits; 250 off-site inspection and compliance reports.	Consultants' reports. Inspection reports.	There are firms in the market that have the expertise needed for this work.
(iii) Information systems to gather, process, assess, and disseminate statistics and financial data.	Systems procured and installed; software developed and in place.	Information outputs. Hardware and software inventories.	Computer hardware and software procurement adheres to the project timetable.
(iv) Workshops to train cooperatives' staff in applying financial and prudential standards.	10 workshops to train staff of cooperatives and CONFECOOP.	List of courses. Programs. Reports.	Training program is designed and delivered as per the project timetable.

PROPOSED RESOLUTION

COLOMBIA. TECHNICAL COOPERATION. STRENGTHENING OF THE SAVINGS AND LOAN CREDIT UNION SYSTEM

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, on behalf of Multilateral Investment Fund, to enter into such agreements as may be necessary with the Ministry of Finance and Public Credit and the Credit Union Confederation of Colombia and to adopt such other measures as may be pertinent for the execution of the plan of operations referred to in Document MIF/AT- _____, with respect to a technical cooperation, the purpose of which is the strengthening of the savings and loan credit union system.

2. That up to the amount of US\$ 1,415,000 is authorized for the purpose of this resolution, to be disbursed as follows: up to US\$750,000 from the Technical Cooperation Facility, and up to US\$665,000 from the Human Resources Facility of the Multilateral Investment Fund.

3. That the above mentioned sum is to be provided on a non-reimbursable basis.