

STRENGTHENING OF THE BANKING AND INSURANCE COMMISSION

(TC-94-10-44-0)

EXECUTIVE SUMMARY

EXECUTING AGENCIES: Banking and Insurance Commission [Comisión de Banca y Seguros] (CBS) and Central Bank of Honduras [Banco Central of Honduras] (BCH)

OBJECTIVE: The objective of the program is to support reform of the financial sector and the capital market to encourage their development by facilitating private-sector access to investment financing and lowering the cost of that financing. More specifically, support will be provided in preparing a new regulatory framework for the stock market and the insurance market (as major institutional investors) and assistance will be offered in implementing the prudential regulations required under the new Financial Institutions Act and the Banking and Insurance Commission Act, passed in October 1995. In addition, the new supervisory agency - the Banking and Insurance Commission - will be offered assistance in its initial stages. Its technical areas will be strengthened, with stress on the supervision of financial institutions, which will help to avoid unnecessary risks and encourage better allocation of savings.

DESCRIPTION: The MIF funding would be used to support four subprograms:

Subprogram I. Support for reforms of the regulatory framework governing the financial system, the insurance market, and the stock market, through consulting services to: (i) prepare the prudential regulations required under the new Financial Institutions Act and the bill on the deposit insurance system; (ii) prepare a bill on insurance companies and the prudential regulations required under the new legislation; and (iii) prepare a stock market bill and the main regulations needed.

Subprogram II. Support for the Banking and Insurance Commission in establishing its structure and operating procedures and manuals, through consulting services to: (i) redefine the supervision model and establish a suitable organizational structure; (ii) prepare a manual of functions; (iii) establish a

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salary structure and develop a recruitment plan; and (iv) prepare manuals of procedures for line areas.

Subprogram III. Support for the strengthening of information systems, through the provision of funds for: (i) the procurement of equipment and software (up to 70% of the cost); and (ii) consulting services to identify and develop systems.

Subprogram IV. Support for a professional development program in the form of funding for: (i) study visits to other supervisory institutions in the region; and (ii) consulting services to develop training programs through courses and in-service training.

Program execution will largely be the responsibility of the CBS, although the BCH will participate in some components of subprogram I, particularly in drafting legislation. The BCH will also be designated as the beneficiary since the CBS does not have full legal capacity, reporting as it does to the BCH. Last, to facilitate execution, the program has been designed to minimize the number of consultants to be contracted for the different subjects and technical specialties required.

FINANCING:

Modality:	Grant
Local contribution:	US\$ 180,000
MIF:	US\$1,530,000
Total:	US\$1,710,000

**EXECUTION
SCHEDULE:**

24 months

**ENVIRONMENTAL
CLASSIFICATION:**

At its meeting on August 8, 1995, the Environment Committee classified this as a category II operation.

I. COUNTRY ELIGIBILITY

- 1.1 The Donors Committee declared Honduras eligible for all types of MIF financing on December 14, 1993.

II. THE PROJECT

A. Frame of reference

- 2.1 In 1990 as part of the structural adjustment program, the government undertook a gradual reform of the financial sector which included rationalization of the bank rediscount mechanism and liberalization of interest rates.
- 2.2 Continuing that reform, in October 1995 Congress passed a new Financial Institutions Act which came into effect in November of that year. The new legal framework largely corrects the serious weaknesses in the regulatory framework, including removal of barriers to the entry of new institutions, incorporation of all financial intermediaries into the supervisory regime, and strengthening of prudential regulations. It also fortifies the government's supervisory capacity over the sector, which will be reassigned to a new institution – the Banking and Insurance Commission (CBS) – for a change in the old system under which the Central Bank of Honduras was responsible for supervision through the Office of the Superintendent of Banks and Insurance.
- 2.3 As a complement to the Financial Institutions Act, in October 1995 Congress passed the Banking and Insurance Commission Act which establishes the basic structure of the commission and lays down its principal functions. Aside from supervision of the insurance sector, it will also oversee the stock market and the pension system. The Banking and Insurance Commission Act establishes that the CBS is responsible for supervising these three areas, but fails to give it specific powers to exercise that function. Instead it refers to other laws already in existence or to be developed. As mentioned in paragraphs 2.6, 2.12, and 2.13 below, the legislation governing the insurance market, the stock market, and the pension system leaves much to be desired. Therefore, if supervision in these areas is to be effective, substantial reforms in the legal framework will need to be made.
- 2.4 Under the new act, the CBS is composed of a board of directors with three full-time members, and the Office of the Superintendent of Banks and Insurance, its technical corps, through which the board will supervise the different areas. The members of the board of directors have already been appointed under the new act, and the CBS is required to begin operating six months after the act came into force on December 8, 1995.

- 2.5 To be effective, the reforms to the legal framework governing financial institutions require an additional effort to ensure that the Banking and Insurance Commission will have the technical capacity to carry out its functions. This will involve correcting the institutional weakness exhibited in the past by the Office of the Superintendent of Banks and Insurance (SBS), which used to be part of the Central Bank of Honduras (BCH).
- 2.6 The Honduran government has also expressed interest in continuing with regulatory reforms to promote the development of the capital market. The country has no stock market act and the markets currently operating - the Honduran Stock Exchange established in 1990 and the Central American Stock Exchange established in 1993 - are chiefly governed by their internal regulations and the Commercial Code. The regulatory framework for the insurance system also needs revamping. Furthermore, a strategy should be developed to restructure the pension fund system and the Honduran Social Security Authority [Instituto Hondureño de Seguridad Social].
- 2.7 Through the BCH, the government requested support from the Multilateral Investment Fund for a program to strengthen the technical body responsible for supervising the financial and insurance sectors, and for assistance in preparing a coherent regulatory framework for the capital market. In this last regard, it should be noted that the regional technical-cooperation project funded by the MIF to harmonize the capital markets in Central America is supporting establishment of: (i) a compensation and liquidation system for the Honduran exchanges; and (ii) self-regulatory measures. Studies in the area of pensions are being conducted with bilateral support.

B. Objectives

- 2.8 The main objective of the project is to support reform of the financial sector and the capital market to encourage their development by facilitating private-sector access to investment financing and lowering the cost of that financing. More specifically, support will be provided for preparation of a new regulatory framework for the stock market and the insurance market, and assistance will be offered in implementing prudential regulations for the financial sector that are geared to the new financial legislation. The CBS will also be assisted in its initial stages. Its technical areas will be strengthened with special emphasis on finance, which will result in more efficient supervision of banks to avoid undue risks and encourage better allocation of savings.

C. Activities

- 2.9 To attain the objectives described in the preceding paragraph, the project will provide support in four areas: (i) the regulatory framework governing the financial system, the insurance market, and the stock market; (ii) the internal organization and working

procedures of the CBS; (iii) strengthening of CBS information systems; and (iv) training for CBS employees and managers.

- 2.10 The specific activities and expected results for each subprogram are described below. Annex I presents a summary of program activities. To facilitate execution, the program has been designed to minimize the number of consultants to be hired for the different technical areas. Seven long-term consultants will be contracted as well as a consultant to act as general coordinator of the program. However, to make the program more flexible and considering that some long-term consultants may have to be replaced during program execution, MIF funding for contingencies has been increased to 15% of project costs.

Subprogram I. Support for reforms of the regulatory framework governing the financial system, the insurance market, and the stock market

- 2.11 An appropriate legal framework is crucial for ensuring that the capital market can develop. At present, Honduran legislation in this area presents serious shortcomings, although efforts are being made to modify the framework under the leadership of the BCH.
- 2.12 Stock market activities are chiefly subject to the Commercial Code and internal regulations. The market is basically primary, trades few stocks, and its information standards are low. The CBS is responsible for supervising the stock markets, but under the existing law, it is limited to establishing accounting rules and has no authority to impose sanctions. A bill to regulate the stock market was prepared in 1993 to correct those shortcomings.
- 2.13 As a supplement to the stock market act, legal reforms are required to facilitate the development of institutional investors. From this standpoint, it is necessary to revise the legal framework governing insurance companies, given the role they could play in developing the capital market and the benefits that could stem from the expansion of insurance services. Current regulations governing the insurance sector have many drawbacks, including the lack of a dynamic mechanism to ensure financial soundness, excessive restrictions on investments, and the gaps in regulations in important areas. In 1994 the BCH made some headway in preparing a preliminary draft for a law governing insurance companies.
- 2.14 The government feels that passage of reforms to the Financial Institutions Act will make it possible to proceed with reforms to the legal framework governing the capital market. Last, it will be necessary to develop new prudential regulations and charts of accounts to make the legal reforms effective.

a. Specific objectives

- 2.15 The specific objective of this subprogram is to help establish a coherent regulatory framework for financial institutions, the stock market, and insurance companies, as institutional investors.
- 2.16 The proposed technical assistance will support the government's efforts by designing prudential regulations and charts of accounts to comply effectively with the recent financial reform. Assistance will also be provided in preparing legislation to govern the deposit insurance system (which is an aspect referred to in the new Financial Institutions Act). The program will also help in preparing draft legislation on the insurance sector and presenting it to Congress, and the main prudential regulations and charts of accounts that the law requires. With respect to the stock market, the program will help in drafting a stock market act and presenting it to Congress and to prepare the most important prudential regulations in that regard.

b. Specific activities

- 2.17 MIF funding will be used to hire specialized consultants to assist the BCH and the CBS in preparing the draft legislation, regulations, and the prudential standards mentioned in paragraph 2.16.

Component a. Support for a regulatory framework for the financial system, insurance companies, and the stock market

- (i) A specialist in regulation of financial systems will help in preparing draft legislation governing the deposit insurance system and presenting it to Congress (three months).
- (ii) A specialist in regulation of financial systems will help to prepare regulations for the Financial Institutions Act and the Banking and Insurance Commission Act (approximately two months). This activity will be performed by the same consultant identified for task (i).
- (iii) An expert in the regulation and supervision of insurance companies will help in preparing draft legislation on insurance companies and the accompanying regulations, based on the headway already made in this area, and presenting the bill to Congress (three months).
- (iv) An expert in stock market regulation will help in preparing draft legislation on the stock market and the accompanying regulations, based on the headway already made in this area, and presenting it to Congress (three months).

Component b. Preparation of prudential regulations and charts of accounts

- (i) A specialist in the regulation and supervision of financial systems will identify and prepare the rules required for the new regulatory framework for financial institutions, based on international standards. The rules for the financial sector will be developed in close coordination with the insurance supervision department to identify prudential regulations common to both the bank supervision department and the insurance supervision department, thus avoiding duplication (approximately seven months). This activity will be performed by the consultant identified for tasks (i) and (ii) of component a.
- (ii) A consultant specializing in accounting with experience in preparing accounting plans for financial institutions will prepare the master chart of accounts for all financial institutions and train CBS staff in its use (four months).
- (iii) An expert in the regulation of insurance companies will identify and prepare the rules required for the new regulatory framework for insurance institutions, based on international standards, in addition to the common prudential regulations for the financial sector to be prepared under activity (i) of this component (two months). This activity will be performed by the same consultant identified for task (iii) of component a.
- (iv) A consultant specializing in accounting with experience in preparing charts of accounts for insurance institutions will prepare a master chart of accounts, including the design and details of a unified system for presenting financial statements that reflects the new prudential regulations and accounting standards (three months). This activity will also involve training for the department's staff and the insurance companies in use of the chart of accounts, and will be performed by the same consultant identified for task (ii) of this component.
- (v) An expert in stock market regulation will help to prepare the most important prudential regulations (three months). This activity will be performed by the same consultant identified for task (iv) of component a.

2.18 MIF resources will be supplemented by counterpart funding for the logistical and material support needed to hold seminars to publicize the reforms in the legal framework governing the financial sector and the capital market. Although the activities identified in this subprogram will require the cooperation between the BCH and

the CBS, the BCH will bear specific responsibility for component a and the CBS for component b.

Subprogram II. Internal organization, procedures, and operating manuals

- 2.19 The recently-passed Financial Institutions Act and the CBS Act seek to provide the new supervisory agency with the legal powers it requires for effective supervision, despite the fact that in some areas the conditions are not as stringent as internationally-accepted prudential regulations. If the objectives of the legal reforms are to be attained, the new CBS must be provided with the technical capacity and working tools needed to carry out its functions. In the new CBS it will be necessary to correct the weaknesses inherent in the traditional supervisory model and in the current structure of the Central Bank's SBS. The Central Bank also suffers from shortcomings in its working procedures and information systems.
- 2.20 The traditional supervisory process was too heavily based on inspection, to the neglect of other aspects such as financial analysis and legal considerations that would determine the scope of the SBS's functions. The CBS requires a new structure to correct these shortcomings, including a legal unit, a studies unit, and restructuring of the divisions in the two supervisory departments. Furthermore, the CBS must develop an administrative services area if it is to be independent. ^{1/} It is also indispensable to reinforce the structure of its information systems and to procure additional equipment.
- 2.21 The new CBS is expected to absorb most of the staff of the SBS. However, the establishment of new areas in the CBS and understaffing in some areas of the SBS will make it necessary to prepare a staffing plan and to identify professional profiles tailored to the different areas. The CBS also requires support in establishing a salary policy that will permit it to attract and retain qualified professionals.
- 2.22 The SBS has virtually never had manuals or instructions for systematic organization of the work performed by its different departments and employees, which has stood in the way of both coordination inside the institution and the recruitment of new staff. The CBS will require a manual of functions tailored to its new organization and a personnel manual which sets out the new salary policy and defines staffing profiles for the different areas.

^{1/} The CBS will continue to report to the BCH but will have administrative independence. Its budget will be passed by Congress and financed in equal parts with funds from the BCH and the institutions supervised.

- 2.23 The line areas also require specific manuals for their functions. The SBS currently has a manual of procedures for the inspection of financial institutions and one for insurance companies, but they must both be revised to update them and incorporate the respective elements of the new prudential regulations for each sector. Also required are a manual on financial analysis, a manual on control of legal limits and prohibitions which defines the limits to be monitored periodically, and a manual on evaluation by external auditors. These three manuals could be shared by the insurance supervision department and the bank supervision department, thereby reducing costs.

a. Specific objectives

- 2.24 The main objective of this subprogram is to establish an organizational system in the CBS that will permit it to respond efficiently to the new supervisory model that the legal reforms seek to develop. It will therefore be necessary to make numerous changes in the SBS's current organizational chart, define a new personnel management policy, identify additional staffing requirements, and develop working procedures.

b. Specific activities

- 2.25 MIF funds will be used to hire an expert to help coordinate execution of the different components for strengthening the CBS and to contract consultants to assist in implementing the organizational adjustments, establishing a personnel management policy, reviewing staffing requirements, and preparing manuals of procedures for the bank supervision department and the insurance supervision department.
- 2.26 The MIF resources will be supplemented by counterpart funding for logistical and material support for the different activities. To ensure that the program does not get bogged down in the preparation of specific products such as manuals, rather than producing permanent solutions, active participation by CBS staff and senior management will be required and a senior CBS official will be appointed to act as counterpart to the consultant acting as general coordinator.
- 2.27 More specifically, MIF funds will be used to hire consultants in the following areas.

Component a. Internal organization and staffing

- (i) A consultant to act as general coordinator of the institutional strengthening program will be hired for an initial stay of approximately three months, followed by two-week visits every three months. The consultant must have extensive experience in the institutional development of supervisory agencies, preferably in the

banking area, and will directly support the CBS official appointed as coordinator of the institutional strengthening program. The consultant will help to redefine the supervisory model, develop a proposal for the new organization of the CBS, and lay the groundwork for preparing a new manual of functions and personnel profiles. The consultant will help to prepare proposals to reform the salary structure and the plan for short- and medium-term recruiting. He or she will also help to design the terms of reference for the other consultants required under the program, propose candidates, and supervise their work.

- (ii) A consultant with extensive experience in the institutional development of an insurance regulatory agency will be hired for a total of 1.8 months on a part-time basis to help define the new structure of the insurance supervision department, including the main posts and functions; identify the technical standards required under the new legal framework; advise on basic working procedures and public disclosure; and cooperate with the general coordinator in the plan of work to strengthen the insurance supervision department. This activity will be performed by the same consultant working on task (iii), component a, of subprogram I (paragraph 2.17).
- (iii) A consultant with experience in business administration and organizational development will be hired for a total of approximately five months to prepare the manual of functions and the personnel manual, assist the general coordinator in reviewing the salary structure and in defining a recruitment plan, and support the general organization of the administration department.

Component b. Preparation of manuals of procedures for the supervision of financial institutions

- (i) A consultant with training in economics or accounting, with stress on auditing and finance, and experience in the preparation of manuals of procedures for bank supervision will be hired for nine months to prepare the main procedural manuals for bank supervision, which include: (i) the manual of inspection and accounting procedures; (ii) the financial analysis manual; (iii) the manual on control and legal limits; and (iv) the manual on external auditors. The procedural manuals should not be theoretical but should offer practical methodological support to facilitate the work of inspectors and analysts. Training must also be provided in their use. This component will be carried out by the same consultant cooperating in activities (i) and (ii), component a, subprogram I (paragraph 2.17).

Component c. Preparation of manuals of procedures for the supervision of insurance companies

- (i) A consultant with training in economics or accounting, with stress on auditing and finance, and experience in the preparation of manuals of procedures for insurance supervision departments will be hired for three and a half months to prepare the manual on accounting inspection and procedures and train its users. This activity will be carried out by the consultant cooperating in activity (iii), component a, subprogram I (paragraph 2.17).

Subprogram III. Strengthening of information systems

a. Frame of reference

- 2.28 The technical assistance program to strengthen the BCH financed by the World Bank provided the SBS with equipment in 1995. However, that equipment, which will be transferred from the SBS to the CBS, will not be sufficient for its requirements, since its main function is to manage and process information. As was mentioned earlier, institutional changes are called for to give greater prominence to the information systems area in the structure of the new CBS, and to provide training courses in systems.
- 2.29 The shortage of equipment to collect and process information about the institutions audited has been a major obstacle to updating existing data banks and to their timely use. The situation has been exacerbated by the SBS's demand for information of little use and by considerable delays and omissions on the part of the institutions subject to supervision in submitting the information requested, which were largely due to the SBS's lack of authority to impose sanctions and its failure to exercise the authority that it does have.
- 2.30 The reports and statistics produced are insufficient. Quarterly reports are issued on the aggregate results of the "system" of bank savings and loans, taking a quantitative rather than an analytical approach. Comparative information on the different institutions is not presented owing to a legal problem relating to the concept of "bank confidentiality", which has been corrected in the new Financial Institutions Act. An annual report is prepared on insurance statistics, but it is published with a considerable delay and is apparently of limited use to insurers. No statistical information is prepared on reinsurers, there is no review of reinsurance contracts, and no register of reinsurers is kept.

b. Specific objectives

- 2.31 The purpose of this subprogram is to introduce a computer system that covers the CBS's main requirements, and provides the means for better supervision and information for the institutions audited, including installation of a risk clearinghouse. Progress has been made in this last area during 1995. A bulletin providing financial statistics will be produced to provide information for the public. A register of reinsurers will be set up, and information will be identified for use by the public and audited institutions, enlarging the scope of the information bulletin.

c. Specific activities

- 2.32 MIF resources will be used to:

- a. Finance a team of consultants, led by an international expert in designing systems for supervisory agencies in the financial and insurance sectors, who will cooperate with local experts in developing information systems. The CBS's additional automation and information requirements will be determined; computer equipment will be installed; the general information system will be completed; subsystems and main modules will be developed (in particular in the insurance area where the need is greatest); and technical staff will be trained. A risk clearinghouse and a reinsurance register will be set up. The information bulletins on finance and insurance will be designed. These activities will require the cooperation of the consultant acting as general coordinator of the program, identified in subprogram II.
- b. Partially finance the procurement of equipment. The counterpart contribution will cover approximately 30% of the total cost of the equipment to be procured under the program.

Subprogram IV. Training

a. Frame of reference

- 2.33 The predominating personnel profile in the SBS - bookkeepers - is not the best suited to its functions. Employees often do not have post-graduate studies, and in some cases have only taken short courses in related areas but not in such subjects as finance or banking, which are crucial for understanding financial business. Modern supervision of financial institutions requires a strong academic background as well as extensive training, including training in areas that are not regularly taught in university programs, to enable employees to keep abreast of developments in this very dynamic area. It is highly important to support the CBS in defining a more suitable personnel profile (included in subprogram II) and in providing training programs. Training should become an ongoing exercise in the CBS to ensure that its staff keeps up to date. However, programs should

begin with the most crucial employees of the CBS and should stress the most relevant areas.

- 2.34 As a key element of the training process, and tapping the international expertise in supervision, specialists will be hired to provide in-service training in inspection and financial analysis for a selected group of staff from the bank supervision department and a smaller group from the insurance supervision department. The training process will set the stage for a study on the solvency of financial institutions - at least the principal ones - and a study on insurance companies.
- 2.35 Visits to other supervisory agencies in the region to learn first-hand about other experiences in supervision would be very useful for practical training, especially in the initial stages of organizing the CBS.

b. Specific objectives

- 2.36 The purpose of this subprogram is to strengthen the technical capacity of CBS managers and employees, through courses in specific areas of supervision, visits to other supervisory agencies in the region, and in-service training in inspection and financial analysis.

c. Specific activities

- 2.37 To achieve the proposed objectives, MIF resources will be used to:
- a. Pay the cost of visits to supervisory agencies in the region, lasting an average of a week and a half, for a group of approximately 20, targeting CBS managers and other senior staff.
 - b. Hire specialists to give courses lasting from two to three weeks, full time, for selected employees, in key areas such as financial analysis, portfolio evaluation, banking law, insurance law, computer-assisted audits, financial soundness (for insurance companies), receivership and liquidation of financial institutions, and financial crisis management. Some courses will also be given in stock market supervision.
 - c. Hire consultants to provide in-service training in inspection and financial analysis, for a group of selected employees from the bank supervision department (for a total of five and a half months) and a group from the insurance supervision department (for a total of four months). Founded on that training, the CBS will conduct a solvency study of at least the main financial entities, and another of insurance companies. The activities under this component will be conducted by the specialists in the supervision of financial agencies and the regulation of insurance companies to be contracted for the activities identified in subprograms I (paragraph 2.17) and II (paragraph 2.27).

- 2.38 MIF resources will be supplemented by counterpart funding for logistical and material support for the training courses. Counterpart funds will also be used to finance basic computer courses.

d. Cost and financing

- 2.39 The following table summarizes the projected cost of each subprogram.

BUDGET (US\$)				
Subprogram	Component	MIF	Counterpart	Total
I. Support for reforms to the regulatory framework of the financial system, insurance market, and stock market	a. Preparation of the legal framework for the financial sector, insurance market, and stock market	133,000	2,000	352,000
	b. Preparation of prudential regulations and charts of accounts	217,000		
II. Establishment of the internal organization of the CBS and operating procedures and manuals	a. Coordination of the program, redefinition of the supervisory function, and internal organization	175,000	73,000	383,000
	b. Bank supervision department: operating manuals and procedures	96,500		
	c. Insurance supervision department: operating manuals and procedures	38,500		
III. Establishment of information systems for the CBS	a. Consulting services	150,000		435,000
	b. Equipment	200,000	85,000	
IV. Training for CBS personnel	c. Information visits	70,000		325,000
	b. Courses	125,000	20,000	
	c. In-service training	110,000		
Other	Contingencies and evaluation	215,000		215,000
Total		1,530,000	180,000	1,710,000

e. Organization and execution

a. Executing agencies

- 2.40 The CBS will bear principal responsibility for project execution, although the BCH will participate in component a of subprogram I.
- 2.41 To help the CBS prepare for startup and support the introduction of suitable prudential regulations, some program activities may begin as soon as the CBS is legally established, i.e. once the members of its

board of directors are appointed (already done) and an executing unit is set up in the CBS (see paragraph 2.4). More specifically, these activities will include component b of subprogram I, component a of subprogram II on organization of the CBS (up to 25% of the MIF funds would be allocated to this activity), and component a of subprogram IV for information visits (up to 20% of the MIF funds would be allocated to this activity).

b. Disbursements

- 2.42 The technical-cooperation funding will be disbursed in accordance with Bank procedures. An agreement between the Bank and the BCH must be signed before the program begins, designating the latter as the beneficiary and making it responsible for execution of component a, subprogram I. Prior to the first disbursement under component a, subprogram I, the BCH must comply with the Bank's general contractual conditions, and present the following: (i) evidence that it has signed an agreement with the CBS to transfer to it the MIF funding for the components for which the CBS is responsible and a commitment by the CBS to execute those components; and (ii) a plan of work for execution of the activities of component a subprogram I.
- 2.43 Prior to the first disbursements under component b of subprogram I, component a of subprogram II for organization of the CBS (up to 25% of MIF funding), and component a of subprogram IV for information visits (up to 20% of MIF funds), in addition to complying with the Bank's general contractual conditions, the CBS must present evidence that:
- (i) The CBS has been legally established with the appointment of the three-member board of directors.
 - (ii) An agreement has been signed between the BCH and the CBS in which the latter assumes responsibility for executing the program components assigned to it.
 - (iii) An executing unit has been established in the CBS.
 - (iv) A plan of work and a timetable for execution of activities have been agreed upon with the Bank.
- 2.44 The following requirements must be met for disbursements above the percentages assigned to the components mentioned in paragraph 2.43 and for release of the first disbursements for the remaining components (components b and c of subprogram II, components a and b of subprogram III, and components b and c of subprogram IV): (i) the CBS has begun to operate, with all the responsibilities of the SBS transferred to the CBS and its staff in place and working; and (ii) a plan of work and a timetable for execution of the activities in this part of the program have been agreed upon with the bank.

c. Supervision

- 2.45 Semiannual progress reports on execution of the subprograms and a summary of the work performed by each consultant will be required. The first report is to be presented six months after the program begins and the final report six months after disbursement in full. The final report will also include a medium-term plan to provide continuity for the strengthening process begun under the technical-cooperation project. The consultant who acts as general program coordinator will prepare the reports and the CBS will present them to the Bank.

d. Feasibility, risks, and other special concerns

- 2.46 Strengthening for supervision of the insurance sector should begin when the reforms to the regulatory framework of the sector are passed. However, even if the reforms are not passed during project execution, it is advisable to proceed with the program components relating to supervision of the insurance sector, given the serious shortcomings in this area, where improvements can be made despite the current legal constraints.
- 2.47 The program seeks to tighten supervision of the financial sector considerably. However, the program should be viewed as a first stage in a longer strengthening process that the CBS authorities should continue.

III. COMPLIANCE WITH PROJECT ELIGIBILITY CRITERIA

A. General project eligibility criteria

- 3.1 MIF financing to strengthen the SBS is fully consistent with the MIF's main objective of developing the private sector. Improvements in supervision of the system are crucial for ensuring that the financial system operates properly, which will help to improve access to financing by private investors, thereby boosting economic growth.

B. MIF criteria for determining project eligibility

- 3.2 The proposal fully complies with the financing criteria established in Article III (Section 2) of the Agreement Establishing the MIF, which states that financing may be extended to governments to support the development of financial systems through the establishment of basic prudential standards and supervisory institutions.

IV. COMPATIBILITY WITH THE BANK'S COUNTRY PROGRAM

- 4.1 The main objectives of the Bank's country program are to support development of the private sector as an engine for economic growth. Under its private-sector development strategy, the Bank attaches special importance to the financial sector and development of the capital market. Strengthening of the CBS will support that strategy by contributing to greater efficiency in the banking system, thereby helping to increase private investment.

V. AVAILABILITY OF MIF FUNDS

A. Type of financing

- 5.1 It is proposed that the project be financed through a grant, on the basis of the following considerations: (a) the Donors Committee declared Honduras to be eligible for all types of MIF financing; (b) section 3 of the country eligibility memorandum outlines Honduras's compliance with the eligibility criteria for obtaining a national donation; (c) the proposed project will have a significant catalytic impact on investment flows, as required under Article III, Section 5(a) of the Agreement Establishing the MIF, since its objective is to improve the supervision and functioning of the financial system, which will be reflected in better access by private investors to financing, thus contributing to economic development.

VI. EVALUATION

- 6.1 An international consultant will be hired who will provide technical assistance, under the supervision of the project team, during preparation of the project completion report to examine whether the specific objectives have been achieved. The aspects discussed in the report will include: (i) improvements in the quality of the inspection reports produced by the CBS; (ii) the quality of the information produced by the CBS; (iii) the level of the information systems, including the risk clearinghouse; (iv) progress in professional development and staff recruitment; and (v) additional plans to give continuity to the strengthening process begun under the program.

PROGRAM SUMMARY

**MIF - FACILITY I
HONDURAS
INSTITUTIONAL STRENGTHENING OF THE BANKING AND INSURANCE COMMISSION**

General objective:

To promote the development of the financial sector and the capital market

Specific objective:

To support the preparation of a suitable legal framework for the financial sector, insurance market, and stock market and strengthen the technical capacity of the CBS, with special stress on banking, which will result in better supervision to prevent undue risks and encourage more efficient allocation of savings.

SUBPROGRAMA	ACTIVITIES	EXPECTED RESULTS
I. Support for reforms to the regulatory framework of the financial system, the insurance market, and the stock market	<p>Recruit specialized consultants to assist the BCH and other institutions in preparing:</p> <ul style="list-style-type: none"> (i) regulations for the new Financial Institutions Act and a deposit insurance system bill; (ii) proposed reforms to the Insurance Institutions Act; and (iii) proposed reforms to the Stock Market Act. <p>Recruit specialized consultants to assist the CBS in preparing:</p> <ul style="list-style-type: none"> (i) The prudential regulations and chart of accounts required for the new Financial Institutions Act; (ii) the main prudential regulations and chart of accounts required for reform of the legal framework governing the insurance sector; and (iii) the main prudential regulations required for reform of the stock market. 	<p>Regulations of the Financial Institutions Act within the first quarter of the program.</p> <p>New prudential regulations and a chart of accounts for financial institutions prepared in the first year of the program.</p> <p>Prudential regulations and regulations for the reforms of the insurance market and the stock market prepared within 18 months after program startup.</p>

MIF - FACILITY I HONDURAS INSTITUTIONAL STRENGTHENING OF THE BANKING AND INSURANCE COMMISSION		
II.	Establishment of an internal organization for the CBS working procedures and manuals	<p>Recruit consultants with experience in the supervision of financial systems and institutional development to help redefine the supervisory model, support the establishment of an organizational structure for the CBS, prepare manuals on functions, identify recruitment needs and help to revise the salary structure, and prepare the main manuals of procedures for financial and insurance supervision. A consultant — preferably a former supervisor of financial institutions — will be contracted to coordinate and advise on the different program activities.</p> <p>Preparation of manuals of procedures within 18 months after program startup.</p>
III.	Establishment of information systems for the CBS	<p>Recruit consultants and procure computer equipment to establish a comprehensive information system covering the CBS's main requirements, including a risk clearinghouse.</p> <p>Develop statistical information bulletins for the public on finance and insurance.</p>
IV.	Training for CBS staff	<p>Recruit consultants to give training courses for CBS staff.</p> <p>Conduct study visits to other supervisory agencies in the region.</p> <p>With support from specialized consultants, develop an in-service training program in the areas of financial inspection and analysis to serve as the basis for studies on the solvency of financial and insurance institutions.</p>

PROPOSED RESOLUTION

HONDURAS. NONREIMBURSABLE TECHNICAL COOPERATION FOR
A PROGRAM FOR THE STRENGTHENING OF THE COMMISSION OF
BANKING AND INSURANCE

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, in the name and on behalf of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the Banco Central de Honduras and to take such additional measures as may be pertinent for the execution of the memorandum of proposal referred to in Document MIF/AT- with respect to a technical cooperation for a Program for the Strengthening of the Commission of Banking and Insurance.

2. That up to the amount of US\$1,530,000, or its equivalent, is authorized for the purpose of this resolution, chargeable to the resources of the Technical Cooperation Facility of the Multilateral Investment Fund.

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