

CREDIT UNION STRENGTHENING PROJECT

(TC-94-08-17-2)

(TC-94-08-12-0)

EXECUTIVE SUMMARY

EXECUTING AGENCY: The Ministry of Finance (MOF) and the Cooperative Credit Union League of Trinidad and Tobago (CCULTT).

RECIPIENTS: The MOF and the CCULTT and its affiliated Credit Unions.

OBJECTIVES: The primary objective of the proposed project is to expand the volume and quality of financial services available to small and microenterprises (SMEs) in Trinidad and Tobago, through the strengthening of the country's Credit Union (CU) industry.

DESCRIPTION: The project would have two principal components: (i) specialized training and technical assistance for the CCULTT and CUs (Subprogram I), and (ii) reform of the legal, regulatory, and supervisory structure which defines framework for CU operations (Subprogram II).

The specific objective of Subprogram I is to improve the quality of the technical assistance and training services to SMEs through: (i) the development and transfer of appropriate financial technologies to the CU industry, and (ii) the creation of an effective external monitoring and reporting unit within the CCULTT, constituting one of the principal elements of a strengthened external supervision system.

The specific objective of Subprogram II is to improve the legal, regulatory, and supervisory framework of the CU industry through: (i) drafting amendments to the existing Cooperatives Societies Act and its Regulations, (ii) drafting of an entirely new Credit Union Law (and regulations), and (iii) developing the necessary prudential norms and enforcement mechanisms consistent with those applied to the banking sector, as well as developing, in conjunction with the CCULTT, an effective and efficient external supervision system.

| | | |
|-------------------|-------------------|---------------|
| FINANCING: | Modality: | Grant |
| | MIF-Facility I: | US\$ 348,120 |
| | MIF-Facility III: | US\$ 955,880 |
| | Local: | US\$ 505,000 |
| | Total: | US\$1,809,000 |

**IMPLEMENTATION
SCHEDULE:**

The execution period would be thirty six (36) months from the date of the signature of the agreement.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

As a condition precedent to the first disbursement of the contribution, the executing agencies will submit to the Bank evidence of:

1. The establishment of a Project Management Committee (PMC) to be comprised by representatives of the MOF, the CCULTT, and the Central Bank of Trinidad and Tobago (CBTT);
2. the selection of a consulting firm to provide services in long-term strategic direction, as well as short-term technical assistance, in financial market regulation, CU examination and prudential supervision;
3. the stabilization fund's subordination to the administrative authority and control of the CUMRU within the CCULTT, and this Fund will no longer be promoted as a share or deposit insurance fund;
4. the repeal of Sections 13(2) and 50(3)(f) of the Co-operative Societies Regulations which currently establish a ceiling on dividends and interest on loans to credit union members;
5. the adoption by the CCULTT of new bylaws which, among other matters, establishes a minimum annual membership fee of 1/8 of 1% of total assets, payable by members on a monthly basis.

**ENVIRONMENTAL
CLASSIFICATION:**

The Environmental Management Committee, at its meeting of May 10, 1995, classified this as a Category II operation.

I. COUNTRY ELIGIBILITY

- 1.1 On November 30, 1993, the Donors Committee declared Trinidad and Tobago eligible to receive financing under all modalities available through the Multilateral Investment Fund.

II. BACKGROUND

A. Economy of Trinidad and Tobago

- 2.1 After the collapse of oil prices in 1982, Trinidad and Tobago's economy contracted by around one-third between 1982 and 1993. Adjustment measures were adopted slowly at first, but with increasing urgency and conviction after 1987. Fiscal and balance of payments deficits were eliminated through fiscal discipline and tight monetary policies. In addition, the government implemented structural reforms through trade and exchange regime liberalization, divestment of state-owned enterprises, and improvements in the legal and regulatory framework.
- 2.2 These policies controlled inflation, reduced external debt, and improved the incentive framework. In 1994, the economy rebounded with a GDP growth of 4.6%. The recovery was led by a boom in petrochemical exports and by increased investment in the hydrocarbon sector, which remains the mainstay of the economy. Much of the increased investment came from abroad and foreign direct investment amounted to one-tenth of GDP. Economic growth led to a moderate decline in unemployment, although at over 16% it still remains a major economic and social problem.
- 2.3 In part because of recent structural reforms, economic prospects are clearly more favorable now than they have been for many years. The macroeconomic situation remains stable, with a strong balance of payments position and a roughly balanced government budget. The economy is likely to continue growing, albeit more slowly. GDP growth will probably be around 2.7% in 1995. The major economic challenges remain diversifying the economy, increasing the competitiveness of the non-oil sectors, and making a sustainable reduction in unemployment.
- 2.4 Interest in the small and microenterprise (SME) sector began to develop as the lack of formal sector employment led to the growth of self-employment and the development of the informal labor market. The fall in real incomes and the need to support private sector employment as an alternative to government jobs, highlighted the limitations with respect to access to services directed to this segment of the business sector (financial, technical assistance and training services, for example). Upon analyzing the existing institutional structures within the financial markets, it has been recognized that credit unions (CUs) appeared to hold out the

greatest potential with respect to deepening access on the part of SMEs to the financial service industry. In addition, the Cooperative Credit Union League of Trinidad and Tobago (CCULTT) has become the primary provider of technical assistance and training services for SMEs throughout the country.

B. The role of CUs as part of the financial system

- 2.5 The financial industry in Trinidad and Tobago is dominated by six commercial banking institutions, eight finance and merchant banks, and seven trust and mortgage companies. There is also a state owned Agricultural Development Bank (ADB), and a development finance company. However, these two last institutions do not mobilize deposits directly from the public. Deposit-taking institutions managed total assets of approximately TT\$18 billion (US\$3.2 billion) at the end of 1994. Over the last few years the government has focussed greater attention upon reforming and modernizing the legal and regulatory framework governing financial markets. In mid-1993, *The Financial Institutions Act* was passed by the Parliament which provides for enhanced regulation of banks and other deposit-taking financial institutions. The Credit Union (CU) industry, however, was excluded from this legal and regulatory reform program.

| Table 1 Deposit-taking Institutions Dec. 1993 | | | | |
|---|--------|-----------------------------|-----------------------------|----------|
| | Number | Total Assets (TT\$Mn) | Total Assets (US\$Mn) | Branches |
| Commercial Banks | 6 | 14,073 | 2,426.4 | 123 |
| Finance Companies and Merchant Banks | 8 | 1,371 | 236.4 | 11 |
| Trust and Mortgage Companies | 7 | 2,611 | 450.2 | 16 |
| CUs | 162 | 2,000 | 344.8 | 162 |

- 2.6 CUs have a very long history in Trinidad and Tobago in which the first institutions were chartered in 1946. In 1952, the Department of Cooperative Development was created within the Ministry of Labor, now headed by the Commissioner of Cooperatives, in order to promote the development and supervision of all cooperatives. The present legislation governing the operations of Cooperatives was enacted in 1971. Although the CUs are relatively small, in the aggregate they appear to be larger than the finance companies and merchant banks,

and similar to the trust and mortgage companies 1/. There are currently 162 credit unions in operation, and it has been estimated that approximately 37% of the population is affiliated to a CU.

- 2.7 Because of the participation of a large segment of the population in CUs, the Government of Trinidad and Tobago (GOTT) has demonstrated a particular interest in supporting their development. In 1982 (Act No. 2 of 1982) the GOTT instituted a particularly powerful individual tax credit for share holdings in CUs up to a maximum of TT\$2,500 per year. At the same time, however, these institutions are not subject to any effective prudential supervision on the part of Government authorities.
- 2.8 The CU system in Trinidad and Tobago grew rapidly through the proliferation of "closed-bond", employer-based institutions. They represented a particularly important alternative for the middle and low income population, which has traditionally been under-served by the commercial banking institutions. The proliferation of a large number of very small CUs was made possible by their of extremely low operating costs and the availability of payroll deduction. Because of their extensive penetration into general household sector, they are particularly well suited to expand their services toward SMEs. However, in order to expand, the CUs need to modernize their credit screening and administration policies.
- 2.9 The contraction of employment in the public sector has had a dramatic effect upon a large number of CUs, whose economic viability has been severely undermined. In one particularly poignant case almost 50% of the membership of a public employee based CU have become unemployed, causing severe financial distress. In order to survive these institutions have had to open their membership to the community at large. While the transformation from employee to community-based membership creates an important opportunity for institutional growth and development, it also poses a serious challenge to their traditional operating philosophy and procedures.
- 2.10 The CU system in Trinidad and Tobago is currently going through a very significant structural adjustment. The number of financially viable institutions will decline significantly through a process of consolidation, mergers and outright failures. During the analysis of this operation, the financial situation of a sample of 19 institutions was evaluated (Annex I). Although there appears to be significant problems related to loan delinquency, the majority of those CUs analyzed are profitable, and their institutional capital base (retained earning) would appear to be sufficient to cover

1/ This represents a very rough estimate since there is no institution (public or private) that systematically collects and analyzes financial statements of the CU sector. In addition, these figures may be somewhat overstated since the book value of their loan portfolios need to be adjusted for loan defaults.

potential losses incurred in their loan portfolios, without impairing its members' shares.

- 2.11 Despite the fact that the vast majority of CUs face a very bleak future operating as independent financial institutions, there is a small core (25-40) that have continued to prosper despite the extremely adverse economic environment. These institutions are characterized by their very dynamic administration, which recognizes the need for institutional change and innovation. The institutional consolidation within the CU industry is proceeding quite rapidly. This consolidation has heightened recognition of the need for specialized technical assistance and training, as well as reforms of the legal framework and strengthening of external prudential supervision.

C. Legal and regulatory structure

- 2.12 The Cooperative Societies Act of 1971 defines the legal framework for all organizations whose property structure and governance follow the rules of a cooperative society (democratic governance structure), independent of the economic sector in which they operate. Cooperative organizations are currently engaged in trading (supermarkets), production (agricultural cooperatives), services (financial, transportation, travel), however all are regulated under this Act. Because of its generic nature, this piece of legislation has proved to be inadequate for purposes of regulating the CU industry.
- 2.13 For example, although the primary purpose of CUs is to promote "thrift" among its membership, the Cooperative Societies Act severely constrains their ability to carry out this important function because of the legal limit imposed on their loan interest and dividend rate structures. In addition, the current law constrains the ability of these institutions to utilize the judicial system to enforce loan contracts. These legal restrictions have severely hampered the ability of CU to remain competitive in the current financial marketplace, undermining their financial viability and placing their members savings at considerable risk. The view that the current legal framework must be reformed if CUs are to remain viable in the current financial environment, is widely held by both government officials as well as industry leaders.

D. Prudential supervision

- 2.14 Government supervision of CUs has historically been carried out by the Commissioner of Cooperatives, which is a dependency of the Ministry of Labor. This government office has been charged with various conflicting tasks such as: promotion, development, and supervision of cooperatives. Historically, this government office has not had the financial resources nor the human capital required to carry out the delicate function of supervision of financial intermediaries. At present, there are no prudential norms which

serve to constrain or guide CU operations, nor any effective GOTT oversight.

- 2.15 CUs mobilize savings from the general public and as a result require a specialized set of prudential norms and highly trained professionals to adequately carry out their supervision. Despite the fact that CUs are financial intermediaries, unlike other deposit-taking institutions participating in this market, they are not regulated by the banking law, nor directly supervised by the Central Bank of Trinidad and Tobago (CBTT).
- 2.16 The GOTT has recognized this institutional weakness and, in response to financial difficulties confronting various CUs in 1992, it transferred responsibility for supervision of CUs to the Ministry of Finance (MOF) and commissioned a study of this segment of the financial industry. Although this study identified some of the more egregious legal and regulatory deficiencies, as well as suggested reforms, further action by the GOTT requires a more clearly defined, long-term strategy. Nevertheless, this study served as a catalyst, opening an important public debate regarding the appropriate regulatory philosophy and institutional structure in which the CUs have emphasized the need for a system of self-regulation, and have taken some steps in this direction, while the GOTT has emphasized the need for greater governmental oversight.
- 2.17 In response to the significant difficulties confronted by a number of CUs, and the proposed intent on the part of the GOTT to increase governmental supervision, in 1993 the CUs decided to create a stabilization fund as a way to strengthen self-regulation. This fund has received widespread support among the CUs that in turn promote it as a form of deposit insurance. However, the creation of a private deposit insurance fund is ill-advised because CUs are not subject at this time to any credible prudential regulation and supervision, and neither the fund capitalization nor the annual premium are related to an explicit measurement of underlying risks. Although the creation of this Fund was an attempt to increase self-regulation, because of its potential to introduce serious moral hazard and adverse selection problems, its objectives and operating procedures need to be substantially re-designed.

E. The CCULTT

- 2.18 The CCULTT is a second tier cooperative, property of 129 credit unions throughout the country. This institution has served as the primary lobbying vehicle for the CU industry. In addition, over the years the CCULTT has been charged with the responsibility for providing technical assistance, training and the purchase of inputs, for which in 1990 the CCULTT established its Cooperative Services Division. Unlike most second tier institutions throughout the region, the CCULTT has not engaged in financial intermediation, thus avoiding some very serious governance and financial problems which have beset other organizations.

- 2.19 The current financial structure of the CCULTT is relatively weak, limiting its ability to attract highly qualified technical expertise, and thus undermining the quality of the services it offers to its membership. The most important obstacle confronted by the CCULTT are its outdated bylaws. According to the CCULTT's bylaws, CUs are required to pay only TT\$2 per member per year, plus 1% of net income (after statutory deductions). Those CUs with net income of less than TT\$25,000 pay only the membership dues, while those with net income above this threshold pay the 1% of net income - capped at TT\$20,000 a year 2/. The quality of the services provided by the CCULTT have been seriously compromised by their financial fragility, which only serves to undermine the willingness on the part of the CUs to increase their financial support. The reform of the CCULTT's bylaws, together with initial support to upgrade the quality of their services are critical for the financial sustainability of the CCULTT.

F. Financial services and the small and microenterprise sectors

- 2.20 The persistently high unemployment rate in T&T over the past 10 years, has heightened interest in the support for the small and microenterprise sectors. Since 1986, unemployment has averaged over 20% of the labor force. The GOTT has demonstrated great interest in supporting the development of the SME sector creating and supporting specialized institutions such as the Small Business Development Company (SBDC), which has instituted (primarily with GOTT resources) a loan guarantee program for this segment of the population. Although the SBDC provides other non-financial services, all recent evaluations of its loan guarantee program have demonstrated that it is financially unsustainable.
- 2.21 One of the most important NGOs dedicated to providing credit services to the microenterprise sector has been FundAid. FundAid began lending directly to the microenterprise sector in 1991 after receiving funding from the Small Projects Program of the Bank. FundAid has been beset by problems of high loan delinquency, high operating costs, and the inability to mobilize resources in the domestic financial markets. Its loan portfolio has contracted consistently since 1991.
- 2.22 The CCULTT has been operating a Small Business Training Unit (SBTU) since 1992, and has become recognized as the principal institution in Trinidad and Tobago providing training programs for small businesses. For example, the SBTU has provided training in the areas of record keeping, credit and cash management, marketing and entrepreneurship to the SBDC, the ADB, the Cooperative Development Bank, and the Republic Bank.

2/ While the CU's in the Dominican Republic pay between .5% and .75% of total assets per year in dues to their second tier association, one of the largest CUs in Trinidad and Tobago pays the equivalent of .007% of their total assets in dues.

- 2.23 The primary objective of the CCULTT's SBTU is to further the development of the micro and small business class in Trinidad and Tobago, while increasing the CU support for this class. In order to successfully achieve these objectives the SBTU would need to reinforce its expertise in the area of credit analysis and administration, so as to achieve significant expansion of CU credit portfolios towards this segment of the market. Therefore, in addition to the traditional support provided directly to SMEs, there is a need to reform and strengthen the capability of the SBTU to support the CUs with technical assistance and training so they can better attend this segment of the market.

III. THE PROJECT

A. Objectives

- 3.1 The primary objective of the proposed project is to expand the volume and quality of financial services available to small and microenterprises (SMEs) in Trinidad and Tobago, through the strengthening of the country's CU industry.
- 3.2 CUs have a particular vocation to service this segment of the business class. They also have the capacity to deepen domestic savings mobilization and, because of their relatively low operating costs, they are able to penetrate thin financial markets in urban as well as rural areas of the country. However, in order for CUs to play a more dynamic role in this sector, both their internal operations and legal framework require strengthening so as to improve their effectiveness and efficiency as financial intermediaries.

B. Description

- 3.3 The proposed project is designed to address two distinct, though clearly interrelated, obstacles which seriously impinge upon the future development of CUs: (i) outdated business practices which limit their ability to service the SME sector, and (ii) inappropriate legal, regulatory and supervisory framework. On the one side, institutional strengthening would be effectively leveraged through the deepening of domestic deposit mobilization. On the other side, however, if CUs are to become more aggressive in the area of deposit mobilization, an appropriate legal framework and a system of effective external supervision would have to be put in place. Based on the above, the project would have two principal components: (i) specialized training and technical assistance for the CCULTT and CUs (Subprogram I); and (ii) reform of the legal, regulatory and supervisory structure which define the framework for CU operations (Subprogram II).

1. Subprogram I: Specialized training and technical assistance

- 3.4 The specific objective of this Subprogram is to improve the quality of the technical assistance and training services to SMEs through: (i) the development and transfer of appropriate financial technologies to the CU industry; and (ii) the creation of an effective external monitoring and reporting unit within the CCULTT, constituting one of the principal elements of a strengthened external supervision system.
- 3.5 The Project would significantly strengthen and expand the range of services provided by the CCULTT through its existing SBTU. In addition to improving the quality and range of training services provided directly to SMEs, the SBTU would develop and transfer appropriate credit and deposit mobilization technologies to member CUs in order to improve their outreach to the SME sector. Specifically, the project would provide financial support for the SBTU, helping to improve the quality of its services by contracting specialized technical staff and gaining access to short term technical expertise.
- 3.6 The most important and innovative element of this project would be the transfer of appropriate credit screening and administration technology to these financial intermediaries. Their traditional, share-based lending, would be replaced with appropriate cash-flow analysis and project finance. The introduction of group-lending technologies, in the case of the smallest borrowers, would contribute to maintain their cost structure lean, while improving loan recovery. Credit administration would be reformed to allow for the introduction of an internal incentive structure consistent with an aggressive, yet prudent expansion in their portfolio of SME loans.
- 3.7 The project would support the creation of a new specialized Credit Union Monitoring and Reporting Unit (CUMRU) within the CCULTT, as an integral part of the strategy for increased external supervision of CUs. This Unit would be charged with developing the necessary management information systems which would facilitate the early detection of financial distress among its member institutions. The financial information collected and analyzed in turn would be provided to a Credit Union Supervision Unit (CUSU) within the MOF.
- 3.8 The CUMRU would be able to determine to what degree its members are in compliance with the prudential norms to be developed by the MOF and, in coordination with the CCULTT's SBTU, would help prepare individualized technical strengthening and workout plans for each of its member institutions. The stabilization fund mentioned in paragraph 2.17 would be brought under the SBTU, and a clear and transparent set of policies would be developed to determine the conditions under which any particular CU can receive financial assistance from this Fund.

- 3.9 It is expected that the resources provided by the project would serve to defray the initial investments in equipment, contracting and training of specialized personnel, and development of systems and procedures, required for the transfer of appropriate financial technology to the CUs by the CCULTT. It is expected that by the end of 3 years of project implementation, the CCULTT would have substantially improved the value of its training and technical assistance services to the CUs and SMEs and, through the reform of the institution's bylaws and fee structure, would allow the CCULTT to fully finance these services.

2. Subprogram II: Legal, regulatory and supervisory reform

- 3.10 This Subprogram of the project would have two sub-components: (i) reform of the legal framework, which would include drafting amendments to the existing Cooperative Societies Act and its Regulations, as well as the drafting of an entirely new Credit Union Law (and Regulations); and (ii) the development of the necessary prudential norms and enforcement mechanisms consistent with (though not exactly the same as) those applied to the banking sector, as well as the development, in conjunction with the CCULTT, of an effective and efficient external supervision system. Primary responsibility for the implementation of this component of the project would lie with the Monetary, Fiscal and Trade Division within the MOF, which would create a specialized CUSU. The CBTT would also collaborate closely with the MOF, providing specialized technical support to this Unit.
- 3.11 In an effort to limit the transactions costs for the MOF, while at the same time supporting the concept of limited self-regulation of the CU industry, the CCULTT would be responsible for the collection, analysis and transfer of all financial statements as well as other relevant information to the MOF, consistent with the prudential norms developed at the MOF. Since the CCULTT is the property of the CU system, it would not be responsible for the enforcement of prudential norms developed by the MOF, but the CCULTT would support its members in the compliance of these standards. Those CUs which are not members of the CCULTT would be required to submit their financial statements directly to the CU Unit within the MOF.
- 3.12 The project would finance the purchase of equipment, short term technical assistance to support the development of policies and procedures, as well as to contract specialized technical assistance for the reform of the legal framework. This initial subsidy is deemed necessary because the CU Supervision Unit represents a relatively new activity for the MOF, and initially its personnel would require access to technical support as well as extensive training. Financing these costs in the initial stages would help to avoid unnecessary delays in project implementation. The conceptual design of the project would contribute to minimize the recurrent cost of external supervision by transferring some of these costs to the CCULTT (and therefore onto the CUs).

3. Technical assistance

- 3.13 The project would finance the services of a consulting firm to provide both the long term and short term technical expertise to both the CCULTT and the MOF over the three years of project execution. The consulting firm would provide the services of one long term consultant to provide strategic direction and manage the technical assistance. The short term technical assistance would be provided in the areas of financial market regulation, CU examination, and prudential supervision primarily for the MOF. The CCULTT would be provided with technical expertise in the areas of general financial management, CU supervision, SME credit specialists, and business training specialists. The consulting firm would be contracted and managed by a three-member Project Management Committee to be conformed by the MOF, CBTT and CCULTT.

C. Project cost, source of financing, and cost recovery

- 3.14 Total Project costs have been estimated at the equivalent of US\$1.8 million, of which the MIF would finance US\$1.3 million. Table 2 outlines the distribution of the budget by major components, and a detailed budget is included in Annex II. Project execution would be completed in 3 years, although the legal and regulatory reform program is expected to be completed in 18 to 24 months.

| Table 2 Budget in US\$ | | | | |
|--|-----------|---------|---------|-----------|
| | MIF | CUs | MOF | TOTAL |
| Component I | 329,500 | 151,000 | | 480,500 |
| Component II | 117,200 | | 354,000 | 471,200 |
| Technical Assistance | 786,760 | | | 786,760 |
| Mid-Term and Final Evaluation | 50,000 | | | 50,000 |
| Annual External Audits | 20,540 | | | 20,540 |
| Total | 1,304,000 | 151,000 | 354,000 | 1,809,000 |
| Budget Distribution by MIF Facilities a/ | | | | |
| MIF-Facility I | 348,120 | | | |
| MIF-Facility III | 955,880 | | | |

a/ The distribution by Windows I and III was arrived at by assigning 50% of travel expenses of the short term technical assistance, evaluations and annual audits, and a proportional distribution of overhead.

- 3.15 As designed, the project would finance on a non-reimbursable basis the initial investments in equipment and technical assistance for the CCULTT and the MOF for each of the two principal components. Although the MIF would provide non-reimbursable financing to the implementing institutions, the conditions precedent for the disbursement of project resources requires increased financial

support on the part of the CUs toward the CCULTT and the financial support of the GOTT in the establishment of a Unit specialized in CU supervision.

- 3.16 As part of the project, the CCULTT would revise its bylaws to change the structure of CCULTT dues, significantly increasing the financial support on the part of CUs. In addition, the CCULTT would develop an appropriate fee structure for the services provided to its members. It is expected that as a result of this project the CCULTT would become financially self-sustainable through the sale of its services and membership fees.

IV. PROJECT IMPLEMENTATION AND DISBURSEMENTS

A. Institutional structure of the project: Project Management Committee (PCM)

- 4.1 The proposed model for prudential supervision of the CUs involves two different institutions (CCULTT and MOF), and therefore two implementing agencies. In order to assure adequate coordination, a PMC would be created. This Committee would be comprised of one representative from the CCULTT, one from the MOF and one from the CBTT. The PCM would be responsible for project execution, and would serve as the principal contact point between the Bank and the two executing agencies. Disbursement requests and project reports from the executing agencies (CCULTT and MOF) would be channeled to the Bank through the PMC.
- 4.2 A consulting firm would be contracted by the PMC following Bank procedures, for a period of 36 months. The consulting firm would provide a long term project director who would be responsible for managing the technical assistance to be provided to both the CCULTT and the MOF. The consulting firm would report directly to the PMC.

B. Special conditions precedent for first disbursement

- 4.3 The Project is designed to improve the effectiveness and efficiency of the CU industry in order to improve access on the part of the SMEs to financial services. However, in addition to technical assistance, significant institutional and legal reforms are required if the CUs are to develop into competitive financial intermediaries. The failure to carry out the suggested reforms would severely compromise their long term competitiveness and therefore undermine the effectiveness of the technical resources invested by this project. As a result, Project execution requires that certain special conditions be met by the implementing agencies before it can become eligible for disbursement. Therefore, as a condition precedent to the first disbursement of the contribution, the beneficiary would submit to the Bank evidence of:

- a. the establishment of a PMC to be comprised by representatives of the MOF, the CCULTT and the CBTT,
- b. the selection of a consulting firm to provide services in long-term strategic direction, as well as short-term technical assistance in financial market regulation, CU examination and prudential supervision,
- c. the stabilization fund's subordination to the administrative authority and control of the CUMRU within the CCULTT, and
- d. the repeal of Sections 13(2) and 50(3)(f) of the Co-operative Societies Regulations which currently establish a ceiling on dividends and interest on loans to Credit Union members,
- e. the adoption by the CCULTT of new bylaws which, among other matters, establish a minimum annual membership fee of 1/8 of 1% of total assets, payable by members on a monthly basis.

V. VIABILITY AND RISKS

A. Viability

- 5.1 Although the CU industry in Trinidad and Tobago is currently confronting one of the most serious institutional crises of its existence, there are an important number of individual institutions that have continued to grow and develop. These institutions represent the most important single source of financial services for the small and microenterprise population. The managers and boards of directors of the majority of CUs, as well as officials from the GOTT recognize the need for significant change, and have requested technical support in order to analyze and carry out the necessary external reforms. Because of the widespread support, and potential for future development of the CU System, this Project would serve as an important catalyst for change, significantly improving access on the part of SMEs to the financial service industry.

B. Risks

- 5.2 The protracted decline in GDP from 1982 to 1993 has seriously undermined the economic and financial viability of a large number of CUs. Despite this, a significant number of institutions have been able to continue to grow and develop. The closure and merging of an important number of CUs has the potential to undermine the confidence of the public in the system as a whole. At the moment, the CUs are not subject to any prudential supervision by the GOTT, and do not have access to any "lender of last resort" such as the CBTT. However, the proposed project is designed primarily to fill the institutional void in CU supervision and define and enforce

specific prudential norms. The implementation of the project, with its emphasis upon prudential internal management and strengthened governmental oversight, would serve to create greater confidence on the part of the CU membership. The restructuring of the Stabilization Fund to operate as a central liquidity facility would contribute to improve liquidity management within the CU industry, and reduce incentives for excessive risk-taking by CUs.

- 5.3 The most important risk for the long term development of the CU industry is the inadequate legal and regulatory framework. The current legal framework represents a significant obstacle for the profitable and prudential management of CUs and both the Government officials as well as leaders within the CU industry recognize and support the need for change. To address this, the proposed project would provide specialized technical assistance to help support the reform of the legal and regulatory framework. However, as a precedent for first disbursement, the GOTT would revise the Cooperative Societies Regulations eliminating the ceiling on dividends and interest on loans to credit union members.

VI. COMPLIANCE WITH PROJECT ELIGIBILITY

- 6.1 The proposed project is consistent with the general purpose, overall goals and general objectives of the Agreement Establishing the MIF, in the sense that it supports sound policies which would foster small business and microenterprises, while encouraging greater participation of the civil society.
- 6.2 The proposed project is also consistent with the programming objectives and specific programs and activities of MIF's Technical Cooperation Facility as well as MIF's Small Enterprise Development Facility. With regards to the former, it supports the strengthening of modern financial sector and the institutional strengthening of regulatory agencies. With regards to the latter, it supports the development of complete financial services, the participation of non-profit community organizations in sustainable private sector development, the strengthening of the financial base of intermediaries, and the development of innovative financial technologies.

VII. COMPATIBILITY WITH BANK'S COUNTRY PROGRAM

- 7.1 The proposed operation is consistent with the guidelines set forth in the current Country Programming Paper for Trinidad and Tobago, in the sense that it supports microenterprise and informal sector initiatives, as well as policy and institutional reforms within the financial sector. More specifically, the proposed program:

- a. supports creative and innovative viable private, non-governmental and community-based organizations as an additional force in providing technical assistance and credit services to the growing informal sector; and
- b. supports additional reforms and related activities that enhance entrepreneurial development, promotion of micro-enterprise development programs or projects that generate employment, as well as, ancillary technical assistance and credit programs.

VIII. AVAILABILITY OF MIF RESOURCES

A. Funding modality

- 8.1 The project would be financed by means of a grant. On December 8, 1993, the Donors Committee declared Trinidad and Tobago eligible to receive financing under all modalities available through the MIF.

B. Allocation of MIF resources

- 8.2 **Funding Modality.** The project is expected to be financed through a grant based on the following points: (i) Trinidad and Tobago was declared eligible for all modalities of financing under the MIF by the Donors Committee on November 30, 1993; (ii) the compliance of Trinidad and Tobago with the criteria of eligibility for obtaining grant resources at the country level (Article 3, Section 5b of the MIF Agreement) is detailed in section III paragraphs 3.1, 3.2 and 3.3 of the Eligibility Memorandum of the country (MIF/GN 8); and (iii) the proposed project would have an important catalytic impact as required by Article 3 Section 5 (a) of the MIF Agreement since the project would have a great impact on the availability of financial services to small and microentrepreneurs.

IX. PROJECT MONITORING, REPORTING, AND EVALUATION

A. Monitoring and reporting

- 9.1 In order to assure compliance with the goals of the Project a Project Management Committee would be established which would be ultimately responsible for Project execution. A management information system is to be established at both the CCULTT and the MOF, in order to assure that the necessary base line data required for Project monitoring is available.
- 9.2 The compliance of the purpose of the proposed program would be monitored through: (i) the establishment of a Credit Union Monitoring Unit which would provide the necessary data, on a monthly basis, to evaluate the financial health and growth of the

CU system, based on a series of key financial ratios geared towards improved solvency and operational efficiency; and (ii) the establishment of a CU Unit within the MOF which would provide necessary information regarding the enacted legal, regulatory and supervisory reforms.

- 9.3 The PMC would be required to present a semi-annual report to the Bank regarding the execution of the Project, which should include the progress obtained in each of the sub-components of the project, as well as identifying any particular obstacles in project execution. The compliance of the outputs and activities of the proposed program would be monitored through the information to be provided by CCULTT and the MOF, based on a set of objectives and indicators which are described in detail in the logical framework matrix presented as Annex III.

B. Evaluations

- 9.4 The Bank would conduct a mid-term evaluation of project execution in order to assure that its implementation is being carried out in a satisfactory fashion, and project objectives can be expected to be achieved at the conclusion of the project. The evaluation should be carried out after the conclusion of 18 months of implementation. The evaluation should be based upon an assessment of the attainment of the project indicators presented in Annex III, as well as any other indicators the evaluation team deems important. Particularly important during this stage would be the implementation of the institutional and legal reforms contained in the project. A final evaluation should be conducted within six months of project completion.

PROPOSED RESOLUTION

TRINIDAD AND TOBAGO. TECHNICAL COOPERATION. CREDIT UNION STRENGTHENING PROJECT

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 Government of Trinidad and Tobago 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 credit union system.

2. That up to the amount of US\$1,304,000 is authorized for the purpose of this resolution, allocated as follows: up to US\$348,120 from the Technical Cooperation Facility and up to US\$955,880 from the Small Enterprise Development Facility of the Multilateral Investment Fund.

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