

PROJECT TO SUPPORT THE CREDIT UNION AND WORKERS' BANK SYSTEM

(TC-00-03-02-4)

EXECUTIVE SUMMARY

Beneficiaries/ Executing Agency:	The direct beneficiaries of the proposed project will be the clients of the credit union and workers' bank system, the member cooperatives (49 credit unions and seven workers' banks), and the system Federation (FEDECREDITO), which will serve as the executing agency.	
Objectives and Components:	The general objective of the proposed project is to provide microenterprises and small businesses with greater access to financial resources by modernizing and institutionally strengthening the credit union and workers' bank system. This will expedite the incorporation of the system's member institutions (credit unions and workers' banks) into the regulated financial sector, in the context of the new Nonbank Financial Intermediaries Act. The modernization and institutional strengthening will mainly entail implementing FEDECREDITO's strategic plan, in order to comply with the requirements of the new Act for the strengthening and transformation of FEDECREDITO, for the benefit of the institutions and all the users of the system, small savings account holders, and those using credit services. The plan will be executed in the five main areas that follow: (1) organizational development; (2) financial management; (3) development of client services; (4) internal control and auditing; and (5) development of communications and information technology.	
Financing:	MIF Grant: Window III-A	US\$2,000,000
	Local Counterpart:	US\$ <u>1,300,000</u>
	Total:	US\$3,300,000
	Execution period:	US\$30 months
	Disbursement period:	US\$36 months
Exceptions to Bank policy:	None	
Special Contractual Conditions:	As a condition precedent to the first disbursement of the Bank's loan, the executing agency (FEDECREDITO) must submit to the Bank evidence that: (1) the institutional executing unit to be headed by an external advisor has been established and is made up of	

representatives from FEDECREDITO's administration and Board of Directors (governing body) and from the credit unions and workers' banks; (2) a permanent external advisor has been selected, who will be in charge of project management to provide strategic and technical advisory services; (3) the terms of reference for contracting the consultants needed to develop the various project components have been prepared; (4) an activities timeline for the first year of the project has been prepared; and (5) an implementation manual and the selection and eligibility criteria for consulting firms have been prepared (see paragraph 9.1).

**Committee on
Environment
and Social
Impact:**

The proposed project was reviewed by CESI at its meeting on 13 October 2000, and its recommendations have been incorporated into the project (see paragraph 4.7).

I. COUNTRY AND PROJECT ELIGIBILITY

- 1.1 The Donors Committee declared El Salvador eligible for all modalities of financing from the Multilateral Investment Fund (MIF) on 3 December 1993. The proposed project is eligible for MIF financing under the Small Business Development Facility (Facility III-A) since it will help ensure the modernization of El Salvador's system of credit unions and workers' banks, and thus, provide small savings account holders, microenterprises, and small businesses with greater access to financial services.

II. BACKGROUND

- 2.1 During the 1990s, much of the Salvadoran authorities' efforts were focused on the reconstruction process necessitated by the civil conflict of the 1980s. Despite progress made during the 1990s, which was reflected in important economic and political changes, structural reforms that have helped ensure stable macroeconomic control, State modernization, and economic liberalization, significant social and economic challenges remain if the country is to effectively lower the poverty rate. To achieve this, faster economic growth is needed, which requires substantially enhancing efficiency in the use of the factors of production in such a way as to reverse the recent economic downturn that has led to a further expansion of the already large informal economy. Within this context, the Government of El Salvador's priority to consolidate a strategy of providing services to microenterprises and small businesses acquires even greater importance.
- 2.2 One of the primary obstacles to the development of microenterprises is limited access to the credit needed to finance investments and provide working capital. At the same time, the importance of mobilizing savings to maintain the sustainable development of microfinance intermediation is increasingly clear. In El Salvador, in addition to progress made in strengthening banking institutions, particularly the Banco Multisectorial de Inversiones (BMI) and the Financiera CALPIA¹, the development of financial cooperatives has been covering this activity in an important way: there are now 56 institutions within the credit union and workers' bank system (49 credit unions and 7 workers' banks) located throughout the entire country.
- 2.3 At the end of 1999, the member institutions of FEDECREDITO had an active loan portfolio of ¢1,137,800,000 (US\$130 million), with 119,352 loans granted. The consolidated assets of the credit unions and banks grew from US\$78.7 million in 1995 to US\$151.8 million in 1999, and the consolidated portfolio grew from US\$69.3 million to US\$130.5 million over the same period. Nevertheless, the system depends heavily on external resources, especially from the BMI, the

¹ The MIF had an equity investment in CALPIA and successfully sold its shares in the institution in 2000.

second-tier government bank. At the end of 1999, more than 37% of the portfolio was financed through borrowing facilities from international donors and banks. During the same fiscal year, 10% of the system's funding came from member fees. It is important to highlight that while the FEDECREDITO system is of great significance and has broad geographic coverage as a mechanism for financing microenterprise and very low-income savers, the degree of financial development of the majority of its members is rather basic, and technical support is essential for it to run smoothly.² FEDECREDITO, whose membership is made up of credit institutions, has been recognized as one of the most important promoters of microfinance, delivering financial and nonfinancial services on a steady basis.

- 2.4 The Salvadoran banking system currently comprises 13 banks and a finance corporation; the latter's operations primarily address the needs of microenterprises and small businesses. The banking system's loan portfolio totaled some US\$5 billion. Within the context of the Salvadoran market, FEDECREDITO plays an important role as a lending institution. The system of credit unions and workers' banks had portfolio operations totaling ₡1,137,800,000 at the end of 2000, equivalent to 3% of the banking system portfolio. Moreover, according to active portfolio statistics released by the BMI, FEDECREDITO is the seventh largest in terms of the rediscounted amount (₡158.3 million) and the largest in terms of the number of eligible loans granted (4,390). This attests to the FEDECREDITO system's commitment to serving sectors with scarce resources which —because of their economic situation— have practically no access to the traditional banking system, and supporting them on the basis of a cooperationist, common-bond philosophy.
- 2.5 In relative terms, the following describes how FEDECREDITO compares with Financiera CALPIA and the Federation of Savings and Loan Cooperatives of El Salvador (FEDECACES) within the microcredit market: At the end of 1999, the FEDECREDITO system's assets were ₡1.247 billion, while CALPIA's were 20.5% of that number, or ₡255.9 million. In addition, the FEDECREDITO system had liabilities of ₡999.2 million, compared with CALPIA's ₡199.1 million. The FEDECREDITO system had ₡327 million in equity and ₡26.4 million in profits and CALPIA had ₡56.9 million and ₡8.9 million, respectively. CALPIA granted 2,903 loans financed with BMI resources, 66.1% of the number granted by the FEDECREDITO system, for a total of ₡116.6 million, or 73.7% of the FEDECREDITO system's amount. CALPIA is the second largest institution in terms of number of operations and the ninth in terms of loans granted with BMI resources. The FEDECACES system is comprised of 30 finance cooperatives located in major cities throughout the country. As of December 1999, it had assets of ₡949 million, or 76.1% of the FEDECREDITO system's assets, while its liabilities were ₡665 million, or 66.8% of the FEDECREDITO system's. The FEDECACES system had ₡284 million in equity, compared with the

² Detailed data on the financial situation of the members are available in the files of RE2/FI2.

FEDECREDITO system's ₡327 million, and its loan portfolio was ₡737 million, while the FEDECREDITO system's was ₡1,137,800,000.

- 2.6 The consolidated financial statements for 2000 show that the credit union and workers' bank system will generate a 3% average net return on portfolio, which represents an 11.2% return on its consolidated equity capital. However, the scale of operations and financial performance vary significantly among the various institutions. The overdue portfolio represented 10% of total loans in September 2000, while the ratio of profits to net worth was 13% on the same date, and the ratio of net worth to total assets was 27%. In the past, nonbank financial activities were limited due to the absence of an adequate legal framework.
- 2.7 In order to ensure better access to, and increase the number of financial services that promote rural and urban development in El Salvador, and particularly to attract small savings accounts and finance microenterprises and small businesses, Salvadoran authorities introduced and promoted the Nonbank Financial Intermediaries Bill in the legislative assembly. The bill (Decree 849) was approved in March 2000 and will enter into force on 1 July 2001, its effective date having been postponed due to the adjustments necessary in the Salvadoran economy in the wake of the new monetary integration framework (dollarization).
- 2.8 The new law strengthens and promotes the private character and cooperative nature of the credit unions and workers' banks, as well as the Federation (FEDECREDITO) that joins them together under one system. The new legal framework allows credit unions to perform transactions savings with a market-based approach (third-party, nonmember savings deposit operations are authorized), thereby creating a window of opportunity for further development of the credit unions. The related regulations, which under the new law will be issued by the Superintendencia del Sistema Financiero [Office of Financial System Oversight] (SSF), will ensure not only that small account holders in the system are protected, but also that the financial needs of individuals with scarce resources, microenterprises, and small businesses—a sector that has generally been ignored by the traditional banking system—will be met.
- 2.9 Under the new law, almost 90% of the members of FEDECREDITO would be qualified as nonbanking financial intermediaries in terms of the minimum equity required by the new law, and will be subject to the requirements and supervision of the SSF, so that they are authorized to attract third-party deposits as a small percentage of their liabilities. Although the members of FEDECREDITO express their intention to expand their financial intermediation business gradually and prudently, the management capacity of each member needs to be improved, especially in the areas of financial risk and internal control, which are essential components of the new financial intermediation authorized under the new law. Moreover, it will be more effective to implement these new requirements through the strengthening of FEDECREDITO, given that the latter's organization needs to

be reviewed so that it can provide better services to its members, while promoting standardization of procedures, internal control, and performance evaluation of the beneficiary members, in the context of the new law.

- 2.10 The Bank's promotion of this activity clearly falls under its policy of fostering the development of microenterprises and small businesses as a necessary step towards achieving long-term, sustainable economic development, while taking into account that competitive conditions for underserved sectors must be protected and improved in such a way as to promote job creation and the fight against poverty.

III. OBJECTIVES OF THE PROJECT AND ITS COMPONENTS

- 3.1 The general objective of the project is to provide microenterprises and small businesses with greater access to financial resources by modernizing and institutionally strengthening the credit union and workers' bank system and expediting the incorporation of FEDECREDITO member institutions into the regulated financial sector, as provided for under the new Nonbank Financial Intermediaries Act, which will enter into force in July 2001. In so doing, the competitiveness and efficiency of the entire financial system will be improved. The project also seeks to strengthen and modernize the functional and financial aspects of the credit unions and workers' banks by ensuring the successful adoption of the regulatory framework and the efficiency of the inspection and supervision systems. According to FEDECREDITO management, all registered members have expressed their intention to become regulated institutions and maintain their membership in the Federation.
- 3.2 The modernization and institutional strengthening will mainly entail implementing FEDECREDITO's strategic (organizational and business) plan, which will bring it into compliance with the Nonbank Financial Intermediaries Act. This is designed to strengthen and transform FEDECREDITO for the benefit of its member institutions (the credit unions and workers' banks) and all of the system's users, small savings account holders and credit service users, i.e., individuals with scarce economic resources, microenterprises, and small businesses. In the development of the plan, the following five main areas have been identified, which will be executed as project components to achieve the aforementioned objective: (1) organizational development; (2) financial management; (3) development of services to clients, member institutions; (4) internal control and auditing; and 5) development of communications and information technology.
- A. Component 1 – Organizational development (MIF US\$350,400; Local US\$233,600)**
- 3.3 FEDECREDITO is not part of the government. It is a mixed-economy cooperative association, since its sole shareholders are credit unions and workers' banks, its

resources do not come from the government, and it is subject to inspection by an external auditor and SSF control and oversight. Full organizational development is provided for under the Nonbank Financial Intermediaries Act, inasmuch as government representatives will no longer sit on FEDECREDITO's governing body. Two basic elements have been identified under the organizational development component. The first has to do with the internal development of FEDECREDITO. In addition to restructuring its internal organization so that the responsibilities of the various departments are clearly delineated and modernized, the following administrative and integration tools need to be developed: professional development programs through training, analysis, and redesign of administrative and operational procedures; and a benchmarking system that allows for the comprehensive assessment of FEDECREDITO and provides support in decision making. These activities and those called for under the other project components will constitute FEDECREDITO's strategic plan. This component will finance the hiring of consultants who specialize in these areas, so that by December 2001, the system (FEDECREDITO and its members) will have administrative and operating procedures manuals in place.

- 3.4 The second element is related to improving sectoral organization. This requires a better assessment of the microenterprise sector, so that its demands and needs can be adequately met. In addition, productivity and efficiency standards must be designed and implemented within a benchmarking system that makes it possible to monitor the member institutions and adopt measures to improve their performance.

B. Component 2 – Financial management (MIF US\$471,000; Local US\$314,000)

- 3.5 As part of the financial management component, FEDECREDITO will strengthen all of its financial administration systems, which activity will require a reliable, efficient comprehensive accounting system that enables it to keep adequate records for all operations and quickly access information about its own financial situation and that of its member cooperatives. An administrative system for its loan portfolio will also be developed that will allow it to systematically and effectively manage the member cooperatives' and its own loan operations.
- 3.6 In addition, in accordance with the regulations set by the Office of Financial System Oversight (SSF), a treasury system must be developed and implemented for management of liquidity excesses, securities, the reserve requirement, and the supporting records for these operations, and that automatically generates accounting records and entries, as well as the corresponding reports. The design and implementation of a stabilization fund³ is provided for under the Nonbank Financial

³ The stabilization fund provides financial assistance to cooperatives experiencing problems that could, or already have, led to bankruptcy. (Art. 107 of the Nonbank Financial Intermediaries Act). The fund will be comprised of contributions from the members and some of the projects of FEDECREDITO, according to regulations issued by the SSF to this end.

Intermediaries Act, for the purpose of providing financial coverage to FEDECREDITO member institutions. Finally, as one of the tools used to improve the financial administration of the FEDECREDITO system, a risk management system will be designed and implemented primarily to manage the risks associated with interest rates, liquid holdings, and exchange rates. By June 2002, at least 100 officers from the 56 member institutions will have received training in the area of attracting deposits and network transactions.

C. Component 3 – Development of services for member cooperatives (MIF US\$ 309,000; Local US\$ 206,000)

3.7 In order to better serve the member cooperatives, activities in two areas must be carried out. Activities in the first area are designed to provide the member cooperatives with the technical support that they need to more effectively manage their businesses. This requires the development and standardization of business strategies and procedures and financial and nonfinancial products within the system, consistent with the current and potential needs of microenterprises, small savings account holders, and the poor sectors of the population applying for loans. To this end, a coordinated program providing administrative and financial advisory services to the member cooperatives will be designed and implemented for the purpose of developing their business management skills and capacity so that the needs of microenterprises, small businesses, and small savings account holders can be met. Trainers specializing in these areas will be hired so that by June 2002, an executive training program will be available for the 56 members and at least two executives will have been trained from each of the member cooperatives.

3.8 The second area of action is geared towards developing activities that promote the cooperationist system. Along these lines, a plan to encourage membership and foster a common bond among the system's clients will be designed and implemented. This is an extremely valuable part of strengthening the cooperative system, as an alternative for supporting low-income sectors of the population, in view of its cooperationist philosophy of support for the economic development of the population.

D. Component 4 – Internal control and auditing (MIF US\$103,800; Local US\$69,200)

3.9 Under this component, the existing internal control system will be strengthened by updating relevant manuals, regulations, and procedures. The Nonbank Financial Intermediaries Act and its regulations, to be issued by the SSF, will be used as a frame of reference for this activity. In addition, a comprehensive monitoring system will be developed, based on the uniformity of the member cooperatives' accounting systems, and the internal auditing system of the credit unions and workers' banks will be strengthened in order to ensure greater consistency in internal control. In order to complete the modernization of the monitoring system, an early warning

system will be designed and implemented. This system will use benchmark indicators, such as evaluation standards and audits of the member cooperatives, to help ensure that the financial integrity of these institutions is monitored and that expeditious measures are taken to safeguard it.

E. Component 5 – Development of communications and information technology (MIF US\$594,000; Local US\$396,000)

- 3.10 FEDECREDITO will modernize its communications and information technology systems by developing compatible platforms that enable all the systems of member institutions to interact with one another and with the SSF, which is the regulatory agency for FEDECREDITO. Under this component, economies of scale will be used in choosing, buying, and installing the information technology tools that best meet the needs of FEDECREDITO, the credit unions and the workers' banks. This will help ensure that operational procedures and systems, equipment, and basic software are standardized so that a financial network can be set up among the member institutions. In order to derive the maximum benefit from the modern information technology system, training will be provided so that all member cooperatives receive the new technological tools and the support needed to use them effectively. In any case, the value of this project component will not exceed 30% of the total project cost and at least 30% of this component will be financed with counterpart resources.

IV. EXECUTING AGENCY AND BENEFICIARIES

- 4.1 **Executing agency.** FEDECREDITO will serve as the executing agency for the project. FEDECREDITO was established under the Rural Credit Act of December 1942 as the "Federación de Cajas de Crédito" [Credit Union Federation] or "Cooperativa Central" [Central Cooperative] and was defined as an autonomous, public-interest institution, and set up in the form of a corporation with an initial contribution from the government. The Rural Credit Act was repealed and superceded by the Credit Union and Workers' Bank Act in 1991. This new act recognized the Federation of Credit Unions and Workers' Bank Limited still as an autonomous, public-interest institution. However, several decisions handed down by administrative courts and the Supreme Court have concluded that FEDECREDITO is not a government enterprise, but rather a mixed-economy cooperative, since, as is stipulated under the 1991 Act, its only stockholders are the credit unions and workers' banks, its financial resources do not come from the central government, and it is subject to independent audits and to SSF inspection and oversight. Under the Nonbank Financial Intermediaries Act, governmental representatives no longer sit on FEDECREDITO's governing body. One of FEDECREDITO's objectives is to advance the cooperative movement in El Salvador, especially as it relates to granting loans to workers, producers, artisans,

and small-scale industry and business, for which purpose it is authorized to conduct credit activities.

- 4.2 **Execution method.** An institutional executing unit (IEU) will be created within FEDECREDITO and will be headed by an external advisor who will remain for the duration of program execution. Aside from this advisor, the IEU will be comprised of representatives from FEDECREDITO's administration and Board of Directors (governing body) and from the credit unions and workers' banks, and will be responsible for executing the technical aspects of the proposed project. The establishment of the executing unit and appointment of an external advisor will be conditions precedent to the first disbursement. In addition, FEDECREDITO's existing administrative department will act as an administrative unit for project management and will report to the IEU on matters related to project execution.
- 4.3 **Beneficiaries.** The direct beneficiaries of the project will be the clients of the credit unions and workers' banks, the member cooperatives (49 credit unions and 7 workers' banks), and of course, FEDECREDITO.
- 4.4 **Monitoring.** The logical framework describing the project's execution, monitoring, and evaluation can be found in Annex I. Once the institutional executing unit is created, FEDECREDITO will develop an annual work plan to be submitted to its Board of Directors and the IDB-MIF. Each year a new work and financial plan will be submitted for the next execution period. In addition, the independent auditor contracted for the project will submit financial reports to the Bank's satisfaction, as well as the duly audited financial statements of FEDECREDITO.
- 4.5 The executing unit will submit progress reports (technical and financial) 60 days after the end of each semiannual period. The Bank's Country Office in El Salvador will monitor project execution through progress reports, consultants' reports, the disbursements and financial statements submitted to the Bank by the executing unit, and the results of planned project evaluations. The Country Office will use these reports to monitor the progress of the project and to prepare a final report within the three months following the last disbursement.
- 4.6 **Status of project preparation.** Preparation for the project is well under way. FEDECREDITO specialists have written a draft of the manual that describes how the project is to be implemented and sets forth the selection and eligibility criteria for consulting firms. Completion and implementation of the manual will be a condition precedent to the first disbursement. Draft terms of reference for the international tendering process to be used in selecting a consulting firm have also been prepared. FEDECREDITO already has some experience in providing information services, technical support, and training, and will seek to strengthen and expand its experience in these areas under the proposed project. It is therefore expected that the conditions precedent will be fulfilled within two months of the signature of the agreement with the Bank.

- 4.7 **Committee on Environment and Social Impact (CESI).** The project was reviewed by CESI at its meeting on 13 October 2000. In accordance with its recommendations, basic skills training in occupational health, the environment, and occupational safety will be provided under the third component (Development of services for member cooperatives), which is closely tied to other project activities, for employees of the member cooperatives. In particular, training will cover the provisions of the 1998 Environment Act and its regulations, which were issued in 2000, and the Bank's "Guidelines for improving the environmental quality of loan operations for microenterprises." This activity will be carried out in accordance with the instructions set forth in PR-103, Appendix 4.

V. COST AND FINANCING

- 5.1 The total estimated cost of the project is US\$3.3 million. FEDECREDITO will contribute 40% (US\$1.3 million) of the total, half of which will be in cash and the rest in kind, and the remaining 60% of the cost (US\$2 million) will be financed by the MIF. The total cost is broken down by investment and financing source in the following table.

Components (in U.S. dollars)	MIF	LOCAL	TOTAL	%
Component 1				
Organizational development	350,400	233,600	584	18%
Component 2				
Financial management	471,000	314,000	785,000	24%
Component 3				
Development of services for member cooperatives	309,000	206,000	515,000	16%
Component 4				
Internal control and auditing	103,800	69,200	173,000	5%
Component 5				
Development of communications and information technology	594,000	396,000	990,000	30%
General project coordination	57,600	38,400	96,000	3%
Independent evaluations (interim and final)	40,000	0	40,000	1%
Audit		20,000	20,000	1%
Subtotal	1,925,800	1,277,200	3,203,000	97%
Contingencies	74,200	22,800	97,000	3%
TOTAL	2,000,000	1,300,000	3,300,000	
%	61%	39%	100%	

- 5.2 The project execution and disbursement periods will be 30 months and 36 months, respectively. A revolving fund equivalent to 10% of the MIF's contribution will be established in accordance with the estimated requirements for project execution to help ensure that funds are disbursed as needed for various project activities. The resources of the MIF and of the local counterpart will be managed under independent bank accounts.
- 5.3 **Accounting and auditing.** FEDECREDITO, through the institutional executing unit and the administrative unit, will be responsible for: (1) establishing and maintaining adequate accounting, financial, internal control, and filing systems that will make it possible to identify in detail sources and use of project funds. Project records will be kept in such a way that: (a) amounts received from various sources can be identified; (b) information on project expenditures is incorporated, distinguishing between MIF contributions and funds from other sources; and (c) the details needed to identify purchased goods and contracted services are provided; (2) opening separate and specific bank accounts for the MIF and local counterpart contributions, as a condition precedent to the first disbursement; (3) processing requests for disbursements from the Bank; and (4) preparing and submitting to the Bank throughout project execution semiannual reports on the revolving fund and the annual financial statements for the project, which must be audited by independent auditors acceptable to the Bank.
- 5.4 **Sustainability.** The sustainability of the project and FEDECREDITO depends on the institution's capacity to generate the funds needed to cover operating costs, while serving its clients –the credit unions and workers' banks. FEDECREDITO has developed a plan that will allow it to gradually increase its own income from membership fees and payments for financial, technical, and training services. FEDECREDITO's financial program is approved annually by its Board of Directors and ratified by its members. FEDECREDITO must submit its plan for institutional strengthening and compliance with the new Nonbank Financial Intermediaries Act to the SSF. Given FEDECREDITO's long history in providing various types of technical assistance and training to its members, no problem is expected in terms of payment for services to be provided by the project.

VI. JUSTIFICATION AND RISKS

A. Justification

- 6.1 The Bank's support of the proposed project is consistent with the general guidelines set forth in the current country paper, and particularly with the policy of fostering the development of microenterprises and small businesses as a necessary step in achieving long-term, sustainable economic development, taking into account that the competitiveness of the most disadvantaged sectors must be protected and improved to promote job creation and further the fight against poverty.

- 6.2 In the interest of its country's financial development, the Government of El Salvador has been updating the existing legal framework for both the commercial banks and the so-called nonbank financial institutions. The proposed project seeks to develop and strengthen the FEDECREDITO member cooperatives within the framework of the new Nonbank Financial Intermediaries Act, recently approved by the Salvadoran legislature.
- 6.3 The new law strengthens and promotes the private character and cooperative nature of the credit unions and workers' banks, as well as of the Federation that joins them together under one system. Furthermore, the new law and its regulations, which strongly complement this project, will help ensure that small savings account holders, microenterprises, and small businesses, active participants in the FEDECREDITO system (the Federation, the credit unions, and the workers' banks) can count on a financial intermediation system that is composed of financially sound, solvent, competitive, and functional institutions. In so doing, small account holders in the system will be protected, while the demand for financial services among individuals with scarce resources, microenterprises, and small businesses—a sector generally ignored by the traditional banking system—will be met.
- 6.4 The Bank approved a MIF technical cooperation operation with the SSF (MIF/AT-237), which has not yet started up, since ratification by the Congress is pending. The Bank has also discussed with the authorities the feasibility of a new financial sector lending operation (ES-0125). While both operations are related to the proposed operation, neither provided for strengthening the credit union and workers' bank system. In addition, under the new act, FEDECREDITO will become a private entity, making the proposed project compatible with existing operations. The MIF is supporting the project with the Comisión Nacional de la Micro y Pequeña Empresa [National Microenterprise and Small Business Commission] (CONAMYPE) to articulate the overall policy of sector support (MIF/AT-321). The project with CONAMYPE that is under way, with emphasis on the regulatory framework for microenterprise, small business, and nonfinancial service registries, assumes full complementarity with the proposed project.

B. Risks

- 6.5 While the new legal framework adopted by the authorities for nonbank financial institutions represents a formalization of intermediation activities, it also provides a window of opportunity in which the nonbank financial institutions could experience more significant growth by allowing them to attract savings account holders not associated with the FEDECREDITO system. Uncontrolled growth of intermediation activities, and in particular the loan portfolio, could lead to an adverse selection of risks, potentially compromising not only the solvency of the financial institution in particular, but also that of the entire system of credit unions and workers' banks. It could even generate systemic financial problems that would jeopardize the entire financial system and, consequently, the economic situation of

the country. The proposed project's emphasis on prudential internal management along with the importance that the new Nonbank Financial Intermediaries Act confers on the monitoring and supervision of these institutions indicate that the system of credit unions and workers' banks will develop in a way that reduces incentives to assume excessive risk.

VII. EVALUATION

- 7.1 Two external evaluations that will be contracted and financed through the Bank with MIF resources will be carried out. Once 50% of the MIF resources have been disbursed, independent consultants will be contracted to carry out a midterm evaluation that assesses: (i) the progress made in fulfilling project objectives, using the indicators for monitoring and assessing the impact of the operation; and (ii) the achievements made.
- 7.2 A final evaluation will be conducted within 90 days after project completion. This evaluation will assess the degree to which specific project objectives have been fulfilled, the quality of services offered, project sustainability, and the impact of the project.

VIII. EXCEPTIONS TO BANK POLICIES AND PROCEDURES

- 8.1 No exceptions to the Bank's policies and procedures are anticipated.

IX. SPECIAL CONTRACTUAL CLAUSES

- 9.1 As a condition precedent to the first disbursement, the executing agency (FEDECREDITO) must submit to the Bank evidence that: (1) the institutional executing unit has been established and is made up of representatives from FEDECREDITO's administration and Board of Directors (governing body) and from the credit unions and workers' banks; (2) a permanent external advisor has been selected to provide strategic and technical advisory services; (3) the terms of reference for contracting the consultants needed to develop the various project components have been prepared; (4) an activities timeline for the first year of the project has been prepared; and (5) an implementation manual and criteria for consulting firm selection and eligibility have been prepared.

LOGICAL FRAMEWORK
PROJECT TO SUPPORT THE CREDIT UNIONS AND WORKERS' BANKS SYSTEM

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
small savings account holders, microenterprises, and small businesses with access to financial services.	Financial monitoring indicators for FEDECREDITO member institutions; periodic reports from FEDECREDITO and the SSF	The publication by FEDECREDITO and the SSF of all standards, regulations, statutes, and corresponding manuals	The pertinent authorities issue the required norms and regulations. The SSF develops the necessary conditions for ensuring efficient preventative supervision.
OBJECTIVE: To financially strengthen FEDECREDITO in order to bring it into line with the Nonbank Financial Intermediaries Act, which is designed to modernize, and transform the system for the benefit of its members – credit unions and workers' banks – and microenterprises – the small savings account holders – the individuals with scarce financial resources, microenterprises, and businesses that use its credit services.	By June 2002, the FEDECREDITO system will have a uniform accounting system and will have submitted to the SSF in electronic form its first financial statements. Upon project completion in December 2003, the FEDECREDITO system will carry out accounting and financial administration in a standardized way. It will also have a more technical managerial administration and all of its member institutions will have participated in the training program called for under the proposed project.	Consultants' interim and final evaluation reports	By December 2002, the FEDECREDITO system (through the Federation and its member institutions) have successfully adapted to the norms and regulations stipulated under the new Nonbank Financial Intermediaries Act.
COMPONENTS: 1. Institutional development of FEDECREDITO in order to establish the system's strategic plan 2. Training of all the financial management systems	By December 2001, updated manuals for administrative and operational procedures will be implemented within FEDECREDITO and its 56 member cooperatives. By June 2002, specialized training for FEDECREDITO and its 56 member cooperatives in areas such as "attracting deposits" and "network transactions" that	Organization charts and minutes from the meetings of the FEDECREDITO and member cooperatives' Boards of Directors, in the hands of the institutional executing unit; and information from the Bank's Country Office in El Salvador. There will be no government representatives on FEDECREDITO's Board of Directors. Reports from SSF visits to FEDECREDITO and its member cooperatives	The Central Reserve Bank of El Salvador and the SSF issue the necessary norms and regulations that are related to this component. Financial resources are available when needed to carry out the activities related to this component.

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>nt of services for member s</p> <p>ng of the internal control and stem</p> <p>nt of the communications and technology system</p> <p>ES</p> <p>IZATIONAL OPMENT</p> <p>ze and restructure the internal ization of FEDECREDITO</p> <p>ze and restructure the ization of the credit unions and ers' banks</p> <p>op comprehensive training l and tools</p> <p>CIAL MANAGEMENT</p> <p>then financial administration</p> <p>op new financial systems</p>	<p>are necessitated by the modernization of the system's procedures will be completed.</p> <p>By June 2002, a modern professional development program will be in place for executives of the 56 member cooperatives, and 100 of them will have participated in it.</p> <p>By December 2001, internal control manuals, regulations, and procedures will have been updated and implemented in FEDECREDITO and its 56 member institutions.</p> <p>By December 2002, the information technology required for the financial network will have been installed in the offices of FEDECREDITO, the credit unions, and the workers' banks</p> <p>Budget (\$159,000)</p> <p>Budget (\$161,000)</p> <p>Budget (\$264,000)</p> <p>Budget (\$468,000)</p> <p>Budget (\$317,000)</p>	<p>Reports submitted by FEDECREDITO to its Board of Directors</p> <p>Reports from member institutions submitted to FEDECREDITO and the SSF; reports from SSF visits</p> <p>Reports submitted by FEDECREDITO to its Board of Directors</p> <p>Annual reports submitted by the member institutions to their shareholders' meeting</p> <p>Reports from SSF visits</p> <p>Organization charts and resolutions made by the Boards of Directors of the credit union and workers' banks</p>	

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>DEVELOPMENT OF SERVICES TO MEMBER COOPERATIVES</p> <p>Provide the member cooperatives with technical support in business management</p>	<p>Budget (\$411,000)</p>	<p>Accounting records and supporting documents for payments in the hands of the institutional executing unit, and other supporting records and statistics related to project coordination</p>	
<p>Develop activities for promoting the cooperative movement</p>	<p>Budget (\$104,000)</p>		
<p>INTERNAL CONTROL AND ACCOUNTING</p>			
<p>Strengthen FEDECREDITO's internal control system</p>	<p>Budget (\$66,000)</p>	<p>Reports from SSF visits</p>	
<p>Strengthen the internal control systems of credit unions and workers' banks</p>	<p>Budget (\$107,000)</p>	<p>Financial information published by FEDECREDITO and the SSF</p>	
<p>DEVELOPMENT OF COMMUNICATIONS AND INFORMATION TECHNOLOGY</p>			
<p>Prepare and implement a financial information system for FEDECREDITO, the credit unions, and the worker's banks</p>	<p>Budget (\$593,000)</p>	<p>Reports submitted by FEDECREDITO to its Board of Directors; reports submitted by the member institutions to their shareholders' meeting and Boards of Directors</p>	
<p>Prepare and install a database and operating system infrastructure for FEDECREDITO, the credit unions, and the workers' banks</p>	<p>Budget (\$80,000)</p>		
<p>Install a communications hardware and software infrastructure for FEDECREDITO, the credit unions, and the workers' banks</p>	<p>Budget (\$80,000)</p>		
<p>Upgrade the hardware systems (servers, workstations, and remote stations) of local networks of FEDECREDITO, the credit unions, and the workers' banks</p>	<p>Budget (\$237,000)</p>		

ARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
ADMINISTRATION OF THE PROGRAM BY THE INSTITUTIONAL EXECUTING UNIT			
Establish the institutional executing unit	Budget (\$40,000) Creation of the IEU	Accounting records of the IEU and other supporting records and statistics related to the proposed project	Financial resources are available when needed to carry out the activities related to this component
Employ a permanent coordinator who provide advisory services to the executing unit	Budget (\$56,000)	Documentation from the Bank's Country Office in El Salvador Documentation to assess progress of the proposed project in the hands of the IEU Visits to FEDECREDITO and its member institutions	

PROPOSED RESOLUTION

**EL SALVADOR. NONREIMBURSABLE TECHNICAL COOPERATION FOR A
CREDIT UNION SYSTEM SUPPORT PROGRAM.**

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 "Federación de Cajas de Crédito y de Bancos de los Trabajadores Limitada" of El Salvador and to take such additional measures as may be pertinent for the execution of the project memorandum referred to in Document MIF/AT- with respect to a technical cooperation for a credit union system support program.
2. That up to the amount of US\$2,000,000, or its equivalent in other convertible currencies, is authorized for the purpose of this resolution, chargeable to the resources of the Small Enterprise Development Facility of the Multilateral Investment Fund.
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.