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## **PROJECT ASSISTANCE COMPLETION REPORT**

**Agreement No ESR VI - MOU 4  
Banco Federado  
July 1, 1988 - December 15, 1995**

### **PROJECT PURPOSE AND GOAL**

The purpose of this project is to strengthen the national system of savings and loan cooperatives, by providing Fedecredito funds to capitalize Banco Federado, thereby helping consolidate and strengthen Banco Federado by leveraging the capital base for access to different BCCR rediscount facilities, and by providing resources to the system to finance productive credit, housing credit, and to create a Guarantee Fund for savings and loan cooperatives that are members of the federated system

The specific goals include 1) helping create a strong private cooperative bank capable of channeling credit to small and medium sized farmers and companies in rural areas, 2) provide credit opportunities for small business, 3) provide credit opportunities for low cost housing, 4) strengthen the cooperatives through technical assistance, and 5) help stabilize the savings and loan cooperatives through a Guarantee Fund, thereby promoting rural savings mobilization

### **BACKGROUND**

Banco Federado is the successor of the defunct Banco Cooperative de Alajuela Banco Coopealajuela was founded in June 1984 with a capital of only \$5 million, without any

support of major cooperatives. The bank collapsed in September 1986 due to the inadequate level of capitalization. At that time the BCCR approached Fedecredito to take over the defunct bank.

Fedecredito found that Banco Federado could not play an important role as a financial intermediary for the savings and loan cooperatives, if it were not properly capitalized, especially after the crisis in the financial sector at the end of 1987. Therefore, Fedecredito approached the GOCR for assistance and the President requested that AID support Banco Federado with a \$300 million donation, from the ESR VI local currency fund. Fedecredito was to contribute \$73,794,299.90 colones from its own resources represented by share certificates.

The design of the Project was closely coordinated among Fedecredito, Banco Federado, USAID and the appropriate government offices. In late 1987 AID provided funds to Fedecredito to conduct a project feasibility study. This study included an analysis of the market demand, recommended an organizational structure, and analyzed the economic viability of the bank.

At the time Fedecredito was comprised of 53 Savings and Loan Cooperatives with total assets of \$6 billion and total deposits of \$3 billion which represented nearly 70% of the total deposits of all the private banks. The Savings and Loan Cooperatives were well distributed all over the country, 33 cooperatives were in the rural provinces. Sixty-five

percent of the above mentioned deposits came from rural areas. However in 1989, the federated system had a very low leverage with a debt to equity ratio of only 3:1.

Capitalization of the Banco Federado, would allow opportunities for better leverage of its capital base through access to the different BCCR rediscount facilities. With the higher leverage more credit could reach primarily the small and medium size farmers and businessmen, an area in which Fedecredito had already substantial experience.

The beneficiaries at the time were primarily the small and medium size farmers and manufacturers in the rural areas, and the 53 member cooperatives with their 147,000 members. The financing was extended to the final sub-borrowers primarily through its member cooperatives, however, some direct financing to small farmers and manufacturers, members or non cooperative members was also feasible.

The expectation was to create new job opportunities in rural areas and contribute to overcome the credit shortage in the agriculture sector. In addition at least 20% of the resources were channelled to finance rural housing construction.

The cooperatives were to benefit by additional credit activities with their members, by the technical assistance they would receive from Fedecredito (financed with the 40% of the preferred dividend after year four), and through the guarantee fund, which would strengthen their position as a recipient of savings from cooperative members.

Banco Federado was designated as the implementing institution, although the GOCR was to be responsible for project monitoring. As a temporary measure, USAID/OPS was to monitor the project during its first year. However, due to time delays, changes in the government administration, and the inability of the Guarantee Fund to get off the ground, AID continued the monitoring role until December 31, 1995.

### PLANNED INPUTS AND MAJOR OUTPUTS/ACCOMPLISHMENTS

The total of 300,000,000 colones were donated to Fedecredito, which immediately was used to purchase preferred shares to be issued by Banco Federado. (In the cooperative system preferred shares are called "Certificados Especiales de Aportación") These preferred shares would be recognized by the AGEF as part of the Bank's equity. According to audit reports, the funds were invested as stipulated in the Agreement, in the following breakdown:

- a Approximately 45% to finance small farmers
- b Approximately 35% to finance small industry
- c Approximately 20% to finance the construction and improvement of rural shelter housing projects

Interviews of 15 Cooperative General Managers indicated that indeed the financing received from Banco Federado under the "AID Program" was very beneficial to these

cooperatives. These funds provided working capital and helped improve the image of the cooperatives after the 1987 crisis. The funds also drew-in new clients who became members to obtain the special financing but to date still continue to be active cooperative members.

Banco Federado paid Fedecredito a 12% preferred dividend on the "Certificados Especiales de Aportación". This preferred dividend, amounting to ₡36 million annually, was used in the following way:

- a. Forty percent (₡14.4 million) was used to finance technical assistance. For the first four years technical assistance was provided from Fedecredito to Banco Federado. On the fifth year, the technical assistance was provided directly to the member cooperatives by Fedecredito. This assistance was primarily in the area of bank management, credit analysis and follow-up, and general bank operations. The funds paid for consultants and training seminars.
- b. Sixty percent (₡21.6 million) was earmarked by the Agreement to establish a Guarantee Fund to protect the savings of the cooperative members of the system within nine months after project initiation. The Fund was to serve as a deposit insurance fund, similar to the FSLIC in the US. However, this output was not accomplished within the time frame of the Agreement, and a Structural Strengthening Fund was created in lieu of the Guarantee Fund.

Delays in the design of the Guarantee Fund component lead to a re-analysis of the needs, and by October 1995, Fedecredito and USAID agreed that it was best to create a Structural Strengthening Fund rather than the Guarantee Fund. This measure was taken because the cooperatives were not sufficiently financially stable, nor was the fund large enough, to assure that the Guarantee Fund would not be depleted with the closure of one or two cooperatives. Fedecredito's proposal to further strengthen the credit unions and improve the administrative weaknesses to meet the requirements of the 1994 Supervision Law through a Structural Strengthening Fund seemed the most adequate and beneficial for the credit unions. Amendment No 1 to the MOU No 4, signed on December 27, 1995, provided for this change.

The main objective of the Structural Strengthening Fund is to provide savings and loan cooperatives affiliated to Fedecredito with a support mechanism that will accelerate the process of administrative and management improvements in the areas of bad loan accounts and the building of a newly required capital institutional reserves under the 1994 Supervisory Law for the Cooperative Credit Unions.

### FINANCIAL STATUS

With the signing of the Amendment No 1 of the Agreement, AID approved the proposal to replace the Guarantee Fund with a Structural Strengthening Fund for the savings and loan cooperatives. The Amendment No 1 established the procedures to be followed

by Fedecredito in the creation and management of the Structural Strengthening Fund to begin in 1996. This action would then close one of the 1993 audit findings related to the Guarantee Fund.

The 1993 Audit Report was the last originally required under the MOU No 4 Agreement since AID monitoring responsibilities were to have ceased by then. However, the delays on the approval of the Guarantee Fund, (later to be redesigned as the Structural Strengthening Fund), led AID to require an overall audit for 1994 in Amendment No 1.

USAID received the draft 1994 audit on April 24, 1996. Although there are a few recommendations, the auditors indicate that there are no questioned costs. USAID has also received the written comments from the General Manager of Fedecredito responding to the findings. One of the findings mentioned, as in the 1993 audit, is that Fedecredito has not created or put into practice the Guarantee Fund as stipulated under the Agreement, and that AID has not approved the regulations for this Fund. Based on documentation of 1994, this finding is true, however, this finding is corrected by the Amendment No 1 to the Memorandum of Understanding (signed 12/27/95).

Although the original Agreement is effective until June 30, 2003, AID monitoring responsibilities were ended by the signing of the Amendment No 1. The Amendment No 1 designated the General Superintendency of Financial Entities (SUGEF) as the monitoring agency of the Structural Strengthening Fund for a two year period, i.e.,

January 1, 1996 through December 31, 1997 Monitoring responsibilities only pertain to the administration of the Structural Strengthening Fund, since the parties agreed that Fedecredito's compliance and good administration of MOU funds in the past, did not reflect a need to monitor the entire fund After December 1997, the Structural Strengthening Fund would be at the total discretion of Fedecredito

### LESSONS LEARNED

It is important for project officials to be flexible in adjusting implementation plans In this case the establishment of a Guarantee Fund was not considered to be the best alternative for the use of the 60% of the preferred dividend Discussion about the best way to establish the Guarantee Fund took almost six years causing much delay in project implementation However, all parties agreed that a more appropriate use of the funds was devised with the creation of a Structural Strengthening Fund, since this option provides an incentive component for the credit unions to obtain financial solvency at a quicker pace and, at the same time, assures that the fund will not be consumed by the unfortunate closure of a credit union

Nonetheless, implementation delays have repercussions in the planning for the different components of a project AID as the responsible monitoring institution, should have been more insistent in following up the 1992-1993 audit recommendations to avoid delay in project implementation and close-out

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