



Final Report

**ACTIVITY TO PROMOTE FINANCIAL TRANSPARENCY
IN ECUADOR**

**Technical Assistance to the Deposit Guarantee Agency
Agencia de Garantía de Depósitos (AGD)**

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USAID Objective 1.1 : Critical private markets expanded and strengthened
G/EGAD SSO 3: Support appropriate and functioning economic policies, market reforms, and institutions in emerging markets and priority countries
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TABLE OF CONTENTS

EXECUTIVE SUMMARY

- I BRIEF HISTORY OF THE AGENCIA DE GARANTIA DE DEPOSITOS**
 - A) Creation of Agency**
 - B) Historical developments and Current Status**

- II DETAILED SUMMARY OF TECHNICAL ASSISTANCE**
 - A) Overview of Technical Assistance**
 - B) Closed Banks Resolution Strategies**
 - C) Asset Management and Disposition Strategies**
 - D) MIS and Other Implementation Strategies**
 - E) Obstacles, Practical and Legal**

- III PORTFOLIO IDENTIFICATION PROJECT**
 - A) Overview of Project**
 - B) Initial Phase of Portfolio Identification Project (January to February 2000)**
 - C) Phase two of Portfolio Identification project (February to may 2000)**
 - D) Preliminary Conclusions**
 - E) Costs/Benefits Analysis (11 cases)**
 - F) Implications of Conclusions**
 - G) Implementation of Strategies and Obstacles**

- IV APPENDICES**
 - A) Project Tangible Results**
 - B) “Shrimpera” Case Study**
 - C) Ten Cases Study/ Costs-Benefits Analysis**
 - D) USAID Letter dated April 21, 2000**
 - E) Portfolio Identification/Banco Del Progreso**
 - F) Portfolio Identification Phase One**
 - G) Portfolio Identification Phase Two**

EXECUTIVE SUMMARY

This report summarizes the assistance of Barents Group LLC (Barents) to the “Agencia de Garantia de Depositos” (AGD), an agency created by the Congress of Ecuador and supervised by the “Superintendencia de Bancos” (Super), as contracted and funded by the United States Agency for International Development (USAID).

This report covers Phase I and Phase II of the project beginning in July 1999 and continued to May 2000. The primary goals of the technical assistance can be summarized as assisting the AGD to become operational and developing strategies for the transparent management and disposition of the assets under its control. The objectives of this project have been to assist the AGD:

- to establish an organizational framework for the efficient operation of its delegated functions;
- to develop and implement a business and strategic plan;
- to develop and implement operational and procedural manuals;
- to develop strategies for the administration and disposition of assets under its control.

This report is written to discuss the tangible results and benchmarks as set forth by USAID. We have also included a brief historical summary of the creation of the AGD, and the current operational status of the agency.

During the project's duration, the development of policies, strategies and plans outlined in the objectives was completed. Full implementation of these tools, however, has been delayed due to external and internal AGD organizational issues, discussed below.

Barents would like to acknowledge our partners at USAID who have been committed, responsive and supportive throughout the phases of this project.

The AGD was established by legislation in December of 1998 but has undergone continued changes at the senior management level during 1999, and into 2000. Barents advisors arrived in Ecuador at a time when the government was facing one of the worst economic and financial crisis in the country's history, and was technically and financially unprepared to assume the control of more than a dozen failed financial institutions.

The first General Manager of the AGD had resigned in May 1999 and the agency was not fully operational at the time of Barents arrival in July 1999. By January 2000, the AGD was on its fourth General Manager and was still not fully operational although it controlled 16 closed financial institutions, 4 government intervened banks, and approximately over 70% of the country total assets.

The following highlights some of the most significant tangible successes achieved by the Barents team during the life of this project:

- Barents advisors have provided written recommendations and advice to the AGD in the initial drafting and subsequent editing of the agency's organizational chart. Advisors also assisted in the drafting of job descriptions and staffing requirements.

- Barents advisors assisted in the development and subsequent editing of the AGD's Business and Strategic Plan, incorporating timetables and areas of accountability for all functions of the agency. The plan is still awaiting approval by the agency's Board.
- Barents advisors provided written recommendations on Best International Practices for asset management and disposition, and finalized the Asset Management and Disposition Manual for the AGD. The agency's Board formally approved this manual in December 1999.
- Barents advisors provided drafts of the following manuals: Temporary Administrator, Due Diligence, Code of Ethics and Contractors Oversight. These manuals, as well as many written recommendations provided over the life of the project are still pending approval and implementation.
- Barents advisors provided assistance and written recommendations to the AGD in the implementation of the MIS. The agency made the early determination to use a government intervened bank's system based primarily on cost. On several visits, our advisors provided recommendations to resolve issues, which, due to lack of implementation, have created undue delays preventing the MIS from being operative.

- Barents advisors provided assistance and written recommendations to the AGD on issues such as Public Relations, Training, and Deposit Insurance. Experts in these areas interviewed key personnel at the “Banco Central”, “Superintendencia” and the AGD and submitted written conclusions and recommendations.
- Barents advisors in conjunction with USAID partners, met on a regular basis with other international organizations. The advisors also assisted on a regular basis other Ecuadorian organisms such as the “Banco Central”, and the “Superintendencia’s Unidad Ejecutora”, with special issues regarding IMF and World Bank assistance.
- Barents advisors provided hands-on assistance with a project of portfolio identification starting in January 2000. Due to the inoperability of the MIS, this project, which is still on going, took on great significance in the development of strategies for assets disposition and management issues facing the AGD. The last part of this report covers this activity in great detail since findings and conclusions will have much impact on future strategies for assets under the AGD’s control.

As indicated before, many obstacles developed and stood in the way of implementation, but many of the objectives were achieved thanks to the support, tenacity and dedication of our partners at USAID.

I. BRIEF HISTORY OF THE AGENCIA DE GUARANTIA DE DEPOSITOS

A) Creation of the Agency

In the last three years, the Ecuadorian Financial Sector has undergone many changes in the total size of the institutions operating, in quality of portfolios, in public perception and confidence, and in the legal and regulatory framework it operates under.

Legal changes that impacted the financial sector rest mainly on the creation of the AGD, which provided a legal vehicle to seize control of financial institutions. Regulatory changes have mainly impacted the level of reserves for loan losses, with new requirements on the amounts to be reserved. Capital levels will also be gradually increased, and regulations involving insider lending also have changed. These changes will require a more aggressive level of supervisory attention and closer scrutiny of financial institutions.

Probably the most dramatic changes have occurred in the areas of public confidence, perception and the liquidity of the financial sector. Currently the AGD controls 14 institutions, one finance company and has intervened in four other banks. This has eliminated banks from many locations and has impacted the ability of operating businesses to obtain credit. With defaults on loans growing at an inordinate rate, no opportunities for lending, and the lack of public confidence, the financial sector is very weak. Strategically this may present new challenges and opportunities for strong institutions and may also attract some interest of outside investors. However, the

economy and outside investors' confidence would appear to be at a low point and financial sector recovery may take a number of years.

The “Agencia de Garantia de Depositos” (Agencia or Agency) was created by the Congress of Ecuador in December 1998. The role of the Agency was to be a dual role: deposit insurer covering all depositors, regardless of amount and also as an intervening agency to take over banks perceived not be viable. The law allowed the agency to step in and take over control of a bank, once the “Superintendencia” had declared the bank to not be in compliance with capital requirements.

The AGD had two main tools to take control: “Saneamiento” and direct control. The “Saneamiento” step allowed the agency to place a Temporary Administrator in the institution while a solution or strategy for disposition could be found. Originally this step was to be short-lived, and a plan for disposition was to be prepared and submitted within 90 days of date of take over.

The AGD was to be managed by a General Manager, assisted by staff in the following areas: Management of Assets, Disposition of Fixed Assets, Saneamiento, Finances, Operations, Human Resources, Data Processing and Public Relations. By express intent of the government, the AGD was not to be a large, bureaucratic agency, but rather a facilitator for failed banks. On a reporting basis, the General Manager reported to a Board composed of the following: President of Banco Central, Superintendente de Bancos, Presidential appointee, and AGD's General Manager. Technically, however, the General Manager reports to the Superintendente de Bancos

The AGD was to be self-supporting and generate adequate funds to pay depositors. The government, however, had to intervene in the payment of deposits, as the AGD had no reserves to honor deposits. Facing difficulties with external and internal debts, the government declared a banking holiday and froze all deposits at failed and open institutions. The freeze on deposits was reportedly of the reasons for a government coup in January 2000, which deposed the President.

B) Historical Developments and Current Status

The creation of the AGD was one of the Government's responses to the Ecuadorian financial crisis to address the failure of banks. Since 1994, the “Banco Central” had been warning about disturbing trends in the condition of several small and large institutions, and the “Superintendencia” did not have the vehicle to address closures and change in control. The freeze of deposits was a result of the financial burden on the state to honor deposit guarantees and the realization that disposition of controlled assets would not cover insured deposits.

From December 1998, when the agency was created, to May 1999, the agency operated with a General Manager and a very small Saneamiento unit. From May 1999, three new General managers were appointed. Although an organizational chart was created and approved, many key positions were never filled or have suffered from inordinate personnel turnover. At executive levels, there have been numerous changes that have impacted the operational ability of the agency: three changes in the Ministry of Finance

(most current is the resignation of Jorge Guzman in May 2000) as well as three Superintendentes de Bancos, (with Guzman becoming Minister of Finance).

The government coup that occurred in January 2000, replaced President Mahuad and most of his Ministers. Gustavo Noboa, prior Vice-President took over the Presidency and Jorge Guzman was appointed Minister of Finance. At that time Juan Falconi was appointed, without congressional support, to the Superintendente of Banks, and Luis Villacis was named the new General Manager at the AGD. Except for Guzman, these individuals have very limited banking experience. These changes at the AGD have translated into more delays in program implementation, shifts in priorities and changing strategies.

Aside from being set up organizationally and operationally, the AGD has three main objectives:

1. establish a viable business and strategic plan,
2. convert all its assets to a unified Management Information System and
3. complete a valuation of its assets.

These three objectives are the foundation for any actions to be taken by the AGD and merit immediate attention. With continued crisis, changes in personnel and shifting priorities, these objectives have not been met. As of May 2000, the business and strategic plan prepared by Barents, remained without comment, approval or implementation and the MIS was not operational.

In August 1999, the decision was made to utilize the Filanbanco data processing system as the overall MIS for the AGD. This required conversion of all the banks under control of the AGD with a deadline of October 1999 for full implementation. Fixed assets were not converted until December 1999, and the loan systems are still in process. The end result is that, at a time when assistance from the World Bank was being negotiated, and conditionalities with IMF set, the agency still did not have detailed information of the assets it controlled.

The lack of a viable business plan with timetables and areas of responsibilities has also hurt the agency. There are no clear strategies being communicated to the staff and this has translated into operational paralysis. The biggest impact has been in the continued deterioration of assets controlled by the agency and the lack of resolution for institutions that have been in Saneamiento for over 15 months.

In December 1999, the agency consolidated the operations of various banks into two locations. This measure was supposed to result in managerial and operational efficiencies. While some of this has been accomplished, Banco del Progreso, which represents over 70% of the holdings of the agency, remains as a stand-alone institution. The bank is still not converted to the AGD MIS system and efforts to convert have been plagued with accounting issues and inefficiencies. While the bank has been substantially downsized, it still requires a great number of staff and expenses to operate. Most importantly, the issue of conversion and asset valuation blocks efforts by the agency to

proceed with asset management and disposition strategies and any efforts to come to an early resolution as to the future of the institution.

Decisions continue to be postponed and this is best exemplified by many delays in the seemingly simple effort to sell fixed assets. Initially the AGD attempted to dispose of fixed assets before December 1999. With no inventories of assets in place, the sale was delayed to March. Changes in personnel at the AGD and at the Superintendencia further delayed any action. As of this date, there is still no visible effort to try to sell the inventory of fixed assets. While these assets represent a very small percentage of the holdings of the agency, their value continues to diminish as some assets may be lost or become obsolete with no residual value. Strategies for the balances of the assets, i.e. loan and real estate portfolios also continue to experience delays, mainly due to the lack of reliable information. Meanwhile the AGD continues to be a cash drain on the government as it has been unable to generate any income from its assets to sustain its operations or for payment of deposits.

II. - DETAILED SUMMARY .OF TECHNICAL ASSISTANCE

A) Overview of Technical Assistance

This report is a summary of the accomplishments of technical assistance to the Agencia de Garantia de Depositos (AGD). This technical assistance was funded through the United States Agency for International Development (USAID) in relation to “ Promoting transparency in the Financial Sector”, herein called “the Project”. The narrative discussion follows the scope of work requirements, and relates directly to the tangible results and benchmarks established for this Project for the periods of July 1999 through May 2000.

The main objective of this project has been to assist the AGD in its efforts to organize and transparently dispose of assets from under government control. The technical assistance provided by USAID, through Barents Group LLC (Barents) was focused on the following areas:

- Organizational Framework
- Strategic and Business Planning
- Asset Management and Disposition
- Practical Training and hands on assistance

This reports comments on the accomplishments in each of these areas.

B) Closed Banks Resolution Strategies

By July 1999, the AGD controlled or was otherwise involved with a number of banks. The largest was Filanbanco, a government intervened bank, which remained open. At the end of July, the AGD took over Banco del Progreso, by far the largest bank to control, and also the most complex because of the charges leveled against its main owner. By December 1999, the AGD had control of 14 banks, with Progreso representing the largest share of the government controlled assets.

Once the banks were seized and closed, the AGD appointed an independent Temporary Administrator and took on the responsibilities of paying depositors. Typically the Temporary Administrator would downsize the operations, administer assets and liabilities, while at the same time preparing recommendations for the resolution of the institution.

The strategy of the AGD, while not in writing, has been to maintain the banks in Saneamiento instead of proceeding to liquidation. Liquidation would be a more agile process, particularly as it impacts management and disposition of assets, but it would require immediate decisions on payments to depositors. The government's inability to face a mounting burden of payments to depositors, precluded implementing the liquidation strategy.

Assistance was given in the areas of bank closure procedures and Temporary Administrators' operating manuals. The Temporary Administrators' manual, while

purported initially to be an immediate priority, remains unapproved and not implemented many months after it was delivered to the AGD.

The issue of resolution of closed banks, remains a serious issue for AGD and the government in general. To maintain banks in Saneamiento demands operating funds, which the agency does not have, and also impairs the ability of the administrators to pursue collection of assets vigorously. While in Saneamiento, legal collection matters have to follow a burdensome, lengthy and expensive path, in Liquidation the administrator becomes the judge and can take immediate steps to protect or seize collateral for loans. Liquidation also has some legal implications in regards to any remaining equity past owners may have, disposition of contracts and leases, and mostly in regards to payment to depositors. It is that hurdle, and lack of funds to meet those payments, which has prevented a strategy that many embrace, from being implemented.

Keeping the banks in Saneamiento, also has implications on the powers the agency may or may not have in regards to disposition of assets. At question has been the ability of the agency to directly dispose of assets, rather than have to create a convoluted system through third parties. While this has been discussed many times, there is no clear strategy written down which would allow the agency to dispose at will of any of the assets of the closed banks it controls.

In the case of some banks decisions have been made on a crisis basis. The merger of Previsora with Filanbanco, the strategies for Popular and Continental, are perhaps not the

best solution but are the most immediate. The biggest challenge will be to develop strategies for the disposition of the agency's largest holding, Banco del Progreso, and also to find viable exit solutions for the other smaller banks. Saneamiento was to be a short-term solution, instead many banks have remained in Saneamiento for over a year, and long-term resolution is still protracted in time.

C) Asset Management and Disposition

This was the area where Barents devoted the most time in the project. When the project commenced there were no asset management strategies, policies or procedures in place at the AGD. The AGD approved the asset management manual in December 1999; however, the manual was not disseminated to the AGD's staff and today, implementation has not been pursued.

In discussing this area, segregation should be made between the two types of assets the agency controls. Fixed assets, both in use or controlled, represent approximately 3% of the total assets controlled. Fixed assets are represented by bank furnishings, equipment, artwork, computers, automated teller machines etc. Another type of Fixed Asset controlled is "Other Properties Owned" representing foreclosed properties or businesses which are no longer interest producing assets. The bulk of the assets controlled are represented by the banks' various loan portfolios, which for lack of exact figures approximate US\$ 1.1/1.2 Billion.

The major role and responsibility of the agency is to administer and dispose of these assets to produce cash to pay depositors, as well as fund the operations of the AGD. All strategies for the disposition of assets have implications on the ability of the government to meet its internal debts to depositors.

On many occasions, the management of the AGD publicly expressed that asset management and disposition responsibility would be out-sourced to the private sector. This would be done in order to utilize the best possible expertise in the field of asset management and disposition, to maintain transparency in the process, and to avoid rampant corruption, as uncovered in the banks. When these strategies were being developed and disclosed, the AGD had little or no detailed portfolio information. The volume of assets available for management and disposition was substantially inflated in the AGD's projections.

Fixed assets in many banks had not been inventoried prior to converting to the AGD/Filanbanco MIS system. In many cases substantial adjustments were necessary to account for property missing or no longer available for disposition. Examples include: Other properties owned are carried at inflated book values and require updated valuations for the AGD to effectively market the properties. The "Due Diligence" manual and procedures provided by Barents provided direction to complete this process, but the manual has not been commented on, approved or implemented. AGD strategies for the valuation, marketing and disposition of these properties have to be developed.

The loan portfolios of the closed banks under control of the AGD are discussed in depth below. Due to the lack of reliable information, a special project was started in January 2000, with the main objective of identifying those loans that could be valued and outsourced for administration. The conclusions of this special project will have direct implications on the AGD's strategies for the management and disposition of the assets. From January 2000 to present, this project became the main emphasis of the technical assistance provided by Barents.

D) MIS and other Implementation Matters

The management of the AGD made the decision to utilize the Filanbanco data processing system for the conversion of the closed banks it controls. The rationale for the decision was made due to time and money implications. Each of the closed banks operated on their own independent systems and at some banks there were more than two or three systems processing and integrating information. The conversion and consolidation process from the onset proved to be difficult and to this date the system is not fully operational. The decision to consolidate all of the AGD's assets onto the Filanbanco system was not wrong, however, recommendations and safeguards made by Barents were not implemented, coupled with the lack of adequate personnel support and changing priorities delayed the conversions.

The importance of the MIS implementation and functionality is a priority for any organization that is balance sheet driven. MIS and managerial reporting provide

management with the information necessary to properly and efficiently manage an agency. Negotiations by the GOE, with the World Bank, the IMF and IBD relied upon the information provided by the AGD, which has proven to be faulty. Conditionalities with the IMF agreement set timetables for sale of assets that were impossible to meet and negotiations for technical assistance with the World Bank included components reliant on valid detailed information on the loan portfolios.

When USAID threatened to discontinue its assistance, the AGD focused more of its attention on the conversion process. However at as of this report's date, work at Banco del Progreso is still not completed and while the smaller banks have been converted the financial integrity of the information is questionable.

Over the life of the project, over five manuals were developed and delivered to the AGD, and over 30 diskettes worth of memos, recommendations and advice were also provided. To date, one manual has been formally approved and has not been fully implemented. The balance of the materials provided, Business Plan, strategies etc...remain to be commented on or approved by the AGD

E) Obstacles, Practical and Legal

Since the agency was created in December 1999, there remain legal issues that need to be addressed in order for the AGD to perform its role in an effective manner.

The efficiency and effectiveness of the AGD, have been impacted by issues concerning legal collection rights, legal powers of the Administrators, equity issues in the closed banks, insider issues and depositors' issues. An example concerns the ability of the agency to collect or pass on administration of insider loans. More than 65% of the total portfolio controlled by the AGD are insider loans. Currently the law dictates that these loans have to be collected in full and cannot be restructured or modified, regardless of financial considerations. The inability of the AGD or its agents to restructure these loans make it impossible to contract for third party administration and therefore the only strategy remaining for these credits would be outright sale. Since the majorities of the credits are past maturity or delinquent, have not had payments in over a year, their value at sale would be extremely low with little if any market interest. Various solutions have been expressed by staff at the AGD, clarifying at what point those loans cease to be insider loans once the institution is taken over, modifying the law itself or allowing the Superintendencia to implement new procedures to handle these credits. Until these issues are addressed, the major portion of the AGD's portfolio has little value and remains uncollectable.

Another legal issue that has been debated for many months is the AGD's legal right to dispose of assets. Management of the AGD maintained that they could not directly dispose of their assets but had to create and transfer assets to "fidecomisos" (trusts) to act on their behalf. For months this opinion prevailed and prevented many collections or resolutions of debts by the administrators. Barents had this opinion researched and

concluded that the interpretation was erroneous. However the AGD's legal position remained the same.

Other legal impediments and otherwise cumbersome operative methods for the AGD are reflected the manner in which assets have to be sold, legal enforcement of defaults on credits and right of offset. Barents technical advice covered a number of these issues but they were not addressed by management.

Personnel turnover at management and mid-management levels, lack of stable counterparts, inability to access management when needed, lack of strategy and misplaced priorities made Barents work difficult. Recommendations were made but there was little if any discussion or management attention given to our recommendations. Manuals were written and submitted but have not yet been commented on, approved or implemented. The lack of clear strategy also complicated our work.

In December 1999, the "Unidad Ejecutora" was created under the supervision of the Superintendente. The main objectives for this special unit was to negotiate terms of technical assistance with the World Bank, IBD and any other international donor and supervise performance and completion of the agreements. The creation of the unit coincided with the departure of most of management and middle management at the AGD, which left the agency in a complete state of paralysis. The unit stepped in to make the decisions and again strategies changed. Components of the agreement with the World Bank called for portfolio identification, valuation and disposition by March 2000.

Agreements with the IMF called for asset sales to take place by May 30. Both of these tasks seemed impossible based upon the operational condition of the AGD.

Based on the above, Barents technical assistance in January 2000 shifted its attention to portfolio identification and segmentation. The Barents team was reduced to one advisor who was assigned full-time to this task.

Since the beginning of the year, contact with senior management was limited and contact with the new General Manager, Luis Villacis, occurred only once. Since December 31, 1999, the position of “Gerencia de Activos” remained vacant which removed the only viable counterpart that Barents had within the agency. Contact between AGD’s management staff and Barents’ advisors were almost nil. Given these circumstances, many of the recommendations made remain in need of action. The majority of manuals and the proposed business plan remain in draft form.

III. - PORTFOLIO IDENTIFICATION PROJECT

A) Overview of Project

In December 1999, the “Unidad Ejecutora” was negotiating terms with the World Bank for technical assistance. A large portion of that package was targeted for assistance to the AGD in a number of areas. Specifically two areas required detailed knowledge of the loans in the portfolios controlled by the agency, details that the MIS was not capable of providing. Information was needed to negotiate World Bank conditionalities related to the loans that would be subject to independent valuation, third party administration or sold.

Working with the Barents advisor, a special unit of credit personnel from the various closed banks controlled by the agency was created and positioned at Banco del Progreso, under the leadership of one of Progreso’s credit administrators. The objective assigned by the “Unidad Ejecutora” was to develop viable information on loans over US\$ 1Million by February 24th, 2000, to receive expressions of interest on valuation (Due Diligence) and third-party administration and contract out these tasks.

Within a period of approximately five weeks the task force was to develop loan cards for each credit, containing basic loan and collateral information as well as any other information necessary to facilitate due diligence. The credit files were to be created with

all the required documentation to support the credits. Portfolio information was to be provided by the individual banks with the Temporary Administrators certifying the accuracy of the information. Approximately 93 “master credits” comprised of over 950 individual credits were to be documented. Of that total, approximately 70% of the credits were from Banco del Progreso. The last week before deadline, loans from Banco de Prestamos were added to the base package, changing the total number of loans to an yet undetermined number.

A preliminary report was completed by the set deadline and is discussed below as Phase One of the project. To date the report has only been 95% finalized, and preliminary conclusions, submitted in the attached document, reflected the following:

1. Misinformation by AGD’s management and Unidad Ejecutora as to size and segmentation of the credits that would be available for valuation and administration.
2. Financial integrity issues related to the loans at the banks.
3. Unreliable or otherwise unavailable information at Progreso
4. Large percentage of insider loans
5. Obsolete or unreliable appraisals
6. Large percentage of delinquencies and non-payments
7. Small percentage of loans available for valuation and administration

Points 4 and 7 created a great amount of controversy and disagreement within the AGD and with the Unidad Ejecutora. Given the substantial differences in portfolio totals between perception and reality, the project was expanded to include all loans above US\$

200,000.00 to increase the total base of credits. This became Phase Two of the project, which is currently under way. Barents assistance terminated at this point and Phase Two is being conducted without external or independent assistance.

B) Initial Phase (Phase One)

Phase One can best be summed up by the inordinate obstacles, delays and lack of cooperation encountered. The preliminary conclusions provided the first viable portfolio information crucial to the development and implementation of strategies for the agency.

Since inception of the Project, Barents recommendations had been to obtain information about the AGD's assets and to develop exit strategies based on the portfolio information obtained. This was not achieved and Phase One of the Portfolio Identification Project provided the first accurate information related to the AGD's portfolio of assets.

Phase One was not finalized because of the delays encountered with information from Progreso. Ultimately, a manual balancing of loans had to be done in order to obtain reliable and verifiable information.

The conclusions will not change dramatically. The major and more consequential conclusions will impact the strategies for valuation and third-party administration because of the large amount of insider loans. This would impact the conditions of negotiations set with the World Bank and would require modifications.

C) Phase Two of Portfolio Identification Project

Phase Two commenced in March 2000 and is ongoing. The process has been delayed for the same reasons Phase One was delayed: lack of MIS or reliable information, lack of information at Progreso, lack of cooperation and coordination, lack of operational and system support and shifting priorities. To complicate issues, a new General manager was appointed in the last few weeks, the position of Gerente de Activos was finally filled, and MIS personnel's attention has been detracted with issues concerning the merger of Filanbanco. With no external assistance, the staff involved in the phase One and Two of the portfolio identification project, has encountered lack of support and inordinate delays in getting information.

D) Preliminary Conclusions

Phase One provided basis for comments and these were submitted to USAID, AGD, Unidad Ejecutora and at the request of USAID to other international donors such as the World Bank, IMF, IBD and CAF.

The main findings revolved around the large percentage of insider loans, the large percentage of loans at Progreso, which represents the bulk of the portfolio, and the conditions of files and credits.

The Preliminary Report is attached as an appendix to this report.

The conclusions derived from these findings directly impact strategies for the management and disposition of assets. Attention should be paid to the strategies for insider credits and the immediate need to address the legal issues surrounding those credits. Valuations should be carefully considered and due diligence monies only spent on viable credits supported by viable collateral. Obtaining current information to complete credit files, short credit analysis, and in some cases restructures, will also impact valuation of the credits.

Barents performed a “value/cost” analysis of a major credit at Banco del Progreso as well as ten additional large credits and is discussed below. The conclusions provide alternative strategies for the AGD. The differences in values between “as is” condition and restructured condition are significant and merit consideration, discussion and implementation of policy decisions by the AGD.

There are other considerations that will also impact future strategies: the economy of the country, outside investors’ level of confidence, overall asset quality and credibility of the government and the AGD.

E) Costs/Benefits Analysis

As a preamble to due diligence, Barents was asked to provide assistance with a costs/benefits analysis of a credit in an “as is” condition versus a restructured condition.

The case of “Shrimpera”, a real but fictitiously named company was used. The conclusions are attached as an appendix. The Unidad Ejecutora argued that one case was not conclusive and requested that Barents completed an additional ten cases. The conclusions for these cases are also provided as an appendix to this report. (See note below)

Approximately US\$ 100 Million in loans were analyzed. The analysis involved:

- Obtain current financial information on the companies
- Analyze financial information and project cash-flow
- Analyze debt servicing ability
- Establish scenarios for repayment of debt under various rate environments
- Establish the conditions for restructure of debt
- Derive a present day value to the credit both in an “as is” condition and restructured.

The initial analysis of Shrimpera provided a final range of US\$.03 cents to approximately US\$.15 cents. The additional cases provided ranges of .03 to .16 cents.

Note: All completed cases are available but have not been included. They contain private and confidential information privy to each borrower. The AGD can access these cases at Banco del Progreso, one of the banks it controls.

F) Implications of Conclusions

The case studies provide the basis for disposition alternatives, at a time when the basis for strategies (i.e. size of portfolios, conditions of files and credits etc.) needs to be revised.

At stake are decisions to be made regarding the timing of valuation and administration strategies of assets.

If decisions are made to proceed immediately with independent valuation of credits, without consideration to the collectability of the loans, the process could be costly and inefficient. If the AGD contracts with third party administrators, the present condition of the files and with the limitations applying to insider loans, loan packages will be substantially reduced and will have an adverse effect on fees. If the AGD makes a decision to sell credits in their present condition, the lower values reflected in the cases presented should be used.

The implications of all these decisions are fairly clear:

- Assistance for cost of Due Diligence may have to be renegotiated, since the approximate amount of US\$ 1.5 Million may not adequately cover all loans to be valued.
- The cost of third party administration may have to be revised, since the loan packages are smaller than expected.

- Expectations from sale of loans may have to be revised to take into consideration the impact to values of the different factors described in the case studies.
- Careful consideration should be given to marketing strategies, as in the condition of the portfolios, external interest may be lower than expected.

G) Implementation and Obstacles

The area of asset management and disposition is probably the most important responsibility of the AGD. Any and all strategies for disposition or management of assets will have an impact on future cash flow available to pay depositors, and relieve the mounting burden on the government.

Much of this report has covered implementation issues, and they can best summarized as follows:

- Obtain viable information on the “universe” the agency controls, and
- Establish a Business and Strategic Plan that addresses strategies for this universe.

These two objectives are the foundation of the areas addressed by Barents technical assistance and as indicated in the body of this report, much remain to be implemented.

The AGD faces serious problems related to implementation of its MIS. Despite numerous recommendations, adequate support has not been provided to the resolution of

this problem. Until its MIS issues are resolved and the AGD has accurate knowledge of its portfolio, it will continue to suffer inefficiencies and delays in resolution of its objectives.

A realistic Business Plan must be adopted and communicated. AGD's actions up to now have been responsive to crisis, rather than addressing problems and issues systematically with clear knowledge of direction and accountability. In order to reach these objectives, management attention and personnel support must be present.

In a closing letter to USAID (attached as Appendix C), Barents has recapped its work and its recommendations and states that the AGD needs to refocus its attention on the priorities outline in this report, specifically discussed below:

- The AGD needs consistent oversight, governance and direction.
- The AGD has to approve and implement a working Business and Strategic Plan that will create a framework of priority tasks, realistic timetables and accountability for all within the agency.
- The AGD needs to improve its communication with its staff.
- The AGD must finalize the implementation of its MIS and support the effort with appropriate personnel and management attention.
- The project of portfolio identification must continue and should be a precursor to any decisions on due diligence and any asset management or disposition decision.
- The AGD should implement operating manuals, training, internal controls and improve internal and external communications.

- The AGD needs has an urgent need for personnel, training and assistance in the area of asset management.
- The AGD must address its legal issues and obstacles that need immediate attention and priorities should be set for resolution. Until these obstacles are addressed, the AGD's efficiency and effectiveness will continue to be impaired.

IV APPENDICES

A) Project Tangible Results

The First Phase of the Project commenced July 27th, 1999 and ended October 30, 1999.

The Project Tangible Results for this phase are listed below:

- Assisted the Banco Central with Closed Banks Resolutions Strategies, which were incorporated in a presentation to the Banking Board.
- Drafted an Organizational Chart for the AGD that was formally implemented.
- Submitted a 20 Day work Plan for the AGD
- Drafted a list of Delegated Authorities for the AGD that was formally implemented in December 1999.
- Drafted an Asset Management and Disposition Manual that was formally approved in December 1999.
- Drafted a Temporary Administrator's Manual.
- Drafted a Due Diligence Manual.
- Submitted a report on International Best Practices for asset management and disposition.
- Drafted procedures for Selection and Supervision of Third Party Administrators.
- Reviewed and commented on the Bank Closing Manual.
- Drafted and Submitted a Strategic and Business Plan for the AGD.

Second Phase of the Project

- Drafted a Public Relations Plan
- Drafted a Training Plan
- Drafted an Ethics Manual.
- Submitted the Shrimpera Case Study and ten other Case Studies for Costs/Benefits Analysis.
- Drafted Appendices and Special Forms for the Asset Management and Disposition Manual, which were implemented by the AGD.
- Drafted with Invitation letters and Terms of Reference for contractors that were utilized by the Unidad Ejecutora.
- Commenced Portfolio Identification Project on loans over US\$ 1 Million.
- Submitted Preliminary Report on Portfolio Identification Project.
- Commenced Portfolio Identification Project on loans over US\$200M.
- Submitted Closing comments on assistance and presented to IMF, IBD, World Bank and CAF.

B) Shrimpera Case Study

In November and December 1999, and based on a real credit at Banco del Progreso, Barents provided pre-due diligence recommendations and conclusions. The “Shrimpera” case clearly demonstrated the benefits of file “scrubbing” and restructuring in order to increase the potential sale value of the credit.

C) Ten Cases Study

Barents, at the request of the Unidad Ejecutora, expanded the cost/benefits study done on “Shrimpera” to cover approximately US\$100 Million represented by ten credits at Banco del Progreso. The conclusions did not vary from the initial conclusions on “Shrimpera”.

D) Closing Comments/ Letter dated April 21, 2000 addressed to USAID

Attached as Appendix D, is a copy of a letter requested by USAID, and utilized at a joint meeting with other international donors. The letter recaps the work done by Barents, the conclusions and recommendations reached, and the issues still needed to be addressed by the AGD.