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# Barents Group, LLC

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AGENCIA DE GARANTIA DE DEPOSITOS (AGD)  
ECUADOR

Final Report

Contractor: Barents Group, LLC  
Contract Number: PCE-I-00-99-00006-00  
Country: Ecuador  
Title of Task Order: Rule of Democracy Support/Activity to Promote Financial Transparency in Ecuador  
(AGD Phase I and II)  
USAID Cognizant Technical Office: Quito, Ecuador

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## BACKGROUND

Poor economic conditions exacerbated by the crises in Asia, Russia, and Brazil as well as inadequate regulation have resulted in a severe banking crisis in Ecuador that has included a sustained “banking holiday” and the effective shut down of credit intermediation and payment activities. The result has been severe economic hardship and political instability. The Government of Ecuador (GOE) has been working with the World Bank and other multilateral institutions to resolve the crisis but substantial challenges remain. As part of its efforts to address banking sector problems and eroding public confidence, the GOE established the Agency for the Guarantee of Deposits (AGD) at the end of 1998 to accomplish two main objectives: protect depositors and resolve troubled financial institutions. Accomplishing either objective has proven to be substantially more challenging than originally envisioned.

The AGD was expected to protect depositors using funds accumulated through taxes on bank deposits and government bonds issued on its behalf. However, bank failures quickly and largely exceeded AGD resources to settle depositor claims. Within its first year, the AGD had to intervene or take control of 14 banks, including the largest and most complex bank in the country before funding, staff and operating policies and procedures were in place. Unable to settle claims or public fears, the Government declared a banking holiday freezing all bank deposits. This freeze has placed the GOE and the AGD under increasing pressure and scrutiny to find a solution to the crisis.

With regard to failing bank resolution, the GOE authorized AGD to intervene or take control of any financial institution considered to have problems. The AGD has authority to either take direct control of a bank or to exercise “Saneamiento”, an interim step that involves placing a Temporary Administrator to oversee operations and prepare a resolution strategy. This step was intended to be short-lived, and a disposition plan was to be prepared and submitted within 90 days after intervention. In order to determine the extent of problems and the appropriate resolution strategy the AGD can require banks to undergo an external audit. The AGD can demand that troubled banks undergo rehabilitation including a change in management. The AGD also has the authority to undertake asset resolution, determine the condition for sale of the bank and the equity investment required to rehabilitate the bank.

### AGD Governance, Organization and Management

The AGD was established as a separate entity under the governance of a Board consisting of the President of Banco Central, the Superintendente de Bancos, a Presidential appointee and AGD’s General Manager (GM) who directs daily operations. While the Board is responsible for AGD operations, the GM reports directly to the Superintendente de Bancos.

The GM has a relatively small support staff as the Government expressly stated that AGD was not to become a large bureaucracy but an efficient facilitator of failing bank resolutions. The AGD was organized along key functional areas but the staff assigned

has been far less than optimal given the size and severity of the crisis.<sup>1</sup> Almost from its creation, the AGD has had to take on a rapidly growing caseload of failing banks while lacking the necessary financial resources, skilled personnel and organizational structure. The AGD's General Manager was changed twice during its first year of operation. In January 2000, Ecuador experienced a Government Coup that resulted in changes in the President, Minister of Finance and the General Manager of the AGD. Most recently, a new GM was appointed in May of this year. These changes in management and direction have made it extremely difficult for AGD to organize, plan and execute its operations. With the help of USAID, the World Bank and others much of the foundation has been built but many key operational positions remain unfilled and key policies and procedures remain to be approved.

#### USAID Assistance

In July of 1999, as part of its ongoing effort to support the vitality and transparency of Ecuador's financial sector, the USAID contracted with Barents to provide technical assistance to AGD.<sup>2</sup>

#### Objectives of USAID's Technical Assistance (TA) Program

This Technical Assistance (TA) program was designed to assist the AGD organize and efficiently dispose of assets under the government control. Technical assistance focused on organizational framework; operating policies and procedures; business and strategic planning; and, asset management and disposition. The USAID issued two specific task orders. The first task order focused on developing strategy and fundamental procedures and required Barents to perform the following activities:

- Review FDIC operating manuals relating to bank resolution and liquidation for applicability in Ecuador and propose adoption or modification where appropriate;
- Provide for the preparation of selected operating manuals in the Spanish language;
- Assist in the development of an outsourcing strategy for the effective management and recovery of assets including the design of contracts with appropriate incentives, a sound bidding process and effective oversight.

The second task order continued to support strategy development but also focused on providing AGD practical management and operational advice. Specifically, Barents was required to perform the following tasks:

- Advise on the management and disposition of assets including the use of best international practices;
- Assist in the development of a functional Management Information System (MIS);
- Advise and assist AGD in the reconciliation of its General and Subsidiary ledgers;
- Assist AGD in the drafting of a Business Plan ;
- Review existing policies regarding delegation of authority and ethics both employee and contractors.

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<sup>1</sup> Personnel were assigned to asset management, fixed asset disposition, financial operations, operations, human resources, data processing and public relations.

<sup>2</sup> The TA program was funded under Contract #PCE 1-802-99-00006-00, Task Orders 802 and 807.

- Provide asset management and disposition training to AGD staff, contractors and selected professionals from other public sector institutions.

When assigning the above tasks, USAID recognized the volatile nature of Ecuador's financial sector and the evolving role of the AGD. Barents' advisors were instructed to maintain the flexibility necessary to provide assistance in related areas not specifically identified in the Task Orders. However, USAID emphasized that Barents' advisers were not to function as AGD employees and were not to become involved in making decisions regarding the rehabilitation or liquidation of specific banks.

An important example where Barents' advisers were asked to be flexible and take on new responsibility involved portfolio identification. In December 1999, the GOE established a special unit under the supervision of the Superintendente called "Unidad Ejecutora". This special unit was charged with negotiating technical assistance agreements with the World Bank and any other international donor and supervising the performance and completion of the agreements. The Unidad Ejecutora began negotiating with the World Bank for assistance that included technical assistance to the AGD. The negotiations required compiling detailed knowledge of the agency's loan portfolio although the necessary information systems and procedures had not been developed. Further complicating matters was the fact that most of AGD's senior and middle managers had left before the negotiations took place and this left the agency effectively leaderless and unable to function. The Unidad Ejecutora stepped in to fill the management void and shifted focus to rapid portfolio identification, valuation and disposition and Barents' advisers were asked to shift their focus to the loan due diligence process.

#### Scope of Work Performed

The first Task Order began on July 1999 and ended on October 30<sup>th</sup>. During that initial two-month period, Barents completed the following tasks:

##### Organizational framework

- Provided written recommendations and assisted in the drafting and subsequent editing of the agency's organizational chart.
- Assisted in the drafting of job descriptions and staffing requirements.
- Prepared operational Delegations of Authority that was formally implemented in December 1999.

##### Operating Policy and Procedures

- Drafted various operations manuals that are awaiting final approval. These manuals address the following activities: Temporary Bank Administration, Asset Due Diligence, and Code of Ethics and Contractors Oversight.
- Provided detailed written recommendations regarding how to approach, develop and implement an adequate management information system, particularly one that sufficiently informs management about the assets in their control to develop effective resolution strategies. However, based largely on perceived cost savings,

AGD opted to rely on the system of one of the intervened banks that has resulted in expensive delays.

- Provided expert advisors who interviewed key personnel at the Banco Central, “Superintendencia” and the AGD and prepared written recommendations in Public Relations, Training, and Deposit Insurance.
- Reviewed and commented on the Bank Closing Manual.
- Drafted procedures for Selection and Supervision of Third Party Administrators.

#### Strategic and Business Planning

- Assisted in the development and subsequent editing of the AGD’s Business and Strategic Plan that is awaiting approval by the agency’s Board.
- Drafted a Public Relations Plan.
- Assisted in the development of the Banco Central with Closed Banks Resolutions Strategies that were presented to the Agency Board for approval.

#### Asset Management and Disposition

- Provided written recommendations on Best International Practices for asset management and disposition, and prepared an Asset Management and Disposition Manual that was substantially approved intact by the Board in December 1999.
- Drafted Appendices and Special Forms for the Asset Management and Disposition Manual that the AGD subsequently implemented.
- Prepared case studies on how to approach decisions based on a Costs/Benefits Analysis.

In addition, the advisors accomplished the following:

- In conjunction with USAID, met on a regular basis with other international organizations.
- Frequently assisted and advised the “Banco Central”, and the Unidad Ejecutora regarding special issues regarding IMF and World Bank assistance.
- Provided extensive assistance regarding AGD’s portfolio identification initiative that started in January 2000 including:
  1. Drafting Invitation letters and Terms of Reference for contractors to be retained by the Unidad Ejecutora.
  2. Prepared and submitted a Preliminary Report on Portfolio Identification Project.
  3. Commenced Portfolio Identification Project on lower amount loans.

In response to a special request, Barents prepared a study of selected major credits that reflected the potential value differential between selling credits on an “as is” basis compared to a restructured basis. This work can be used in the formulation of asset recovery strategies. This analysis encompassed:

- Obtaining current financial information on the companies
- Analyzing financial information and project cash-flow
- Analyzing debt servicing ability
- Establish scenarios for repayment of debt under various rate environments

- Establish the conditions for restructure of debt
- Derive a range of present value comparisons for the credit both in an “as is” condition and restructured.

## **CURRENT STATUS OF THE TA PROGRAM**

During the current year, the contact between Barents’ technical advisors and the AGD has been somewhat limited since the position of Gerencia de Activos became vacant; that position had served as the primary point of Barents’ contact within the agency. However, discussion with AGD staff indicate little progress has been made to implement important recommendations and the majority of manuals and the proposed business plan remain in draft form.

### **Organizational Framework**

As mentioned previously, AGD has a General Manager and a very small Saneamiento unit. During its first year and half of operations, the GM position has been changed three times. An organizational chart was approved but retaining key personnel has proven to be very difficult and a number of key positions remain vacant. The AGD has also seen multiple changes within its Board with the Minister of Finance and the Superintendentes de Bancos each having been changed three times. The numerous changes in governance and management have had a significant adverse impact on the AGD’s operations.

The government coup that occurred in last January replaced the country’s President 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 to the Superintendente of Banks, and Luis Villacis was named the new General Manager at the AGD.

### **Operational Policies and Procedures**

In August 1999, the AGD decided to rely on data processing system of a bank it controlled to meet the Agency’s asset inventory and management needs. The original intent was to convert all the banks under AGD’s control to a centralized system by October 1999 but as so often is the case with complex data conversions the process fell significantly behind schedule. Fixed assets were not converted until December 1999, and the loan systems conversions 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.

In December 1999, the agency consolidated the operations of various banks into two locations in hopes of realizing managerial and operational efficiencies. Progress has been made although the largest bank that accounts for over 70% of the AGD assets remains on a separate MIS system and efforts to convert have been plagued with accounting issues and inefficiencies. 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.

The rationale behind the decision to convert the closed banks to an existing bank system is understandable. Depending on the capacity and integrity of the host system to meet management needs, such a consolidation holds the promise of significant savings both in time and money. However the difficulty of such a task has proven to be very challenging. 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 is not fully operational and a number of safeguards recommended by Barents have not been implemented in part reflecting the lack of adequate personnel support and changing priorities.

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 with outside donors were based on faulty information, and conditionalities imposed in some of the agreements, set timetables for sale of assets that were impossible to meet.

After numerous conversations with USAID in March 2000, relating to technical assistance, the AGD prioritized the conversion process. However, as of this report's date, much of the work is still not completed.

### **Strategic and Business Planning**

The lack of a viable business plan with timetables and areas of responsibilities has 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.

By July 1999, the AGD controlled or was otherwise involved with a number of banks. The largest was a government intervened bank, which remained open. At the end of July, the AGD took over another bank, by far the largest, difficult to control because of legal ownership issues, and also the most complex. By December 1999, the AGD publicly had control of 14 banks, with one of these, representing the largest share of the government-controlled assets.

Once the banks were seized and closed, the AGD appointed independent Temporary Administrators, and took on the responsibilities of paying depositors. Typically the responsibilities of the Temporary Administrator would be to 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 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 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. When 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 in regards to payment to depositors.

Keeping the banks in Saneamiento also has implications on the powers the agency may or may not have in regards to disposition of assets. The ability of the agency to directly dispose of assets has been questioned by the agency itself, and 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 mergers of government intervened banks, and the strategies for some of the others, are perhaps not the best solutions, but offer the most immediate resolutions. The biggest challenge will be to develop strategies for the disposition of the agency's largest bank, 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.

### **Asset Management and Disposition**

Decisions continue to be postponed and this is best exemplified by many delays in the seemingly simple effort to sell fixed assets. 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.

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; but dissemination and implementation have been slow.

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 a small percentage 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.

The bulk of the assets controlled are represented by the banks' various loan portfolios, which for lack of exact figures has been estimated to be over US\$ 1.00 Billion (The AGD is the source for this figure)

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.

The management of the AGD publicly expressed, on many occasions, that asset management and disposition responsibility would be out-sourced to the private sector and outside contractors. 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. When these strategies were being developed and disclosed, the AGD had no detailed portfolio information.

Fixed assets in many banks had not been inventoried prior to converting to the AGD's conversion to the new MIS system. The inventories established existing assets in the possession of the AGD available for sale. The "Due Diligence" manual and procedures provided by Barents provided direction to complete this process, but the manual has not been formally approved or implemented. AGD strategies for the valuation, marketing and disposition of these properties have yet to be developed.

### **Portfolio Identification**

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 Unidad Ejecutora coincided with the departure of most of management and middle management at the AGD, which left the agency in a complete state of paralysis. This new unit stepped in to make AGD management decisions and again strategies changed. One of the priorities became portfolio identification, valuation and disposition within a very short time period. These tasks and timetables presented extremely difficult challenges given the lack of information systems and experienced operational management.

The AGD established a special task force of credit personnel from the various banks under its control that, with technical assistance from Barents, was charged with compiling sufficient information on selected larger loans to develop management and disposition strategies. Developing loan files with basic loan, collateral and other information took approximately five weeks but resulted in the first real due diligence of AGD's asset portfolio. The importance of developing reliable asset information cannot be overemphasized and Barents has repeatedly stressed the need to based asset strategies on reliable information. The work achieved by the Task Force represented an important first step in understanding the scope of information problems that must be addressed in order to support guide asset management and disposition strategies.

A preliminary report was completed by the set deadline and is discussed below as phase one of the portfolio identification project. Preliminary conclusions reflected the following:

- Misinformation as to size and segmentation of the credits that would be available for valuation and administration.
- Financial integrity issues related to the loans at the banks.
- Unreliable or otherwise unavailable information at the largest bank.
- Obsolete or unreliable appraisals
- Large percentage of delinquencies and non-payments.

Based on the findings of the special task force, the AGD began refining its asset strategies and decided to lower its original due diligence size threshold in order to increase the amount of qualifying credits. This expansion initiative commenced in March 2000 and Barents technical assistance terminated before its completion. This report does not reflect any findings conclusions reached by the task force.

## **RECOMMENDATIONS FOR FOLLOW-ON TECHNICAL ASSISTANCE**

The following areas will need resolution to enable the AGD to effectively carry out its mandate

### **Legal Issues**

Important legal issues must be addressed in order for the AGD to perform its role in an effective manner. Issues concerning legal collection rights, legal powers of the Administrators, equity issues in the closed banks, insider issues and depositors' issues have impacted the efficiency and effectiveness of the AGD. An example concerns the inability of the agency to collect or pass on administration of insider loans. Current law dictates that these loans have to be collected in full and cannot be restructured or modified, regardless of financial considerations. This restriction applies to the AGD or its agents and makes contracting for third party administration to improve values impossible – even in cases where such administration could easily improve values. The only option remaining for these credits is outright sale at very low prices. Staff at AGD have suggested various solutions such as modifying the law, stipulating that such loans taken

over by the AGD cease to be considered insider loans 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 uncollectible.

Another legal issue that has been debated for many months is the AGD's legal right to dispose of assets. The AGD has taken the position that it cannot directly dispose of their assets but had to create and transfer assets to "fidecomisos" (trusts) to act on their behalf. This position has prevented Temporary Administrators from initiating loan collection or resolution procedures that very likely could have benefited asset recoveries. Barents believes the current law does provide the AGD the flexibility to resolve assets directly and has encouraged the AGD to reconsider its position.

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.

### **Organizational and Operational Issues**

A new General Manager has been appointed who must be given sufficient time and latitude to understand and manage the AGD. Management stability is essential for any organization, especially one faced with AGD's complex and difficult challenges. The AGD must reduce personnel turnover rates at management and mid-management levels. The high management turnover has made developing a clear and consistent operating strategy extremely difficult – for both the AGD and its Barents' advisors. Changing management and priorities without a clear operational strategy certainly complicates efforts to implement operational standards as evidenced by the fact that key operations manuals are still awaiting Board action.

### **Asset Management and Disposition**

The first phase of the portfolio identification project provided the basis for preliminary conclusions that were submitted by the task force to the management of the AGD. The main findings reflected the segmentation of the portfolios, a large percentage of loans at one of the major banks, and the conditions of files and credits.

The conclusions derived from these findings directly impact strategies for the management and disposition of assets. Decisions will have to be made by the AGD management regarding legal and operational issues on the portfolios of credits it controls. Valuations will have to be carefully considered, and obtaining current information to complete credit files, and short credit analysis, will also have to be completed.

Barents was asked to perform a study on some major credits as a precursor to Due Diligence. 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 and overall asset quality.

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.) needed to be revised. At stake are decisions to be made regarding the timing of valuation and administration strategies of assets, and the ultimate potential sale value of the credits.

The implications of all these decisions are:

- Cost of Due Diligence.
- Cost of third party administration since the size of loan packages is smaller than anticipated.
- 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.
- Marketing strategies will have to be carefully considered due to overall conditions of the portfolios and external interest.