Report Number: ICRR0022182

1. Project Data

Project ID P154219	**Project Name** Deposit Insurance Strengthening Project
Country Bulgaria	**Practice Area(Lead)** Finance, Competitiveness and Innovation

L/C/TF Number(s) IBRD-85960	**Closing Date (Original)** 31-Dec-2018	**Total Project Cost (USD)** 319,734,000.00
Bank Approval Date 18-Mar-2016	**Closing Date (Actual)** 31-Dec-2019	

	IBRD/IDA (USD)	Grants (USD)
Original Commitment	327,465,000.00	0.00
Revised Commitment	327,465,000.00	0.00
Actual	319,734,000.00	0.00

Prepared by	Reviewed by	ICR Review Coordinator	Group
Paul Holden	John R. Eriksson	Christopher David Nelson	IEGFP (Unit 3)

2. Project Objectives and Components

a. Objectives

The Objective of the project (PDO) was to strengthen the financial and institutional capacity of the Borrower so as to enable it to meet its deposit insurance and bank resolution obligations. (Financing Agreement, p. 5). The ICR (p. 8) notes that “the Borrower” refers to the Bulgarian Deposit Insurance Fund (BDIF).

The objective can be parsed into two key outcomes:

- Outcome 1: Strengthen the financial capacity of the BDIF
- Outcome 2: Strengthen the institutional capacity of the BDIF

b. Were the project objectives/key associated outcome targets revised during implementation?

No

c. Will a split evaluation be undertaken?

No

d. Components

Initially the project specified only one component, which was “strengthening the financial and institutional capacity of the BDIF, (estimated total cost at appraisal US$327.47 million equivalent; actual financed cost was US$319.743 million). However, this was parsed into two components in the PAD to reflect the two outcomes of the PDO, (ICR,pp.8-9[JE1]) although in the Loan Agreement (p. 5) it is shown as one component.

The first component aimed to strengthen the financial capacity of the BDIF in order to be able to have sufficient financial capability to meet disbursement requirements in the event of a further bank failure. In 2014, a failure of the fourth largest bank in the country had drained the liquidity of the BDIF. The failure necessitated the payout of EUR1.9 billion (ICR p. 6), with the assistance of a government loan. The payout exceeded the EUR 1.07 billion of accumulated reserves of the BDIF by a substantial margin, leaving it with only EUR232 million in reserves by March 2015, which would have been insufficient to cover payouts in the event of a further bank failure.

The component was to be achieved through meeting ten Disbursement Linked Indicators (DLIs) on which disbursements of the tranches of the loan were based. The first group of these involved measures to increase the reserves of the BDIF to the equivalent of one percent of covered deposits. The second group of DLIs involved the recovery of assets from the bankrupt bank in order to further augment reserves of the BDIF. The third set of DLIs involved securing a backstop loan to be drawn in the event of a bank failure requiring additional disbursement of reserves. This loan could not be from the World Bank since the objective of this set of DLIs was to broaden the sources of funding.

The second component aimed at strengthening the institutional capacity of the BDIF. The measures to be taken were based on the recommendations of the International Association of Deposit Insurers (IADI), which focused on improving the ability of the BDIF to recognize and respond to potential banking sector problems through sharing information between the Bulgarian National Bank (BNB) and the BDIF. In addition, an Independent Asset Quality Review of the Commercial Banks in Bulgaria was being undertaken, the results of which were to be shared with the BDIF. An additional sub-component was the improvement of the ability of the BDDIF to engage in deposit payouts and bank resolutions in the event of bank failure.

[JE1]The ICR is clear that the PAD split the PDO in two. This is important since if It was only the ICR that did so, assessing the efficacy of achievement of each sub-PDO separately, rather than just the original PDO, could be questioned. It is not clear in what document and when only the one PDO was cited. Perhaps in the Financing Agreement (FA)?

e. Comments on Project Cost, Financing, Borrower Contribution, and Dates

The total cost of the project at appraisal was estimated at EUR300 million ($327.465 million equivalent). The actua amount disbursed was $319.734 million, with the difference being accounted for by exchange rate fluctuations. Th was financed through World Bank Investment Project Financing.

Disbursements were as follows:

- A EUR100 million advance payment plus EUR150 million on the achievement of five DLIs;
- A further disbursement of EUR50 million during project implementation.

While there was no co-financing, the borrower also secured a loan of EUR300 million from the European Bank for Reconstruction and Development (EBRD).

The borrower did not contribute to the financing of the project because of the liquidity crisis.

Dates: Relevant dates were; Approval, March 18, 2016; Loan effectiveness June 28, 2016; Original closing Decem 2018. There was a level 2 restructuring on December 6, 2018 which extended the closing date to December 31, 2 when the actual closing occurred. The restructuring also changed the results framework but did not change key ou targets.

3. Relevance of Objectives

Rationale

PDOs were relevant for the World Bank Country Partnership Framework (CPF) for 2017-2022 under Area One, Strengthening Institutions for Sustainable Growth (CPF p. 16), one of the three objectives of which is “improved resilience and stability of the financial sector”. It goes on to add (p. 18) “A pivotal dimension of the WBG support under this Objective is a financing instrument to the BDIF “

The PDOs remained relevant. The 2019 Country Learning Review (p. 1) states: “The main program areas of the CPF remain relevant…in the financial sector, additional support for institutional strengthening of the deposit insurance scheme”. The contribution of the project supported strongly the compliance of the BDIF with the core principals of the IADI. The relevance of objectives is rated “high”. The banking system was in crisis and there was a substantial risk of loss of confidence in financial institutions, which could have resulted in a financial meltdown.

Rating

High

4. Achievement of Objectives (Efficacy)

OBJECTIVE 1

Objective

Strengthen the financial capacity of the BDIF

Rationale

The results chain for this objective involved strengthening the financial capacity of the BDIF through rebuilding its reserves, which had been completely depleted by the payouts associated with the failure of the KTB bank. The rebuilding of reserves was to occur through:

i. The collection of premiums in 2016 and 2017 from the remaining commercial banks. This had been the mechanism for funding the BDIF in the past, but premiums had not taken balance sheet risks of the banks into account.;
ii. Going forward, premium payments would be adjusted for risk so that banks with riskier portfolios would pay additional amounts;
iii. The loan from the World Bank:

iv. An additional loan of EUR300 million from the EBRD;
v. Recovery of assets from KTB, the failed bank.

Recovery of assets under item (v) was complicated by the fact that shareholders of KTB contested in court the withdrawal of the banking license. Since assets could only be sold by the BDIF once the banking license was withdrawn, rebuilding reserves through this channel was delayed. Initially, a requirement of the World Bank loan had been that asset recovery would lead to the BDIF having a reserves to deposit ratio of 1.5 percent. This was changed in the restructuring to one percent on the basis that the court case was outside the control of the BDIF. This also changed the requirement of one of the DLIs regarding the recovery of assets from the bankrupt KTB Bank. However, the ICR (p. 13) notes that the case had been ongoing for more than two years and that the resources were “already in a KTB bankruptcy account at the BNB and could not be used for purposes other than the recovery of creditors”. Furthermore, asset recovery from KTB was assisted by amendments to the Bank Bankruptcy Law (BBL) that were undertaken specifically for this purpose.

The rebuilding of the financial capability of BDIF was in accordance with the findings by the IADI that the “assessment recommends that the authorities should aim for expedited replenishment of the deposit insurance fund” (ICR p. 9). The BDIF essentially had negative reserves since payouts had exceeded its accumulated reserves. The total payout amounted to EUR1.9 billion, compared with the accumulated reserves of the BDIF of EUR1.07 billion, with the balance covered by the government loan. This allowed for the reimbursement of 95 percent of insured deposits and 102,250 of insured depositors by the end of February 2015.

There was no evidence of malfeasance in the payouts to depositors. The ceiling on the amount of each payout to KTB depositors was in accordance with the EU deposit insurance directive of EUR100,000. There were also exclusions on payouts to shareholders (shareholders with more than five percent voting power, members of the bank management and supervisory board, directors, auditors, together with closely related parties, and sophisticated investors such as government institutions, municipalities, pension funds and insurers (Interview with the TTL).

The outcome indicator for this PDO was that BDIF reserves reach the equivalent of one percent of covered deposits in the absence of bank failures compared with a baseline of 0.75 at the end of December 2015 (ICR p. 26). The original target had been 1.5 percent. The target was formally revised to one percent on December 17, 2018. However, by the completion of the project, actual reserves amounted to the equivalent of 2.16 percent. The target was exceeded.

The rating for this objective is “high” on the basis that not only did the rebuilding of reserves go ahead in a satisfactory manner in spite of the court case, but also that by completion of the project, reserves were double the target amount. In addition, all protocols for payouts were observed.

Rating
High

OBJECTIVE 2

Objective
Strengthen the Institutional Capacity of the BDIF

Rationale
The causal chain for this objective involved the following measures that were designed to strengthen the institutional capacity of the BDIF:

i. An updated information sharing agreement between BDIF and BNB on the financial status of commercial banks that would increase the amount of information available to the BDIF regarding the financial health of the institutions whose deposits it insured;
ii. BNB shared with BDIF the results of its Asset Quality Reviews of the commercial banks, which would have a similar effect as the previous measure;
iii. The BDIF conduct a survey of the public awareness of its role in order to build knowledge and confidence in the banking system;
iv. That the BDIF prepare a contingency plan that would be operationalized in the event of future bank failures so that it could act expediently in a time of crisis.

These measures were all put in place and plausibly relate to strengthening the institutional capacity of the BDIF.

Additional measures for institutional strengthening of the BDIF were put in place and monitored by the project team as part of ensuring the DLI conditions were met. These contributed to institutional strengthening and included contingency planning, information sharing with the regulator and the collection of risk based premia as contributions to the BDIF (ICR, p. 12).

The outcome results indicator was that the BDIF perform “its legally mandated technical functions, including in any future bank failures in which its resources are utilized”. The technical functions of the BDIF were achieved compared with these not being in place at the outset of the project. They were based on the recommendations of the IADI.

However, this outcome indicator also partly refers to future actions that did not take place within the life of the project. The project team maintained (interview with the TTL) that “it is still possible to assess the improvement in institutional capacity based on the progress achieved in specific areas that required strengthening at the time of project preparation, according to the IADI assessment”. The measures that were put in place strengthened the institutional capacity of the BDIF. However, the outcome indicator chosen did not measure this.

Given these minor shortcomings, the rating for this objective is Substantial.

Rating
Substantial

OVERALL EFFICACY

Rationale
The first outcome indicator was met and exceeded by the end of the project, so that in the event, the reduction of the reserve to deposit ratio that occurred as part of the restructuring was not needed. With regard to the institutional strengthening of the BDIF, the measures required were all put in place by the end of the project, though the evidence base for institutional transformation is limited.

The second outcome indicator was achieved, except for that portion relating to future actions, which were impossible to achieve since they related to future bank failures, the occurrence of which were not possible to know. Navigating these indicator issues makes it difficult to be certain of the institutions long term capacity to deal with future bank failures.

With a "High" rating for objective 1, strengthening the financial capacity of the BDIF and a "Substnatial" rating for strengthening the institutional capacity of the BDIF, the overall efficacy rating is Substantial.

Overall Efficacy Rating

Substantial

5. Efficiency

The ICR (p. 17) indicates that economic rates of return (ERR) were not estimated as part of the analysis of project efficiency, since the nature of the project did not lend itself to such calculations. Nevertheless, efficiency was based on a scenario analysis that compared what might have occurred if the BDIF had not received the World Bank loan. The analysis identified the positive "chain effect" that consisted of:

- Obtaining the EBRD loan that probably would not have been granted if the World Bank loan had not occurred;
- Being able to repay the government loan, that carried a significantly higher interest rate than the World Bank loan.

The rebuilding of reserves, the restoration of confidence in the financial system, and the improvement in the regulatory structure occurred significantly faster as a result of the policy actions in the World Bank loan. Efficiency is therefore rated substantial.

Efficiency Rating

Substantial

a. If available, enter the Economic Rate of Return (ERR) and/or Financial Rate of Return (FRR) at appraisal and the re-estimated value at evaluation:

	Rate Available?	Point value (%)	*Coverage/Scope (%)
Appraisal		0	0 ☐ Not Applicable
ICR Estimate		0	0 ☐ Not Applicable

* Refers to percent of total project cost for which ERR/FRR was calculated.

6. Outcome

With a high rating for relevance of objectives, a substantial rating for efficacy and a substantial rating for efficiency, the overall outcome rating is Satisfactory

a. Outcome Rating

Satisfactory

7. Risk to Development Outcome

The greatest risk to the banking system of Bulgaria was that the project <u>not</u> go ahead. With the fourth largest bank in the country having failed and the confidence in other banks in the financial sector weakening, there was a high degree of systemic risk that could have resulted in a more general banking collapse. Furthermore, the PAD (p. 6) points out that the failure of KTB exposed weaknesses in the supervisory framework of the BNB, further casting doubt on the ability of other banks to weather the storm that had begun with KTB's failure.

The risk to achieving the development outcome was reduced not only by strengthening the BDIF but also by improving the overall regulatory structure of the financial system, including the cooperation between the BDIF and the BNB. Nevertheless, increasing the equity portion of the balance sheets of the commercial banks would further reduce the risks to the system.

8. Assessment of Bank Performance

a. Quality-at-Entry

The design of the project was sound against a background of the severe pressure on the financial system of Bulgaria. There was ambiguity in some of the DLIs and the design of the project did not fully consider the possibility of delays in the recovery of assets from KTB bank. Since the shareholders of KTB opposed the removal of the banking license, resolution was delayed. Asset recovery could only occur once the banking license had been withdrawn. The process was complicated and necessitated the issue being considered by a court system that was unfamiliar with bankruptcy issues. This could possibly have been foreseen when the project was being designed, but it is difficult to envisage any changes in the outcome.

Apart from this issue, the project was well designed to assist the BDIF weather the storm through which it was going. The project was not without risks, in particular arising from the possibility that the Bulgarian authorities would not have the ability and willingness to implement the necessary measures. The inclusion of the DLIs ensured that disbursements would only take place once certain conditions had been met. This reduced risks by incentivizing the BDIF and the BNB to expedite the necessary reforms and upgrading of processes in order to ensure the timely disbursement of funds.

The soundness of the project prepared against a background that included the possibility of systemic meltdown as well as strong project design contributed to a satisfactory quality at entry

Quality-at-Entry Rating
Satisfactory

b. Quality of supervision

The continuity of the World Bank team was a strength of the project. It enhanced supervision and strengthened the working relationship with the client institutions, thereby contributing to the success of the project. Although the BDIF had not had previous experience with similar projects (ICR p. 23), this continuity built up a level of trust that resulted in ongoing communication and discussions between the BDIF and the project team. The ICR points out (p. 23) “The achievement of each DLI was verified by the BDIF and confirmed by the WB team and independent performance auditor.”

The ICR also points out that although technical assistance was not part of the project, the World Bank team worked closely with the BDIF to provide in-depth comments on documents prepared by this staff, particularly those related to the DLIs. The ICR notes (p. 23) that the BDIF placed substantial value on this support.

The close working relationship that developed between the Bank team and the two key institutions as a result of strong supervision contributed to the outcome. All necessary steps were taken to ensure that the policy actions were implemented and the support of the Bank team was highly valued. The quality of supervision is therefore rated highly satisfactory.

Quality of Supervision Rating
Highly Satisfactory

Overall Bank Performance Rating
Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

The design of the M&E framework for the financial strengthening of the BDIF was in the main, clear. The causal chain linking prior actions with outputs and the outcome was easily derived. Since the project linked to disbursements to the achievement of the DLI indicators, which were in general clearly specified and unambiguous, the M&E framework provided a system of control that was relatively clear-cut and not open to alternative interpretations that could have led to conflict. Furthermore, a verification process was put in place to independently certify that the DLI's had been achieved, which further reduced the potential for disagreement over what had been achieved.

With regard to the outcome indicator that measured the achievement of the institutional strengthening of the BDIF, the indicator referred not only to actions that had been achieved (that the BDIF perform its legally mandated technical functions) but also future actions (including in any future bank failures in which its resources are utilized). Having an indicator that related to future bank failures outside the time frame of the project essentially nullified its usefulness, especially since the policy actions were designed to limit further failure of banks. Nevertheless, with respect to institutional strengthening, the project linked the recommendations of the IADI to the PDO, which again allowed for arm’s length criteria to be utilized.

b. M&E Implementation

Since the M&E framework related closely to the achievement of the DLI's, it was not difficult to ascertain the extent of progress against the PDO that related to the financial strengthening of the BDIF. The ICR notes (P.22) that for each DLI achieved, a notification letter was submitted by the BDIF. In addition, progress reports were submitted that outlined achievements in the preceding period as well as plans for the next period. These were then discussed as part of the supervision missions.

c. M&E Utilization

The ICR (p. 22) states “The WB team had to confirm achievement of DLIs based on evidence provided by the BDIF as per the verification protocol, and the discussions during missions allowed the team to make the decision about extending the project closing date and revising one of the PDO indicators.”

Apart from the selection of an indicator that was of little use, as described above, the M&E framework made a substantial contribution to the success of the project.

M&E Quality Rating

Substantial

10. Other Issues

a. Safeguards

No environmental or social safeguards were triggered by the project

b. Fiduciary Compliance

The ICR (p. 22) notes that financial records and audit reports were inspected by a Financial Management Specialist on a regular basis and there were no findings of non-compliance.

c. Unintended impacts (Positive or Negative)

In order to speed up the recovery of assets from KTB, the BBL was amended, which strengthened the institutional framework for the financial system. An unintended positive impact of the project was an improved bankruptcy framework.

d. Other

N/A

11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Satisfactory	Satisfactory	
Bank Performance	Satisfactory	Satisfactory	
Quality of M&E	Substantial	Substantial	
Quality of ICR	---	Substantial	

12. Lessons

The ICR offers the following lessons with some modification of language by IEG:

Results based financing, particularly when combined with an effective results framework that involves unambiguous success criteria can be a powerful instrument to achieve PDOs. In Bulgaria, project design ensured that disbursements occurred upon achievement of clearly specified criteria that were independently verified. Although funds were used to bolster the financial position of the

BDIF, they also resulted in the financial strengthening of the institution as well as enhancing its institutional capabilities. This could be a valuable lesson for World Bank operations directed at supporting deposit insurance schemes.

In the design of projects in which disbursement depends on achieving DLIs, it is important to consider the implications of indicators, the achievement of which are beyond the direct control of the borrower. In Bulgaria, the process of bankruptcy of KTB had to go through the courts, which led to delays in its liquidation and recovery of assets. This is an issue that needs to be considered at the preparation stage of the project.

IEG offers an additional lesson:

The importance of continuity in project teams is often overlooked. Continuity ensures that confidence is engendered and that unforeseen issues that inevitably arise during the course of a project can be resolved in a timely manner. In Bulgaria, continuity of the project team contributed substantially to the successful completion of the project.

13. Assessment Recommended?

---

14. Comments on Quality of ICR

The ICR is well written and describes the issues faced by the World Bank and the BDIF clearly. It describes well the challenges facing the BDIF as the implications of the failure of KTB Bank spread through the financial system. Its description of the DLIs is clear and notes how these contributed to the achievement of the PDOs. More discussion of the institutional issues would have been welcome, but overall it is a sound document.

a. Quality of ICR Rating
Substantial