ICR Review

Operations Evaluation Department

Report Number : ICRR10495

1. Project Data :	
OEDID:	L3365
Project ID :	P005495
Project Name :	Financial Sector Development Project
Country:	Morocco
Sector:	Financial Sector Development
L/C Number:	L3365
Partners involved :	
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2. Project Objectives, Financing, Costs and Components :

Objectives : This is a hybrid project comprising a financial sector adjustment operation (L3365) and 8 lines of credit to financial institutions (L3366-3373). The adjustment component sought to support (i) the transition towards indirect monetary control; (ii) the development of domestic financial markets, in particular for government securities; (iii) freeing of interest rates and the elimination of directed credit policies; and (iv) the strengthening of the regulatory and supervision framework of the banking system . The investment component provided term financing to eligible firms for investment sub-projects mainly in private, export-oriented industries, consisting of a package of 8 loans to Banque National pour le Developpement Economique (BNDP) and 7 commercial banks. An objective of investment component was that sub-loans of less than US$2 million would represent about two-thirds of all onlending, and about 80 percent of the Bank loans would finance industrial development, and the rest would be for tourism and other projects. **Financing :** The adjustment component comprised an IBRD loan for US$ 125 million, the investment component, an IBRD loan for US$ 110 million. (Note: the President's Report identifies US$ 100 million cofinancing in the form of an IFC-led syndicated loan. No information is provided on this. See comments on ICR below.) **Costs and Components :** The adjustment component accounted for US$ 125 million and was fully disbursed, while the credit line utilization came to US$ 76.7 million, so that US$33.3 million out of a commitment of US110 million was canceled.

3. Achievement of Relevant Objectives :

Concerning the adjustment component: (i) credit ceilings were removed, (ii) a legal framework for capital market operations was adopted, and the treasury bill auction market was opened to insurance companies and enterprises, (iii) the central bank's automatic preferential refinancing rate was reduced by limiting the eligibility of small -scale enterprises for medium-term loans and export credit, the ratio of mandatory placements of sight deposits in Treasury bonds at below-market rates was reduced, and the ratio of mandatory placements of bank deposits in rediscountable medium- and long-term housing loans was reduced; and (iv) the legal, regulatory, and supervisory framework for banking operations was strengthened, and capital adequacy standards were raised to international levels . *Concerning amounts of the credit line* which were disbursed, 80.4% of the total was utilized in sub-loans under US$2 million, while 81% of the actual amount of sub-loans financed industrial investment.

4. Significant Achievements :

The removal of credit ceilings and the reduction of mandatory placements of deposits were important improvements . However, it should be noted that these reforms were also pursued in at least one subsequent operation (L3928), so that the reforms under this package of loans was clearly only partial . Nevertheless, there are reasons for phasing in reforms of this nature, so that the reduction of mandatory placements of deposits, even if not complete, was a significant achievement.

5. Significant Shortcomings :

At the time of the loan, the Bank's loan pricing policies were inflexible and over time the credit lines became noncompetitive as Moroccan banks found less expensive sources of money . Thus, US$33.3 million of the credit line was not utilized and canceled. This was a shortcoming of Bank policy (subsequently corrected), not of the loan. The positive side is that Moroccan banks were positioned, partly by the reforms supported by the project, to take advantage of non-IBRD sources of funds.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Satisfactory	
Institutional Dev .:	Partial	Substantial	The move away from directed credit and towards indirect monetary controls warrants a rating of substantial for institutional development.
Sustainability:	Likely	Likely	The ICR rates sustainability of the adjustment component as "Likely", but the sustainability of the investment component as "Uncertain Given the relative importance of the reforms supported by adjustment component, it seems appropriate to combine the two ratings into one rating of "likely".
Bank Performance:	Satisfactory	Satisfactory	
Borrower Perf .:	Satisfactory	Satisfactory	The ICR rates Borrower performance as satisfactory for implementation of both the adjustment and investment components, highly satisfactory for preparation of both components, and highly satisfactory for covenant compliance for adjustment and the commercial bank investment component. However, it rates covenant compliance for BNDE, and for the Government as guarantor of this component, as deficient. Taken all together, this implies an overall ICR rating of "Satisfactory".
Quality of ICR:		Satisfactory	

7. Lessons of Broad Applicability :

The investment component was underutilized because it could not be competitively priced given Bank lending policies at the time. The subsequent introduction of LIBOR- based pricing policies would have facilitated the full utilization of this type of loan. There is also a question as to whether it is appropriate for the Bank to provide capital to commercial lending institutions in a country like Morocco, or whether adequate management of the economy and the framework for the capital account should permit access of domestic banks to international markets .

8. Audit Recommended? ○ Yes ● No

9. Comments on Quality of ICR :

The ICR is generally satisfactory, but with some shortcomings . (1) It could have more fully explored the need for IBRD lending for commercial banks. (2) The loan was cofinanced with a US$100 million syndication led by IFC, as specified in the President's Report. The ICR should have commented on the outcome of this cofinancing . (3) There is neither a statement nor analysis of repayment status /arrears. The ICR should have presented some information on this as an important indicator of sustainability. (4) The ICR should have included a list of specific tranche release conditions (as in the President's Report, paragraph 4.27) and the specifics of their achievement, rather than the general presentation given in ICR paragraph 6. (5) Out of US$77 million onlent, about US$12.5 million went to 3 sub borrowers (one of which was Nestle Maroc). The ICR could have commented on this downside of untargeted lending. (An additional US$16 million seems not to be identified by sub borrower.)