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Report No. 13724

PROJECT COMPLETION REPORT

SENEGAL

FINANCIAL SECTOR ADJUSTMENT PROGRAM
(CREDIT 2077-SE)

NOVEMBER 22, 1994

Industry and Energy Operations
Sahelian Department
Country Department V
African Regional Office

FISCAL YEAR

July 1 - June 30

WEIGHTS AND MEASURES

All weights and measures are in metric units

ABBREVIATIONS AND ACRONYMS USED

BIAOS	-	*Banque Intemationale pour l'Afrique Occidentale du Sénégal*
BICIS	-	*Banque internationale pour le commerce et l'industrie du Sénégal* (Commercial Bank)
BIS	-	*Banque Islamique du Sénégal*
BSK	-	*Banque Sénégalo-Koweitienne*
BCEAO	-	*Banque Centrale des Etats de l'Afrique de l'Ouest* (Central Bank of West African States)
BNDS	-	*Banque Nationale de Développement du Sénégal*
BOAD	-	*Banque Ouest-Africaine de Développement*
CBAO	-	*Compagnie Bancaire de L'Afrique Occidentale*
CNCAS	-	*Caisse Nationale de Credit Agricole du Sénégal* (CNCAS)
FSECAL	-	Financial Sector Adjustment Credit
MASSRAF	-	*Massraf Faygal Al Isami du Sénégal*
ONCAD	-	*Office national de coopération et d'assistance au développement* (defundt groundnut marketing agency)
SOFISEDIT	-	*Société Financière Sénégalaise pour le Développement de l'Industrie et du Tourisme*
SDID	-	*Société de Développement International Desjardin*
SONABANQUE	-	*Société Nationale de Banque*
SONAGA	-	*Société de Guarantie d'Assistance et de Credit*
SNR	-	*Société Nationale de Recouvrement*
UMOA	-	*Union Monetaire Ouest Africaine*
USAID	-	Unites States Agency for International Development
USB	-	*Union Sénégalaise de Banque pour le Commerce et l'Industrie* (USB)

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THE WORLD BANK
Washington, D.C. 20433
U. S. A.

Office of Director-General
Operations Evaluation

November 22, 1994

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Senegal - Financial Sector Adjustment Program (Credit 2077-SE)

Attached is the Project Completion Report on Senegal - Financial Sector Adjustment Program (Credit 2077-SE), prepared by the Africa Regional Office, with Part II prepared by the Borrower.

The Financial Sector Adjustment Program was designed to (a) rehabilitate and restructure the banking sector; (b) reduce public shareholding in banks and improve bank regulation and supervision; and (c) improve the process of financial intermediation and hence promote growth. The upfront measures undertaken for the reform of the financial sector were part of region-wide reforms in banking, credit and monetary policies of member countries of the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO), of which Senegal is a member. Specific reform measures associated with the second tranche release were related to the recapitalization of three state banks, recovery of bad debts, and reduction of the Government's shareholding in the banking system.

Despite delays, the Government achieved the liquidation of six banks and the recapitalization of two state banks (a third bank was among those liquidated). The reduction in Government ownership in the banks was partially achieved. Banking supervision and regulation were enhanced. But the collection of bad debt did not progress as well as expected. Not only was it inadequate overall, but it was even less effective for large borrowers.

The operation's outcome is rated as marginally satisfactory. Sustainability is rated as uncertain, since the financial sector could only remain healthy if structural adjustment succeeds. The institutional development is rated as modest. The PCR quality is satisfactory.

An audit is planned.

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REPUBLIC OF SENEGAL
FINANCIAL SECTOR ADJUSTMENT PROGRAM
(CR. 2077-SE)

PROJECT COMPLETION REPORT

Table of Contents

REPUBLIC OF SENEGAL
FINANCIAL SECTOR ADJUSTMENT PROGRAM
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PROJECT COMPLETION REPORT

PREFACE

This is the Project Completion Report (PCR) for the Financial Sector Adjustment Loan (FSECAL) to Senegal approved by the Board on December 18, 1989 for an initial amount of SDR 35.3 million (US$45.0 million equivalent) from IDA. The two tranches of the credit were fully disbursed, the first at effectiveness and the second on February 21, 1992.

This PCR was prepared by Bank staff based on information available on the President's Report, aides-memoir, loan documents, a study of project files and discussions with Bank staff. The Borrower completed Part II and submitted it to the Bank in March 1993.

REPUBLIC OF SENEGAL
FINANCIAL SECTOR ADJUSTMENT PROGRAM
(CR. 2077-SE)

PROJECT COMPLETION REPORT

EVALUATION SUMMARY

I. OBJECTIVES

The aim of the program, supported by the Financial Sector Adjustment Loan (FSECAL), was to develop a strong financial sector. The development of a viable financial sector would not only enhance the structural adjustment efforts of the Senegalese authorities, it would complement reforms approved for the region as a whole by the *Union Monetaire Ouest Africaine* (UMOA) Council of Ministers in August 1989. The November 1989 Letter of Sectoral Development Policy specifies three main goals: (i) the rehabilitation and restructuring of the banking sector; (ii) the reduction of public shareholding among banks and the introduction of appropriate bank regulation and supervision; and (iii) the development of mechanisms that would improve financial intermediation in terms of credit allocation and mobilization of resources.

II. PROJECT IMPLEMENTATION

The credit was approved by IDA's Board on December 18, 1989 and became effective three days later, when the first tranche, representing 60 percent of the loan amount, became available. The second tranche was intended for release nine months later. However, its release was postponed because four of seven specific conditions for release remained unfulfilled. These conditions were: (i) finalizing the restructuring of three banks - *Banque Internationale pour l'Afrique Occidentale du Sénégal* (BIAOS), *Banque Sénégalo-Koweitienne* (BSK) and *Massraf Faygal Al Isami du Sénégal* (MASSRAF); (ii) reduction of the public sector participation in the share capital of *Caisse Nationale de Credit Agricole du Sénégal* (CNCAS) to 25 percent or less; (iii) meeting the targets for bad debt recovery as specified under the adjustment program; and (iv) removal of institutional constraints that would interfere with the provision of technical assistance for mutualist banking operations. In particular, the status of the third condition (iii), the shortfall in the bad debt recovery targets of the publicly-owned banks, proved the main obstacle to the timely release of the second tranche.

Despite delays, project implementation appears to have been largely consistent with the reforms and stages envisaged in the Letter of Financial Sector Development Policy.

III. RESULTS

Evaluation of the programs's results poses a problem since it is apparent that satisfactory information on bad debt recovery was never obtained, even though an audit was commissioned and efforts were made to determine the extent to which recovery had taken place over time.

A. Monetary and Credit Policy Reforms

The objective was to support and enhance a series of monetary and credit policy reforms announced by the UMOA Council of Ministers in August 1989. These UMOA reforms included the removal of the sectoral allocation of credit, the partial liberalization of interest rates and the removal of preferential rates, the implementation of a new system of crop financing, a new system to determine borrower creditworthiness, and revision of the bank-by-bank credit ceilings. With the exception of liberalizing interest rates, which continued to be administratively set and aligned with the Paris money market rate, these reforms were implemented. In an effort to enhance these UMOA reforms, the following four actions were included in the FSECAL to form part of the conditions for second tranche release.

(i) The Government of Senegal was to review, in consultation with the BCEAO, the system of bank-by bank credit ceilings and to consider replacing this direct mechanism with an indirect instrument of monetary policy. In June 1990, with USAID assistance, the Government produced a study of a bank reserve requirement system which could be used as an indirect instrument of monetary control to replace bank-by-bank credit ceilings. After reviewing this system, the BCEAO decided to introduce bank reserve requirements on a gradual basis in the whole UMOA zone. No timetable for implementation was provided as the Central Bank felt that it would be impractical to introduce a new instrument to control liquidity in a single member country or for the zone, when restructuring of the banking system was not yet complete. Because the Government had completed its review and the BCEAO's commitment to introducing required reserves in the zone was apparent, the condition for second tranche release was considered to have been met. In October 1993, however, the BCEAO felt that the bank restructuring was in a final stage and that the initial phasing in of reserve requirements would be appropriate. Required reserves were to be calculated at a rate of 1. 5 % of a bank's sight deposits and short-term credit (excluding crop credit).

(ii) The program provided for the Government to review the new crop finance system. In conjunction with the BCEAO and the Bankers' Professional

Association, the Government carried out a study which showed that the new system had been satisfactorily implemented with respect to sources of financing, the syndication of crop credit, and the repayment of the credit according to the appropriate crop cycle. However, three safeguards, which had been provided for in the August 1989 reforms and which were to be enforced from October 1, 1990 as a condition for second tranche release, failed to be implemented. These were: (1) the borrowers would have to put up 10 percent of their crop financing needs out of their own funds; (2) the borrowers would have to comply with financial viability criteria established by the BCEAO; and (3) an independent organization would be established to hold and manage crop inventories. Because of financial weakness on the part of the borrowers and because efforts to establish an organization to hold and manage crop inventories met with difficulties, the BCEAO decided to postpone these plans. IDA accepted these delays on the basis of the complexities of the crop credit system.

(iii) The program provided for a review of the prior authorization system, a mechanism used in cases where a loan would put a customer's total borrowing from the banking system above CFAF 200 million in Senegal. The BCEAO justified the procedure as a quality control instrument and as a way to ensure compliance with sectoral credit targets. In practice, the system failed to successfully monitor the creditworthiness of large borrowers and, in 1989, the BCEAO dropped the sectoral guidelines. Furthermore, the procedure was administratively cumbersome, resulting in delays that reduced the banks' ability to respond promptly to the economy's credit needs. In December 1990, the UMOA replaced the prior authorization system with a rating system of the financial viability of borrowers, allowing the BCEAO to determine their refinancing eligibility for loans above the same threshold of CFAF 200 million. The new system has been implemented on a gradual basis, from January 1, 1992 and is expected to be fully operational by January 1, 1995. Since few borrowers have a total exposure in excess of CFAF 200 million and the BCEAO exerts an indirect control only on those borrowers seeking refinancing, the new system was considered a liberalization of the lending process and therefore a fulfillment of the relevant condition for second tranche release.

(iv) The FSECAL supported the Government's establishing and maintaining an appropriate macroeconomic environment appropriate to financial sector reform. In 1989/90, Senegal's macroeconomic performance faltered owing to conditions adverse to agricultural production, as well as to a border conflict with neighboring Mauritania. The most significant deterioration was apparent with respect to Senegal's fiscal performance.

The overall fiscal deficit which, on a commitment basis and excluding grants, was 2.6 percent of GDP in 1987/88, increased to 4.1 percent of GDP in 1988/89 and deteriorated even further to 4.3 percent in 1989/90. In light of the relative size of the overall fiscal deficit, the Government, IDA, and the IMF agreed in July 1990 on an austere public finance program for 1990/91. Overall, the Government implemented this program successfully, by turning the fiscal deficit into a budget surplus of 0.2 percent of GDP, by eliminating external payment arrears, and by reducing domestic arrears significantly. In August 1991, the Government, IDA and the IMF agreed on a macroeconomic framework for the period July 1991 through December 1992. Assessing whether the condition for the relevant second tranche release had been met, IDA staff argued that substantial progress had been made in establishing an appropriate macroeconomic environment for financial sector reform.

B. Bank Regulation and Supervision

In addition to the creation of the *Commission Bancaire*, the program provided for the Senegalese government to take a number of steps to strengthen the bank regulatory and supervisory framework. In October 1991, a new set of prudential regulations were issued, including the establishment of accounting standards to be enforced from October 1, 1995. Also, a new Banking law was enacted in June 1992. Because these measures could only be monitored after the anticipated closing of the Credit, no conditionality was attached to their implementation.

By the beginning of 1994, the bank regulatory and supervisory framework was acceptable. However, the successful implementation of the banking chart of accounts has yet to be analyzed and represents a threat to the development of a financially sound banking sector in Senegal, given the poor enforcement of accounting standards that have prevailed.

C. Bank Restructuring and Liquidation

Under the program, three banks (all of which had less than 25 percent Government ownership) were to be restructured and recapitalized by their shareholders: *Banque Senegalo-Koweitienne* (BSK), *Massraf Fasal Al-Islami* (MASSRAF) and *Banque Internationale pour l'Afrique Occidentale au Sénégal* (BIAOS). Ultimately, BSK was liquidated in October 1990 because shareholders failed to put up sufficient funds to recapitalize it. MASSRAF, which was renamed *Banque Islamique du Sénégal* (BIS), had its license withdrawn in December 1989 and did not resume operation until June 1992 when all contributions to the required new share capital had been mobilized. BIAOS, which was renamed *Compagnie Bancaire de L'Afrique Occidentale* (CBAO), was recapitalized with financial contributions from shareholders, the BCEAO, and the

Government. The bank was majority owned by local private investors; the Government kept a 29 percent participation which it reduced to 10 percent by June 1992.

Five[1] banks under Government control were liquidated: *Société Nationale de Banque* (SONABANQUE), Société de Guarantie d'Assistance et de Credit (SONAGA), Société *Financière Sénégalaise pour le Développement de l'Industrie et du Tourisme* (SOFISEDIT), ASSURBANK, and *Banque Nationale de Développement du Sénégal* (BNDS). Their assets and liabilities were transferred to the national recovery agency, *Société Nationale de Recouvrement* (SNR), which started operating in June 1991.

The balance sheet of another bank, *Union Sénégalaise de Banque pour le Commerce et l'Industrie* (USB), was also transferred to the SNR. The sound assets of USB and an equivalent amount of liabilities were separated out and used to create *Credit Lyonnais* Senegal, with 5 percent Government ownership.

D. Government Divestiture

An objective of the FSECAL was privatization of the banks in Senegal. The Government was required to reduce its direct and indirect participation in all banks to not more than 25 percent. Aside from BIAOS and MASSRAF, two "healthy" banks had public ownership in excess of 25 percent. *Banque Internationale pour le Commerce et l'Industrie* (BICIS), a commercial bank, reduced government participation from 42 percent to 25 percent in March 1991 by selling shares to private investors as well as its own staff. *Caisse Nationale de Credit Agricole du Sénégal* (CNCAS), an agricultural bank, began privatization early in 1990 when an NGO purchased 4 percent of the Government's 45 percent shareholding. Subsequent attempts to effect further Government divestiture proved difficult, owing to concerns about the long term viability of the institution. The *Banque Ouest-Africaine de Développement* (BOAD) agreed to act as an independent trustee and take on a participation of 17 percent; the Government narrowed down its "official" share to 24 percent but the trusteeship situation continues.

E. Bad Debt Recovery

Another objective of the FSECAL was to recuperate the bad debt owed to the banks beginning in October 1988, when the restructuring of the banking sector started. With a projected total bad debt recovery of CFAF 32 billion, cumulative recovery targets were set at CFAF 9.8 billion by June 1990, CFAF 16 billion by the end of February 199 1, and CFAF 23.4 billion by the end of December 1991. Because of the difficulty of obtaining reliable information on the recovery of bad debt, and in particular separating out recovered bad debt from good credit, an audit was undertaken by an internationally-

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1 These five banks were liquidated, but because SONAGA, a guarantee fund, was a subsidiary of SONABANQUE, the number of liquidated banks is often counted as four.

known auditing firm (*Cabinet* Aziz Dieye) financed by USAID. This first effort to determine the exact amount of bad debt recovery was not entirely successful. By April 1991, the auditing firm had been able to obtain recovery data (CFAF 9.5 billion) for the period June 1989 to February 28, 1991, but failed to obtain data for the initial recovery period, October 1988 to June 1989. A subsequent audit, which came out in October 1991, claimed to have filled this gap with an estimated CFAF 5 billion, but information on loan recoveries pertaining to SOFISEDIT were not included. Perhaps because of omitted SOFISEDIT recoveries, the audit reports total collection of CFAF 22 billion by the end of December 1991, a figure somewhat below the target of CFAF 23.4 billion. The second tranche was finally released in January 1992, after it had been determined that assessment of that particular second tranche condition would have to be made on a qualitative rather than quantitative basis, owing to the difficulty of obtaining complete and uniform data for all liquidated banks.

A recovery agency, *Société Nationale de Recouvrement* (SNR), was established in February 1991. This company received the assets and liabilities of the seven banks which had been liquidated (BSK, BIAOS, USB, ASSURBANK, BNDS, SONABANQUE/SONAGA, SOFISEDIT) and enjoyed the advantage of being able to seize debtors' financial and material assets without going to court. After a protracted start-up period, generated by the difficulty of resolving the variety of accounting methods used by the individual liquidated banks, the company began operation in June 1991. The company emphasized debt recovery and the refund of deposits to small depositors. The recovery rate showed an improvement. Before the establishment of the SNR, from October 1988 to June 1991, CFAF 12 billion had been recovered. Subsequent to the establishment of the SNR and over a shorter period of time, from June 1991 to September 1993, CFAF 19.3 billion was recovered.

The bad debt recovery program had been criticized because of its focus on retrieving debt from small, as opposed to large, debtors. The overall recovery rate had been 18 percent, 23 percent for small debtors and only 8 percent for the large debtors. It was hoped that, with the establishment of the recovery company, this pattern could eventually be reversed. Information on the size of the credits recovered by the SNR has not been provided, making it impossible to assess its performance on bad debt recovery from large debtors. However, it is unlikely that the recovery rate on nonperforming loans to large debtors improved very much, since political considerations in Senegal often took precedence over sound banking practices or concerns about income distribution.

The SNR reported that it had reimbursed small depositors, beginning with those depositors with the smallest accounts (CFAF 100,000 or less). By September 1993, small depositors had been reimbursed a total of CFAF 9.9 billion and the ceiling on deposit size moved up to CFAF 22 million by November 1993. The SNR has complained that many small depositors failed to come forward to collect on their claims. The evolution of the banks' balance sheets over time showing the payment of claims to depositors, the recovery of bad loans, and the maturing of performing credits would document the progress of the recovery agency over time. However, the only balance sheets which have been received are three consolidated balance sheets pertaining to the start-up of the SNR, the 31st of May, the 1st of June and the 30th of September 1991 (see Table 1). Between May 31st and June 1st, total assets of the seven banks fell from CFAF 375 billion to CFAF 275 billion. Assets appearing as a loss item, amounting to approximately CFAF 86 billion, were written off and the consolidated net worth of the institutions being liquidated indicated a change in capital and reserves from positive CFAF 27 billion to negative CFAF 56 billion. By the end of September, the CFAF 86 billion in losses had been restored to the balance sheet. The overall balance sheet looked very much the same as that of May 31st, except that CFAF 140.6 billion in BCEAO refinancing appears to have been transferred to the "deposits of governments" item. Subsequent balance sheets, which would permit an assessment of the progress of the SNR, have not been forthcoming.

F. Government Payment of Annual Liabilities Generated by Bank Restructuring

The FSECAL required that the Government be current in the payment of all liabilities attributable to the financial sector restructuring. These liabilities amounted to about CFAF 182 billion, composed of CFAF 131 billion owed to the BCEAO and other banks, and CFAF 50.7 billion owed to depositors. In addition, the Government agreed to make cash contributions amounting to CFAF 14 billion to compensate the restructured banks which took over more deposit liabilities than performing assets and to bear the cost of layoffs incurred by the restructuring.

The BCEAO agreed to convert bank debt totaling CFAF 126.5 billion into a term loan payable over 15 years, with a three year grace period at an interest rate of three percent per annum. On the due dates, payment of interest and principal were to be deducted from the Government's account at the BCEAO. The repayment of debts to depositors and other banks, cash contributions to the restructured banks and the settlement of layoff indemnities were all to have been taken care of with the proceeds from bad loan recovery and external budget support. However, because of the lack of a clear information and accounting system, at the time of initiation of the program, it is not possible to fully document the payment of these liabilities.

G. Action Program to Facilitate the Establishment of Grass-roots Banks

With technical assistance financed by the Canadian International Development Association (CIDA) over a two year period from April 1990 to March 1992, the Government of Senegal was to implement a program of actions to promote the concept of grass-roots banking operations and, in particular, to encourage the creation of banking structures operating according to cooperative or mutualist principles. By mutual consent of CIDA and IDA, the *Société de Développement International Desjardin* (SDID) was contracted to provide the necessary technical experts.

TABLE 1

BALANCE SHEET - NATIONAL RECOVERY COMPANY - Opened June 1, 1991

The consolidated balance sheets (DEC 612) of the 7 liquidated banks

		May 31, 1991	June 1, 1991	Change May/June1991	Sept 30, 1991
ASSETS					
		(in millions of CFA francs)			
(1) Cash	(10)	211.80	211.80		86.00
(2) Reserves and deposits at BCEAO	(20)				
(3) Banks and correspondent banks	(30)	10,544.40	7,149.50	-3,394.90	5,730.40
(4) Loans to other financial institutions	(40)	964.40	160.60	-803.80	962.90
(5) Governments and non-financial internat'l institutions	(50)	8,586.60	8,586.60		8,863.20
(6) Credits	(60)	162,733.40	146,890.30	-15,843.10	158,259.20
non-performing loans w.o. provisioning		126,747.10	113,012.50	-13,734.60	
non-performing loans w. provisioning	(65)	36,238.30	25,451.70	-10,786.60	
(7) Other assets Net	(70-80)	106,100.20	111,805.90	5,705.70	107,689.60
(8) Losses	(90)	86,283.10		-86,283.10	86,480.40
(9) TOTAL ASSETS = TOTAL LIABILITIES		375,423.90	274,804.70	-100,619.20	368,071.70
LIABILITIES					
(11) BCEAO refinancing	(10)	140,573.30	137,832.20	-2,741.10	0.00
(12) Refinancing of banks and correspondent banks	(20)	13,781.30	7,332.00	-6,449.30	14,194.40
(13) Deposits and loans of other financial institutions	(30)	7,381.30	5,679.60	-1,701.70	7,249.10
(14) Deposits and loans of governments & non-finan internat'l instits	(40)	54,164.20	54,164.20		191,789.70
(15) Deposits of other economic agents	(50)	41,165.70	40,943.80	-221.90	35,709.70
(16) Other	(60)	90,942.20	84,875.20	-6,067.00	81,177.10
(17) Capital and reserves	(70)	27,415.90	-56,022.30	-83,438.20	35,291.70
of which: - general provisions	(71)	278.00	278.00		n.a.
- capital	(77)	12,715.80	25.00	-12,690.80	n.a.
(18) Earnings	(90)				2,660.00
(19) TOTAL LIABILITIES + CAPITAL AND RESERVES		375,423.90	274,804.70	-100,619.20	368,071.70
(20) Off- Balance Sheet Activities					
Loan commitments	(10)	2,104.80	2,104.80		2,581.50
Guarantees	(20)	16,817.50	16,817.50		17,056.90
	(30)	123,088.60	123,088.60		123,833.00
(21) Memorandum item:					
net foreign liabilities		6,718.80	6,719.90	1.10	

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Lastly, given the extreme difficulty of this operation, it may be useful to stress the importance of having the Bank not only monitor operations, but maintain all records of appraisals and supervision missions. For this purpose, the following elements are essential: (i) good follow-through by the task manager, (ii) filing of all supervision reports and appraisals in the Central Files, and (iii) a standardized methodology for supervision missions based on the comparison of actual results with targets set up for tranche release.

PROJECT SUSTAINABILITY

The long term sustainability of the program will depend on the good will and commitment of the Government of Senegal, the BCEAO and the executing agencies, such as the *Commission Bancaire*. Measures adopted after the closing of the loan provide some evidence of such commitment.

- In the area of monetary and credit policy reform further steps toward the use of indirect instruments of monetary management were taken in October 1993, in particular, when the money market was reformed, interest rate determination became subject to a weekly interbank deposit auction, and reserve requirements were introduced.

- The FSECAL laid the groundwork for a banking system where banks are monitored on a regular and systematic basis, utilizing internationally-accepted standards of bank regulation and supervision. Such a framework should prove highly sustainable under the aegis of the *Commission Bancaire* and the BCEAO.

- The restructuring of BIAOS, BSK, MASSRAF and USB, as well as the liquidation of SONABANQUE/SONAGA, SOFISEDIT, ASSURBANK, and BNDS, has been completed. The balance sheets of the liquidated banks have been passed on to the recovery agency, the SNR, where the debt recovery effort continues. The SNR has stated that since June 1991 (when it began operation) through September 1993, it has recovered debt amounting to CFAF 19.3 billion. This is more than half the CFAF 35.5 billion recoveries reported since October 1988, when the recovery effort began. It remains to be seen how much more bad debt can be recuperated by the SNR and whether large debtors are called upon to fulfill their financial obligations.

- Government divestiture of bank shares to a maximum participation of 25 percent in each bank has been completed, with the exception of CNCAS. The trusteeship arrangement, whereby the *Banque Ouest Africaine de Développement* (BOAD) agreed to hold some shares of CNCAS so that the GOS could bring its shareholding to less than 25 percent, continues without firm resolution.

- The Canadian-financed project to provide technical assistance to an action program to promote a mutualist banking network was carried out. As a result, rural areas of Senegal previously without access to financial intermediation are benefiting from the operation of mutualist savings and credit banks. In addition, the BCEAO has decided to expand the grass-roots banking experiment beyond the borders of Senegal, to other countries of the UMOA. A draft law regulating mutualist banking is expected to be adopted for the whole region by the end of 1994.

REPUBLIC OF SENEGAL

FINANCIAL SECTOR ADJUSTMENT PROGRAM

(CR. 2077-SE)

PROJECT COMPLETION REPORT

PART I - PROJECT REVIEW FROM BANK'S PERSPECTIVE

1. PROJECT IDENTITY

Project name:	Financial Sector Adjustment Program
Credit Number:	2077-SE
Effectiveness Date:	December 21, 1989
Closing Date:	June 30, 1992
IDA Credit	
Approved:	SDR 35.3 million
Disbursed:	SDR 35.3 million
Region:	Africa
Country:	Senegal

2. PROJECT BACKGROUND

2.1 Context

The credit in the amount of SDR 35.3 million was approved by the Board of Executive Directors on December 18, 1989, with cofinancing from France (US$ 34 million) and the United States (US$33 million). It became effective on December 21, 1989, when the first tranche representing 60 percent of the credit (SDR 21.2 million) was made available. The second tranche was expected to be released nine months later, i.e., in September 1990.

2.2 Sector development objectives

The program, supported by the Financial Sector Adjustment Credit (FSECAL), was aimed at developing a strong financial sector capable of enhancing the structural adjustment efforts of the Government. It was intended to complement zone-wide reforms adopted by all the countries of the *Union Monetaire Ouest Africaine* (UMOA) in August 1989. During the preparation of the FSECAL, the Government was a shareholder in nine of Senegal's 15 banks and exercised direct control over five. In 1986, a liquidity crisis had taken place in eight of the 15 banks. To deal with their liquidity problems the distressed banks had increasingly resorted to accumulating overdrafts from the Central Bank (BCEAO: *Banque Centrale des Etats de l'Afrique de l'Ouest*). In 1988, however, when the BCEAO halted the provision of these additional refinancing facilities, the operation of these banks came to a virtual standstill. Table 2 summarizes the financial position of the Senegalese banking system as of September 30, 1988.

Table 2: SUMMARY SITUATION OF THE BANKING SYSTEM
(CFAF billion)

	Eight distressed Banks	Sound banks	Total
Total loans	323	166	489
Non-performing loans	233	6	239
Capital & reserves	36	29	65
BCEAO refinancing	167	30	197

Source: World Bank Staff Appraisal Report, 1989.

Problems in Senegal's banking sector had arisen owing to economic and institutional factors common to all countries in the UMOA. Unfavorable economic conditions (drought, deteriorating terms of trade), inappropriate financial sector policies (artificially low interest rates, preferential rates to selected sectors), a lack of fiscal discipline, and a virtual absence of bank supervision all contributed to the banking sector crisis. These problem banks were also plagued by poor management, government interference, and a lack of internal controls over lending decisions.

In June 1989, the UMOA Council of Ministers decided to consolidate on concessional terms (15 years, with a three years' grace period, at three percent interest) most of the BCEAO's claims on banks in need of liquidation or restructuring. The reforms, intended to make the banking sector more amenable to the introduction over time of a more market-based system included: (i) creation of a supranational banking commission with jurisdiction in each country; (ii) complete revision of banking legislation and regulation; (iii) incorporation of crop credits in country credit ceilings under more rigorous financial controls; (iv) incorporation of government guarantees on domestic borrowings of public and private enterprises into the limits of government borrowing from the central bank; (v) abolition of sectoral credit targets; (vi) abolition of the preferential rediscount rate and establishment of a rediscount rate set above the money market rate; and (vii) widening of bank lending margins.

2.3 Linkages between project, sector and macro policy objectives

IDA Credit 2077-SE was to support an action program by the Government of Senegal designed to complement the UMOA reforms in terms of institutional and systemic changes in the financial sector aimed at preventing systemwide failure; to restructure Senegal's banking sector; and to lay the groundwork for the development of efficient financial markets.

The successful implementation of the FSECAL was seen to depend to a large extent on the macroeconomic stabilization program proposed under the SAL IV, which was in the last stages of preparation, and the ESAF of the IMF, then in its second year of implementation. Both the SAL IV (approved by the Board February 9, 1990) and the ESAF contained specific policy measures aimed at improving macroeconomic performance.

3. PROJECT OBJECTIVES AND DESCRIPTION

3.1 Project objectives

The general objectives of the project were to help the Government of Senegal address the financial difficulties apparent in the banking sector. Specific objectives were to provide:

(a) a macroeconomic framework consistent with the objectives of the program;

(b) timely service by the Government of its liabilities incurred in the process of financial sector restructuring;

(c) a review of the methods, procedures and, if warranted, the implementation timetable for the replacement of bank-by-bank credit ceilings by market-oriented mechanisms;

(d) a review of the performance of the revised system of crop credit financing and of prior authorizations for borrowings, and measures proposed to correct any deficiencies revealed by such reviews;

(e) financial restructuring for three banks;

(f) a reduction of public sector ownership to 25 percent or less in each financial institution;

(g) realization of the bad debt recovery targets set up by the program;

(h) preparation of an action plan to facilitate the establishment of grass-roots banks.

3.2 Project description

The program had five components: (i) a monetary reform component directed toward promoting monetary and credit policy that would (eventually) allow interest rates and loan amounts to be market determined; (ii) a bank regulatory and supervisory component designed to control financial risk; (iii) a bank restructuring component designed to remedy Senegal's insolvent banking sector; (iv) a financial sector widening and-deepening component focused on mobilizing resources for the growth and development of the financial system; and (v) a macro-stability component emphasizing continued improvement in the country's fiscal and current account deficits.

A. Monetary reform component

By incorporating a number of specific monetary and credit policy reforms into the FSECAL, this component was designed to support zone-wide reforms. These specific reforms pertained to interest rate policies and bank margins, bank-by-bank credit ceilings, crop marketing credits, the sectoral allocation of credit, the prior authorization mechanism, government guarantees of public enterprise borrowings, and taxation.

i. Interest rates and bank margins: In August 1989, UMOA's Council of Ministers abolished the two discount rates, the "normal" rate (TEN: *taux d' escompte normal* and the lower "privileged" rate for loans targeted for priority sectors (TEP: *taux d' escompte privilégié).* The Council put in place a single money market rate (TMM: *taux du marché monétaire)* as the key interest rate. The level of the TMM was initially aligned with that of the Paris money market rate, but was eventually to be determined by market forces. The Council of Ministers also decided that excess demand for money market deposits would be met through a last-resort facility of the Central Bank, whose discount rate (TES: *taux d' escompte)* would be higher than the TMM. The TES was to serve as the base rate to which allowed margins could be added, so that bank margins would improve to more profitable levels.

ii. Bank-by-bank credit ceilings: With an eye toward replacing bank-by-bank credit ceilings and as a condition of second tranche release, the FSECAL required that the Government undertake a study focusing on more market-oriented mechanisms.

iii. Crop marketing credits: In August 1989, the Council of Ministers agreed that crop credit should become subject to bank credit ceilings for the first time. Subjecting the crop credits to bank credit ceilings, along with the abolition of the TEP, was intended to reduce the incentive for export/marketing companies to substitute crop credits for normal financing. In addition, the Government of Senegal agreed that any bank could decide independently whether or not to make a crop credit, thus allowing the banks to take into account the creditworthiness of the potential borrower. The second tranche release of the FSECAL called for a review of this new system and implementation of any corrective measures needed to improve its functioning.

iv. Sectoral allocation of credit: The system of targeting credit for "priority" sectors (such as, small and medium-sized enterprises) was abolished by the Council of Ministers in August 1989, on the grounds that the Government had played an active role in seeing to it that credit was allocated to favored enterprises or individuals. The FSECAL was designed to support the introduction of more "market-oriented mechanisms" into financial intermediation.

v. Prior authorization mechanism: The prior authorization mechanism had been revised and liberalized, i.e., the threshold of acceptable exposure permitted a single borrower was increased and the time-consuming application procedure dropped. Under the FSECAL, the revised system was to be reviewed and, if necessary, corrective measures taken, as a condition for second tranche disbursal.

vi. Government guarantees of public enterprise borrowing: The UMOA Council of ministers agreed in its August meeting to eliminate most of the commercial banks' incentives to favor government-guaranteed debt. In line with this zone-wide policy, the Government of Senegal decided to abstain from issuing guarantees on loans. The FSECAL required that Government guarantees of domestic borrowing be formally abolished by the decree of September 10, 1989.

vii. *Taxe sur la Prestation de Service* (IPS): As a tax on the interest paid on loans, the TPS imposed a substantial additional cost on the borrower, and tended to discourage investment. This tax of 17 percent represented a significant source of Government revenue. Therefore, as part of the FSECAL program, the Government was requested to come up with a schedule for phasing out the 17 percent TPS gradually over a period of five year, beginning June 1990.

B. Bank regulatory and supervisory component

In August 1989, the UMOA Council of Ministers agreed that a zone-wide *Commission Bancaire* would be set up by October 1990 and be made up of two members from each country of the UMOA, plus France. Also, it was decided that banking laws and regulations would be revised and come into effect by October 1990. Furthermore, at the time of FSECAL appraisal, work had begun on the introduction of a uniform accounting system. The bank regulatory and supervisory component of the program supported all of these measures to strengthen and reform bank supervision and control mechanisms.

C. Bank restructuring and privatization component

In June 1989, after consulting with the Bank and bilateral donors, the Government of Senegal completed a comprehensive program to restructure the banking system. This program had three aims: (i) maintaining only those banks that would be profitable after restructuring; (ii) reducing government interference in the banks' management through privatization and by limiting the Government's share capital in any bank to a maximum of 25 percent; and (iii) developing a plan for financing the restructuring with annual Government contributions consistent with the limitations of its budget. To aid the restructuring exercise, the Government of Senegal decided to create a recovery company to take over liquidated banks and to actively pursue recuperation of bad debt. The bank restructuring and privatization component of the FSECAL supported the above three aims by requiring that CFAF 9.8 billion of bad debt (out of a total required recovery of CFAF 32 billion) be collected by June 1990, that the Government be current in its annual financing costs (CFAF 10 to 15 billion) on a CFAF 126.5 billion term loan covering the bank restructuring, that the Government reduce its direct and indirect participation in CNCAS and BICIS to 25 percent, and that the Government complete restructuring of BSK, BIAOS, and MASSRAF.

D. Promoting grass-roots institutions:

This component of the FSECAL benefited from the collaboration of a CIDA technical assistance team. It was launched to assist the Government of Senegal in preparing an action plan for the establishment of a banking network operating on mutualist principles. In particular, it focused on: (i) the creation of an environment favorable to the emergence of a network of mutualist savings and credit institutions; (ii) the formulation of proposals and a strategic plan for assisting this network of mutualist banks: (iii) the establishment of a unit at Senegal's Ministry of Economy, Finance and Plan (MEFP) to coordinate and assist mutualist banking activities. By assisting the Government of Senegal in the preparation and initial implementation of an action plan to generated grassroots interest in mutualist banking, this component aimed at amplifying and improving Senegal's financial intermediation system.

E. Macroeconomic stability

This component was intended to make sure that the macroeconomic program was on track and the country's performance was consistent with the annual Policy Framework Paper and the SAL IV, which was approved in February 1990.

4. PROJECT DESIGN AND ORGANIZATION

4.1 Project development

The loan was identified following a Bank appraisal mission to Senegal in June 1989. Negotiations between IDA and the Government of Senegal were held on November 2 and 3, 1989 in Dakar, Senegal. The Appraisal Report was submitted to the Executive Directors of the Bank in December 1989. The credit in the amount of SDR 35.3 million was approved by the Board of Executive Directors on December 18, 1989. It became effective on December 21, 1989, when the first tranche representing 60 percent of the credit (SDR 21.2 million) was made available.

Project Preparation Facility funding of US$200,000 equivalent was approved on April 21, 1989; it was provided to help the Government of Senegal complete the preparation (mainly with respect to banking sector reform) for the FSECAL. On August 13, 1990, the Canadian Contribution Agreement between Senegal and IDA (acting on behalf of Canada) was signed. The Contribution Agreement provided CDN$1,273,000 to cover the costs of technical assistance to the part of the project devoted to the Promotion of Mutualist Banking Operations.

4.2 Evaluation of project design and organization

The Bank's work in appraising and designing the project was valuable because it helped: to identify the range of problems confronting the country's financial sector; to identify ways to assist Senegalese authorities in moving away from direct methods of monetary control toward indirect methods; to minimize Government intervention in the sector; to encourage the development of a market economy; to restore the health of the banking system; and to explore alternative types of financial institutions capable of mobilizing savings to meet the funding needs of borrowers in rural areas with less access to credit.

Although the Appraisal Report mentioned the lack of a common chart of accounts for the banking sector, it failed to mention the weak and unreliable auditing framework and its potential impact on the realization of the FSECAL. Without periodic audits, realized according to generally accepted international standards, there was no mechanism for systematically supervising the FSECAL by tracking the incidence of bad debt recovery, the liquidation (or restructuring) of ailing banks, and the reimbursement of depositors.

5. PROGRAM IMPLEMENTATION

5.1 Actual program start-up

The FSECAL was approved by IDA's Board on December 18, 1989 and became effective three days later when the first tranche, representing 60 percent of the credit, became available.

5.2 Length of implementation period and history

While the date initially set for project completion was June 30, 1991, postponement was necessary twice, first to December 31, 1991, then to June 30, 1992. The delay arose from the fact that four of the conditions for second tranche release had not been met, that is: (i) completion of the restructuring of BSK, MASSRAF, and BIAOS; (ii) the amount of bad debt recovery targeted in the program; (iii) reduction of Government ownership to 25 percent or less in two banks, BICIS and CNCAS; and (iv) the removal of constraints interfering with the provision of technical assistance for the development of an action program to promote mutualist banking operations. The main obstacle to an earlier release of the second tranche proved to be the inability to fulfill the bad debt recovery target required under condition ii.

5.3 Disbursements and procurement

Program costs totaled SDR 35.3 million, including a PPF advance of USD$200,000 (SDR 156,888 equivalent). Disbursement was completed on June 30, 1992.

The proceeds of the credit were used to reimburse 100 percent of the CIF costs of eligible general imports, with procurement of petroleum and food imports limited to 22 percent each of the total disbursements. Eligible imports by public agencies and the private sector which exceeded US$2 million were subject to international competitive bidding. Procurement by public agencies for items costing below this threshold followed standard government practices, while procurement by private entities were to be in accordance with normal commercial practices.

A special account was opened at the Central Bank, the BCEAO, to facilitate disbursements. Upon effectiveness, an initial deposit of 60 percent of the loan amount was made. This account was replenished upon the basis of fully documented reimbursement applications in excess of US$500,000 or, for smaller amounts, on the basis of a statement of expenditures.

6. PROJECT RESULTS

6.1 Objectives in view

The general program objective was to develop a strong financial sector which would form a solid foundation to support Senegalese authorities in their structural adjustment efforts. More specifically, financial sector strengthening was seen as resulting from:

(a) the rehabilitation and restructuring of the banking sector;

(b) the revision of Government policies with respect to the banking sector;

(c) the promotion of alternative structures (mutualist savings and credit banks) for the purpose of broadening and deepening deposit mobilization.

6.2 Results achieved

A. The rehabilitation and restructuring of the banking sector

The restructuring and liquidation of eight distressed banks in Senegal's banking system, a process which began in December 1989, was completed by June 1992 when the program closed. Under the program, BSK, MASSRAF and BIAOS were to be restructured and recapitalized by their shareholders. Since BSK's shareholders failed to put up sufficient funds to recapitalize it, the bank was liquidated in October 1990. Five Government-controlled banks (SOFISEDIT, SONABANQUE/SONAGA, BNDS, ASSURBANK and USB) were liquidated; the sound assets of USB, plus an equivalent amount of liabilities, were separated out from the liquidated institution and used to create *Credit Lyonnais* Senegal. A review of Senegal's banks completed in January 1994 indicates that, as of September 1992 and June 1993, the commercial banking sector was in reasonable shape suggesting the positive impact of the bank restructuring and liquidation carried out under the FSECAL. Unfortunately, information was not supplied by the *Sociéte Nationale de Recouvrement* (SNR) tracing the recovery of both sound and bad debt, losses on unrecoverable debt, utilization of capital and/or external (American and French) financing to pay off depositors. Therefore, the process of liquidation and restructuring cannot be said to have been monitored or verified.

Government divestiture of shares in Senegalese banks, bringing participation to a maximum of 25 percent per bank, was successfully carried out, with one exception. Privatization of the *Caisse National de Credit Agricole du Sénégal* (CNCAS) was not realized. When exactly the institution will be privatized remains in question. According to a MOF communication dated March 16, 1993, a decision has not yet to be obtained from the BCEAO or the BOAD.

Ascertaining and effectively promoting the incidence of bad debt recovery was not fully achieved, presumably because the banking sector did not have standardized methods of accounting and internal auditing. Despite two audits financed by USAID, it remained uncertain whether bad debt recuperation figures excluded normal recovery on sound credits. In any case, bad debt recovery appears to have been somewhat below target. The incidence of recovery from the largest debtors was noted to have been low compared to recovery rates pertaining to small borrowers and, despite the supposed anonymity of the large borrowers, it was commonly known that this group was "privileged," and included prominent marabouts, members of the National Assembly and the Administration. As to the reimbursement of depositors from the proceeds of the debt recovery, starting with small accounts of CFAF 100,000 or less, the SNR has recently claimed that many depositors failed to come to be reimbursed. Again, there were no files kept tracking the uses of recovered funds, but it is likely that revenue from debt collection was utilized by the SNR to cover its operating costs.

The objective of strengthening bank supervision and regulation was achieved. With the establishment of the *Commission Bancaire*, in October 1990, supervision of the banks became regularized (on an annual basis) and a systematic, comprehensive procedure for bank examination and reporting was adopted. Furthermore, a prudential framework, defined by the new banking law and the directive approved by the UMOA Council of Ministers in June 1991 (that became effective on October 1, 1991), established regulations which followed international standards for capital adequacy, asset quality, liquidity and maturity matching. The renovated prudential regulations reduced some major accounting loopholes with respect to accrual of past due interest and provisioning of non-performing loans. Furthermore, the new banking laws gave the BCEAO the right to determine accounting rules for the banks to follow. As a result, the BCEAO developed a Chart of Accounts which must be implemented by the banks beginning October 1995. The BCEAO has made a commitment to facilitate the process via the development of training and assistance/follow-up programs. The technical, financial, and human resources that will be required from each bank to implement the Chart of Accounts will be a formidable challenge to the banks and will weigh on their profitability during the first years of implementation.

B. The revision of Government policies with respect to the banking sector

The FSECAL supported zone-wide reforms by effectively pressing for the replacement of administrative controls on money and credit by indirect controls, as a way of fostering a more efficient and flexible monetary policy. In June 1990, the Government of Senegal produced (with the assistance of USAID) a study of a bank reserve requirement system which could be used as an instrument of monetary control to replace bank-by-bank credit ceilings. Having reviewed the study, the BCEAO announced in December of 1990 that it would introduce, on a gradual basis, bank reserve requirements for the entire UMOA zone. No definite timetable or details of implementation was provided at that time, as it was considered impractical to burden the banks with reserve requirements while restructuring of the banking system of member countries was under way. At the beginning of October 1993, however, the BCEAO instituted a system of mandatory reserve requirements.

The program permitted the Government to benefit from a review (done by the BCEAO, the Bankers' Professional Association, and the Government) of the revised system of prior authorizations. As a result, the BCEAO began in October 1991 to prepare a rating scheme ("*accord de classement*") to replace the one previously used under the prior authorization system. Although better than the previous one, this new annual rating scheme faces problems not easy to resolve, such as, the aforementioned unreliable accounting and auditing information.

The review done by the BCEAO, the Bankers' Professional Association and the Government also analyzed the performance of the revised crop credit system and found that it had been implemented satisfactorily in terms of financing, the syndication of crop credit, and the repayment of credit within each crop campaign period. However, the accuracy of this conclusion appears to be questionable, as the Government has been criticized for not making interest payments on consolidated *Office National de Coopération et d'Assistance au Développement* (ONCAD) debt. In addition, CNCAS' 1992 financial problems appear to have arisen from continued accumulation of non-performing crop credit.[2]

The extent to which the Government remained current in the payment of annual liabilities incurred during the course of the financial sector restructuring, a condition for second tranche release, seems questionable. These liabilities included debts to the BCEAO, the commercial banks, and depositors. Full servicing of these liabilities could not have been properly tracked, given the difficulties apparent in obtaining reliable information on the bad debt recovery of restructured/liquidated banks and the lack of

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2 The *Caisse Francais de Developpement* (CFD), a shareholder of CNCAS, became concerned by the amount of non-performing crop credit in the institution's portfolio and requested permission to investigate its financial condition. The study, completed in October 1993, confirmed the decentralized and inadequate financial management of the institution and its resulting deterioration.

information on the utilization of collection proceeds. Also, payments on defunct ONCAD credit would have been part of these liabilities and the Government has been criticized for not making interest payments on rediscounted ONCAD debt held by sound and unsound banks.

C. The exploration and promotion of mutualist structures

A Canadian grant-financed technical assistance project was part of the FSECAL; it successfully assisted the Government in preparing a well-structured action plan to promote the establishment of a banking network operating on mutualist principles. It also produced various studies of legal and regulatory frameworks for mutual savings/credit institutions designed to facilitate their establishment and operation. Via the technical assistance of this project a specialized unit was set up within the MOF which facilitates the environment for the establishment of mutualist savings and credit institutions.

The project also developed an effective Communications Program capable of generating public awareness of the activities and potential benefits of mutualist savings/credit operations. The unit ensured that at least seven articles were published in widely distributed publications and that the main elements of mutualist banking operations were described in detail for the benefit of the population. The published articles included such topics as "The Bank of the Excluded," "The Project Which Will Save the Stock Exchange," "Filling the (Banking) Gaps." In addition, *Trait-d' Union, a* monthly bulletin focusing on savings/credit cooperatives, was introduced and published regularly during the implementation period. Twenty-one separate reports were also produced. These brought together information on the norms and procedures of mutualist savings institutions, lessons from the experience of other countries, and proposals for facilitating the development of future mutualist institutions in Senegal.

6.3 Variances between planned and actual results

The variances in project results can be attributed to the following causes: (i) the ambitious nature of the program given the severity of Senegal's banking crisis, (ii) the Government's fiscal difficulties, (iii) the lack of proper standards of accounting and an auditing framework to monitor financial workouts, to track bad debt recovery, and to observe the revised system of credit allocation.

6.4 Project impact

The comprehensive restructuring and privatization policy inherent to the FSECAL, plus the development of prudential and supervisory frameworks, brought about a relatively sound, although somewhat fragile, banking sector in Senegal. The good health of the banking sector bodes well for the future development of a strong, efficient financial system.

The monetary and credit policy reforms that took place with the support of the FSECAL provide a base for further reforms which should eventually enhance the performance of an economy characterized by a free market system and indirect monetary controls.

Finally, the Canadian-financed technical assistance component of the FSECAL promoted the conceptual and institutional framework for implanting a network of mutualist credit/savings institutions in Senegal.

7. PROJECT SUSTAINABILITY

A. Rehabilitation and restoration of the banking sector

The program laid the groundwork for a healthy, privately-owned banking system which is monitored on a regular and systematic basis. Furthermore, the lending activities of these institutions appear to be currently predicated on borrower creditworthiness, rather than political influence. As a result, the banks in Senegal have been found to be relatively sound and quite liquid. Even those banks (foreign-owned) with net foreign liability positions appear to have withstood the losses sustained at the time of the January 12, 1994 devaluation.

The prudential and supervisory framework which was developed by the BCEAO according to internationally accepted norms should provide a good foundation upon which to maintain the health of the banking sector.

B. Monetary and credit policy

The sustainability of the effects of changes in monetary and credit policy designed to promote indirect instruments for monetary control will depend on the commitment of the Government and the BCEAO to this liberalization process.

C. Development and promotion of grass-roots institutions

As a result of the Canadian-financed project to develop an action program to facilitate and promote the establishment of a network of grass-roots institutions, parts of the country without previous access to financial intermediation are benefiting from the local operation of mutualist savings and credit banks. In addition, the BCEAO decided to expand the mutualist banking experiment beyond the borders of Senegal to other countries of the UMOA. A draft law on mutualist banking was written by the BCEAO, with the help of Canadian consultants, and is expected to be adopted for the whole region sometime in 1994.

8. BANK PERFORMANCE

During the pre-appraisal stage, the Bank made a concerted effort to target reforms for the FSECAL that would dovetail UMOA-wide policy reforms made by the Council of Ministers in August 1989. Policy changes in Senegal were viewed in the context of changes in the UMOA framework, owing to the recognized limitations of the Senegalese to act independently of the UMOA. Such an approach on the part of the Bank made the adjustment measures of the FSECAL complement the regional goals, thereby promoting their usefulness and sustainability.

Two areas of concern were mentioned by IDA during the pre-appraisal period. Neither became fully recognized elements of the adjustment operation and, therefore, were never incorporated into the FSECAL policy matrix. They were: (i) the strengthening of accounting, audits and disclosure, and (ii) the promotion of an efficient judicial system for the purposes of effectively recovering non-performing assets and collateral. These were areas that later caused problems, particularly with respect to the monitoring and collection of bad debts, and led to a delay in the disbursal of the second tranche.

Supervision missions were carried out in a satisfactory manner, but the resulting reports appear to have been somewhat imprecise in their evaluation of whether the conditions for second tranche disbursement had been fulfilled. Since it was apparent that certain conditions (the bad debt recovery target, the privatization of CNCAS, the requirement that the Government remain current on its restructuring liabilities) could not be fully met, confirmation of their fulfillment does not seem warranted. Rather, a waiver would have served as the appropriate course of action.

8.1 Lessons learned from the project

The program supported by the FSECAL was extremely ambitious and much needed as more than half of the fifteen banks in the system required liquidation or restructuring. Several lessons may be drawn from its implementation and results.

The first lesson learned is that any program which includes liquidation and restructuring of financial institutions must have the underlying support of good auditing and accounting standards, as well as a detailed monitoring information system. If such standards and systems do not exist, or if they do exist, but are not fully respected and implemented, the program should include measures to remedy the situation. Otherwise, any program will encounter difficulties similar to those experienced by this FSECAL, where statistical proof that financial action had actually been taken was incomplete and/or unreliable.

The second lesson learned relates to the very unequal incidence of bad debt recovery from small versus large debtors, with a much higher recovery rate among small debtors. The inequity in the relative sizes of recovery suggests special privileges enjoyed by certain groups, i.e., large enterprises and wealthy individuals, which would better have been anticipated and taken into account as a possible condition for tranche release.

Lastly, it may be useful to stress the importance of having the Bank not only monitor operations, but maintain all key records of appraisals and supervision missions. For this purpose, the following elements are essential: (i) good follow-through by the task manager; (ii) filing of all supervision and appraisal reports in the Central Files; and (iii) a standardized methodology for supervision missions based on the comparison of actual results with targets set up for tranche release.

9. BORROWER PERFORMANCE

9.1 Main strengths and weaknesses

Neither the BCEAO nor the SNR was able to provide data tracking the process of bank restructuring and liquidation from its inception December 31, 1989 through to the close of the FSECAL, June 30, 1992. Information on the evolution of the balance sheets of the eight insolvent banks during their restructuring or liquidation, including (i) their utilization of recovered assets, (ii) remaining capital and (iii) external (IDA, French and American) funding to pay off depositors -- was not forthcoming. Reliable information which completely separated out bad, from sound, debt recovery was also unavailable, although two audits were attempted by a local auditing firm (*Cabinet* Aziz Dieye) affiliated with Coopers and Lybrand.

Also, the Government of Senegal was slow in reducing the relative size of its participation in BICIS and CNCAS, thereby contributing to a delay in second tranche disbursal.

The BCEAO proved very supportive to the action program to facilitate grass-roots banldng and is currently attempting to extend the experiment to other countries of the UMOA.

Owing to the efforts of the BCEAO and the newly established supervisory agency, the *Commission Bancaire*, there is satisfactory supervision and regulation of the banks remaining in Senegal after the restructuring.

9.2 Lessons learned by the borrower

The borrower became aware of the importance of maintaining detailed accounts and consistent standards of accounting and auditing. Such records promote good financial management, enable the implementation of audits at regular intervals, and are essential to the health and prosperity of a developing financial sector.

10. PROJECT RELATIONSHIP

10.1 Cooperation between the Bank and the Borrower

The Government of Senegal proved to be slow to respond to those conditions for second tranche release which directly involved its own actions. This response retarded the process, making it difficult for the Bank to proceed with the program.

10.2 Cooperation between the Bank and other donors

Relations between the Bank and other donors (France and the United States) were excellent throughout the program.

Relations between the Government of Senegal, the Canadian Agency for International Development (CIDA), and IDA were exemplary throughout the implementation of the mutualist banking technical assistance part of adjustment operation.

11. **CONSULTING SERVICES AND TECHNICAL ASSISTANCE**

The technical assistance, financed by Canada, provided services and studies that were useful to the program.

The audit services were satisfactory, although *Cabinet* Aziz Dieye had to contend with an environment where international accounting standards do not prevail and audits are not a regular practice.

12. **PROJECT DOCUMENTATION**

Not all of the data relevant to the preparation of this PCR were readily available. Relevant data appears to have been lacking for several reasons: (i) the Government, the BCEAO and/or the SNR did not provide it, (ii) record keeping is poor and not done on a regular basis in Senegal.

PART III - STATISTICAL INFORMATION

1. Related Bank Loans and Credits and/or Follow-on Adjustment Operations

Loan/Credit No. &Title	Approval date	Purpose	Status
Cr. 1656-SE SAL II	February 1986	To support a comprehensive action program of policies and measures aimed at accelerating growth in production and employment and strengthening public sector management.	Closed
Cr. 1802-SE SAL III	May 1987	To provide continued support to reforms started under SAL II, and for increasing public resource management.	Closed
Cr. 2909-SE SAL IV	February 1990	To support process of structural reforms began in 1985 by two previous SALs.	Closed
Cr. 2107-SE Agriculture Sector (SECAL)	March 1990	To generate adequate lower risk technology for improving farmers' and herders' incomes in a sustainable manner and undertake priority research programs at the Research Institute (ISRA).	Supervision
Cr. 2266-SE Transport Sector Adjustment	June 1991	Seeking to improve transport efficiency and reduce transport costs.	Supervision

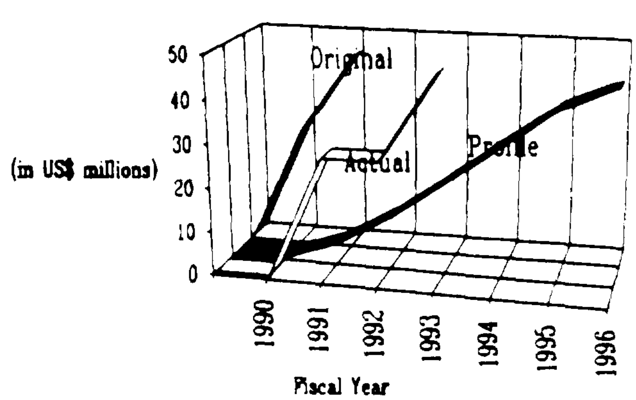
2. Project Timetable

First Mention in Files (as an independent operation)	June 1987
Issues Paper	April 19, 1988
Pre-appraisal	May 2-20, 1988
Letter of Financial Sector Development Policy	November 3, 1989
Appraisal mission	June 15-30, 1989
Negotiations	November 2-3, 1989
Board approval	December 18, 1989
Credit signature	December 18, 1989
Credit effectiveness	December 21, 1989
First tranche available	December 21, 1989
Second tranche release	February 21, 1992
Actual closing date	June 30, 1992

3. Credit Disbursements (in US$ millions)

FISCAL YEAR	QUARTER	ACTUAL CUMULATIVE	PROFILE CUMULATIVE	ORIGINAL CUMULATIVE	ACTUAL % OF TOTAL
1990	II			27.00	0%
	III	18.24		36.00	41%
	IV	22.16	2.25	45.00	49%
1991	I	27.94	4.50		62%
	II	27.94	6.30		62%
	III	28.11	8.10		62%
	IV	27.94	9.90		62%
1992	I	27.94	11.70		62%
	II	27.94	13.50		62%
	III	47.17	15.30		105%
	IV	47.59	18.00		106%
1993	I		20.70		
	II		22.50		
	III		24.30		
	IV		27.00		
1994	I		29.70		
	II		32.40		
	III		35.10		
	IV		36.90		
1995	I		38.70		
	II		40.50		
	III		42.30		
	IV		43.20		
1996	I		44.10		
	II		44.55		
	III		45.00		
	IV				

Senegal Banking Sector / Disbursements



Credit Disbursements

	Disbursement Date	in US$ million	in SDR million	As % of Total
First Tranche	12/21/89	26.8	19.9	56
Second Tranche	02/21/92	20.8	15.4	44
		47.6	35.3	100

4. Mission Data

	Month/Year	No. of Weeks	No. of Persons	Staff Weeks
Preparation	May 1988	2.5	6	15
Appraisal	June 1989	.5	2	1
Negotiations	March 1988	.5	4	2
Supervision I	March 1990	1.5	1	1.5
Supervision II	June 1990	1	3	3
Supervision III	October 1990	1.5	1	1.5
Supervision IV	May 1991	2	1	2

5. Use of Bank Resources

A. Staff Inputs

	LENP	LENA	LENN	SPN	PCR	TOTAL
1988	53.8					53.8
1989	56.0					56.0
1990	16.6	1.3	11.5	39.5		68.9
1991				25.2		25.2
1992				7.0		7.0
1993				7.8		7.8
	126.4	1.3	11.5	79.5	0.0	218.7

STATUS OF LEGAL COVENANTS

Section 3.01(a)	The Borrower and the Association shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program and the actions specified in Schedule 3 to this Agreement.	Fulfilled
(b)	Prior to each such exchange of views, the Borrower shall furnish to the Association for its review and comment a report on the progress achieved in carrying out the Program, in such detail as the Association shall reasonably request.	Nothing in the Bank's files indicates conditions pertaining to bad debt recovery were ever fulfilled. A mission noted in 7/90 that, in order for the second tranche to be released, audited figures on bad debt recovery would be required starting with 6/30/90. Despite two audits financed by USAID, it was never clear whether bad debt recuperation figures included or excluded normal recovery on sound credits. Nevertheless, authorization was given by the Bank for second tranche release.
Section 3.02	Except as the Association shall otherwise agree, procurement of the goods to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 2 to this Agreement.	Fulfilled.
Section 3.03(a)	The Borrower shall maintain or cause to be maintained records and accounts adequate to reflect in accordance with consistently maintained sound accounting practices the expenditures financed out of the proceeds of the Credit.	Fulfilled. Expenditures form the proceeds of the Credit on imported food and petroleum products were audited and found to be in compliance.
(b)	The Borrower shall:	
	(i) have the records and accounts referred to in paragraph (a) of this Section, including those for the Special Account for each fiscal year audited, in accordance with appropriate auditing principle consistently applied by independent auditors acceptable to the Association;	Complied. Audits for 6/30/90, 6/30/91 and 6/30/92 on file.

(ii) furnish to the Association as soon as available, but in any case not later than six months after the end of each such year, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Association shall have reasonably requested; and	Complied
(iii) furnish to the Association such other information concerning said records and accounts and the audit thereof as the Association shall from time to time reasonably request.	Complied
(c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of statements of expenditure, the Borrower shall:	
(i) maintain or cause to be maintained, in accordance with paragraph (a) of this Section, records and accounts reflecting such expenditures;	Complied
(ii) retain, until at least one year after the Association has received the audit report for the fiscal year in which the last withdrawal from the Credit Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;	Complied
(iii) enable the Association's representatives to examine such records; and	Complied
(iv) ensure that such records and accounts are included in the annual audits referred to in paragraph (b) of this Section and that the report of such audit contains a separate opinion by said auditors as to whether the statements of expenditure submitted during such fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals.	Complied

PART II - PROJECT REVIEW FROM BORROWER'S PERSPECTIVE

MINISTRY OF ECONOMY, FINANCE AND PLANNING
DIRECTORATE GENERAL OF THE TREASURY
Directorate of the Currency and Credit

PROJECT COMPLETION REPORT ON THE FINANCIAL SECTOR ADJUSTMENT PROGRAM

This report evaluates the financial sector adjustment program implemented by the Senegalese Government since 1986. It compares the present accomplishments with the objectives that were set at that time, in conjunction with the donors, and assesses the results obtained while noting the main problems encountered during the implementation of the program.

I. OBJECTIVES

Following the acute crisis caused by the lack of liquidity and insolvency of the country's banking system, Senegal had to carry out a vast adjustment program to reorganize its banking sector.

Within this broad context, the program took the form of precautionary measures, the drawing up of a financing plan, and finally, restructuring of the establishments in difficulties and particularly those of the public sector.

This restructuring, which is the key component of the program, consisted of rehabilitation or division operations and resulted in a reduction in the number of establishments and in the degree of state involvement in their management together with a combining of the nonreorganized establishments into a financial recovery institution.

II. EVALUATION OF THE PROGRAM

A. Liquidation operations

The implementation of the financial sector adjustment program led to the liquidation of seven establishments (BNDS - SOFISEDIT - SONAGA- SONABANQUE - ASSURBANK - BSK - USB) compared with five as originally included in the program.

The original intent was in fact for BSK to be rehabilitated on the basis of the plan for dividing USB. An agreement had been concluded with the Kuwaiti party which provided for establishment of a new bank and of a collection company. However, the events that occurred in the Gulf left the Kuwaiti party unable to carry out the terms of the agreement, so the Government proceeded with liquidation of the bank.

The cancellation of the bank agreement was signed on September 21, 1990, and a liquidator was appointed at the same time. The rights of the workers (650 staff let go) and of those of the other banks liquidated have been taken care of by the Government using external financing for the purpose and the frozen claims have been transferred to the single collection company (SNR).

B. Collection Company

The approach first considered was to set up a national collection company in USB and BNDS and a third in BSK.

For reasons of transparency of operations, efficiency of proceedings, cost reduction and standardization of accounting procedures for tracking amounts outstanding (covered by performance criteria), it was ultimately considered desirable to establish a single collection company centered on BNDS and which was made responsible for the portfolios of all the banks concerned, including BSK, and for the frozen claims of BIAOS.

The Société Nationale de Recouvrement (SNR), which has been assigned responsibility for collecting the claims of the institutions in liquidation (BSK - USB - SONAGA - SONABANQUE Group - SOFISEDIT - BNDS and ASSURBANK) collected an amount of CFAF 15 billion (in cash by award and as compensation) between June 1991 and October 1992. Two months from the end of 1992, the collection results were well ahead of the targets set for SNR, i.e. CFAF 12.5 billion.

C. Reduction of Government involvement

One of the essential conditions for implementation of the adjustment program, or rather for the support of the donors concerned, was reduction of the Government's shareholdings in the banks to a level below 25%.

In the event, the set-up adopted by USB with the creation of CLS resulted in a reduction of the Government's interest from 62% to 5%.

As regards CNCAS, the proposal to treat USB's and BNDS' shares as trust funds could not be finalized because the different shareholders approached did not accept this principle (BCEAO-CCCE) or have not yet made a decision (BOAD).

D. Banks which have been rehabilitated

1. Banque Internationale de l'Afrique de l'Ouest du Sénégal (BIAOS)

BIAOS carried out an adjustment plan in 1990 which necessitated mobilization of financial resources by its shareholders.

The financial commitments resulting from this plan have been observed by the parties and the sums received in cash or in the form of claims waived (CFAF 6.7 billion Government of Senegal, CFAF 11.4 billion BNDS and CFAF 0.7 billion BCEAO) have made it possible to rehabilitate the bank with the exception of additional liabilities in an amount of CFAF 8.5 billion to be covered, which has been notified to the Government and to BIAOS.

At the same time, the Government signed an agreement with BIAOS on September 14, 1990, for the recovery of provisioned frozen claims amounting to CFAF 44 billion.

In addition, the adjustment program not only brought about a reduction of the Government's share in the bank's capital to 10%, but also led to the increasing of the MIMRAN group's participation and, finally, purchase of the Government's shares by the MIBL group.

The effect of these measures has been to enable BIAOS to initiate a noteworthy recovery, marked by a significant redeployment of assets, greater involvement in the financing of transactions with other countries and the funding of local agricultural products. The generation of a profit in fiscal 1991 and the sizable investments in the money market bear witness to this.

2. The Caisse Nationale de Crédit Agricole du Sénégal (CNCAS)

The rehabilitation policy pursued in recent years has made it possible to post significant results, having favored among other things a return to profitability and the complete clearing of prior losses, during the financial year closed on September 30, 1990.

However, losses reappeared in 1991/1992 and equity shortfalls of CFAF 4.975 billion were found. These were the reasons which prompted the Ministry of Economy, Finance and Planning to assist CNCAS in reconstituting its resources; a government allocation of CFAF 1.6 billion was accordingly notified to CNCAS for 1993.

3. Crédit Lyonnais du Sénégal (former USB)

The agreement concluded with the former USB enabled CLS to commence it activities on July, 1989, with the taking over of about CFAF 13 billion of deposits against CFAF 7 billion of sound assets from the former USB and CFAF 6 billion subscribed 95% by Crédit Lyonnais and just 5% by the Government.

4. Banque Islamique du Sénégal - BIS (MFIS)

Major financial difficulties caused the bank to draw up a recovery plan as of 1988. The staff was reduced by 16 units as planned. However, the recapitalization was delayed by the failure of the main local shareholder, which was unable to come through with the additional capital. The Government accordingly had to request the BIsD to provide the sum in question, set at CFAF 600 million. The BIsD gave its consent in principle. As a provisional solution the Government channeled stable deposits to the bank in sufficient amount for it to hold until the required part of the capital was released. Even so, finalization of the financial arrangements for this plan took longer than anticipated, obliging the authorities to suspend lending and deposit operations by the bank in 1989 as a precautionary measure.

Following the BIsD's and DMI's decision to participate to the extent of CFAF 900 million and CFAF 1,200 million in the bank's capital increase, its restructuring was to be completed before the end of March 1993.

E. Conclusion: Impact of the Adjustment Program on the Banking System

Today, after six years of execution of the adjustment program, the Senegalese financing system is on the whole in financial balance with a surplus cash position and good profitablilty.

This applies to banks such as CLS, BICIS, SGBS, CITIBANK and BHS. However, as regards BIS, BST, and CNCAS, the success of their rehabilitation is greatly dependent on participation within the time limits set by the donors (ADB, BIsD and CCCE) in the strengthening of their equity fund position.

1. Crédit Lyonnais du Sénégal (CLS)

The financial position of CLS is presently more than satisfactory. This is why it has benefited, since 1989, from a more favorable increase in its ordinary lending operations than the other local institutions.

2. Banque Internationale pour le Commerce et l'Industrie du Sénégal (BICIS)

As regards BICIS, the adjustment program has resulted in the Government no longer holding any part of the bank's capital.

Notwithstanding a satisfactory financial position, BICIS has some equity shortfalls that it has decided to remedy by means of a CFAF 4 billion capital increase over a two-year period.

3. Société Générale de Banques au Sénégal (SGBS)

SGBS, which maintained a satisfactory financial position during the financial system crisis, remains sound and its recent decision to implement a CFAF 7 billion capital increase should enhance this position.

4. CITIBANK

The Banking Commission's most recent reports show a very satisfactory financial position for this bank, with good profitability and observance of the prudential rules.

5. Banque de l'Habitat du Sénégal (BHS)

This bank's position does not give rise to any particular concern. However, it should be noted that its activity appears to be largely subject to real estate developers' capacity to channel their deposits to it. BHS has accordingly decided to utilize the former BNDS' Paris agency.

It must be underscored that the bank's future development prospects will have to take the significant changes that have occurred in the low-cost housing sector sufficiently into account. The fact is that since the early 1990s BHS has undertaken financing of a second generation of low-cost housing, characterized by an appreciable increase in risk resulting in particular from the widening of its clientele drawn from the nonwage-earning informal sector and the gradual exhaustion of strategic land reserves, which is causing it to use more and more distant sites for its programs (Keur Massar - Mbao zone).