# ICR Review

Operations Evaluation Department

Report Number: ICRR10105

| 1. Project Data: | |
|---|---|
| OEDID: | L3191 |
| Project ID: | P008478 |
| Project Name: | Financial System Modernization Project |
| Country: | Hungary |
| Sector: | Financial Sector Development |
| L/C Number: | L3191 |
| Partners involved: | none |
| Prepared by: | David Greene (consultant), OEDCR |
| Reviewed by: | Roger J. Robinson |
| Group Manager: | Ruben Lamdany |
| Date Posted: | 06/30/1998 |

**2. Project Objectives, Financing, Costs and Components :**

The project provided US$ 66 million to support modernization and strengthening of the Hungarian financial system. It was intended to finance technical assistance and equipment required to : (1) strengthen the legislative framework, regulation and supervision of the banking system; (2) develop and implement programs to strengthen participating banks' business strategies, organization, policies and procedures and information systems; (3) develop banking infrastructure, including a national clearing system; (4) promote the securities market; and (5) modernize the country's accounting and auditing framework.

**3. Achievement of Relevant Objectives :**

The objective of strengthening the legal, regulatory and supervisory framework was accomplished. A national clearing system was established, but one that was technically less sophisticated had been proposed in the project. The low cost PC-based system established was, however, able to handle most clearing functions. However, the management of the comercial banks proved not to be fully committed to improvements in organization and management, upgrading of information technology, and credit portfolio audits that were to be major project objectives.

**4. Significant Achievements :**

FSMP played a positive early role in establishing legal and regulatory framework for a modern banking system.

**5. Significant Shortcomings :**

The ownership structure and/or governance of the commercial banks, which were joint stock companies owned by the government, enterprises and "institutional investors" was not identified as a potential issue in the appraisal. The project component designed to strengthen the four participating banks was not entirely successful, despite the fact that "most of the consultants" recommendations were adopted. Although 60 percent of the Bank funds provided for this purpose was disbursed, less than a third of the total cost estimated by the appraisal was spent. There was apparently been no follow-up of the four banks to assess the effects of the project on their financial performance. The banks were eventually privatized, but the ICR does not indicate when. The overall strategy of the bank in the financial sector can be questioned. It might have been better to do a TA operation focusing on bank ownership and banking legislation, regulation and supervision and then followed -up with an adjustment operation centered on privatization. The "synergy" between this 1990 operation and the 1997 EFSAL is difficult to assess.

| 6. Ratings: | ICR | OED Review | Reason for Disagreement /Comments |
|---|---|---|---|
| Outcome: | Satisfactory | Marginally Satisfactory | |
| Institutional Dev .: | Substantial | Modest | Failure to deal with governance issues associated with joint stock companies. |
| Sustainability: | Likely | Likely | |
| Bank Performance: | Satisfactory | Satisfactory | |
| | | | |

| | | | |
|---|---|---|---|
| **Borrower Perf .:** | Satisfactory | Satisfactory | |
| **Quality of ICR :** | | Satisfactory | |

**7. Lessons of Broad Applicability :**
The project seems to demonstrate the need to deal with ownership /privatization issues early in the reform process .

**8. Audit Recommended?** ○ Yes ● No

**9. Comments on Quality of ICR :**
The ICR is satisfactory. However, it is somewhat ambiguous on the "governance" issue. It notes that overlooking this was a major shortcoming of the project, but it is vague about how, specifically it affected the project, rating the institutional development (bank strengthening) component satisfactory.