Report Number: ICRR0022761

1. Project Data

Project ID	Project Name	
P158387	Banking Sector Strengthening Project	
Country	**Practice Area(Lead)**	
Bosnia and Herzegovina	Finance, Competitiveness and Innovation	
L/C/TF Number(s)	**Closing Date (Original)**	**Total Project Cost (USD)**
IBRD-87410	31-Dec-2020	64,741,029.66
Bank Approval Date	**Closing Date (Actual)**	
28-Apr-2017	30-Jun-2021	

	IBRD/IDA (USD)	Grants (USD)
Original Commitment	60,000,000.00	0.00
Revised Commitment	60,000,000.00	0.00
Actual	64,741,029.66	0.00

Prepared by	Reviewed by	ICR Review Coordinator	Group
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2. Project Objectives and Components

a. Objectives

The project development objective of the Bosnia and Herzegovina Bank Strengthening Project was "to improve the soundness of the banking sector by enhancing bank regulation, supervision, and resolution capacity and by enhancing the governance of the entity development banks." Soundness of the banking sector was defined as "compliance with prudential norms and capital adequacy and liquidity as well as the existence of a modern regulatory and supervisory framework."

At the first restructuring of the project, the project development objective was restated as "to improve the soundness of the banking sector by enhancing bank regulation, supervision and resolution capacity and by enhancing the development finance framework for COVID-19 affected enterprises."

This ICR Review parses the project development objective as follows.

Objective 1 - To improve the soundness of the banking sector by enhancing bank regulation and supervision.
Objective 2 - To improve the soundness of the banking sector by enhancing resolution capacity.
Objective 3 (original) - To enhance the governance of entity development banks.
Objective 3 (revised) - To enhance the development finance framework for COVID-19 affected enterprises.

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

Yes

Did the Board approve the revised objectives/key associated outcome targets?

No

c. Will a split evaluation be undertaken?

Yes

d. Components

The project had five components. Each component had two sets of generally similar project activities, outcome and output indicators, disbursement-linked indicators and results, and loan allocations and disbursement target dates, each set pertaining separately to the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS), the two autonomous "entities" comprising the state of Bosnia and Herzegovina (BiH). The two restructuring episodes revised the project components as follows: (a) the first component, Strengthening Banking Regulation and Supervision, added a project activity and results indicator; (b) the original fourth project component, Improving the Governance and Business Model of Entity Development Bank, was dropped and replaced by a new fourth component, Promoting Access to Finance to COVID-19 Affected Enterprises; (c) the fifth component, Additional Technical Assistance (Contingency Funding, received a smaller allocation.

Strengthening Banking Regulation and Supervision (EUR6 million estimated at appraisal each for the FBiH and the RS, EUR8.5 million estimated restructuring each for the FBiH and the RS, EUR8.5 million disbursed at closing each for the FBiH and the RS) aimed to help the Federal Banking Agency (FBA) of the FBiH and the Banking Agency of the Republika Srpska (BARS): (a) to strengthen bank capital adequacy and liquidity requirements that would help banks better withstand solvency and liquidity shocks;
(b) introduce a comprehensive risk appetite framework and the Internal Capital Adequacy Assessment Process (ICAAP) for banks; (c) revise and harmonize the bank supervision systems with the European Union's (EU's) European Banking Authority (EBA) Supervisory Review and Evaluation Process (SREP); and (d) implement the SREP methodology (added at restructuring).

Addressing Weaknesses in the Domestic Banking Sector (EUR7.1 million estimated at appraisal each for the FBiH and the RS, EUR7.1 million estimated at restructuring each for the FBiH and the RS, EUR7.1 million disbursed at closing each for the FBiH and the RS) aimed to help the FBA and the BARS to: (a) enhance the terms of reference for Asset Quality Reviews (AQRs); (b) complete outstanding AQRs, including for 12 banks remaining in the 2017 AQR Phase 3 list; and (c) enforce the results of the completed

AQRs, either through mandatory time-bound corrective-action programs or by resolution and/or liquidation programs for the under-capitalized banks.

Improving the Banking Agencies' Abilities to Undertake Bank Recovery and Resolution Functions (EUR7.1 million estimated at appraisal each for the FBiH and the RS, EUR7.1 million estimated at restructuring each for the FBiH and the RS, EUR7.1 million disbursed at closing each for the FBiH and the RS) aimed to help the FBA and the BARS to: (a) prepare and adopt key bylaws and decisions related bank recovery and resolution; (b) establish and operationalize a dedicated bank resolution unit each within the FBA and the BARS; (c) adopt an internal assessment methodology to evaluate recovery plans; and (d) conduct the subsequent assessment of the recovery plans required to be submitted by all banks to the FBA and the BARS.

Improving the Governance and the Business Model of the Entity Development Banks (dropped at restructuring) (EUR7.1 million estimated at appraisal each for FBiH and RS, EUR0 estimated at restructuring, EUR0 disbursed at closing) aimed to support the: (a) preparation and approval of a strategic vision statement for the Development Bank of the Federation of Bosnia and Herzegovina (RBFBiH); (b) preparation and approval of a business plan for the RBFBiH; (c) alignment of the policies, procedures and organization for risk management of the RBFBiH with the requirements for risk management of the FBA for regulated banks; (d) preparation and approval of a strategic vision statement for the Investment Development Bank of the Republika Srpska (IRBRS); (e) the transfer to the IRBRS of assets managed by the development bank for the RS government – the RS Development and Employment Fund, the Eastern Republic of Srpska Development Fund, the Housing Fund, the Share Fund, the Restitution Fund, and the Real Estate and Claims Fund, collectively known as "the Funds" – if the assets were aligned with the IRBRS strategy; and (f) the compliance by the IRBRS with the bylaws of the BARS governing banking regulation in the RS.

Promoting Access to Finance to COVID-19 Affected Enterprises (added at restructuring) (EUR5.5 million estimated at restructuring each for the FBiH and the RS, EUR5.5 million disbursed at closing each for the FBiH and the RS) aimed to support the adoption of: (a) a strategy statement regulating the future development of the RBFBiH; (b) a draft new Law on the FBIH Development Bank; (c) a decree on an interim partial credit guarantee scheme to ensure the continuation of financing for COVID-19 affected enterprises in the FBiH; (d) a strategy statement governing the future development of the IRBRS; (e) a government decree allowing the establishment of credit guarantee schemes to assist the economy of the RS at times of crises or declared emergencies; and (f) a decision detailing the eligibility and pricing criteria, implementation arrangements, and credit guarantee scheme providing financing to COVID-19 affected enterprises.

Additional Technical Assistance (Contingency Funding) (EUR1.6 million estimated at appraisal, EUR0.2 million estimated at restructuring, EUR0.2 million disbursed at closing) aimed to provide complementary technical assistance to government agencies to achieve the project objectives in areas where there were gaps in the technical assistance provided by other donors including by the World Bank Financial Sector Advisory Centre (FinSAC) (funded by the government of Austria), the U.S. Agency for International Development (USAID) Financial Sector Reform Activity (FINRA) Program, and the United Kingdom (UK) Good Governance Trust Fund.

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

Project Cost. The project was estimated to cost EUR56.6 million (US$60 million equivalent) at appraisal; the cost remained the same at the first and second restructuring.

Financing. The project was financed with an IBRD loan of EUR56.6 million (US$60 million equivalent) to Bosnia and Herzegovina. The loan was fully disbursed (US$64.7 million equivalent). The difference in the US dollar amounts between appraisal and closing was due to changes in the EUR:US$ exchange rate over 2017-2020.

Dates. The project was approved on April 28, 2017, became effective on October 25, 2018, and closed on June 30, 2021, six months after the original closing date of December 30, 2020.

Restructuring. The project was restructured twice. The first restructuring on June 25, 2020, pertaining to the RS only, with US$22.8 million disbursed overall, changed the project development objective, revised the results framework, reallocated the loan proceeds between disbursement categories, changed the project implementation schedule, and postponed the loan closing date. The second restructuring on October 29, 2020, pertaining to the FBiH only, with US$54.5 million disbursed overall, further revised the results framework, reallocated the loan proceeds between disbursement categories, and changed the project implementation schedule.

3. Relevance of Objectives

Rationale

Binding Constraints. Banks in the BiH, which dominated the financial sector and were mostly foreign-owned, remained relatively weak in 2016, almost a decade after the global financial crisis of 2008-09 – asset quality and profitability remained poor, non-performing loans were a high 12.1 percent of GDP, and deleveraging by the parent institutions drained the banks of foreign funding. Altogether, the weak condition of several banks limited the sector's ability to support economic growth – credit growth, which topped an average annual 20 percent in 2004-08, slid to an average annual 2 percent in 2009-16. Revitalizing the banking system required more than just addressing individual bank's weaknesses, however, but needed a restructuring of the regulatory and supervisory system as well as of the recovery and resolution framework that governed the operation and affected the performance of the commercial as well as the development banks.

- Regulation and Supervision. The constitutional and political fragmentation of the BiH – the state consisted of two separate semi-autonomous entities, the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS) – carried over onto banking regulation and supervision. Although there was a unified central bank, the Central Bank of Bosnia and Herzegovina, which conducted monetary policy and issued currency under a currency board arrangement, and a common deposit insurance agency, the Deposit Insurance Agency of Bosnia and Herzegovina, both operating at the BiH level, banking regulation and supervision remained the responsibility of two separate banking agencies, the FBA and the BARS, each operating at the entity level. The institutional fragmentation apart, the bank regulation and supervision system in each entity was outdated, based mainly on Basel I requirements, albeit blended with some elements of Basel II and Basel III, whereas the EU had committed to implement Basel III starting in 2013.

- Weaknesses of Banks. Although system-wide solvency and liquidity ratios were sound – the system-wide capital adequacy ratio of 16.1 percent exceeded the regulatory minimum of 12 percent – there were significant pockets of vulnerability among individual banks. Phase 1 of the Asset Quality Reviews beginning in 2016 led to the liquidation of two banks, Phase 2 resulted in significant additional provisioning requirements, while Phase 3 just started. Overall, the reviews revealed serious bank governance problems and risk management deficiencies, including related-party loans, weak underwriting practices, questionable collateral-valuation methods, evergreening of problem loans, the inability of some shareholders to provide support, and hence a reliance on capital support from the public sector to meet prudential requirements. Moreover, the problems may have been understated as the AQR framework itself appeared to be deficient.
- Recovery and Resolution. The banking agencies FBA and the BARS lacked the framework and the capacity – the organization, bylaws, and methods – to deal with cases of the weak or failing banks, situations that required recovery planning, corrective action, and liquidation and/or resolution.
- Development Banks. Apart from the commercial banks, the two state-owned developments banks in the BiH – the RBFBiH and the IRBRS – faced significant operational and governance challenges. The RBFBiH lent directly to the market, muddling its mandate as a development bank. It was only partially supervised by the FBA because it was incorporated under a separate legislation. Meanwhile, the IRBRS had multiple mandates: it was to act as a development bank, have oversight of state investments, manage the portfolio of state-owned enterprises, and manage six developments funds. It was not supervised by the BARS.

Government Priorities. The project development objectives were consistent with *Reform Agenda for Bosnia and Herzegovina 2015-2018*, which sought to advance the process of rehabilitating and modernizing the economy in the medium term with concrete actions in six areas. The second of these structural reform areas, "business climate and competitiveness," focused, among others, on "efforts to safeguard financial sector stability and create the conditions necessary to revive bank lending." According to the document, "financial sector legislation will be adapted to EU Directives and Basel requirements, as applicable to the level of development of the domestic financial market, and at the same time the oversight of banks will be strengthened by the entity banking agencies."

World Bank Group Strategy. The project development objectives were aligned with the *Country Partnership Framework for Bosnia and Herzegovina for the Period 2016-2020*, which committed Bank Group support in three focus areas. The second of these areas, "building conditions for accelerated private sector growth," emphasized, among others, "work on competitiveness and the business environment – including building a more stable and accessible financial sector, particularly for underserved segments in the market." The document stated that "maintaining the stability of the financial sector is a fundamental condition for maintaining macro-fiscal stability in the country."

Rating
High

4. Achievement of Objectives (Efficacy)

OBJECTIVE 1

Objective

To improve the soundness of the banking sector by enhancing bank regulation and supervision.

Rationale

Theory of Change. The bank regulation and supervision regime in the BiH was outdated, based mainly on Basel I. A modernization toward Basel III would involve an alignment and compliance with the three pillars of Basel III. For Pillar I, *Enhanced Minimum Capital and Liquidity Requirements*, the FBA and the BARS would need to issue new regulations and bylaws updating the capital and liquidity requirements for banks, including for Tier 1 and Tier 2 capital, the capital conservation buffer, counter critical measures, liquidity standards (liquidity coverage ratio and net stable funding ratio), and the capital leverage ratio. For Pillar 2, *Enhanced Supervisory Review Process for Firm-Wide Risk Management and Capital Planning,* it would be important for the FBiH and the BARS to introduce the comprehensive risk appetite framework for banks, adopt the ICAAP, and shift from the current CAMELS ratings-based supervision system to the risk-based SREP of the European Banking Authority. For Pillar III, *Enhanced Risk Disclosure and Market Discipline,* the FBiH and the BARS would strengthen their disclosure regimes. By modernizing bank regulation and supervision, the adoption by the FBiH and the BARS of Basel III would enhance the soundness of the banking sector in the BiH.

Instances of weaknesses in BiH banks needed a systematic response – the improvement of the asset quality review (AQR) methodology and process, the completion of the AQR round for 2017, and the enforcement of the AQR results through mandatory time-bound correction action programs or resolution/liquidation programs for all under-capitalized banks. A revised AQR methodology would have to address issues and weaknesses related to the audit scoping methodology, the collateral valuation methodology, the quality of the audit firms, and hence the quality of the AQR itself. Twelve banks (eight in the FBiH and four in the RS) were yet to be subject to the AQR for 2017, for which revised AQR methodology and process could be applied. Enforcement of the AQR results would complete the process, which would have to be repeated at least annually to maintain vigilance over the risks to financial stability posed by weak banks.

Outputs. The project achieved the ten output targets defined for the objective to improve the soundness of the banking sector by enhancing bank regulation and supervision.

- The quantitative impact study of capital and liquidity regulations was completed and finalized for the FBiH, meeting the target.
- Regulations and bylaws covering capital requirements, liquidity requirements, risk management standards, the ICAAP, and consolidated banking supervision were developed and adopted by the FBiH, meeting the target. The new bylaws empower the banking agency to exercise its supervisory authority over all banks in the system to ensure financial system stability. The regulations and bylaws were published and are publicly available in the FBiH website (https://www.fba.ba/eng/regulations-banks).
- A new risk-based SREP methodology, aligned and harmonized with European Banking Authority standards, was adopted by the FBiH in December 2019 after testing the new methodology on commercial banks over a period of six months, meeting the target.
- The quantitative impact study of capital and liquidity regulations was completed and finalized for the BARS, meeting the target.

- Regulations and bylaws covering capital requirements, liquidity requirements, risk management standards, the ICAAP, and consolidated banking supervision were developed and adopted by the FBiH, meeting the target. The new bylaws empower the banking agency to exercise its supervisory authority over all banks in the system to ensure financial system stability. The regulations and bylaws were published and are publicly available in the BARS website (https://abrs.ba/en/podzakoni-banks/c11).
- A new risk-based SREP methodology, aligned and harmonized with European Banking Authority standards, was adopted by the BARS after testing the new methodology on commercial banks over a period of six months, meeting the target.
- The FBA adopted a harmonized AQR framework for the 2017 AQR and approved the final AQR reports on all eight banks in the FBiH not previously subject to the revised AQR methodology, meeting the target.
- None of the FBiH banks subjected to the AQR were determined to be under-capitalized, hence no mandatory time-bound corrective action plan or resolution/liquidation plan was needed. This met the target that all under-capitalized banks have in place either a mandatory time-bound corrective action program or a resolution/liquidation program. However, some of the eight FBiH banks were required to post additional loan loss reserves because of loan impairment.
- The BARS adopted a harmonized AQR framework for the 2017 AQR and approved the final AQR reports on all four banks in the RS not previously subject to the revised AQR methodology, meeting the target
- None of the RS banks subjected to the AQR were determined to be under-capitalized, hence no mandatory time-bound corrective action plan or resolution/liquidation plan was needed. This met the target that all under-capitalized banks have in place either a mandatory time-bound corrective action program or a resolution/liquidation program.

Outcomes. The project achieved the four outcome targets defined for the objective to improve the soundness of the banking sector by enhancing bank regulation and supervision.

- All banks in the FBiH were well-capitalized, with each bank meeting regulatory capital adequacy requirements, hence achieving the target.
- In line with the updated legal and regulatory system, the FBA is able to review and efficiently respond to cases when banks do not meet prudential norms for capital adequacy, according to the ICR, hence meeting the target. The banks in the FBiH all met the prudential norms for capital adequacy and action plans for either corrective action, liquidation, or resolution were not needed, according to the ICR.
- All banks in the RS were well-capitalized, with each bank meeting regulatory capital adequacy requirements, hence achieving the target.
- In line with the updated legal and regulatory system, the BARS is able to review and efficiently respond to cases when banks do not meet prudential norms for capital adequacy, according to the ICR, hence meeting the target. The banks in the RS all met the prudential norms for capital adequacy and action plans for either corrective action, liquidation, or resolution were not needed, according to the ICR.

Additional Information.

- Overall, the regulatory capital to risk-weighted assets ratio for BiH banks improved over the period covered by this project from 15.68 percent in 2017 to 19.18 percent in 2020, and the liquid assets to total assets ratio (liquidity ratio), from 28.37 percent in 2017 to 29.11 percent in 2020, according to International Monetary Fund (IMF) Financial Soundness Indicators database (these data update the numbers cited in the ICR, page 19).
- The bank regulatory and supervisory system in each entity is now aligned with Basel III, according to the ICR.

Rating
High

OBJECTIVE 1 REVISION 1

Revised Objective
To improve the soundness of the banking sector by enhancing bank regulation and supervision (the first objective was not revised).

Revised Rationale
Theory of Change. The theory of change after restructuring remained the same as before restructuring.

Outputs. In addition to the ten output targets achieved before restructuring, the project achieved the two additional output targets introduced with the restructuring.

- The SREP operational procedure was adopted by the FBA, meeting the target. The SREP methodology and operational procedures were used by the FBIH to supervise all 15 banks operating in the FBiH beginning in January 2020, according to the ICR.
- The SREP operational procedure was adopted by the BARS, meeting the target. The SREP methodology and operational procedure were used by the BARS to supervise all eight banks operating in the RS by August 2020, including to supervise those banks off-site, according to the ICR.

Outcomes. The project achieved the same four outcome targets before and after restructuring.

Additional Information. The additional information pertaining before restructuring applied after restructuring.

Revised Rating
High

OBJECTIVE 2

Objective
To improve the soundness of the banking sector by enhancing resolution capacity.

Rationale

Theory of Change. The BiH lacked the independent organization, the legal framework, and the effective toolkits to deal with recovery planning at all banks and liquidation and/or resolution at failed or failing banks. To build the core elements of a recovery and resolution regime, the FBiH and the RS would need to create, staff, and resource independent resolution units, which, even if housed in banking agencies, would operate at an arms-length from monetary policy and from bank supervision and would be responsible for taking resolution decisions on "public interest" banks for which the normal bankruptcy or liquidation procedure would not be an option. The FBiH and RS governments and the FBiH and the BARS would need to pass the laws and issue the bylaws governing the resolution framework, including the availability of the resolution tools – bail-in, sales of business to a private acquirer, bridge bank, and asset separation – that would be aligned with the Financial Sector Board's *Key Attributes for Effective Resolution Regimes* and the EU's *Bank Recovery and Resolution Directive* (BRRD). Because a separate resolution fund would not be immediately created (albeit a Financial Stability Fund had been proposed by the 2014 FSAP), the cost of any resolution would have to be borne by the bailed-in liability holders, the Deposit Insurance Agency, and if need be by the entity budgets. Meanwhile, in addition to their other supervision duties, the banking agencies would oversee the recovery planning system, including by prescribing the methodology for assessing recovery plans and by evaluating the recovery plans submitted by the banks. With these reforms, the BiH would enhance the resolution capacity of the regulators and supervisors and hence the soundness of the banking sector itself.

Outputs. The project achieved all six output targets defined for the objective to improve the soundness of the banking sector by enhancing resolution capacity.

- The FBA adopted regulations on bank resolution and recovery plans, meeting the target. Eleven regulations ("decisions") on bank resolution are posted in the FBA website.
- The FBA established and made operational a resolution unit, the Bank Resolution Division, with an expert advisory body, the Resolution Committee, in February-March 2019, meeting the target. The division is operational, with its own statute and rules of internal organization.
- The number of recovery plans submitted by banks to FBiH and assessed by FBiH in line with the internal assessment methodology was 15, meeting the target.
- The BARS adopted on bank resolution and recovery plans, meeting the target. Twelve regulations ("decisions") on bank resolution are posted in the BARS website
- The BARS established and made operational a resolution unit, meeting the target.
- The number of recovery plans submitted by banks to the BARS and assessed by the BARS in line with the internal assessment methodology was eight, meeting the target.

Outcomes. The project achieved the two outcome targets defined for the objective to improve the soundness of the banking sector by enhancing resolution capacity.

- The FBA is performing its legally mandated technical functions in bank resolution, according to the ICR, meeting the target. Each of the 15 banks operating in the FBiH continue to submit their recovery plans to the FBA following the newly-developed internal assessment methodology adopted by the FBA, according to the ICR.
- The BARS is performing its legally mandated technical functions in bank resolution, according to the ICR, meeting the target. Each of the 8 banks operating in the RS continue to submit their recovery plans to the BARS following the newly-developed internal assessment methodology adopted by the BARS, according to the ICR.

Rating
High

OBJECTIVE 2 REVISION 1

Revised Objective
To improve the soundness of the banking sector by enhancing resolution capacity.

Revised Rationale
No change. As outlined above.

Revised Rating
High

OBJECTIVE 3

Objective
To enhance the governance of entity development banks.

Rationale
Theory of Change. The two state-owned development banks in the BiH – the RBFBiH and the IRBRS, which did not take deposits but performed lending and investment functions and were either only partly or not at all regulated or supervised by the banking agencies – suffered from serious defects and deficiencies with their institutional mandates, corporate governance structures, operational and financial performance, and risk management practices. A comprehensive reform and restructuring of the development banks, starting with the enactment by the entity Parliaments of new legislation to govern the development banks (part of the structural benchmarks of the IMF EFF arrangement of 2017-19), would consist of: the adoption by the entity governments of strategy statements clarifying the mandates of the development banks; restructuring the balance sheets of the banks including by transferring certain managed assets to the bank, in the case of the IRBRS; strengthening the supervisory boards and committees of the two banks in line with international best practice; introducing independent and comprehensive risk management practices; strengthening the internal audit function and staffing; and subjecting the development banks to the same regulatory and supervisory standards as commercial banks, with some exceptions. These changes should enable the RBFBiH and the IRBRS to increasingly act as wholesale (rather than retail) credit and guarantee institutions and eventually fulfill their functions as "national promotional banks" envisaged by the EC to catalyze long-term investment in the EU member states.

Outputs. The project achieved two of the six output targets defined for the objective to enhance the governance of entity development banks.

- The FBiH government adopted the draft FBiH Development Bank Law in April 2021, which it submitted to Parliament in June 2021, and adopted the strategy statement to govern the future development of the RBFBIH in June 2021, meeting the target. The strategy statement committed the RBFBIH to: comply with the Banking Law; be supervised by the FBA under a regulatory scheme adapted to the bank's funding model; conform to the regulations of the FBA pertaining to corporate governance and risk management; operate predominantly as a wholesale institution; and operate on a financially sustainable basis.

- The shareholders assembly of the RBFBiH did not approve the RBFBiH business plan for 2018-2020, drafted in line with the government's strategy statement for the development bank, failing to meet the target.
- The RBFBiH did not adopt measures to align its risk management organization, reporting lines, policies, and procedures with those required for FBA-regulated banks, failing to meet the target.
- The RS government approved the strategy statement governing the future development of the IRBRS in May 2021, meeting the target. The strategy statement committed the IRBRS to: conform to the regulations of the BARS pertaining to corporate governance and risk management; operate as a wholesale institution; and operate on a financially sustainable basis.
- The IRBRS did not adopt measures to align its regulations with applicable BARS regulations, failing to meet the target.
- The RS government did not transfer of identified Funds' assets to IRBRS in compliance with (a) the amended IRBRS Law and (b) IRBRS regulations and the BARS bylaws governing the application of banking regulations to IRBRS, failing to meet the target.

Additional Information.

- The controversy over the general election in the BiH in 2018 (over the three-member Presidency) and the subsequent failure to form a new government in the FBiH delayed the development bank reforms. The lack of a new formal government in the FBiH delayed the adoption of the strategy statement for the future development of the RBFBiH, a disbursement-linked result that was originally set to be delivered by end-December 2017. Meanwhile in the RS, while working groups were formed to initiate the development bank reforms, a lack of consensus delayed the adoption of the strategy statement for the future development of the IRBRS, a disbursement-linked result that was also originally set to be delivered by end-December 2017.

Rating
Modest

OBJECTIVE 3 REVISION 1

Revised Objective
To enhance the development finance framework for COVID-19 affected enterprises.

Revised Rationale
Theory of Change. As elsewhere globally, the outbreak of the COVID-19 pandemic caused an economic downturn in the BiH in 2020. Bank lending fell 2.1 percent in 2020 in nominal terms after growing an average 6.5 percent annually in 2017-19. In particular, bank lending to the non-financial private sector contracted 4.9 percent in 2020 following growth rates of 5.5 percent annually in 2017-19. In addition to sizable financial support to severely affected firms, and loan moratoria to ease liquidity constraints (starting in April 2020 in the FBiH and RS and lasting up to six months for banks and 6-12 months for leasing and microcredit institutions), the extension of partial credit guarantees would help ease tight financial conditions in the BiH. The offering of

a partial credit guarantee scheme by the RBFBiH and the RS Guarantee Fund, set within the framework of continuing reforms of the development finance institutions albeit on long-term timeline, would help improve the ability of the development banks to provide financial services to COVD-19 affected institutions in the immediate term and to other enterprises in future emergencies or extra-ordinary situations.

Outputs. The project achieved the five output targets defined for the objective to enhance the development finance framework for COVID-19 affected enterprises.

- The FBiH government adopted a bylaw ("decision") in July 2020 (Gazette No. 44/20) detailing the eligibility and pricing criteria and the implementation arrangements for a temporary partial credit guarantee scheme providing financing to Covid-19 affected enterprises, meeting the target. The guarantee scheme was housed in the RBFBiH as a product offering called the Federation Guarantee Fund (FGF). The FGF was capitalized at Bosnia-Herzegovina Convertible Mark (BAM) 100 million and became operational in November 2020.
- The FBiH government adopted the draft FBiH Development Bank Law in April 2021, which it submitted to Parliament in June 2021, and adopted the strategy statement to govern the future development of the RBFBiH in June 2021, meeting the target. The strategy statement committed the RBFBiH to: comply with the Banking Law; be supervised by the FBA under a regulatory scheme adapted to the bank's funding model; conform to the regulations of the FBA pertaining to corporate governance and risk management; operate predominantly as a wholesale institution; and operate on a financially sustainable basis.
- The RS government adopted in government decree in May 2020 (RS Official Gazette No. 44/20) on a temporary partial credit guarantee scheme providing financing to COVID-19 affected enterprises, meeting the target. The guarantee scheme was housed outside the IRBRS, but inside the Republika Srpska Guarantee Fund (RSGF) as a separate fund called the Republika Srpska Guarantee Program (RSGP). The RSGP was it was capitalized at BAM 50 million and became operational in November 2020.
- The RS government adopted a bylaw ("decision') in July 2020 (RS Official Gazette No. 64/20) detailing the eligibility and pricing criteria and the implementation arrangements for the temporary partial credit guarantee scheme providing financing to Covid-19 affected enterprises, meeting the target.
- The RS government approved the strategy statement governing the future development of the IRBRS in May 2021, meeting the target. The strategy statement committed the IRBRS to: conform to the regulations of the BARS pertaining to corporate governance and risk management; operate as a wholesale institution; and operate on a financially sustainable basis.

Outcomes. The project achieved the two outcome targets defined for the objective to enhance the development finance framework for COVID-19 affected enterprises.

- The development finance framework for COVID-19 affected enterprises in the FBiH was enhanced, meeting the target. The partial credit guarantee scheme was operationalized, the eligibility and pricing criteria were applied as planned, and implementation arrangements were followed as planned, according to the ICR.
- The development finance framework for COVID-19 affected enterprises was enhance in the RS, meeting the target. The partial credit guarantee scheme was operationalized, the eligibility and pricing

criteria were applied as planned, and implementation arrangements were followed as planned, according to the ICR.

Additional Information.

- The draft FBiH Development Bank Law, which was submitted to Parliament in June 2021, was passed by the House of Representatives, but has not been adopted by the House of People as of end-2021. The House of People raised questions at the first reading that the government needs to address.
- The uptake of the guarantees was initially low – guarantees by the FGF were equal to only 12.9 percent of capacity, and by the RSGP, only 5 percent of capacity, in April 2021. Since then, the original eligibility criteria have been loosened. By September 2021, the FGF had issued 108 guarantees with a nominal value of BAM 63 million, and the RSGP, 287 guarantees with a nominal value of BAM 25 million.

Revised Rating

High

OVERALL EFFICACY

Rationale

The efficacy of the project before restructuring was substantial. The project achieved 18 of the 22 output targets and all 6 outcome targets for the original objective.

Overall Efficacy Rating

Substantial

OVERALL EFFICACY REVISION 1

Overall Efficacy Revision 1 Rationale

The efficacy of the project after restructuring was high. The project achieved all 23 output targets and all 8 outcome targets for the revised objective.

Overall Efficacy Revision 1 Rating

High

5. Efficiency

Economic Efficiency. The Project Appraisal Document did not conduct a formal economic analysis of the project. Instead, it simply listed the presumptive economic benefits that would be derived from the project, and, separately, the explicit and implicit costs that would be avoided with the successful implementation of the project. According to the PAD (pages 19-20), the banking reforms would: increase confidence in the banking system; channel more domestic savings through the banks; attract EU banks because of the harmonization of domestic banking regulations with EU standards; introduce capital buffers (especially vital to systematically important banks); enhance liquidity risk controls for financial stability; minimize the chances of a systemic banking crisis; better intermediate savings for productive investment; and ultimately promote growth and employment. The banking reforms would avoid the following costs – losses to uninsured depositors and other creditors, as a result of bank failures, and fiscal losses as a result of investments by the state-owned development banks in the commercial banks, in the case of commercial bank failures.

The ICR (page 26) did not conduct a formal economic analysis of the project either. Rather, it argued that the project was cost-efficient with regards to the following terms: (a) two bank failures in 2014 and 2016 resulted in payouts from the Deposit Insurance Agency of EUR71.7 million; (b) the bank failures also inflicted other costs as bankruptcy proceedings dragged on; (c) this project, which aimed to strengthen the bank regulation and supervision regime, the asset quality review and corrective action system, and the recovery planning and resolution framework and, hence, enhance the soundness of the banking system and avert bank failures, would cost EUR56.6 million; (d) in this sense, the economic efficiency of the project could be judged as substantial.

Though this response fails to sufficiently quantify the economic benefits and costs, the project team drew on a number of additional sources of evidence to triangulate and support the project's efficiency rating. The Financial Stability Board and the Basel Committee on Banking Supervision state that strong capital liquidity requirements bring substantial benefits with only modest costs. The aim of BSSP's project activities was to strengthen supervision capacity of both banking agencies. There is existing financial research literature (New York Fed and BIS articles) documenting how the strengthening of financial regulation and supervision and its inherent ability to determine adequate capital (quantitative and qualitative bank capital) can prevent a banking crisis. Depending on the economic model assumptions, there are estimates that a financial crisis could lead to a decline in GDP of 1.5 to 2.4 percent and a banking crisis could result in substantial foregone GDP losses. Improved supervisory powers and strengthening bank capital requirements can also improve the efficient operation of banks. Thus, the overall strengthening of the financial supervision capacity is crucial to the safeguarding of the financial system and ensures considerable upside in terms of efficiency gains for the relatively modest investment. On a practical note, as of today, related to the Russia sanctions within the financial sector, both banking agencies have demonstrated improved competencies by mitigating the negative impacts of Sberbank within BiH. This provides further evidence of the efficiency benefits of the designated funds and how they've been directed. Thus, the economic analysis on balance justifies a Substantial rating.

Operational Efficiency. The project experienced implementation delays. It took 18 months for the project to become effective in the RS, and 36 months in the FBiH. The delay did not, however, affect the results of the first, second, and third components of the project as all results targets were delivered by October 2020, three months before the original closing date of December 20, 2020. The World Bank extended the original closing date by six months to allow the completion of the revised fourth component of the project following the restructuring in June and October 2020. All results targets for the revised fourth component were eventually met. The project funds were fully disbursed.

Efficiency Rating

Substantial

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

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

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

6. Outcome

The outcome of the project is rated satisfactory.

	FBiH		RS	
	Original Objectives	Revised Objectives	Original Objectives	Revised Objectives
Relevance of Objectives	High			
Efficacy				
Objective 1 - To improve the soundness of the banking sector by enhancing bank regulation and supervision	High	High	High	High
Objective 2 - To improve the soundness of the banking sector by enhancing resolution capacity.	High	High	High	High
Objective 3 (original) - To enhance the soundness of the banking sector by enhancing the governance of entity development banks Objective 3 (revised) - To enhance the soundness of the banking sector by enhancing the development finance framework for COVID-19 affected enterprises	Modest	High	Modest	High
Overall Efficacy	Substantial	High	Substantial	High
Efficiency	Substantial			
Outcome Rating	Satisfactory	Highly Satisfactory	Satisfactory	Highly Satisfactory
Outcome Rating Value	5	6	5	6
Amount Disbursed, US$ million	11.4	18.6	27.3	2.7
Disbursement, %	19	31	46	4
Weight Value	0.8	1.2	1.8	.2
Total Weights	5			

Overall Outcome Rating	Satisfactory

a. **Outcome Rating**
Satisfactory

7. Risk to Development Outcome

The risk to development outcome is low. The development outcome that has been achieved in this project is likely to be maintained. In fact, the results of the project activities were acknowledged by the EC as being EU equivalent, which will reinforce the sustainability of the reforms for the medium-long term future. There is a low likelihood that some changes may occur that are detrimental to the ultimate maintenance of achievement of the operation's development outcome.

Political Risk. The complex constitutional set-up and difficult inter-governmental relations in the BiH continue to pose substantial political risks to the sustainability of the project outcomes. The separation of banking regulation and supervision between the FBA and the BARS implies that high levels of coordination between the banking agencies will continue to be necessary moving forward, considering that most banks operate throughout the BiH. Inter-agency coordination will likely remain challenging, however, under the current political setting. Moreover, because the reforms achieved with this project will need to be reinforced with second and subsequent rounds of future reforms, inter-parliamentary cooperation will also be required to enact additional banking legislation. But like inter-agency coordination, inter-parliamentary coordination also faces considerable political hurdles. For example, amendments to the deposit insurance law and to the entity banking laws are needed to create the Financial Stability Fund, recommended by the 2014 FSAP to complete the banking resolution framework. The Financial Stability Fund is crucial to the BiH as the BCCB is unable to act as lender of last result because of the currency board arrangement for monetary policy. But the FBiH and the RS differ widely on their stances with the proposed Financial Stability Fund, according to the *IMF Staff Report on the Bosnia and Herzegovina 2020 Article IV Consultation*.

Institutional Capacity Risk. The FBiH and RS governments and the banking agencies FBA and BARS received considerable technical assistance in the implementation of this project, partly reflecting the agencies' lack of experience and technical expertise to implement the banking reforms, particularly in highly technical fields including risk appetite frameworks, recovery plan assessments, and resolution toolkits. Continued technical assistance to the BiH – from the IMF on the 2014 FSAP recommendations and the EFF structural benchmarks, the FinSAC on the operationalization of the resolution framework, the USAID FINRA program on the harmonization of banking supervision with EU standards, and the UK Good Governance Trust Fund on development bank reforms – should help mitigate the institutional capacity risk over the medium to long term.

Macroeconomic Risk. Economic growth is expected to rebound to 4 percent in 2021 and stabilize at an annual average 3.1 percent in 2022-23 after contracting by 3.2 percent in 2020, the downturn largely due to domestic containment and external spillovers associated with the COVID-19 pandemic. The recovery in the fiscal and external accounts is projected to be more gradual, however, with the fiscal balance not expected to return into surplus until 2023 and the current account balance remaining in deficit in the near-term albeit at a narrowing rate. The baseline outlook is dependent on the success of the COVID-19 vaccination effort (only 27 percent of the adult population was vaccinated at the end of the third quarter of 2021) and on the state of politics at the national and entity levels, according to the World Bank *Macro Poverty Outlook* of October 2021. Any negative outturn in these areas risks downgrading the near-term economic prospects, with adverse impacts on the ability of banks to revive lending and maintain financial system stability.

8. Assessment of Bank Performance

a. Quality-at-Entry

Analytical Foundations. The project design was informed by analytical work produced by the joint IMF and World Bank Financial Sector Assessment Program (FSAP) mission to BiH in 2014. For the banking sector, *The Bosnia and Herzegovina Financial System Stability Assessment* report, finalized in 2015, recommended improvements in banking oversight through the enactment of new banking legislation to strengthen supervisor's powers, the introduction of consolidated supervision, and the improvement of corporate governance and risk management at banks. The report encouraged decisive and timely actions to deal with weak banks, informed by credible diagnostic assessment and focused on a strategy to either facilitate the recovery of these banks or to resolve them in a cost-effective manner. The report also recommended reinforcing the financial safety net by creating an appropriate bank resolution framework and toolkit. These recommendations underpinned the first three components of the project. Meanwhile, the IMF and World Bank technical assistance mission to BiH in 2016 focusing on the fiscal oversight of the development banks revealed deficiencies in the mandates, objectives, governance, risk management, and operational transparency of the development banks and highlighted the need to reform the development banks. These findings and recommendation underpinned the fourth component of this project.

Stakeholder Consultation. The specific reforms supported by this project were drawn from the FBA's and the BARS's own FSAP implementation action plans. The project design also called for adherence to the BiH *Regulation on Consultations in Legislative Drafting* (Official Gazette of BIH, no 81/06 and 80/14) which mandated all ministries and agencies to consult with the general public and stakeholder organizations when drafting any legislative proposal. For this purpose, the FBA and the BARS would post all draft bylaws on their websites, while this project would ensure that records were kept of all comments and suggestions received and explain how the issues raised by stakeholders were addressed in the final legislation or regulation. At the time of the project’s appraisal, the government’s commitment to the development of bank reforms was high. This was evidenced by an agreement reached with the IMF for an Extended Fund Facility in May 2016. The authorities committed – with assistance from the IMF and the WB - to address weaknesses in the banking sector and reform the entity development banks as well as make progress in preparing new legal frameworks governing the Entity development banks. At the technical level, during the time of the project’s appraisal, the Entity governments were preparing drafts of new legislation governing the development banks to address the identified deficiencies in consultation with the World Bank. The new legislation was expected to be enacted in mid-2017.

Donor Coordination. The Word Bank coordinated the design of the project with the IMF, the European Bank for Reconstruction and Development (EBRD), USAID, the Kreditanstalt fur Wiederaufbau, and the EU. As these donors were engaged in various reform initiatives in the BiH, including in the financial sector, the Word Bank sought to ensure consistency between the reforms endorsed by this project and those supported by the other donor programs. For example, the three-year arrangement under the Extended Fund Facility approved by the IMF for SDR 443 million in 2016 aimed, among others, to safeguard financial sector stability and revive bank lending by improving the efficiency and effectiveness of banking supervision, including through better coordination and cooperation among the regulatory agencies, and by closely monitoring bank vulnerabilities. Some structural benchmarks of the EFF arrangement – the adoption by the BiH Parliament of a new draft Law on Banks and amendments to the Banking Agency Law – would provide the legal framework for improvements in banking regulation, supervision, and resolution in the FBiH and RS.

Implementation Plan. The World Bank prepared adequate plans for the implementation of the project. Subsidiary agreements (between the BiH and the FBiH, and the BiH and the RS) and project implementation agreements (between the FBiH the FBA, the FBiH and the RBFBiH, the RS and the BARS, and the RS and the IRBRS) would be executed to govern the implementation of the project. The BiH would create Project Implementation Teams at the FBiH and RS, the composition, functions, and resources of which would need to be acceptable to the World Bank. The FBiH and the RS would adopt Project Operations Manuals, the contents of which would also need to be acceptable to the World Bank and which would detail the project activities (eligible expenditure programs of the FBiH and RS), roles and responsibilities of all entities in the project, M&E indicators, verification protocols for the disbursement linked indicators and disbursement linked results, procurement procedures, and financial management processes. Disbursements of the loan funds would be made against the disbursement-linked indicators defined in the Loan Agreement (if a disbursement-linked indicator were not met on its due date, the loan amount allocated to the disbursement-linked result would remain available until the result was met or the amount was cancelled by the World Bank).

Risk Analysis and Mitigation. The World Bank analyzed the implementation risks faced by the project and advanced mitigation measures that were reasonably adequate to address these risks. For political and governance risk, which it rated substantial, the PAD (page 18) argued that the universal agreement among the donors on primacy of the reforms and the continued active engagement and policy dialogue by the donors with the FBiH and RS governments would strengthen the political commitment of the BiH to the reform measures despite the complex constitutional set-up and political dynamics in the country. To address technical design risk, also rated substantial, operational advice from the donors, technical assistance from external consultants, and intensive supervision by the World Bank would help the FBA, BARS, RBFBiH, and IRBRS deliver on the disbursement linked results, according to the PAD. Moreover, should the financing for technical assistance provided by FinSAC and the UK Good Governance Trust Fund be insufficient, the BiH could draw resources from the technical assistance component of this project. To help mitigate institutional capacity risk, the Project implementation Teams at the Ministries of Finance in the FBiH and RS would help shore-up institutional capacity constraints at the FBA and the BARS which had not had any experience implementing World Bank projects.

Project Ambition. The level of ambition of the original fourth component of the project, Improving the Governance and the Business Model of the Entity Development Banks, was set higher than what could be achieved given the degree of political commitment of the FBiH and RS governments to the reform of the development banks. Adverse political developments in the FBiH and a lack of political consensus in the RS delayed policy decisions on the future of the development banks, necessitating a restructuring of the fourth component of the project. However, the government and World Bank found a way forward in mitigating this shortcoming and worked together in pitching the project at the right level to ensure desirable outcomes.

Given the significant government buy-in and the clear analytical line of sight for the project, overall quality at entry is rated Highly Satisfactory.

Quality-at-Entry Rating
Highly Satisfactory

b. Quality of supervision
The quality of supervision was high. The candor and performance reporting of the ISRs and Aide Memoires within the project's files were of high quality. The Bank team remained technically engaged while the lengthy ratification process continued for an extended period after Board approval. This ensured that technical progress was not negatively hampered by the ratification delays.

Supervision. The World Bank produced nine Implementation Status and Results Reports (ISRs) over the September 2017 to June 2021, about the average two-a-year for investment financing projects. Implementation support missions also filed six highly-informative and substantive Aide Memoires, many jointly with FinSAC technical assistance missions. The World Bank conducted amid-term review in May 2019.

Adaptation. The World Bank was proactive in identifying and helping resolve project implementation issues, based on evidence from the ISRs and the Aide Memoires. The World Bank remained actively engaged with the FBiH and the RS governments in the ratification of the project, which turned out to be a lengthy process involving some 19 steps and taking 18 months for the RS to complete (the project became effective in the RS in October 2018 after Board approval in April 2017) and 36 months for the FBiH (the project became effective in the FBiH in April 2020), practically reducing the project implementation timeline to 32 months for the RS and 14 months for the FBiH. The World Bank restructured the project for the RS in June 2020 and for the FBiH in October 2020 to revise the fourth component of the project following the lack of progress with the development bank reforms.

Quality of Supervision Rating
Highly Satisfactory

Overall Bank Performance Rating
Highly Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design
The Project Appraisal Document (pages 27-30) defined nine outcome (PDO-level) indicators to measure the achievement of the project development objectives. The indicators were well-defined (descriptions were provided in the results framework), were measurable with baseline values and annual and end-line targets, and had identifiable data sources (project reports) and parties responsible for data collection.

The PAD (pages 31-38) also defined 24 output (intermediate results) indicators that were similarly well-defined, were measurable with baseline values and annual and end-line targets, and had identifiable data sources (project reports) and parties responsible for data collection. These indicators also served as disbursement-linked results, the achievement of which would trigger disbursement of the loan funds by the dates and in the amounts set in the Loan Agreement.

The M&E plan called for the Project Implementation Teams at the FBiH and the RS to collect the data required for M&E and verify the disbursement-linked results using the verification protocol outlined in the PAD and Project Operations Manuals. The Ministries of Finance at the FBiH and RS would then measure indicators against the agreed targets, compare the results to the baseline data, tally the results in semi-annual project progress reports, and submit the reports to the World Bank.

b. M&E Implementation

During restructuring, the World Bank: (a) added two output indicators and disbursement-linked results to the first component of the project; (b) retained two, dropped four, and added two output indicators and disbursement-linked results to the fourth component of the project; (c) added two outcome indicators to the fourth component of the project.

According to the ICR, during project implementation: (a) the M&E data were collected in a timely manner by the Project Implementation Teams; (b) were recorded diligently and analyzed methodically; (c) and were used effectively for the purposes set in the M&E plan – monitoring of the project results, disbursement of the project funds, and decision-making with conduct and direction of the project.

c. M&E Utilization

According to the ICR, the M&E data were especially useful for the restructuring of the project. The FBiH and RS governments had not made progress with the strategy statements and other planned reforms for the development banks RBFBiH and ISRBS. Meanwhile, the outbreak of the COVID-19 pandemic caused an economic contraction and a credit crunch in the BiH, necessitating a policy response from the government. The M&E data were useful for the course correction, according to the ICR (page 30).

M&E Quality Rating

High

10. Other Issues

a. Safeguards

Environmental Safeguards. The project was classified as an Environmental Assessment category "C" project at appraisal and did not trigger any World Bank environmental safeguards policy. Environmental and social risk was rated as low in the PAD (page iii). There were no substantial environmental issues during project implementation that negatively affected the project's performance or outcome, according to the ICR (page 30). Environmental and social risk remained low at closing.

Social Safeguards. The project was not expected to have negative social effects at appraisal and did not trigger any World Bank social safeguards policy either. It was unlikely that any social group would be adversely affected by reforms to the institutional, legal, and regulatory frameworks for banks, according to the PAD (page 24). Creating and implementing laws, by-laws, and measures that strengthened the regulation and supervision of banks would promote a stable financial system that enabled access to finance and hence promoted economic growth and shared prosperity, according to the ICR (pages 27-28).

b. Fiduciary Compliance

Procurement. Procurement, principally of consultant services under the technical assistance component and some goods associated with consulting services (no procurement of works was planned), would follow standard World Bank guidelines, according to the PAD (page 62). Procurement risk was rated moderate at appraisal, as the implementing agencies had no experience with Bank procurement. There were no procurement issues during implementation, according to the ICR (page 30), and procurement remained satisfactory throughout project implementation.

Financial Management. The design of the project called for the application of a results-based financing instrument, with a set number of disbursements against disbursement-linked indicators (DLIs). The financial management arrangements namely project financial management staffing, planning, budgeting, internal controls, accounting, reporting, and project audits were acceptable to the Bank throughout the project. The project implementing units were submitting their interim unaudited financial reports timely and such reports have been found acceptable. The audit reports were also submitted on a timely basis and the audit opinions were unqualified for the entire project duration. There were no internal control deficiencies or accounting issues in the management recommendations letters which were prepared by the auditors.

Fiduciary risk was rated moderate at appraisal. Financial management remained satisfactory throughout project implementation.

c. Unintended impacts (Positive or Negative)

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d. Other

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11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Satisfactory	Satisfactory	

Bank Performance	Highly Satisfactory	Highly Satisfactory
Quality of M&E	High	High
Quality of ICR	---	Substantial

12. Lessons

Three lessons are drawn from the ICR (pages 32-33), with some adaptation.

High-quality technical assistance is vital to the success of a banking sector reform program. In this project, the FBiH and RS governments and the banking agencies FBA and BARS received expert technical assistance from the FinSAC, the USAID FINRA program, and the UK Good Governance Trust Fund, apart from the IMF and the World Bank, to design and implement various aspects of banking reform. In particular, the FinSAC, which opened a multi-pillar programmatic engagement with the BiH in 2018 on bank regulation and supervision, assisted with the finalization of the ICAAP, development, testing and application of the SREP, and the development of the model recovery plan for banks. The technical assistance from FinSAC and these international agencies was indispensable to the successful completion of the banking reforms supported by this project, according to the ICR. The quality of the technical assistance was reflected in the determination by the European Commission in October 2021 (Commission Implementing Decision (EU) 2021/1753 of 1 October 2021) that the regulatory, supervisory, and prudential frameworks for credit institutions in the BiH (a non-member third country) was now equivalent to that in the EU.

The alignment of the level of ambition of a reform measure with the degree of political commitment of the government to the reform is crucial. In this project, the political commitment of the FBiH and RS governments to the reform of their development banks, RBFBiH and IRBRS, was weaker than assumed at appraisal and did not match the elevated results targets set in the original loan agreement. The lack of progress with the governance reform measures necessitated a restructuring of the project, which required a new project action that was more attuned to the political will that the governments could muster at the time of restructuring – the adoption of strategy statements for the future development of the RBFBiH and the IRBRS. The experience illustrates the importance of aligning the scale and scope of reform measures with the degree of political commitment of the authorities to the reform objectives.

Public credit guarantee schemes designed for emergency situations are not necessarily suited for normal times. In this project, partial credit guarantee schemes were offered as temporary liquidity measures in response to the economic downturn and credit crunch caused by the COVID-19 pandemic. There is often an inclination in post-crisis periods to extend and even regularize emergency measures beyond their intended purpose. While public credit guarantee schemes serve to unlock finance in economies or economic sectors marked by market failures and imperfections, their adoption requires informed thinking and careful planning by the authorities. In particular, guarantee operations would need to be governed by legal and regulatory frameworks, supervisory and prudential norms, and governance and risk management principles, which would differ between crisis and normal situations.

13. Assessment Recommended?

No

14. Comments on Quality of ICR

Consistency with Guidelines. The ICR was prepared consistent with OPCS guidelines. The document presents a comprehensive and detailed record of the activities, disbursement-linked indicators, disbursement-linked results, results targets, disbursement amounts, and target disbursement dates for each component of the project, both before and after restructuring – the tables are especially useful for understanding the scope, tracing the changes, and reporting the results of the project. Following the restructuring of the project and the revision of the project development objective, the ICR performed a split ratting of the project outcome, consistent with the guidelines

Conciseness. The extensive use of tables allowed for a concise presentation and discussion of the project activities and results.

Results Orientation. The ICR assessed the efficacy of the project based on the outcome and output indicators defined in the results framework. Because the output indicators were also used as disbursement-linked results triggering disbursement of specific amounts of the loan fund, the disbursements indicate that the achievement of the indicators would have been thoroughly vetted by the Word Bank and the Project Implementation Teams. The narratives accompanying the results tables are highly informative.

Quality of Analysis. The ICR presents convincing evidence for the restructuring of the fourth component of the project, owing largely to adverse political developments in the FBiH and a fallout in political commitment in the RS. The ICR also presents convincing arguments for continuing with the reform of the development banks, albeit at a more deliberate pace in the medium to long -term.

Lessons Learned. The ICR offered five lessons, three of which are presented in this ICR Review. In general, the lessons are backed by evidence. For example, the quality of technical assistance delivered to the project is evidenced by the finding that the resulting BiH bank regulatory and supervisory frameworks are at par with EU standards. Moreover, the lessons are useful to guide future courses of action by the authorities on development bank reforms and government credit guarantee schemes.

a. Quality of ICR Rating

Substantial