OPERATION EVALUATION SUMMARY

Crisis response to banks in south-eastern Europe

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EBRD EVALUATION DEPARTMENT

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Executive summary

This study is an evaluation of the EBRD's crisis response to subsidiary banks in south-eastern Europe. The project consisted of transactions to support bank stability and place capital in the real economy. The Board approved these projects under the umbrella of regional funding packages to four parent bank groups. Each loan was committed in 50% tranches with only the first tranche disbursed. All loans have been repaid and completed. At the time of project origination, each of these bank groups was an existing EBRD client.

The selected bank subsidiaries were considered systemically important banks in their local markets and core assets of the parent groups. Therefore, the role of the EBRD's support was to send a strong confidence signal in the local markets and help maintain the stability of the financial systems in the respective countries.

The credit lines were aimed at on-lending to SMEs and corporate clients in the respective countries with 50% of proceeds from each project available for refinancing of the existing loans and 50% of proceeds to be used for new lending decisions in favour of SMEs and corporate customers. The evaluation focuses on the results in the south-eastern European subsidiaries but also looks at the parent bank level to ensure full understanding.

The evaluation report attempts to answer the following high-level questions.

1. To what extent were the EBRD's objectives achieved particularly in terms of systemic bank stability in south-eastern Europe and limiting parent bank funding?

2. What was the signal sent to the marketplace by the EBRD's efforts, which also needs to be viewed in the context of the Joint IFI Action Plan and the Vienna Initiative, and what was the impact of that signal?

3. What was the counterfactual—what would have happened without EBRD support?

The overall project performance rating is good based on a 'Relevance' rating of *excellent*, 'Results' rated *fully satisfactory*, and 'Efficiency' *fully satisfactory*. 'Expected additionality' was *fully verified* considering the crisis response; alignment with the EBRD strategies; lending and terms not available in the market; and extensive conditionalities. The demonstrated additionality was not quite as high because the EBRD funds were seen as "useful" but not "necessary."

The operational objectives or outputs related to lending were *partly achieved*. The banks were able to on-lend the EBRD finance but customer loans tended to decline. The outputs related to more mature and diversified funding were partially achieved. The EBRD loans helped extend the maturity of the banks' funds but they were unable to attract longer-term finance in the market. The project also strived to increase customer deposits. The deposit-related operational objectives were achieved as customer deposits increased as a percent of total liabilities.

The desired outcomes were to decrease parent borrowing, increase/maintain finance in the real economy, and strengthen subsidiary stability. "Decrease parent borrowing" and "strengthen subsidiary stability" were achieved. Parent debt funding decreased over the course of the project and the subsidiaries deleveraged in an orderly fashion. The orderly deleveraging in concert with regulators demanding larger financial cushions, a focus on deposits, and less lending contributed to stable subsidiaries as evidenced by improved loan to deposit ratios, capital adequacy ratios, and adherence to national bank requirements.

"Increase and/or maintain finance in the real economy" was not achieved as benchmarks related to total assets and market share were not met.

The project impacts were preservation of transition achievements in market expansion and competition, demonstration of successful restructuring, and sending a signal to the marketplace. The impacts were judged *fully satisfactory* based on a clear demonstration of successful restructuring through reductions in parent borrowing, increased liquidity, and a focus on depositors, and the transmission of a signal to the marketplace by the association with the EBRD and the impact of the Joint Action Plan's finance. The impact of preserving transition achievements in market expansion and competition was *partly achieved* because the bank subsidiaries survived and increased stability and liquidity but were not able to preserve the previous market gains. In summary, most of the project objectives, which were focused on preserving rather than advancing transition because of the crisis situation, were achieved and the overall rating was *good*.

Findings

The EBRD stamp of approval as a signal to the marketplace in a crisis situation was the most important component of the project.

At the time of project origination, there was worry of rapid and significant deleveraging in the bank subsidiaries causing massive deposit outflow leading to instability in these subsidiaries which in turn could weaken both the local banking systems more broadly and the parent banks. The amount of funding disbursed by the EBRD, although useful was not necessary as the subsidiaries were sufficiently capitalised and national regulators demanded increased liquidity. Yet, the transactions with the EBRD were useful and significant since the association with the EBRD helped the borrowing banks keep depositors, attracted other IFIs, and bolster the reputation of the banks. One of the parent bank representatives said the EBRD loans indicated that, "… markets were able to help with the crisis."

Unlinked policy dialogue served as an agent to increase impact.

In the Operation Performance Assessment, the Banking team reported policy dialogue was not a component of the projects with the south-eastern European subsidiaries. While technically true, the EBRD was involved in policy dialogue through its work in the Vienna Initiative which served as a companion to the project but not formally incorporated in the Board document. The EBRD was able to conduct joint assessments of the south-eastern financial sectors with the other IFIs, bring together national banks for relatively cohesive regulation, and gain commitments from parent banks to avoid rapid, excessive deleveraging. These efforts augmented the primary stabilisation measures of lending, regulation and state aid.

Opinions differ on risk of a subsidiary with a weak parent.

Within the EBRD, there were differences of opinion regarding the systemic risk to subsidiaries from a weak parent bank. Credit and risk management voiced opposition to the crisis response package. The package was ultimately approved but the second tranche of loans, based on escalating parent bank risk, was cancelled. The participating banks and national regulators believed the opinion that there was high systemic risk was unwarranted because they were appropriately capitalised and ring-fenced. One national bank believed the EBRD messaging sent erroneous signals indicating weakness in the subsidiaries. The majority of the participating banks thought the EBRD loans, although useful, were too small to provide significant support to the subsidiaries let alone the larger bank groups. Most of the banks wanted not only the second tranche of funds but other instruments such as swap and trade finance facilities at that time. The EBRD was facing exposure limitations and could not invest any more at that time, though a number of the banks later received and used both swap and trade finance limits from the EBRD. While each stakeholder held an opinion that was completely valid from their own perspective, the banks, the EBRD's clients, were surprisingly disappointed and perplexed that they were unable to receive additional funding beyond the first tranche of funds.

Recommendations

Because of the origination and approval process in combination with the transaction size and political dimensions of the crisis response to bank subsidiaries in south-eastern Europe, this project was unique and EvD hesitates to offer recommendations for future operations because of limited applicability.

With this understanding, there was a communications error regarding the commitment of the second tranche of funding. EvD advises in the future that Banking should be more attentive to the notification process for the cancellation of a tranche of funds in a project of this size and public visibility; the notification timing and the designated EBRD emissary should be decided further in advance.

Lessons

Tranching of project for flexibility in design was critical

Considering the size of the project, the level of exposure, the parent bank risk, and the uncertainty around the unfolding crisis, it was imperative that the disbursement was divided into two tranches. While the borrowers believed they could have utilised both tranches, the two-tranche approach gave the EBRD maximum flexibility to assess a rapidly changing situation before committing to full disbursement.

Active leadership and mission focus in multilateral collaboration extends EBRD's relative influence

The size of the EBRD's total financial commitment relative to other IFIs and multilateral bodies was small. However, by leadership in the Vienna Initiative in combination with focus on the financial sector in south-eastern Europe, the EBRD was viewed as a key player, if not the key player, in the multilateral support to the financial sector in south-eastern Europe.

Ratings

Criteria / *Sub-Criteria*	EvD Ratings	EvD Weight
1. Relevance	**Excellent** Excellent (recommended)	
1.1 Strategic Relevance	*Excellent*	*Medium*
1.2 Relevance of Design	*Fully Satisfactory*	*Medium*
1.3 Additionality - Expected	*Excellent*	*Medium*
1.4 Additionality - Demonstrated	*Fully Satisfactory*	*Medium*
2. Results	**Fully Satisfactory** Fully Satisfactory (recommended)	
2.1 Achievement of Outputs	*Partly Unsatisfactory*	*Medium*
2.2 Contribution to Expected Outcomes	*Fully Satisfactory*	*Medium*
2.3 Contribution to Expected Impacts	*Fully Satisfactory*	*Medium*
2.4 Performance against Benchmarks	*Not Applicable*	*Not Included*
2.5 Unanticipated Results	*Not Applicable*	*Not Included*
3. Efficiency	**Fully Satisfactory** Fully Satisfactory (recommended)	
3.1 Financial Performance of Project/Client	*Fully Satisfactory*	*Medium*
3.2 Implementation Efficiency	*Not Applicable*	*Medium*
3.3 Bank Investment Profitability	*Fully Satisfactory*	*Medium*
3.4 Bank Handling	*Fully Satisfactory*	*Medium*
3.5 Consultant Performance	*Not Applicable*	*Medium*
Overall Project Performance Rating:	**Good** Good (recommended)	
4. Derived Ratings		
4.1 Transition Impact	*Fully Satisfactory*	
4.2 Environmental & Social Performance	*Not Applicable*	
4.3 Additionality	*Excellent*	
4.4 Sound Banking	*Fully Satisfactory*	