SIMULTANEOUS DISCLOSURE

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

ECUADOR

INVESTMENT PROGRAM TO SUPPORT FINANCIAL INCLUSION

(EC-L1110)

LOAN PROPOSAL

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ABBREVIATIONS

ATM	Automated teller machine
BCE	Central Bank of Ecuador
BOO	Banca de las Oportunidades [Bank of Opportunities]
CEMLA	Center for Latin American Monetary Studies
FAR	Fiduciary Agreements and Requirements
GDP	Gross domestic product
HDB	Human Development Bond
ICAS	Institutional Capacity Assessment System
IFI	Intermediary financial institution
NBC	Nonbank correspondents
NPS	National payments system
PEP	Project Execution Plan
PFS	Popular finance structure
POS	Point of Sale
PRM	Project Risk Management
PSE	Popular and solidarity-based economy
SEPA	Procurement Plan Execution System
SOA	Service-oriented architecture
TOR	Terms of reference

PROJECT SUMMARY

ECUADOR
INVESTMENT PROGRAM TO SUPPORT FINANCIAL INCLUSION
(EC-L1110)

Financial Terms and Conditions				
Borrower: Republic of Ecuador Executing agency: Central Bank of Ecuador (BCE)			Flexible Financing Facility*	
			Amortization period:	25years
			Original weighted average life:	15.25 years
			Grace period:	12.6 years
			Disbursement period:	5 years
Source	**Amount (US$)**	**%**	Interest rate:	LIBOR-based
IDB (OC)	10.0 million	59.9	Inspection and supervision fee:	**
Local	6.682 million	40.1	Credit fee:	**
Total	16.682 million	100.0	Currency:	U.S. dollars from the Bank's Ordinary Capital

Project at a Glance
Project objective and description: The objective of the operation is to foster access to financial services by the population, particularly in geographic areas characterized by limited financial penetration and low income levels. This will be achieved by supporting and strengthening intermediary financial institutions (IFIs), popular finance structures (PFSs), and the national payments system (NPS), thus helping to increase the number of individuals served by the financial system (paragraph 1.22).
Special contractual conditions: 1. Precedent to the first disbursement of the financing: The BCE will: (i) appoint the program's technical team; (ii) approve the program's Operating Regulations; and (iii) sign the subsidiary agreement with the Ministry of Finance. **2. Precedent to the disbursement of the funds for component 1 of the program:** The BCE will: (i) select a concurrent audit firm under agreed upon procedures and pursuant to terms of reference (TOR) that have received the Bank's no objection (the audit will apply to direct incentive and cofinancing competition processes); and (ii) approve a standard TOR model for direct incentive and cofinancing competitions (paragraph 2.3).
Exceptions to Bank policies: None
Project consistent with country strategy: Yes [X] No [ ]
Project qualifies as:[1] SEQ [ ] PTI [X] Sector [ ] Geographic [X] Headcount [ ]

* Under the terms of the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule as well as currency and interest rate conversions, in all cases subject to the final repayment date and the original weighted average life. When weighing such requests, the Bank will take market conditions and operational and risk management considerations into account.

** The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

[1] Financing for small and vulnerable countries; Institutions for growth and social development; Loans to reduce poverty and enhance equity.

I. DESCRIPTION AND RESULTS MONITORING

A. Frame of reference, problem to be addressed, and rationale

1.1 **Macroeconomic environment**. The Ecuadorian economy grew 3.58% in 2010 and 7.78% in 2011, following moderate growth of 0.36% in 2009.[2] The rise in oil export prices reduced the current account deficit in the balance of payments to -0.3% of the gross domestic product (GDP) in 2011 from -3.3% of GDP in 2010. For 2012, the current account is projected to have a surplus balance of 0.5% of GDP. The unemployment rate was 6% in 2011 and is expected to remain near 5.8% in 2012.[3]

1.2 **The Ecuadorian financial system.** The financial system consists of public and private banks, mutual aid societies, financial companies, and credit unions. As of December 2011, 84 private-sector institutions were operating in the country: 25 banks, 4 mutual aid societies, 10 financial companies, and 45 credit unions, along with 5 public-sector institutions. Financial deepening as measured by the credit-to-GDP ratio is 27.4% as of March 2012. Private and public banks account for most of this ratio (15.9% and 5.9%, respectively), followed by credit unions (3.6%), financial companies (1.6%), and mutual aid societies (0.4%). Commercial financing accounts for 52.6% of the credit portfolio, while consumer credit represents 30.5%, mortgage credit 8%, and microcredit 8.8%. The capital adequacy ratio is on the order of 13.1% of risk-weighted assets, and thus higher than the 9% minimum. The past due portfolio is 3.9% of total credit, with reserve coverage of 165.7%.[4]

1.3 **Financial inclusion**. The literature and empirical evidence show that access to financial services plays a critical role in development by promoting economic growth, reducing income inequality in the population, and improving household poverty conditions.[5] Financial inclusion means broader access to and use of a range of financial services by the population, including savings, credit, payments, transfers, and insurance, at a reasonable cost.[6]

1.4 Inclusive financial systems provide instruments that enable lower-income individuals to tread a smoother path of consumption and protect themselves against negative shocks.[7] Financial inclusion policies are aimed at enhancing the financial system's capillarity, lowering costs, and removing barriers to access by taking action at three levels: (i) macro: reforms of the legislative and regulatory framework; (ii) meso: reforms designed to strengthen the financial architecture, credit information, the payments systems, and consumer protection; and (iii) micro:

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[2] Change in GDP at constant prices. IMF, World Economic Outlook Database, April 2012.

[3] IMF, World Economic Outlook Database, April 2012.

[4] Data from the Superintendency of Banks of Ecuador.

[5] A current summary of studies and empirical evidence is available in: Financial Inclusion and Stability: What Does Research Show? CGAP Brief, May 2012. www.cgap.org.

[6] See, for example: G20 Financial Inclusion Experts Group—ATISG Report, 25 May 2010; Measuring Financial Inclusion. Asli Demirguc-Kunt, Leora Klapper, April 2012, World Bank.

[7] Global Financial Inclusion Database, World Bank, http://go.worldbank.org/TN8C86K630.

support to financial institutions in order to expand coverage. Implementing the policies requires solid institutions to prevent these actions from becoming diluted over time.

1.5 Traditionally, financial inclusion has focused on expanding access to credit for the unserved population. However, focusing on a single financial service can be counterproductive, since adverse shocks can lead to even greater poverty if the financial burden created is too heavy for the debtor to bear. It is therefore important to promote saving as a way of covering basic risks affecting income and as a first step toward access to a wide range of financial services. By creating collateral, saving allows individuals to make payments and obtain access to credit. In addition, the use of savings accounts requires transactional channels that allow deposits, transfers, and payments to be made easily and at an accessible cost. Technology is vital for performing transactions by phone or through magnetic media, at points of sale (POS) or via automated teller machines (ATMs). To use these channels, efficient and modern payment platforms are needed.

1.6 **Financial inclusion in Ecuador.** The Government of Ecuador has reaffirmed that financial inclusion and the popular and solidarity-based economy (PSE)[8] are government policies aimed at helping to mitigate poverty and foster economic development. Accordingly, the objectives of the 2009-2013 Plan Nacional de Desarrollo para el Buen Vivir [National Development Plan for Good Living Conditions] include[9] "[e]stablishing a social, solidarity-based, and sustainable economic system." Moreover, the mission guidelines of the Central Bank of Ecuador's (BCE) strategic plan, ratified by the BCE board of directors, include (i) financial system stability and (ii) support for the financial inclusion policy.

1.7 The level of financial inclusion in Ecuador is low, as reflected in the indicators of access to and use of financial services. The number of ATMs and branches in relation to the population measures the demographic penetration of these services. Higher values indicate greater possibilities of access and opportunities to use financial services on the part of households and businesses.[10] Ecuador has the lowest indicators in the Andean region in terms of ATMs per 100,000 adults (12.8 versus an average of 24.4 in the other Andean countries)[11] and branches per 100,000 adults (1.6 versus an average of 9.5 in the other Andean countries).[12] With regard to proxy indicators of the use of financial services, the banking system credit to GDP ratio is 21.8%[13] (compared to an average of 24.1% in the other Andean

[8] The Ecuadorian Constitution (Article 31) provides that the popular and solidarity-based sector is to consist of credit unions, solidarity-based partnerships, village banks, and savings banks.

[9] Strategic objective 11, policy 11.13.

[10] For a description of the concept of access to and use of financial services, see: *Reaching out: Access to and use of banking services across countries*. Beck, Demirguc-Kunt and Martinez Peria, World Bank, 2005.

[11] Bolivia: 17.53; Colombia: 29.56; Peru: 22.26; and Venezuela: 28.19. CGAP (2010), Financial Access.

[12] Bolivia: 6.94; Colombia: 14.30; and Peru: 7.31. No data on Venezuela. Commercial banks. CGAP (2010).

[13] Data for public and private banks, March 2012.

countries) and the bank deposit to GDP ratio is 31.2% (somewhat higher than the 30.4% average in the other Andean countries).[14]

1.8 The lack of access to financial services in Ecuador is particularly notable in low-income, rural, and marginal urban areas. Thus, while cantons with poverty rates below 20% of the population have 12 points of service[15] (ATMs, POS, branches, agencies) per 100,000 inhabitants, this indicator drops to 9 in the country's poorest cantons. In the four poorest deciles of the population, only an average of 6.5% has access to savings accounts. This indicator climbs to 22% for the four richest deciles.[16] Lack of access is due to a series of factors:[17] (i) absence of the appropriate channels and technologies needed to expand coverage to relatively inaccessible geographic areas; (ii) high transaction costs for small transactions and/or transactions in remote geographic areas; (iii) information asymmetries between financial service providers and potential customers; and (iv) a national payments system (NPS) that does not allow for efficient, online transactions and broad coverage by economic actors.

1.9 **The national payments system (NPS).** A modern NPS, with appropriate technology and an appropriate legal and regulatory framework, is needed if financial transactions are to be conducted efficiently, on a large scale, and with adequate coverage. A country's payments system includes a set of instruments, banking procedures, and funds transfer systems that ensure effective monetary circulation.[18]

1.10 In Ecuador, the BCE manages and operates the NPS, executing 72.4 million transactions yearly for an aggregate amount of US$195.704 billion (more than 3.6 times the country's GDP).[19] NPS transactions are both large and small. The NPS has difficulty responding effectively to the needs of the financial system and the PSE due the following shortcomings:[20] (i) obsolete technology infrastructure inconsistent with the transactional level; (ii) different settlement and payment structures and arrangements for the various NPS components; (iii) inability to perform transfers online with gross settlement in real time; (iv) nonexistence of an oversight function; and (v) a legal framework lacking comprehensive treatment for all NPS components and actors.

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[14] Data for March 2012. The Andean group includes the countries listed in note 10.

[15] This definition of "points of service" is a specific example of the "service channels" concept described in paragraph 1.12.

[16] See Annex I of the monitoring and evaluation plan and the general intervention guidelines.

[17] A fuller description is available in the general intervention guidelines.

[18] Committee on Payment and Settlement Systems, Bank for International Settlements www.bis.org/publ/cpss00b_es.pdf.

[19] Data provided by the BCE. 2010.

[20] Assessment by the World Bank and the Center for Latin American Monetary Studies (CEMLA). These institutions conduct the Western Hemisphere Payments and Securities Settlement Forum, whose objective is to describe and assess payments and securities settlement systems.

1.11 The NPS shortcomings affect the quality, type, and volume of transactions in the economy. The population faces high transaction costs when performing financial transactions, since current technology does not allow for mass transactions from mobile devices. In Ecuador, 92% of all adults with bank accounts make deposits by going to a bank branch and 60% make funds withdrawals the same way. Only 4.5% make deposits through an ATM (the average in Latin America being 20%) and 36% make withdrawals from ATMs (56.4% average in Latin America). It is estimated that only 17% of the adult population has a debit card and only 1.2% uses a cell phone to pay bills.[21] This situation is relatively more detrimental for those who live far from a point of service and are forced either to transact in cash or to travel and thus incur in time delays and risks. Even those receiving the Human Development Bond (HDB) do so for the most part in cash.[22]

1.12 **Instruments to promote financial inclusion in Ecuador**. Enhancing access to financial services requires increasing the availability of channels (ATMs, POS, magnetic media, phone, branches, nonbank correspondents (NBC)) that allow for secure transactions and low transaction costs. In turn, this requires: (i) modernizing the NPS, so that it can support efficient transaction performance; and (ii) establishing mechanisms that enable intermediary financial institutions (IFIs) and popular finance structures (PFSs) to make more channels and services available to the population. At the same time, the population needs a healthy financial education as a basis for making informed decisions on the products its uses and the risks it assumes.

1.13 The BCE is driving a modernization and substantial reform of the operational aspects of the NPS (hardware, software, processes) and its governing regulatory framework. In addition, the BCE wishes to implement a policy aimed at increased IFI and PFS coverage, especially in underserved geographic areas and demographic groups. To this end, it has studied successful experiences in other countries with similar objectives, focusing particularly on the experience of the Bank of Opportunities (BOO) in Colombia. The BOO is a government program administered by Banco de Comercio Exterior (Bancoldex) and designed to promote access to financial services for families living in poverty, households outside the banking system, microentrepreneurs, and small enterprises.

1.14 The BOO was created in 2006 as a US$50 million competitive fund and was supported by the Bank to improve the payments system and the availability of inclusive financial services in Colombia.[23] The BOO carries out interventions through: (i) cost subsidy: auctioning funds to intermediaries, by activity or product, when not initially profitable; (ii) project cofinancing: contributing part of the cost of

[21] The Little Data Book on Financial Inclusion, World Bank, 2012.

[22] Government conditional cash transfer program. Information from Financial Inclusion through the Human Development Bond in Ecuador, Samariego and Tejerina (2010), IDB.

[23] See Bank's country strategy with Colombia, 2007-2010, paragraph 3.22, and the matrix for this country strategy.

projects that promote innovative financial inclusion approaches; and (iii) technical assistance: contributing in kind by contracting advisors with experience in financial inclusion.[24]

1.15 There is abundant evidence of the BOO's achievements and outcomes. From its inception, it has ensured coverage practically throughout Colombia. While 28% of the country's municipios (309 municipios) lacked coverage in 2006, that percentage had dropped to 0.4% (4 municipalities) by year-end 2010. Between July 2008[25] and December 2011, the BOO made it possible to increase the number of NBCs more than fivefold, from 4,523 to 19,930, and the number of the monthly transactions they perform from 262,034 to 4,471,947 (growth of more than 16-fold). The number of points of service per 100,000 inhabitants (NBCs, bank branches, and ATMs) rose from 21 to 52.9. The sustainability of these interventions is worth highlighting; the programs having concluded, the entities now use their own funds to keep the points of contact open.

1.16 **Proposed intervention.** The proposed program includes: (i) improving the NPS's technological and operational aspects and its regulatory framework in order to modernize the NPS, provide for online transactions, and build a modern and broad structure of financial channels and products; and (ii) creating a competitive fund to provide assistance to IFIs and the PFSs in installing service channels (ATMs, POS, magnetic media, phones, and NBCs) and increasing the supply of financial services. The fund's operations will be based on the BOO experience, including the use of competitive processes and the investment instruments described in paragraph 1.12.

1.17 **Size of the demand for resources.** With regard to the NPS, the necessary funds, which the BCE has estimated at US$9.5 million,[26] will be used to procure hardware, procure and develop software, and implement and test equipment and processes. With regard to the competitive fund, estimates[27] were made on the basis of the BOO's performance over five years (the length of the program). During this period, the BOO used US$29.5 million to achieve coverage in practically all of the country's municipios. At the start of the BOO, 28% had no coverage. In Ecuador the percentage is similar: it fluctuates between 27.6% and 31.2%, depending on the indicator.[28] Adjusting for the difference in population, the amount required to support the program would be lower than in Colombia, with a maximum of about US$8 million. Another approach to the demand for funds is to examine the proposed activities. Maintaining the Colombian mix in terms of yearly number of

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[24] A complete description is available at: www.bancadelasoportunidades.gov.co.

[25] July 2008 is used as a starting point because, since that date, there are figures available for all variables. See "Metas, resultados y logros" [Targets, outcomes, and achievements] www.bancadelasoportunidades.gov.co, and general intervention guidelines.

[26] The procurement plan provides an itemization of this amount.

[27] General intervention guidelines.

[28] Points of service and savings accounts, respectively.

calls for proposals and average cost, and adjusting the scale to reflect a smaller market, it is estimated that the amount required would not exceed US$7 million.

1.18 **Beneficiary population.** The banked population will benefit from the NPS reforms through reduced transaction times and the ability to use electronic devices. In addition, those mobile channels will make it possible to provide financial services to the unbanked population, particularly in areas far removed from a bank branch, which are typically the poorest. Expanding the NPS will make it possible to encompass intermediaries not currently connected, such as credit unions, most of whose customers are located in the poorest areas[29] and will now be able to open savings accounts and collect government subsidies and social security benefits, among other advantages. Regarding the competitive fund, the areas of action and the beneficiary population will be determined by segmenting the country's cantons on the basis of population density, income/poverty, financial coverage, and contribution to GDP. Interventions will begin in areas of lower income, low financial coverage, and medium population density.[30]

1.19 **The Bank's experience in the Ecuadorian financial sector**. The Bank has performed interventions in the financial sector, coordinated through dialogue with the main stakeholders, generating knowledge and becoming a strategic partner in the financial inclusion policy. The principal outcomes include the Financial Safety Net Law and the strengthening of risk supervision for regulated IFIs and credit unions. In addition, MIF supported the BCE through a project aimed at expanding NPS participants under the Network of Networks model,[31] and will provide continuity through the NPS reforms resulting from this operation. In 2011, the Bank approved loan EC-L1073[32] to enhance financial inclusion through second-tier resources provided to PFSs so they can extend credit to microentrepreneurs.

1.20 **Priorities of the Ninth General Increase in the Bank's Resources (GCI-9).[33]** By contributing to the development of credit and financial markets, this operation is aligned with the sector priority of "institutions for growth and social welfare." Moreover, by prioritizing interventions in lower income areas, it is aligned with the targets of lending for "poverty reduction and equity enhancement" and lending to "small and vulnerable countries."

1.21 **The Bank's country strategy with Ecuador.** The operation is framed within the IDB Country Strategy with Ecuador (2008-2011) (document GN-2490), in effect until 31 October, 2012, in the Strategy Matrix area of "productive development and access to financing," under the items "modernize the financial system" and "design

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[29] Information on credit unions in the poorest areas is available in the general intervention guidelines.

[30] Details on canton segmentation and targeting are available in the monitoring and evaluation plan.

[31] ATN/ME-12030-EC, aimed at helping to incorporate remittance beneficiaries into the formal financial system, particularly in marginal and rural areas.

[32] Global Credit Program for Microfinance Support in Ecuador (EC-L1073; 2651/OC-EC).

[33] Document AB-2764.

a financial system architecture," thus contributing to the credit/GDP and deposits/GDP ratios.

B. Objectives and expected outcomes

1.22 The program's general objective is to foster access to financial services by the population, particularly in geographic areas characterized by limited financial penetration and low income levels. This will be achieved by supporting and strengthening the PFSs, IFIs, and the NPS, thus helping to increase the number of individuals served by the financial system.

1.23 The specific objectives are to: (i) expand the supply of financial services, particularly in geographic areas characterized by limited financial penetration and low income levels; and (ii) enhance the transactional efficiency of the NPS.

1.24 The program calls for the execution of two components: (i) competitive fund to support financial inclusion; and (ii) implementation of the new NPS.

1.25 **Component 1: Competitive fund to support financial inclusion.** This component will support expanding the supply of financial products and services and coverage of unserved geographic areas and demographic groups through a competitive fund. The fund will be managed by the BCE, since it needs to be managed by a strong and consolidated institution and, moreover, promoting financial inclusion is one of the BCE's new strategic guidelines (see paragraph 1.6). The fund will be used to, among other things, cofinance[34] technical assistance projects and the procurement of goods, services, technology, and inputs needed to expand the supply of financial services by qualifying IFIs and PFSs (see paragraph 3.6). In addition, the component calls for training activities for IFIs, PFSs, and the general population, disseminating the benefits and possibilities offered by the fund. The program guidelines, described in the program's Operating Regulations, set forth (see paragraph 3.5) the: (i) objective of the competitive fund; (ii) minimum targeting criteria for its operations; (iii) financeable activities; (iv) eligible entities; (v) support instruments: (vi) financeable amounts, counterparts, and items; and (vii) monitoring and evaluation.

1.26 **Component 2: Implementation of the new NPS.** This component will strengthen the NPS infrastructure through: (i) hardware procurement; (ii) software development and/or procurement; (iii) testing and implementation of processes; and (iv) training and educating financial entities and the general population on the use and functionality of the NPS (for example, informing the population regarding the new transaction possibilities available through the NPS). This component will allow IFIs and PFSs to perform online transactions and will provide an efficient platform that, once its capacity is expanded, will allow a greater number of beneficiaries to perform transactions. The technological modernization will allow IFIs and PFSs to offer their customers new service channels (phone, magnetic, virtual), thus reducing access and transaction costs and, in turn, expanding financial product and service

[34] The term "cofinance" refers to grants that will cover only a fraction of the project or procurement amounts.

offerings to encompass a greater portion of the population, particularly in low-coverage geographic areas.

C. Results indicators

1.27 **Program indicators.** In line with the general objective, the impact indicator is the total number of new financial system users in the program's beneficiary IFIs and PFSs. The outcome indicators, aligned with the specific objectives, are: (i) number of new financial transactions performed by users of the program's beneficiary IFIs and PFSs; (ii) average processing time per transaction in the NPS; and (iii) number of transactions processed online in the NPS.

1.28 The output indicators are: (i) number of new points of service set up by the competitive fund's beneficiary IFIs and PFSs; (ii) number of competitive fund's beneficiary IFIs and PFSs; (iii) number of IFIs and PFSs trained on the benefits of using competitive fund resources; (iv) number of IFIs and PFSs integrated into the BCE payment infrastructure under direct processing standards; (v) implementation of the action plan to improve NPS infrastructure (software and hardware) at the BCE; and (vi) number of NPS users trained in the system's use and functionality.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instrument

2.1 This operation will take the form of an investment loan of US$10 million, providing resources to the BCE to create and operate the competitive fund and finance the necessary NPS reforms.

2.2 **Retroactive financing.** The Bank may recognize eligible expenses incurred by the beneficiary starting on 2 May 2012,[35] provided such expenses are incurred under the framework described in operational policy OP-504, Recognition of expenditures, retroactive financing, and advance contracting; operations processing manual PR-200, Sovereign-guaranteed operations – General overview; and procurement policies set forth in documents GN-2349-9 and GN-2350-9. It is estimated that the beneficiary will require up to US$2 million to start the activities described in sections (i), (ii), and (iii) of component 2 (paragraph 1.26). These activities are vital for carrying out the aforementioned reforms of the NPS, without which none of the other activities in the program can be carried out.

2.3 **Disbursements.** The disbursement period for program resources is five years. Resources not part of the retroactive financing will be disbursed through advances, reimbursement of expenses incurred, and direct payment to providers or contractors. These disbursements will be made under an itemized financial plan reflecting actual funding needs for a period of six months. The financial plan will be prepared at the start of the program and will be updated in accordance with developments in the program's execution. **As special conditions precedent to the**

[35] Date of project profile approval, as set forth in operational policy OP-504.

first disbursement of the financing, the BCE will: (i) appoint the program's technical team (see paragraph 3.2.); (ii) approve the program's Operating Regulations; and (iii) the sign the subsidiary agreement with the Ministry of Finance. In addition, as special conditions precedent to the disbursement of funds for component 1 of the program, the BCE will: (i) select a concurrent audit firm under agreed upon procedures and pursuant to terms of reference (TOR) that have received the Bank's no objection (the audit will apply to direct incentive and cofinancing competition processes); and (ii) approve a standard TOR model for direct incentive and cofinancing competitions.

2.4 The program's cost is summarized in the following table:

Program cost by sources of financing (US$)

	IDB contribution	**Local contribution (BCE)**	**TOTAL**
Component 1	6,000,000	250,000	6,250,000
Component 2	4,000,000	5,532,000	9,532,000
Management team	0	100,000	100,000
Evaluations (impact, midterm, and final)	0	300,000	300,000
Annual external and operating disbursement audits	0	500,000	500,000
Total	**10,000,000**	**6,682,000**	**16,682,000**
Percentage	**59.9**	**40.1**	**100.0**

B. Main risks and mitigating measures

2.5 **Environmental and social risks.** The loan will not have a direct impact on the environment. It is expected to have positive social effects by promoting actions that foster access to financial services by the population, particularly the lower-income population. According to Directive B.13 of the Environment and Safeguards Compliance Policy (document GN-2208-20, operational policy OP-703), classification is not required for this operation. The Access to Information Policy (operational policy OP-102) will be observed.

2.6 **Fiduciary risks.** The fiduciary risks and mitigating actions are described in Annex III, Section III of the Fiduciary Agreements and Requirements (FAR) and in the Risk Matrix. The main fiduciary risks identified as medium level are: (i) the limited capacity of IFIs or PFSs to submit eligible projects for component 1, for which the mitigating measure called for is to provide them with technical assistance in submitting projects; and (ii) inappropriate use by IFIs and PFSs of the resources allocated through component 1, for which the mitigating measures will be to: (a) contract a concurrent audit to supervise the delivered funds; (b) staff the management team with experienced professionals with technical expertise in tracking and monitoring project outcomes during their execution; and (c) prepare the program's Operating Regulations, including a detailed description of execution procedures, requirements, and internal controls.

2.7 The FAR reflect the financial and procurement management guidelines to be used during program execution and the type of fiduciary supervision, as well as the fiduciary risks identified during the operation's preparation. The FAR are the result of an analysis of the fiduciary context of the country and the executing agency, inputs from the risk workshop conducted with staff from the program's participating entities, and the outcomes of meetings held by the project team and executing agency officials as well as other key stakeholders who will be involved in program execution.

2.8 **Other risks and key issues.** The other risks identified as medium level, and their mitigating measures, include: (i) delays in signing the loan contract. In this regard, aside from monitoring government procedures and providing support for the fulfillment of conditions precedent, the operation amount means that the signing depends solely on the Ministry of Finance,[36] which has been continuously involved. It is worth noting that this operation's components and activities are not dependent on the outputs, outcomes, or functioning of operation EC-L1073, which has yet to be signed by Ecuador; consequently, the delay in the latter operation's execution will not affect the fulfillment of this program's objectives; (ii) a drop in the level of commitment of the borrower and the executing agency. In this regard, the BCE is expected to formalize its role in financial inclusion by approving the relevant regulations; and (iii) delays in approval of the technical cooperation operation designed to support the loan operation. This approval process will be monitored.

2.9 The risk analysis also included an institutional capacity assessment of the BCE, based on the Bank's Institutional Capacity Assessment System (ICAS), which indicated that there is a low level of risk.

2.10 **Economic analysis.** The program's benefits are measured by the increase in income of new customers with savings accounts, since these accounts are the initial step on the path of financial inclusion (see paragraph 1.5), and they also require an efficient NPS that can channel transactions. Costs take into account the cost of acquiring new customers (loan and BCE counterpart contribution amount, distributed among the potential beneficiaries) and the operating expenses of managing the new customers, estimated on the basis of available data for a sample of institutions. Based on these indicators, a base scenario for the program shows an economic return of 25%.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 **Borrower and executing agency.** The borrower will be the Republic of Ecuador and the executing agency will be the BCE.

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[36] Article 140, item 2 of Ecuador's Code of Public Planning and Finance.

3.2 **General execution and management arrangements.** The program will be executed through the Department of Special Projects, reporting to BCE General Management. This department will include a technical team consisting of a program director, a program assistant, a specialist and support specialist in banking and microfinance, and a specialist and support specialist in PFSs. Appointing the technical team will be a condition precedent for the first disbursement under the program.

3.3 The technical team will be responsible for the program's technical, operational, financial, and procurement management, as well as for coordinating with the other areas of the BCE. The program director and assistant will be responsible for financial and procurement management, with the full support of the BCE's Financial Department.

3.4 An internal committee will be created for the execution of component 1 and will consist of: (i) the Deputy General Manager of the BCE, who will chair it; (ii) the General Banking Director; and (iii) the Director of Economic Statistics. The Special Projects Director will act as the committee's secretary. The committee's main responsibilities will include analyzing and approving the calls for proposals and precontractual documents and recommending approval of projects, competitions, and other competitive fund disbursements.

3.5 **Program Operating Regulations.** The program will be executed on the basis Operating Regulations which: (i) will be consistent with the rules and policies of the BCE and the Bank and with the laws in effect in Ecuador; and (ii) will establish that failure to comply with their provisions will prevent access to Bank financing. Any changes to the Operating Regulations will be decided by the BCE based on the Bank's recommendations and/or suggestions and subject to the Bank's no objection. BCE approval of the Operating Regulations will be a condition precedent to the first disbursement under the program.

3.6 **Component 1: Competitive fund to support financial inclusion.** The areas of action will be determined by segmenting the country's cantons on the basis of population density, income/poverty, financial coverage, and contribution to GDP. Interventions will start in areas of lower income, low financial coverage, and medium population density.[37] The fund's activities will be carried out under the terms described below.[38]

a. **Eligible entities.** These will include IFIs and PFSs subject to supervision[39] and ancillary financial system companies that partner with them to submit proposals. The minimum financial and operating requirements and indicators to be met will be established in the design of each competition.

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[37] Details on canton segmentation and targeting are available in the monitoring and evaluation plan.

[38] Resources from the technical cooperation operation supporting this program, EC-T1254, will be used to prepare detailed TOR for each type of competition. The TOR will require the Bank's no objection.

[39] Through the Superintendency of Banks and the Ministry of Economic and Social Inclusion (MIES), subsequently to be transferred to the Superintendency of the Popular and Solidarity-based Economy.

b. **Support instruments.** The following instruments will be used to grant fund resources to eligible entities:

   (i) **Direct incentives.** To promote the installation of points of service (including ATMs, POS, and magnetic media) and develop financial products for the target population, direct incentives will be used to finance interventions in which candidates are asked to offer products and services with similar characteristics. The amount will be less than or equal to 50% of the first-year cost and will decrease over time.

   (ii) **Project cofinancing.** Resources will be granted through partial disbursements consistent with projected expenses for implementation of the financed project. This type of support will be used to finance interventions in which a common objective is set and candidates submit different proposals for achieving this objective. It will provide for a maximum amount and will decrease over time.

   (iii) **Technical assistance.** Contracting of consulting services to support the IFIs and PFSs on issues to be determined in each competition. The internal committee will determine the maximum amount for each competition and the criteria for counterpart contributions by the beneficiary entities.

c. **Calls for proposals.** Resources are to be allocated pursuant to calls for proposals that ensure free competition for potential beneficiaries.

d. **Award and announcement**. The internal committee will award the resources to the bidders that achieve eligibility scores, based on evaluation criteria to be determined for each competition. The results of competitions and awards will be publicly announced by posting on the BCE website.

3.7 **Component 2: National payments system.** Resources will be used for hardware procurement, software development and procurement, testing and implementation of processes, and training and education of NPS users and the general population on the use and functionality of the NPS.

3.8 These activities will strengthen the NPS, making it possible for credit unions, financial networks, and IFIs to connect to this system. The NPS strengthening will be based on an action plan consisting of three phases to be executed simultaneously: (i) NPS migration to a technically strengthened architecture; (ii) product and service development in the new architecture (HDB payment, online transfers, interbank payments); (iii) implementation of the Billetera Móvil [mobile wallet], a system for transactions (business transaction payments and/or transfers of small amounts) via cellular phone.

3.9 **Procurement of goods and services.** The procurement policies for this operation are those set forth in Bank documents GN-2349-9 and GN-2350-9. The procurement plan contains a breakdown of the procurement to be undertaken during program execution, and includes: (i) contracts for goods, nonconsulting services, and consulting services; (ii) the proposed procurement methods for works, goods, and nonconsulting services and for selecting consultants; and (iii) the Bank's procurement review procedures.

3.10 In addition, a Project Execution Plan (PEP) has been prepared for the five years of program implementation, with the activities and procurement indicated in the procurement plan. The procurement plan will be updated annually or whenever the operation requires substantial procurement changes. The current version of the procurement plan will be available in the Procurement Plan Execution System (SEPA). Any proposed procurement plan revision must be submitted to the Bank for approval. The FAR include the procurement management details. As provided in the aforementioned procurement policies, procurement for component 1 using funds allocated to IFIs and PFSs through the relevant competitions will be carried out by these entities pursuant to customary business practices and under BCE supervision.[40]

3.11 **Audits**. The program's external audit services will be provided by a firm as set forth in Annex III. Within 120 days following the end of the executing agency's fiscal year, the BCE team will submit the program's annual audited financial statements to the Bank. The last set of audited financial statements will be submitted within 120 days following the scheduled date for the operation's last disbursement. In addition, with the justification for each disbursement, the executing agency will submit an independent review conducted by an audit firm satisfactory to the Bank, covering the supporting documentation for the transactions associated with the cost incentives and project cofinancing granted to the IFIs and PFSs included in the disbursement request.

B. Monitoring and evaluation arrangements

3.12 The program will use the Bank's general procedures for the monitoring and evaluation of investment operations. Thus, monitoring and evaluation will be based on the Results Matrix indicators (Annex II).

3.13 **Reports.** Program execution will be monitored by means of semiannual progress reports prepared by the executing agency and submitted to the Bank within 60 days following the end of each six-month period, that is to say, at 31 August and at 28/29 February of each year. The reference point for the reports will be fulfillment of the commitments set forth in the Results Matrix and the methodology established in the monitoring and evaluation plan.[41]

3.14 **Supervision.** Disbursements will be based on a review, in the form of concurrent audits[42] applicable to the direct incentive and cofinancing competition processes.

[40] The Bank's procurement policies, as set forth in sections 3.12 and 3.14 of documents GN-2349-9 and GN-2350-9.

[41] See monitoring and evaluation plan.

[42] Procedure agreed upon at the analysis mission of 6-18 May 2012. It consists of a review by an external audit firm of the records and supporting documents for payments made.

The Bank will schedule inspections of the BCE to verify fulfillment of the program's contractual conditions.

3.15 **Midterm evaluation.** Within 33 months from the date of the first disbursement, or once 50% of the loan proceeds have been committed, whichever occurs first, the borrower, through the executing agency and with the Bank's support, will conduct a midterm evaluation of: (i) achievement of objectives and attained outcomes, based on the Results Matrix; and (ii) the possibility of taking the necessary measures if the program is deemed not to have substantially achieved its objectives.

3.16 **Impact evaluation.** This will be performed through an experimental methodology using control groups. The information for the study will be compiled in two stages: in the first, data will be collected for the baseline, and the exercise will be repeated at the conclusion of the program. Further details may be found in the monitoring and evaluation plan.

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	**Aligned**		
Lending Program	**(i) Lending to small and vulnerable countries, and (ii) Lending for poverty reduction and equity enhancement.**		
Regional Development Goals			
Bank Output Contribution (as defined in Results Framework of IDB-9)			
2. Country Strategy Development Objectives	**Aligned**		
Country Strategy Results Matrix	**GN-2490**	**The intervention contributes to improving access to financing by modernizing the financial system and improving the financial system architecture.**	
Country Program Results Matrix	**GN-2661-4**	**The intervention is included in the 2012 Country Program Document.**	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability	**Highly Evaluable**	**Weight**	**Maximum Score**
	9.6		10
3. Evidence-based Assessment & Solution	**8.8**	**25%**	**10**
4. Ex ante Economic Analysis	**10.0**	**25%**	**10**
5. Monitoring and Evaluation	**9.6**	**25%**	**10**
6. Risks & Mitigation Monitoring Matrix	**10.0**	**25%**	**10**
Overall risks rate = magnitude of risks*likelihood	**Medium**		
Environmental & social risk classification	**B.13**		
III. IDB´s Role - Additionality			
The project relies on the use of country systems (VPC/PDP criteria)	**Yes**	**Financial Management: Budget, Treasury, Accounting and Reporting. Procurement: Information System.**	
The project uses another country system different from the ones above for implementing the program			
The IDB's involvement promotes improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	**Yes**	**EC-T1254. The objective of technical cooperation is to improve and strengthen the operation of SNP administered by the ECB to support the process of financial inclusion.**	
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan.	**Yes**	**The impact evaluation of the program will produce valuable lessons on the effectiveness of financial inclusion interventions.**	

The project is aligned with IDB institutional priorities. The project contributes to two Bank's lending priorities: (i) Lending to small and vulnerable countries and (ii) Lending for poverty reduction and equity enhancement. The project is also aligned with the country strategy's objectives to improving access to financing by modernizing the financial system and improving the financial system architecture.

The objective of the project is to promote public access to financial services, especially those located in smaller geographical areas of deepening Financial and lower levels of income. The project document and its annexes provide a clear and complete justification for the project. Problems and their causes are identified and discussed. The project's potential beneficiaries are also identified and described. Evidence of the effectiveness of similar interventions is also discussed. Although the project impact could have been defined more precisely, the project's metric is well defined and the result matrix includes valid indicators with baseline and targets. The project document includes a complete cost/benefit analysis. It also includes a monitoring and evaluation plan that is complete and follows the DEM outline. The evaluation strategy is based on an experimental methodology.

The risks are identified in the risk matrix rated for magnitude and likelyhood, include mitigation measures and related metric to track their implementation.

RESULTS MATRIX

INDICATOR MATRIX

Program objective	To foster access to financial services by the population, particularly in geographic areas characterized by limited financial penetration and low income levels. This will be achieved by supporting and strengthening intermediary financial institutions (IFIs), popular finance structures (PFSs), and the national payments system (NPS), thus helping to increase the number of individuals served by the financial system.

Indicators	Unit	Baseline Year 2011	Interim measurements				Targets	Source	Comments
			Year 1	Year 2	Year 3	Year 4	Year 5		
IMPACT: Increase in the number of persons served by the financial system, particularly in areas of limited financial penetration and lower income levels									
Total number of new financial system users in the program's beneficiary IFIs and PFSs (cumulative)	Number	0					237,189	Program monitoring system, IFI and PFS databases	Cumulative target

Indicators	Unit	Baseline Year 2011	Interim measurements				Targets	Source	Comments
			Year 1	Year 2	Year 3	Year 4	Year 5		
OUTCOMES									
Number of new financial system users in the program's beneficiary IFIs and PFSs (cumulative)	Number	0	28,370	78,078	132,230	186,665	237,189	Program monitoring system, IFI and PFS databases	Cumulative target
Number of new financial transactions performed by users of the program's beneficiary IFIs and PFSs (cumulative)	Number	0	340,435	936,936	1,586,766	2,239,977	2,846,265	Program monitoring system, IFI and PFS databases	Cumulative target
Average processing time per transaction in the NPS[1]	Minutes	300	300	260	220	200	180	BCE NPS statistics (monthly frequency)	Average time from the moment the transaction order is generated to the moment it is credited in the final beneficiary's account.
Number of annual transactions processed online in the NPS (cumulative)	Number	760,133	833,894	1,036,897	1,380,696	1,866,024	2,480,439	BCE NPS statistics (monthly frequency)	Cumulative target

[1] The new NPS will be introduced gradually. It will operate in parallel with the current NPS until the technological structure of the entities can accommodate the new information and technology requirements.

Indicators	Unit	Baseline Year 2011	Year 1	Year 2	Year 3	Year 4	Year 5	Target	Source	Comments
OUTPUTS COMPONENT 1: COMPETITIVE FUND TO SUPPORT FINANCIAL INCLUSION[2]										
Number of new points of service[3] of the competitive fund's beneficiary IFIs and PFSs	Number	0	0	175	330	330	85	920	Semiannual BCE reports	Cumulative target
Number of IFIs and PFSs benefiting from the competitive fund	Number	0	0	7	8	6	4	25	Semiannual BCE reports	Cumulative target
Number of IFIs and PFSs trained on the benefits of using competitive fund resources	Number	0	0	30	30	20	10	90	Semiannual BCE reports	Cumulative target
OUTPUTS COMPONENT 2: IMPLEMENTATION OF THE NEW NATIONAL PAYMENTS SYSTEM										
Number of IFIs and PFSs integrated into the BCE payment infrastructure with straight-through processing (STP) standards	Number	132	20	20	20	20	20	232	Semiannual BCE reports	Cumulative target
Implementation of action plan to improve NPS infrastructure (software and hardware) at the BCE	% implemen-tation	0	10	70	20	0	0	100	Semiannual BCE reports	100% equals a fully implemented plan
Number of NPS users trained on the system's use and functionality.	Number	600	60	60	60	60	60	900	Semiannual BCE reports	Cumulative target

2 These projections are based on the best available estimates. Due to the program's innovative nature, they could change over the course of program execution.
3 Points of service are deemed to include ATMs, POS, branches, agencies, extension windows, and transaction centers.

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Project number: EC-L1110

Executing agency: Central Bank of Ecuador (BCE)

Prepared by: Marco Andrés Alemán (procurements specialist) and Gustavo Palmerio (FMP/CEC)

The institutional evaluation for fiduciary management of the project was performed on the basis of: (1) the fiduciary context of the country; (2) the results of the fiduciary risk assessment; (3) an analysis of the BCE using the ICAS tool; (4) work meetings with the project team; and (5) meetings with staff from the various areas of the BCE. As a result of this evaluation, procurement and financial management fiduciary agreements have been prepared for project execution.

I. FIDUCIARY CONTEXT OF THE COUNTRY

Procurement system: The Sistema Nacional de Contratación Pública [National Public Procurement System] (SNCP) was approved through the SNCP Act in August 2008. The substantial changes introduced include creating the Instituto Nacional de Compras Públicas [National Public Procurement Institute] (INCOP) as the governing body for public procurement. With Bank support, INCOP carried out a diagnostic assessment of the SNCP using the OECD/DAC methodology, which showed the SNCP to be at medium development. The diagnostic assessment's final report has been approved by the government and published in Ecuador's public procurement portal.

Financial management system: Since January 2008, government entities have been using the e-SIGEF financial management system, which efficiently integrates the budget, accounting, treasury, and electronic payment processes with centralized information technology and the use of web-based technology. In addition, central government entities are subject to control and oversight by the highest auditing body, which is the Office of the Comptroller General of Ecuador (CGE). In general terms, the country's financial management systems are adequately developed and, for purposes of executing Bank-financed projects, need to be supplemented at the moment in the areas of specific financial reporting and external audits (to be performed by a firm acceptable to the Bank).

II. FIDUCIARY CONTEXT OF THE EXECUTING AGENCY

The program's executing agency will be the BCE, acting through the Department of Special Projects, which will be responsible for program management, promotion, and supervision.

The BCE is a legal entity subject to public law and in existence for an indefinite term. It is responsible for its own technical and administrative management and has its own equity. Its duties are to implement, execute, oversee, and apply the State's monetary, financial credit, and foreign-exchange policies, and its objective is to safeguard currency stability. As part of its duties, the BCE manages and operates the National Payment System (NPS). More than 72,377,419 transactions are executed annually through the NPS for an aggregate amount of approximately US$195.704 billion, more than 3.6 times the country's GDP.

During program execution, the BCE will be required to interact with intermediary financial institutions (IFIs) and popular finance structures (PFSs) that are potential beneficiaries of component 1 "Competitive fund to support financial inclusion," working together with these entities (strengthening actions, training, and execution of the competitive funds through subsidies and/or cofinancing of projects submitted by the entities) .

In preparing this program, the BCE's institutional capacity was analyzed by means of the ICAS tool, yielding a low-risk general rating.

The BCE uses country procurement systems. However, with regard to financial management, the Bank has its own income and therefore does not use the e-SIGEF integrated national system for its own accounting purposes. Instead, it has an internally developed proprietary system known as Sistema de Gestión Transaccional [Transaction Management System] (SGT), which allows for recording, operating (processing), and consulting interlinked budget and accounting modules. Budget and accounting items have the same code, enabling this linkage.

III. Fiduciary Risk Evaluation and Mitigating Measures

Based on available program information, workshops, and work meetings conducted with the BCE and other actors, certain fiduciary risks were identified as set forth in the relevant risk matrix, the most significant of which are the following:

a. Limited capacity of IFIs and PFSs to submit eligible projects for component 1 "Competitive fund to support financial inclusion."

Factors: Multiplicity of potentially beneficiary IFIs and PFSs with varying institutional capacity, which means that some might lack the resources to submit eligible projects.

Impact: Delays in execution – Concentration of eligible projects in a limited number of IFIs and PFSs with the capacity to submit eligible projects.

Mitigating measures: (i) Include specialists in the program management team to help those IFIs and PFSs with limited capacity to submit projects that may be deemed eligible.

b. Improper or inefficient use by IFIs and PFSs of the resources allocated through component 1 "Competitive fund to support financial inclusion."

Factors: Little experience in executing this type of project on the part of the IFIs and PFSs.

The program's innovative characteristics affect BCE monitoring of the execution of the projects allocated to the IFIs and PFSs.

Impact: Funds used improperly or inefficiently.

Mitigating measures: (i) Staff the management team with a group of experienced professionals with technical expertise in tracking and monitoring project outcomes during project execution. (ii) prepare the program's Operating Regulations, providing a detailed description of execution procedures, requirements, and internal controls; and (iii) contract a concurrent audit for supervision of the funds delivered through component 1 in the subsidy and cofinancing instruments.

IV. CONSIDERATIONS FOR THE SPECIAL CONDITIONS OF THE CONTRACTS

Some points to be considered:

- Appointment of the program's management team, staffed by suitable personnel with the Bank's no objection.
- Approval of the program's Operating Regulations.

V. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

1. Procurement execution

The procurement plan will list the procurement to be conducted under the program, and may be updated on an annual basis or whenever necessary. The Project Team Leader is responsible for approving the procurement plan and keeping it up to date during program execution.

The program calls for procurement of goods and services and contracting of consultants in accordance with the policies outlined in documents GN-2349-9 and GN-2350-9, respectively, and as set forth in the Bank-approved procurement plan. For component 1 "Competitive fund to support financial inclusion," procurement will be carried out by the IFIs and PFSs pursuant to customary business practices, under BCE supervision. The consulting and nonconsulting services related to the technical assistance and the training and dissemination activities included in component 1 will be contracted by the BCE through the processes set forth in the aforementioned policies.

Bank-approved Standard Bidding Documents (SBDs) and Requests for Proposals (SRFPs) will be used for the procurement of goods and nonconsulting services, individual consultants, and consulting firms that involve amounts or reference budgets exceeding country thresholds. SRFPs agreed upon by the Bank and the executing agency will be used for procurement below the threshold amounts.

2. Initial procurement plan

The procurement plan is included in the Proposal for Operations Development (POD) as an annex. In addition, the Procurement Plan Execution System (SEPA) will be used for procurement planning and monitoring purposes.

3. Procurement supervision

In view of the fiduciary context of the executing agency and the level of risk associated with the operation (low), the following initial thresholds have been set for ex post supervision:

a. Procurement of goods and services for an estimated total amount less than or equal to the equivalent of US$250,000.00.

b. Contracting of consulting services with consulting firms at an estimated total cost less than or equal to the equivalent of US$200,000.00.

All other contracts will be subject to ex ante review by the Bank, including any direct procurement of goods and services and direct selection of consulting firms or individual consultants.

The type of supervision may vary during program execution, based on the implementation of mitigating measures and the degree of executing agency strengthening.

4. Special provisions

a. Special measures. No special measures are provided.

b. Other procedures: There are no other procedures.

5. Records and files

The executing agency will be required to keep updated records and properly organized files for review by the Bank, pursuant to the following guidelines:

a. The file containing procurement documents will be in a single folder that is easily distinguishable from folders documenting processes financed with local contribution resources or nonprogram resources.

b. Documents will be duly organized, paginated, and numbered to make them easily and immediately locatable and identifiable, and will at all times be available for audit purposes.

6. Advance procurement and retroactive expense recognition:

The improvements identified in component 2 are essential for a more efficient NPS. The expenses that could be subject to retroactive financing refer to the implementation of component 2 activities (i), (ii), and (iii) starting 2 May 2012 in an estimated amount of up to 20% of the loan. Thus, the projected retroactive financing is for this total, in the framework of Operational Policy OP-504 Recognition of expenditures, retroactive financing, and advance contracting, Manual PR-200 Sovereign-guaranteed operations – general overview, and the procurement policies set forth in documents GN-2349-9 and GN-2350-9.

VI. Financial Management Agreements and Requirements

1. Programming and budget

The Código Orgánico de Planificación y Finanzas Públicas [Code of Public Planning and Finance] (COPYPF) establishes the general rules governing budget programming, formulation, approval, execution, control, evaluation, and disbursement. These general rules are applied to the execution of Bank-financed programs in Ecuador.

While BCE income and expenditures are not part of the general government budget, for proforma budget preparation purposes, the BCE is required to comply with the COPYPF and the technical rules, guidelines, classifications, and catalogues issued by the Ministry of Finance.

Accordingly, the BCE has an automated system that enables proper control and monitoring of the institutional budget. This system consists of two modules:

- "PRO" (Operator budget system), fed by the user or the person responsible for the budget at each of the areas known as budget responsibility centers.
- "PRA" (Administrator system), operated by the financial director and budget area director, who manage access to and profiles of the PRO system, budget consolidation, and relevant modifications.

The program's budget will be based on the annual work plan agreed upon by the Bank and the executing agency and will serve as a basis for its formal inclusion in the general government budget.

The BCE will manage the program's disbursements and budget allocations and use its internal systems to control the budget execution performed every four months.

2. Accounting and information systems

BCE accounting is performed through the aforementioned SGT. This system has a functionality known as light accounting system, which is used by the BCE for other types of projects requiring specific control. In addition, the SGT has several modules, including:

- ACT - Account administrator, where the charts of accounts are entered;
- ADM - Administrator, where transactions are defined and parameterized (parameters, accounts, breakdowns, calculation formulas).
- OPE - Accounting operator, used by the accounting responsibility centers (CRCs) to upload accounting information.
- SIF - Financial information system, used for inquiries, reports, processing of transaction information, and posting and issuance of financial statements.
- COPY - Support application used for copying transactions as backup and copying work to be sent for production.

A light accounting database was developed for the program through these modules. Linked to the BCE accounting system, this database makes it possible to identify transactions by source of financing, investment category, and other activities. Given the system's characteristics, it was agreed with the executing agency that the BCE's current system would be used for this loan operation.

The IFIs and PFSs will perform financial management through their own systems. These systems must allow verification that resources are being used for the program's specific purposes.

3. Disbursements and cash flow

Starting in 2008, the Government of Ecuador instituted a Cuenta Única del Tesoro [General Treasury Account] (CUT) mechanism, merging the treasury management function of all entities that are part of the central government. The implementation of this mechanism did not eliminate the special account or specific purpose system, which is used within the BCE solely to receive multilateral loan proceeds, including from IDB loans.

To receive IDB loan disbursements, the Ministry of Finance, acting in coordination with the BCE, will be required to open and maintain an account at the BCE. For record-keeping purposes, these resources will immediately be moved to the CUT, from which all resources disbursed by the IDB will be transferred to a special account to be created at the BCE for program management purposes.

Program disbursements will be made in the form of advances of funds based on the program's actual liquidity needs, pursuant to a detailed financial plan reflecting the program's actual funding needs for a period of six months. The financial plan will be prepared at the start of the program and will be updated as program execution takes place.

The executing agency will submit disbursement requests to the Bank together with the program's financial and cash flow plan for the next 180 days. The evidence of use of resources will be provided with the following disbursement request, once at least 80% of the advanced resources have been executed.

The supporting documents for expenses incurred or payments made will be subject to ex post review. However, at the request of the executing agency, it has been determined that a portion of the expenses related to the component 1 competitive fund (only those arising from the project subsidy and cofinancing instruments granted to IFIs and PFSs) will be supported by a report issued by an external audit firm following an assurance service review aimed at certifying the records and supporting documents for expenses incurred and payments made. Any expenses deemed ineligible by the aforementioned report will have to be reimbursed using local contribution resources.

4. Internal control and internal audit

On the subject of internal control systems, the Constitution of Ecuador establishes that the Office of the Comptroller General of Ecuador (CGE) is responsible for directing the control system, which consists of the internal audit, external audit, and internal control of public-sector entities and private-sector entities using public resources, as well as for issuing the regulations governing the performance of these functions.

The BCE has an internal auditing unit which reports directly to the CGE. However, the program's Operating Regulations will include the main internal control processes needed to ensure that the controls are functioning properly. During execution, the fiduciary team will evaluate compliance with, and the quality of, these processes.

5. External control and reports

Since the CGE does not currently have sufficient capacity to exercise external control over projects financed with external debt resources, the program's external audits will be conducted by first-tier independent auditors (international audit firms) acceptable to the Bank, pursuant to Bank requirements. During execution, the BCE will present the program's annual audited financial statements in accordance with the Bank's guidelines and based on terms of reference previously approved by the Bank. It will also present the reviews of the evidence of use of resources described in item 3 above. The audit costs will be covered by local contribution resources.

6. Fiduciary supervision plan

Supervisory activity	Supervision plan			
	Nature and scope	FREQUENCY	Responsible entity	
			Bank	Third party
OPERATIONAL	Review of progress report	SEMIANNUAL	Fiduciary and sector team	
	Portfolio review with executing agency	In accordance with Ministry of Finance (MF) requirements	Fiduciary and sector team	MF
FINANCIAL	Inspection visits	QUARTERLY	Fiduciary specialist	
	Financial audit	ANNUAL	Fiduciary specialist	Executing agency
	Review of evidence of IFI and PFS expenditures arising from subsidies and cofinancing of projects (report by external auditing firm)	With each disbursement	Fiduciary specialist	Executing agency
	Review of disbursement requests	With each disbursement	Fiduciary team	
PROCUREMENT	Ex ante procurement review only for direct contracting and selection and procurement involving reference amounts exceeding country thresholds for that type of process.	During program execution for procurement exceeding the established amounts.	Project Team Leader/with support of procurement specialist	Executing agency
	Procurement plan update	Annual	Project Team Leader/with support of procurement specialist	Executing agency
COMPLIANCE	Fulfillment of conditions precedent	ONE-TIME	Fiduciary team	
	Budgetary allocation	ANNUAL	Fiduciary specialist	Executing agency
	Presentation of audited financial statements	ANNUAL	Fiduciary specialist	Executing agency

7. Execution arrangements

The program will be managed within the BCE's institutional structure through the Department of Special Projects. This department will report directly to General

Management and will be responsible for the program's technical, operational, financial, and procurement management, as well as for coordinating with the other areas of the BCE.

The Director of Special Programs will act as project manager and be supported by: (a) a financial administrative assistant; (b) a procurement specialist; and (c) a technical team consisting of two bank and microfinance professionals and two PFS professionals. In addition, an internal committee consisting of senior officials will be created for the primary duty of recommending allocation of the competitive funds to IFIs and PFSs through subsidies and/or cofinancing of projects.

This team will work in coordination with the BCE areas or departments that perform duties related to the program's execution, and will also coordinate with the beneficiary IFIs and PFSs under component 1 "Competitive fund to support financial inclusion."

The fiduciary activities will be performed under the direct responsibility of the financial administrative assistant and the procurement specialist, but with comprehensive support from the BCE's Financial Department, whose purview encompasses the accounting, budget, cost, and payment processes.

The program's Operating Regulations will describe the program's execution mechanism in detail.

VII. Procurement Table

This table is available at the electronic link Procurement plan.