Armenia: Development of a Deposit Guarantee Scheme

Ex post evaluation report

OECD sector	2403000	
BMZ project ID	2003 65 312 (Investment) 2003 70 155 (Complementary Measure)	
Project executing agency	Ministry of Finance and Economy of Armenia	
Consultant	GBDS	
Year of ex post evaluation report	**2010 (2010 sample)**	
	Project appraisal (planned)	**Ex post evaluation report (actual)**
Start of implementation	2nd quarter 2005	2nd quarter 2005
Period of implementation	36 months	46 months
Investment cost	EUR 3.90 million	EUR 3.90 million
Counterpart contribution	---	--
Financing, of which Financial Cooperation (FC) funds	EUR 3.90 million	EUR 3.90 million
Other involved institutions / donors	---	---
Performance rating	2	
• Relevance	2	
• Effectiveness	2	
• Efficiency	2	
• Overarching developmental impact	2	
• Sustainability	2	

Brief description, overall objective and project objectives with indicators

Under the project "Development of a Deposit Guarantee Scheme" (BMZ ID 2003 65 312), German Financial Cooperation (FC) provided EUR 3.5 million as start-up finance to put a deposit guarantee scheme in place. The high initial capitalisation demonstrates the financial stability of the scheme to the public and reduces the costs of the initial capitalisation, which would otherwise have to be borne by savers. In addition, a complementary measure was financed with the sum of EUR 0.4 million to support the establishment of the deposit guarantee fund, the training of its staff and the support of the introduction of the deposit guarantee law.

The objective of the project was to establish a functioning deposit guarantee scheme that was firmly backed by the banks and accepted by the general public for the purpose of mobilising additional local savings and stabilising the banking system (project objective). This was intended to contribute to the development of a functioning financial system as an important element for the further development of the Armenian economy (overall objective). The project targeted small savers who were to be offered protection for their savings. At the meso level, the project was also expected to indirectly benefit the Armenian banks by improving their funding on the basis of customer savings deposits, while at the macro level it was expected to benefit the Armenian economy through an improved supply of credit.

The following indicators were defined to measure the achievement of the overall objective: (1) reduction of the differences in deposit interest rates between various banks and (2) reduction of the interest margin in the banking sector to below 10% on average by 2006. The indicators for the achievement of the project objective were: (1) increase in the ratio of all customer savings deposits to GDP to 20% by 2006; (2) correct handling of compensation claims without jeopardising the deposit guarantee scheme, and (3) increase in the population's familiarity with the deposit guarantee scheme and their understanding of its working methods as verified by surveys.

Project design / major deviations from the original programme planning and their main causes

The borrower was the Armenian Government, represented by the Ministry of Finance and Economy. The FC loan of EUR 3.5 million was granted at IDA conditions for a term of 40 years including 10 grace years and at 0.75% interest p.a., and it was channelled to the deposit guarantee fund at identical terms. The funds were available to the deposit guarantee fund immediately after they were ready for disbursement on 15 September 2005. We have received no evidence of any misappropriation.

The Armenian Deposit Guarantee Fund (ADGF) currently has a staff of six persons. The staff is composed of the Director, the Assistant Director, the Senior Economist, the Economist, the (part-time) Lawyer and the (part-time) Accountant. In addition, the ADGF is controlled by an internal auditor. The consultant advised the fund, conducted various workshops and organised educational tours abroad for the staff members. In early 2008 a change in the management of the ADGF took place when the Director and the Senior Economist left the Fund. Their departure meant a major loss of knowledge and experience. It extended the project timeline as new staff members had to be recruited.

Key results of the impact analysis and performance rating

The deposit guarantee fund is an important milestone on the road map of Armenia's banking sector towards a Western-style financial system. After the population had lost a great deal of confidence in the banking sector following its transformation into a market-oriented financial system and the associated funding problems of the domestic banks as well as the low savings of the population, the establishment of a fund of this sort was appropriate to address these problems.

The project reaches small savers in particular, who tend to belong to the poorer half of the population. The project supports men and women equally and no difference in access to savings can be observed for any one gender. The project was not intended to protect the environment or natural resources, and negative environmental impacts can be ruled out. The project has had a positive influence on good governance through the creation of a new state institution on the basis of a governance model operating to Western rules.
In a summarised assessment, we have arrived at the following rating of the programme's developmental efficacy:

Relevance: the project conception was suitable for addressing the core problem of the financial sector: the population's lack of confidence in the financial sector. Deposit guarantee funds are a core element for the development of an efficient financial sector which, in turn, contributes to economic development and therefore has been and continues to be one of the priorities of the partner country. A suitable deposit guarantee fund design that ensures that claims can be paid is also of high importance for small savers who represent the poorer, albeit not the poorest, segment of the population. More and more studies have been confirming the positive role of secure savings options for the population as they meet their day-to-day challenges and realise investment projects. Thus the project was fundamentally aligned with the current development policy objectives and priorities of the Federal Government in the financial sector and has the potential to support poverty reduction objectives (MDG). We therefore rate the overall relevance of the project as good (sub-rating 2).

Effectiveness: All indicators for the achievement of the project objective were met. The ratio of customer savings deposits to GDP was 22.5%, exceeding the target value of 20%. The degree of familiarity of the deposit guarantee system in the population has definitely risen (2006: 23%). The last Surveys conducted in December 2010 revealed a degree of familiarity of 74%. Whether claims are being handled properly cannot yet be assessed because no claim has yet been filed. Despite some weaknesses, the institutional conditions permit the conclusion that the deposit guarantee fund will fulfil its function in the event of a claim as well. A decisive factor will be that the Central Bank supports the ADGF optimally in its work. As the experience gathered so far demonstrates that the Central Bank is willing to support the work of the ADGF through the further development of the disbursement procedures in the event of a claim, we rate the effectiveness of the project as good (sub-rating: 2).

Efficiency: We rate the financial situation of the ADGF as good. Since the EUR 3.5 million initial capitalisation provided by KfW, the fund assets have increased to EUR 10.3 million on the basis of member contributions and interest earnings. The insurable deposits, for their part, amount to EUR 246,779,704. In the period from 2005 to 2010 the net interest earnings received by the ADGF averaged 6.6%. They are entirely sufficient to cover the running costs of the fund. In our view, there was no better alternative that could have restored confidence as fast as the chosen institutional form of a deposit guarantee scheme. Without the initial capitalisation provided under FC it would have taken the fund assets many years to grow from the premiums collected by the banks before a convincing insurance protection had formed, or the Armenian Government would have had to assume these functions. The latter, however, could have led to disincentives for the insured banks, and it would have linked the protection of confidence directly to the creditworthiness of the Armenian state. For these reasons we also rate the allocation efficiency as good, so that we arrive at a good rating overall of the efficiency of the project (sub-rating: 2).

Overarching developmental impact: The overall objective of the project was to contribute to the development of a functioning financial system, an important element for the further development of the Armenian economy. Measured against the indicators, the overall objectives have not been fully achieved. The difference between the interest rates paid by the various banks on the deposits was 9.5% in the year the deposit guarantee scheme was introduced but increased temporarily to 15.2% after the financial crisis. In this case, however, the impacts of the financial crisis probably interfered with the effect of the deposit guarantee scheme. The strong heterogeneity of the effects of the crisis on the different banks is likely to be the main reason for the strong increase in the difference between the interest rates. The second indicator for the achievement of the overall objective, the reduction in interest margins, can be regarded as having been fulfilled. The project succeeded well in reaching the target group of Armenian small savers and significantly mobilised their savings. The number of deposit accounts and their volume increased substantially. The funding options for the banks have increased significantly since project appraisal. The positive development of the financial sector is exemplified not only by the increase in the average maturity of loans and the noticeable increase in the ratio between bank assets and GDP, but also by the clear deepening of financial intermediation (the ratio of loans granted to the private sector to GDP increased from 8.7% in 2005 to 23.7% in 2009). We rate the developmental efficacy of the project as good (sub-rating 2).

Sustainability: The AGDF will most probably remain capable of performing its function without further support from abroad in the long term; in all likelihood it will not require further capitalisation. Based on its solid financial development so far and its positive environment, the fund can be expected to meet the overall objectives in future as well. A crucial factor will be the involvement of the Central Bank in the continuing improvement of the disbursement procedures in the event of a claim. As it has taken initial steps in this direction, we conclude that the CBA also has a strong interest in a functioning deposit guarantee fund. We rate the sustainability of the project as good. (Sub-rating: 2).

In a summarised assessment of the above impacts and risks, we rate the project as good overall on the basis of the aspects we have evaluated (overall performance rating: 2).

General conclusions and recommendations

None.

Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being relevance, effectiveness, efficiency and overarching developmental impact. The ratings are also used to arrive at a final assessment of a project's overall developmental efficacy. The scale is as follows:

1	Very good result that clearly exceeds expectations
2	Good result, fully in line with expectations and without any significant shortcomings
3	Satisfactory result – project falls short of expectations but the positive results dominate
4	Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results
5	Clearly inadequate result – despite some positive partial results, the negative results clearly dominate
6	The project has no impact or the situation has actually deteriorated

Ratings 1-3 denote a positive or successful assessment while ratings 4-6 denote a not positive or unsuccessful assessment

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability) The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The overall rating on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Ratings 1-3 of the overall rating denote a "successful" project while ratings 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally "successful" only if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are rated at least "satisfactory" (rating 3).