Ex Post-Evaluation Brief
Azerbaijan: Development of a Deposit Insurance Fund

Programme/Client	Development of a deposit insurance fund BMZ No: 2002 66 254	
Programme executing agency	Azerbaijan Deposit Insurance Fund (ADIF)	
Year of sample/ex post evaluation report: 2011*/2011		
	Appraisal (planned)	Ex post-evaluation (actual)
Investment costs (total)	EUR 5.0 million	EUR 5.0 million
Counterpart contribution (company)	-	-
Funding, of which budget funds (BMZ)	EUR 5.0 million	EUR 5.0 million

* random sample

Project description: This FC project encompassed the structuring, establishment and initial capitalisation of ADIF, a deposit insurance fund. The package of measures comprised initial capitalisation in the amount of EUR 5.0 million (an FC loan) accompanied by an investment of EUR 1.0 million, which together aimed to create a sustainable structure for the fund, to strengthen it from an institutional perspective (staff, planning, systems and processes), and to support the implementation of internationally recognised standards.

Objective:
The overarching developmental objective (the overall objective) of this FC measure was to contribute to the development of a functioning financial system, this being an important element of national economic progress. The project objective was to create a deposit insurance scheme and ensure that it was firmly and sustainably established, both at the banks and within the general public, in order to promote the mobilisation of local savings and stabilise the banking system.

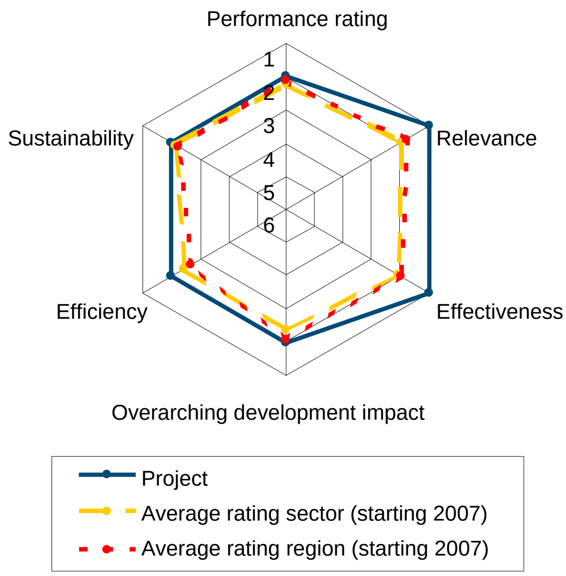
Target group:
Small savers, who have limited opportunities to invest their savings productively and safely.

Overall assessment: Rating 2

Points worth noting:

The Azerbaijani partners (the government and central bank) called on German FC experience in developing deposit insurance schemes at an early stage. This meant that the project, which was fundamentally a partner-managed development, could be supported appropriately right from the outset.

Rating by DAC criteria



EVALUATION SUMMARY

Overall rating: The deposit insurance fund has contributed to greater trust in the private banking domain, and hence has also led to increased competition in the Azerbaijani financial sector. Furthermore, the fund is operating at a high level of efficiency and sustainability. Despite this and due, in particular, to its continuing concentration on the Azerbaijani financial sector and the weaknesses which the fund still exhibits with regard to procedures and IT provision, in our overall appraisal we have confined our assessment to 'good'. **Rating: 2**

Relevance: The project was suitably designed to tackle a core problem, namely the lack of public trust in the financial sector. Deposit insurance funds are a key element in the development of a productive financial sector, which contributes in turn to economic progress. Hence this was - and still remains - one of the priorities of the partner country. Having an institutionally backed deposit insurance arrangement which assures payment in the case of losses is of particular importance to small savers, who generally represent the poorer part of the population. Secure savings opportunities are not only important for realising investments; they are equally essential for the livelihoods of savers. Consequently the project accorded with the German government's developmental objectives and its priorities for the financial sector, as well as supporting MDG poverty reduction goals. The project was well coordinated with other donors; the IMF was involved in particular. On this basis we have assessed the overall relevance of the project as 'very good' (Rating: 1).

Effectiveness: Four years after project appraisal, three out of five project objective indicators relating to the mobilisation of personal savings (especially those of the target group of small savers) have been either attained or clearly exceeded. Between 2007 and 2011, personal deposits climbed much faster than GDP; small savings deposits reached the targeted value of AZN 260 million in 2011 (as against the planned date of 2015); and, at 81%, long-term deposits as a proportion of total deposits are slightly above the target of 80%. Only the two project objective indicators relating to the fund's capital structure – a coverage ratio (fund volume / insured deposits) of 5%, and a fund volume that covers the insured deposits of the two largest private banks to at least 100% - have not yet been achieved; however, it is likely that they will be attained by 2015, as planned. Furthermore, this deposit insurance fund has gained a high degree of recognition, supporting the role it plays in building trust and strengthening the financial system. 70% of those surveyed knew about the fund, which has been publicised via a well-structured website, as well as in numerous interviews and articles. Overall, and also considering the speed with which objectives have been attained, we have assessed the effectiveness of this project as 'very good' (Rating: 1).

Efficiency: The fund's financial situation is considered good. The initial level of capitalisation, which was achieved through a German financial cooperation (FC) loan to the state of Azerbaijan in the amount of EUR 5.0 million, has since been significantly surpassed by cumulative contributions from the banks, which total approx. EUR 27 million. As a result, over the last three and a half years the average fund volume has climbed annually by approx. AZN 9.5 million to currently AZN 37.0 million. The fund has shown a surplus which has increased continuously, reaching EUR 7.9 million in 2010. Net interest income (EUR 0.37 million in 2010) corresponded to an average interest return of 3.6% on the financial investment portfolio, which is attributable to the fund's conservative investment policy. Nevertheless, net interest income was sufficient in itself to cover 56% of total operating expenses in 2010 (94% in 2009). Taking premium income into account (EUR 8.3 million in 2010) shows that operating expenses represent only a fraction (roughly 7%) of total operating income. The resulting surpluses are leading to a continuous growth in fund volume and thereby increasing the amount available to safeguard deposits. In our opinion, the particular institutional format chosen - a deposit insurance scheme - was the best option available for achieving (and securing) such rapid confidence-building effects. This holds true even if there is still scope for a certain degree of improvement, in that the insurance premiums charged to the banks could be formulated on the basis of individual risk. Without the project's target-oriented accompanying measure, the fund would probably not have been established with the same speed and professionalism; and without the initial capitalisation from FC, fund assets would have grown more slowly, and the insurance protection which exists today would have taken correspondingly longer to develop (or the Azerbaijani state would have had to take over responsibility for the insurance function). The latter outcome, however, could have led to disincentives for the insured banks (through providing insurance to those banks which have lower creditworthiness, even if they offer excessive interest rates to attract as many deposits as possible), and hence maintaining trust would have become directly linked to the creditworthiness of the state. For the above reasons, we have also assessed allocative efficiency as good. However, four years after the fund was established there are still problems in the IT provision that supports it, which would make it difficult to settle claims correctly, if the need arose. Yet at the same time new developments (such as risk-oriented premiums) are being pursued, for which the fund is, at this point, most certainly neither qualified nor equipped. Furthermore, despite a good working relationship with the central bank (CBAR), contractual agreement has clearly not yet been reached over the credit line sought, nor regarding the right to deliver bonds early in order to create liquidity. For the above reasons, we have limited our assessment of project efficiency to 'good' (Rating: 2).

Overarching developmental impact: The overall objective of this project was to contribute to the development of a functioning financial system, as an important element in the development of the national economy of Azerbaijan. Measured against the indicators that are due to be reached by 2015, some of the overall objectives have already been achieved, and it is expected that the others will be attained by 2015. Assets owned by the two biggest banks (one of them the majority state-owned bank IBA) as a proportion of total assets have fallen steadily, dropping by nearly four percentage points to 43.8%, this being only just above the 40% level set as an indicator for 2015. Meanwhile the private banks' share of personal deposits stands at 79%; the target set for 2015 of over 50% has thus been markedly surpassed already. Reducing market concentration amongst private banks and strengthening their ability to compete has reduced system vulnerabilities within the banking sector. Moreover, the positive development of the financial sector can be seen in the longer duration of average loan terms and in an overall improvement in financial intermediation - the ratio of private sector lending to GDP has risen from 12.9 in 2006 to 21.7 in (2011)[1]. Furthermore, this ongoing positive development in the financial system has not been interrupted by the financial and economic crises of recent years. Despite this, the dominance of the two largest banks in the sector - especially the majority state-owned IBA, which resisted the establishment of this fund for a long time - is still clearly evident. Even if the objective of '40% market share for the two largest banks by 2015' were achieved, this situation would not significantly alter. We have therefore confined our assessment of the overarching developmental impact of this project to 'good' (Rating: 2).

Sustainability: It is highly likely that the deposit insurance fund will be able to fulfil its long-term obligations, even without any further capitalisation measures being implemented by the donor community. The solid financial development seen to date, the public dialogue, and the positive general environment all suggest that the impact achieved at the overall objective level will continue to be maintained in future. There is judged to be a very high level of government and central bank interest in a functioning deposit insurance fund. German FC expertise was called in at a very early stage, in the fund's initial development phase. This enabled the Azerbaijani partners to establish the fund within an appropriate structure and to start fund operations some two and a half years before its capitalisation with FC funding. We have identified - possibly for this very reason - a high degree of ownership among the Azerbaijani partners. Since then roughly 85% of the deposit insurance fund's resources have been generated through banking sector fees, whereas the German FC contribution amounts to only 15%. Against this background, we have judged the sustainability of this project as 'good' (Rating: 2).

[1] Standard & Poor, February 2011

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).