



51.9	90.53		
48.52	72.26		
10.25	46.99		
189,250	1,892,570	191.54	187.95
237,500	1,109,780	23.76	57.84
28,725,000	47.87	66.4	
74,000	2.3	10.89	
385,000	47.76	68.24	
19,869,200	19,894,200	22.53	47.86
6,124,700	6,847,000	25.76	50.001
16,843,500	18,981,000	24.6	43.66
65,083,110	112,325,000	35.54	43.31
47,142,700	82,545,000	416.88	133.74
6,482,500	6,856,510	101.38	117.18
6,520,900	7,373,000	17.49	41.66
402,860	572,000	1.22	4.7
1,195,300	2,436,000	1.11	2.02
3,940,500	4,806,320	2.22	6.33
200,200	584,774	1.7	4.2



## Corporate Evaluation

# Third Independent Evaluation of Expanded Project Supervision Report Exercise





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Management response to the evaluation available at: <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=35777801>

IIC's Management response to the evaluation available at: <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=499119>

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This document has been edited in accordance the Access to Information Policy. In particular, proprietary information pertaining to private sector firms has been removed.

## ACRONYMS

CAP	Correction Action Plan
CAPEX	Capital Expenditures
EBITDA	Earnings before Interest, Taxes, Depreciation, and Amortization
ECG	Evaluation Cooperation Group
EOM	Early Operating Maturity
ERR	Economic Rate of Return
EROIC	Economic Return on Invested Capital
ESHS	Environmental and Social and Health and Safety
FRR	Real After-Tax Financial Rate of Return
GPS	Good Practice Standards
IDB	Inter-American Development Bank
LD	Loan Document
LTV	Loan-to-Value
MDB	Multilateral Development Banks
OVE	Office of Evaluation and Oversight
PCG	Partial Credit Guarantee
RF	Results Framework
ROIC	Return on Invested Capital
SCF	Structured and Corporate Finance Department
TCD	Technical Completion Date
WACC	Weighted Average Estimated Cost of Capital
TCD	Technical Completion Date
XPSR	Expanded Project Supervision Report
XPSR-A	Expanded Project Supervision Reports Addendum

## EXECUTIVE SUMMARY

This report evaluates the third exercise of the Expanded Project Supervision Reports (XPSRs), prepared by the Structured and Corporate Finance Department (SCF). The exercise represents a step toward full compliance with the Evaluation Cooperation Group's (ECG) guidelines, which require the validation of the XPSRs the same year they reached Early Operational Maturity (EOM). Based on the agreed schedule between OVE and SCF, this goal should be achieved by the end of 2011. This exercise implies the preparation of 13 XPSRs for all projects that reached EOM in 2008 and 2009. According to this agreed schedule, two additional exercises will be conducted by the end of 2011, one for projects that reached EOM in 2010 and another for projects that will reach EOM in 2011.

As in previous exercises, the XPSR validation was an interactive process. OVE and SCF expended several working sessions discussing ratings and analyzing evidence from the project documents. It is worth noting the efforts by SCF to address OVE's requests, in particular regarding ex post calculation of financial and economic rates of return (FRR and ERR) and provision of information about both sub-projects of financial market operations and SCF's monitoring procedures related to some projects. As a result, the level of disagreement between OVE and SCF shrank systematically as the exercise implementation progressed. The level was the lowest among all exercises, consisting of only seven downgrades recommended by OVE – 5% of the total ratings, as opposed to 19% in the second exercise and 13% in the first.

Notwithstanding these ex post efforts, the assessment of project results was limited by ex ante project deficiencies, in particular the lack of an adequate definition of both development objectives with measurable indicators and beneficiaries. As stated in the Bank's Operational Guidelines (GN-2400-7) for non-sovereign guarantee operations, "projects to be financed must have a positive development impact". It is worth noting that the ECG Guidelines defines the development dimensions clarifying that they are "applicable only to institutions that seek to contribute to economic development and poverty reduction", as IDB does. Likewise, the projects also lacked, at the design phase, a clear diagnostic and definition of market failures, limiting the degree to which project additionality could be validated at the XPSR level.

The overall analysis of project performance showed that the projects performed better in terms of IDB Investment Profitability and IDB Work Quality, followed by Project Development Outcome and IDB Additionality. Breaking down the analysis by type of operations, the financial market operations performed slightly better (2.90 on a 5 point scale) than non-financial market operations (2.78). Financial market operations outperformed non-financial market operations in IDB Investment Profitability and IDB Work Quality and underperformed with respect to Development Outcome and Additionality Dimensions.

Regarding Project Development Outcome, the most part of projects achieved satisfactory (38%) and excellent (31%) ratings. Breaking down by the four sub-dimensions of the Project Development Outcome general performance, the projects achieved better results

on Environmental and Social Performance, followed by Business Performance, Contribution to Private Sector Development and Contribution to Economic Development.

Regarding IDB Profitability, the majority of the projects (62%) performed satisfactorily. On the plus side, the exceptions were projects that performed very well (loan credit risk classified as RC1) and provided clear evidence that they are expected to be paid as scheduled. On the other hand, some projects were rated partially unsatisfactory because the transaction had been classified in Watch List due to the higher repayment risk of the project. Only two projects were rated unsatisfactory because one was impaired and the other incurred to a net loss to the Bank.

In terms of IDB Additionality, in which the majority of the projects (69%) also performed satisfactorily, the analysis of the XPSRs underscores that financial Additionality was the most important contribution. Projects generated financial Additionality by offering better terms and mobilizing B-lenders. In terms of environmental Additionality, projects provided Additionality by requiring compliance with higher standards than were prevailing at the time of project approval. However, despite the fact that the majority of the projects included covenants to ensure prudent management practices, the XPSRs lacked the analysis of the corporate governance feature that would be required in order to provide evidence of a project's achievements.

Finally, regarding IDB Work Quality, most projects achieved a satisfactory rating (62%). This overall performance masks mixed results related to the three indicators that comprise the "Work Quality" indicator. Indeed, the projects achieved better results in Monitoring and Supervision Work than in IDB Role and Contribution and Screening, Appraisal and Structuring Work.

ECG-Guidelines also require that OVE assess evidence that lessons learned from previous exercises have been incorporated in most recent operations. An analysis of the sampling of projects analyzed in this third exercise reveals that all projects were prepared even before the first OVE's report was issued (August 2007). Consequently, the design of projects reviewed could not have benefited from the lessons identified in the previous OVE's reports. However, it is important to note that the problems identified in the previous OVE's reports remain present in the current cohort of projects.

It is worth noting that recommendations previously made by both SCF staff and OVE appeared again in the analysis of lessons learned by the SCF's staff in the current exercise. These recommendations refer to the Bank's need to improve screening, appraisal and structuring work in order to guarantee better assessment of project development objectives, such as (i) enhancement of project evaluability and (ii) inclusion of affirmative covenants in the Loan Agreement regarding the provision of both development outcome indicators and information about sub-projects.

In addition to these recommendations shared by OVE and SCF's staff, the latter highlighted others regarding enhancement of appraisal and monitoring work. First, the XPSRs underscored the need for improved risk mitigation mechanisms of environmental

impact from infrastructure projects, and project sensitivity analysis during the project's appraisal in order to insure that expected outcomes could be met.

Second, the XPSRs also recommended improvements in the IDB screening and appraisal work aimed at avoiding negative effects on IDB Profitability in overall operations, by doing the following: (i) adopting covenants adapted to the characteristic of the transaction carried out by the Bank; (ii) enhancing due diligence of Sponsors and (iii) improving Technical Diligence and Construction Risk Mitigation, in particular of Greenfield projects. Likewise, in the Monitoring Work, some XPSRs stressed the need for close monitoring of the market conditions in order to identify problems during project execution.

Third, regarding IDB Additionality, the XPSR's recommendations highlighted the Bank's need at the appraisal phase to clarify the cost-effectiveness of B-Lender mobilization and of introducing adequate incentives on corporate governance. In addition, regarding IDB Work Quality, the lessons stressed the importance of improving coordination among the private and public sector branches of the IDB Group to achieve project results.

Finally, specifically regarding XPSR's preparation, OVE had made previous recommendations related to the provision of client surveys and project economic calculation that remain not fully addressed. On the other hand, the XPSR's peer reviews conducted by SCF hold increased relevance in XPSR quality control. Indeed, the XPSRs benefited from Peers' requests of additional information and clarification about assessments. However, OVE did not find evidence, from the Reviews' minutes analysis, that the Reviews identified the problems underscored by OVE in some XPSRs (e.g. ratings adjustments and the need of FRR or ERR calculations). It is expected that the continuing replication of this procedure will enhance its role of overseeing XPSR quality.

## **Recommendations**

Based on the analysis of the XPSRs, OVE has three overall recommendations. First, for a better assessment of the project's performance in the XPSRs, SCF should ***improve project evaluability*** in both the screening and monitoring phase of the project cycle, by doing the following: (i) enhance the project's design by identifying development objectives with measurable outcome indicators as well as clear diagnostic with identification of market failures the project aims to address; (ii) design contractual mechanisms in order to: a) ensure both tracking and measurement of project's economic and financial indicators and financial and non-financial additionalities; b) monitor information about financial market transactions subprojects, in order to identify indirect effects of the Bank's intervention; c) define monitoring and evaluation system including the need for client participation in SCF surveys.

Second, SCF should ***better identify project intervention models, by conducting impact evaluations studies regarding the most relevant type of interventions*** supported by SCF non-financial and financial market operations. In these studies, SCF should collect and organize evidence of its intervention model's effectiveness, measuring development

impact on beneficiaries, going beyond to individual project analysis, and by doing so, learning about Bank Additionality and results.

Third, SCF should *continue improving the XPSR's preparation*. Specifically, SCF should (i) continue on-going efforts to assure the availability of more accurate information in the calculation of ex ante/ex post FRR/ERR for all projects and for a sampling of sub-projects, if necessary; (ii) produce measurable assessment (i.e. providing measurable indicators with complete metrics, i.e. with baseline, targets and final results achieved) of project contribution to private sector development and financial and non-financial Additionality; (iii) improve the quality of XPSR's Lessons Learned, by addressing prescriptive recommendations of IDB operational improvements and linking them to the evidence of the intervention model; (iv) identify if recommendations raised by its staff in the XPSRs have been implemented and what their results have been; and (v) enhance the Peer Reviews' role on XPSR's quality control by encouraging objectivity and evidence-based requests from participants.

## I. INTRODUCTION

- 1.1 This Third Independent Evaluation Report presents findings from Expanded Project Supervision Reports (XPSRs) prepared by the Structure and Corporate Finance Department (SCF). In order to comply with the Good Practice Standards (GPS) of the Evaluation Cooperation Group of the Multilateral Development Banks (ECG-MDB), OVE is required to prepare this Annual Report for information of the Board of Executive Directors.
- 1.2 In order to address OVE's recommendations and, as a result, to be in full compliance with the ECG Guidelines, this exercise represented a step toward validating the XPSR in same year they have reached early operating maturity (EOM).<sup>1</sup> Based on the agreed schedule between OVE and SCF, this goal should be achieved by the end of 2011. Therefore, this current exercise consists of SCF's preparation of XPSRs that reached EOM in 2008 and 2009, including a cohort of 13 projects – nine from 2008 and four from 2009. According to this agreed schedule, two additional exercises will be conducted by the end of 2011, one for projects that reached EOM in 2010 and another for projects that will reach EOM in 2011.
- 1.3 The consecution of this third exercise coincided with the execution of the ECG benchmark review exercise, carried out by an independent external consultant.<sup>2</sup> This review concludes that SCF's evaluation system now ranks third among all MDBs, meeting 90% of ECG's Good Practice Standards (from 8% in 2005).
- 1.4 As part of IDB's commitment of compliance with ECG, this exercise fully applied the Third Edition of the ECG Guidelines, concluding a transitional process started in the previous exercise. The transition started with the assessment of projects based on four, rather than three, evaluative performance indicators, with Additionality as the fourth and newest. The assessments in the Third Edition were based on the following dimensions: (i) Project Development Outcome; (ii) IDB Investment Profitability; (iii) IDB Additionality; and (iv) IDB Work Quality. (Table 1)

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<sup>1</sup> According to GPS standard 2.1.3, Corporate Projects reach early operating maturity when: (a) the project financed will have been substantially completed, (b) the project financed will have generated at least 18 months of operating revenues for the company and (c) IDB will have received at least one set of audited annual financial statements covering at least 12 months of operating revenues generated by the project.

On the other hand, standard 2.1.4 defines that Financial Projects reach early operating maturity after the lapse of at least 30 months following the IDB final material disbursement for sub-loans or sub-investments, i.e. ignoring disbursements for small follow-up investments in existing client companies and disbursements to cover management fees or other expenses of investment funds.

<sup>2</sup> See Transmission Note RE-370 of "Third Benchmarking Review of ECG Members' Evaluation Practices for Their Private Sector Investment Operations."

**Table 1: Performance Dimension and Standard Ratings**

<b>Performance Dimension</b>	<b>Performance Areas</b>
Project Development Outcome	Project Contribution to Company Business Performance
	Project Contribution to Economic Development
	Project Environmental and Social Performance
	Project Contribution to Private Sector Development
IDB Investment Profitability	Project Gross Profit Contribution to IDB
IDB Additionality	Financial, Environmental, Corporate Governance and Regulatory Additionality
IDB Work Quality	Screening, Appraisal and Structuring Work
	Monitoring and Supervision Quality Work
	IDB Role and Contribution

- 1.5 However, it was in this exercise that OVE inaugurated the preparation of XPSR-A. It consists of written comments about each session of the prepared XPSRs, indicating if additional information was required, or if the evidence presented adequately supported the XPSRs indicator ratings.<sup>3</sup> Finally, some suggestions for rating changes were also included in the XPSR-A.
- 1.6 The evaluation process starts with SCF’s Officers preparing XPSRs for each project, and sending them to OVE for independent validation. Following, OVE’s XPSR-As were sent to SCF, a process that led to some changes and/or requests for further information. As stated by the ECG, “...if the Officers agreed with the comments and the modified ratings, OVE used those ratings in this report. If agreement could not be reached, OVE proceeded to use its own ratings in preparing this Annual Report, while also reporting on the nature of any discrepancy.”
- 1.7 This document is organized as follows. After this introduction, Section II introduces the scope and project’s sampling description, and, reviews and validates the self-evaluation material and ratings. Section III focuses on the main finding of the XPSRs analysis. Section IV displays both the lessons learned as identified in the XPSRs and reviews the implementation of prior recommendations. Finally, Section V concludes and derives recommendations to SCF.

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<sup>3</sup> As stated in the ECG-Guidelines, Third Edition, the Office of Evaluation conducts an independent on desk review of each XPSR to “verify scope responsiveness, evident reliability of the analysis, impartiality and consistency in ratings judgments, and appropriateness and completeness of the identified lessons” and formalizes its findings on the XPSR-As. The XPSR-A assesses the adequacy of each information provided by the XPSRs, such as project description, rationale for Bank’s intervention, performance rating justifications, etc.

## II. OVE REVIEW AND VALIDATION OF SELF-EVALUATION

- 2.1 This section validates the 13 XPSRs corresponding to all the projects that reached early operating maturity during 2008 and 2009. Box 1 below summarizes the main characteristics of the projects evaluated this year. They represent US\$517 million among Loans and Guarantees, supporting total project costs of about US\$2 billion.

### Box 1: Characteristics of the Sample Projects

- The XPSR's cohort consists of eight non-financial market projects and five financial market projects.
- Eight projects consisted of loans and five consisted of guarantees;
- Five projects are in A countries, four in B countries and two in D countries.
- Two evaluated projects corresponded to regional projects

#### A. The Projects

- 2.2 The greatest part of self-evaluated projects (62%) is from non-financial markets. They financed capital expenditures (CAPEX) projects on energy (five loans) and telecommunications (one loan). The Bank also offers a guarantee that provides comfort to investors interested in acquiring local currency bonds by investing in a CAPEX toll-road program. Finally, there is also one infrastructure fund aimed at financing CAPEX of small infrastructure projects.
- 2.3 The other part of the self-evaluated projects (38%) is from financial markets. They represent three guarantees – two for mortgages and one for bonds securitization and two for financial funding, including one specifically for trade financing (.).
- 2.4 It is worth noting that none of the 13 loans related to the 2008-2009 exercises was prepaid, downplaying an issue that prompted an OVE recommendation in the previous exercise.

#### B. The Ratings

- 2.5 The XPSRs rated the projects based on four evaluative performances defined by the Third Edition of the ECG MDB Guidelines: (i) Project Development Outcome; (ii) IDB Investment Profitability; (iii) IDB Additionality; and (iv) IDB Work Quality.
- 2.6 Each of the performance dimensions is assigned a rating based on a matrix that uses a standard four-point scale for each indicator rating. The scale ranges are (i) Excellent (E); (ii) Satisfactory (S); (iii) Partly Unsatisfactory (PU); (iv) Unsatisfactory (U).
- 2.7 OVE and SCF established an interactive rating process that strongly reduced the number of disagreements. Ultimately, these disagreements resulted in OVE's downgrades (seven in total).

- 2.8 Regarding the four overall performance dimensions, the majority of OVE's downgrades are related to Project Development Outcome (57%) with four of the seven downgrades and to IDB Additionality (29%), with two. The remaining downgrade was related to IDB Work Quality Performance (14%). It is worth noting that no upgrade/downgrade was verified for IDB Profitability dimension.
- 2.9 Proportionally, Table 2 shows the greatest part of inadequate ratings (15%) is related to IDB Additionality (two out of 13 ratings), followed by Project Development Outcome (four out of 65 ratings), with 6% inadequate ratings, and IDB Work Quality (one out of 52 ratings), in which 2% of the ratings were inadequate.
- 2.10 Regarding Project Development Outcome ratings, OVE downgraded four ratings related to three projects. The majority of the downgrades were related to private sector development (two downgrades). The others were related to the projects' environmental and social performance (one downgrade) and one overall development outcome performance (one downgrade). Regarding Private Sector Development, two projects were downgraded from E to S because they did not provide clear evidence or positively address at least two of the components of this dimension. Only one project was downgraded in Environmental and Social Performance from S to PU due to the non-compliances related to Technical Completion Date (TCD) and the absence of mitigation evidence regarding potential fragmentation of habitats. Finally, one downgrade (from E to S) was made on one project's overall Development Outcome in order to adjust this rating after the downgrade of Private Sector Development performance.
- 2.11 Regarding IDB Additionality performance ratings, OVE downgraded two projects from S to PU because both projects did not provide evidence of the project's financial or non-financial Additionalities.
- 2.12 Finally, regarding IDB Work Quality performance ratings, OVE downgraded one rating related to the Screening, Appraisal and Structuring Work performance of one project, from S to PU. The reason behind the downgrade was an absence of evidence that mitigation for spills was proposed during the preparation phase, although the loan document (LD) recognizes the possibility of occurrence of spills, and mitigation measures were activated during the project's execution.
- 2.13 It is worth noting that, among all the downgrades applied by OVE, only four of them represented binary changes (from E and/or S to PU and/or U). The reduced number of disagreements (the seven downgrades recommended by OVE) highlights two important points. First, that SCF has improved its evaluability objectivity, increasingly anchored in evidence-based justification for the project's ratings. Second, that the interactive process provided opportunities for clarifications and provision of new evidence from SCF in order to address OVE's requests about some projects. The result of this process is illustrated by the comparison between Tables 2 and 3. The percentage of disagreements out of the

total number of ratings has reduced from 31% to 5% during OVE’s validation process.

2.14 In particular, it is worth noting SCF’s efforts in calculating Financing (FRR) and Economic Rate of Return (ERR) for CAPEX projects as well as provision of information about some sub-projects of financial operations.<sup>5</sup> If systematically done, this process could lead to an improved accountability system for project results assessment.

**Table 2 Adequacy of SCF’s final report ratings**

OVE ratings	a. Total	b. Adequate		c. Inadequate	
		Number	% (b/a)	Number	% (c/a)
PROJECT DEVELOPMENT OUTCOME	65	61	94%	4	6%
IDB INVESTMENT PROFITABILITY	13	13	100%	0	0%
IDB ADDITIONALITY	13	11	85%	2	15%
IDB WORK QUALITY	52	51	98%	1	2%
<b>TOTAL</b>	<b>143</b>	<b>136</b>	<b>95%</b>	<b>7</b>	<b>5%</b>

**Table 3. Adequacy of original XPSR ratings**

OVE ratings	a. Total	b. Adequate		c. Inadequate	
		Number	% (b/a)	Number	% (c/a)
PROJECT DEVELOPMENT OUTCOME	65	44	68%	21	32%
IDB INVESTMENT PROFITABILITY	13	13	100%	0	0%
IDB ADDITIONALITY	13	4	31%	9	69%
IDB WORK QUALITY	52	38	73%	14	27%
<b>TOTAL</b>	<b>143</b>	<b>99</b>	<b>69%</b>	<b>44</b>	<b>31%</b>

2.15 Notwithstanding, an important issue that affects some ratings was the lack of evidence of the Bank’s performance. For instance, as noted in most of the XPSR-As, the project’s additionality ratings could have benefited from a definition of market failure that justified the Bank’s intervention. Likewise, from some financial operations, both economic development and private sector contributions’ performances lack evidence due to a lack of indicators and beneficiaries at the screening phase. Finally, since SCF has not been tracking project results, there is a lack of evidence about its project development objectives’ achievements.<sup>6</sup> This aspect is particularly relevant, since, as stated in the Bank’s Operational Guidelines (GN-2400-7, part IV) for non-sovereign guarantee operations, “projects to be financed must have a positive development impact”. It is worth noting that the ECG Guidelines defines the development dimensions clarifying that they are “applicable only to institutions that seek to contribute to economic development and poverty reduction”, as IDB does.

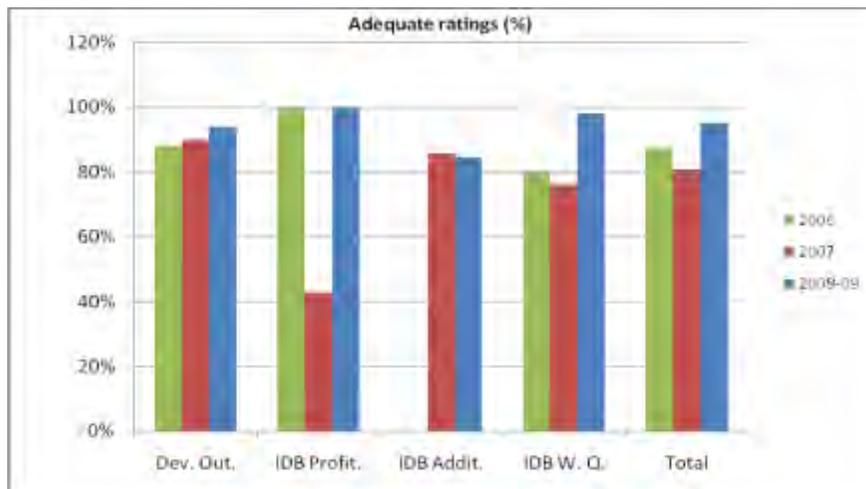
<sup>5</sup> For instance, as OVE requests, SCF calculates ex post ERR and FRR for six out of eight non-financial market operations.

<sup>6</sup> Out of the 13 projects validated in this XPSR’s exercise, only 23% of projects correctly defined their development objectives, only 8% identified the market failure they intended to address and only 23% provided a rationale that justifies the Bank's intervention.

### C. Trend Analysis of the Rating Validation

- 2.16 Along the three reports, OVE has validated 32 XPSRs: five in the first report, 14 in the second and 13 in the current report. Although three exercises are not a sampling large enough to capture an identifiable long-term tendency, the three OVE validation reports attempt to identify provisory trends and therefore may yield valuable information.
- 2.17 Figure 1 shows the Evolution of the Adequate/Inadequate Ratings as a percentage of the total number of ratings, both regarding each dimension and the total terms. The three exercises show a percentage of adequate/total ratings above 80%. This suggests there is a high compatibility of analysis between OVE and SCF regarding the scope and interpretation of the information provided for each project. Most of this high compatibility is a result of two main factors that strongly reduced the number of disagreements: the ECG-GPS guidelines support, and a provision of additional information by SCF to address OVE's requests throughout an interactive rating process. Indeed, the mismatch in ratings between OVE and SCF has reduced since the previous exercise from 19% (27 out of 140 ratings) to only 5% (seven out of 143). In terms of evolution, the adequate/total ratings decreased from the first (87%) to the second report (81%), and strongly increased from the second to the current report, when it reached the high percentage of 95%. It is worth noting that the higher disagreement rate of the second exercise could be related to the validation of prepaid projects, which represented the majority of projects in that sampling.

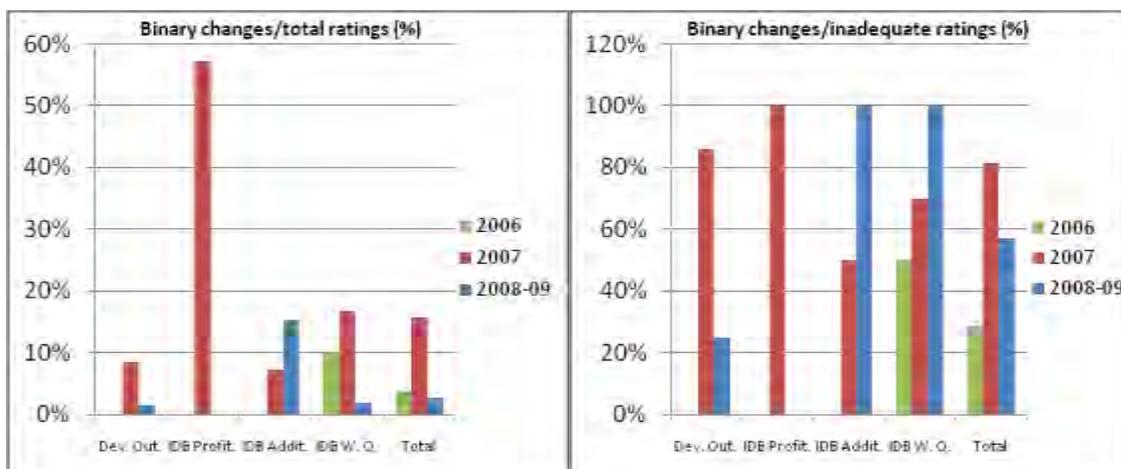
**Figure 1. OVE's Three Validation Exercises for XPSR's Ratings**



- 2.18 Regarding Project Development Outcome dimension, Figure 1 shows an increasing evolution of adequate ratings ranging from 88% in the first report to 94% in the current report. This reinforces previous observation about SCF's efforts in providing additional information and new evidence during the interactive process of XPSR preparation.

- 2.19 Regarding IDB Investment Profitability dimension, it is worth noting that a complete agreement (no upgrade/downgrade) was verified in the first and current reports. The second report shows a low rate of adequate ratings (43%), explained by the abovementioned ratings of prepaid projects.
- 2.20 Regarding IDB Additionality dimension, the second and third exercises show high and clearly similar adequate ratings (86% and 85% respectively). In the first exercise, ECG-GPS did not include IDB Additionality dimension as a specific evaluative performance.
- 2.21 Finally, regarding IDB Work Quality dimension, Figure 1 shows that, after a decrease of 4% (from 80% to 76%) in adequate ratings between the first and the second exercises, the third report strongly increased the rate of agreement to a high of 98% for the total ratings of this dimension.
- 2.22 Figure 2 shows the Evolution of the Number of Binary Changes (from E and/or S to PU and/or U) as a percentage of both the total number of ratings and the number of inadequate ratings. In terms of trend, the overall percentage of Binary Changes/Total Ratings initially increased from 4% in the first to 16% in the second report, and then to 3% in the current report. Again, it should be stressed that the worse performance shown by the high rate of binary changes of the second exercise could be mainly explained by the validation of prepaid projects, which comprised the majority of the sampling's projects. In fact, the binary changes/total rating for IDB Investment Profitability dimension in the second exercise reached 57% while it was 0% in both the first and third exercises.

**Figure 2. Three Exercises OVE's Binary Changes**



- 2.23 Finally, it is worth noting that, with the exception of IDB Additionality dimension, in which the second report performed better than the current, the percentage of binary changes followed a similar pattern of increasing evolution between the first and the second exercises, and a strong fall to the current report.

### III. THE MAIN FINDINGS OF THE XPSR'S ANALYSIS

3.1 This section presents the analysis results for the 13 XPSRs. The general performance of the projects (Table 4) shows that projects performed better regarding both IDB Investment Profitability (15% of E and 62% of S) and IDB Work Quality (23% of E and 61% of S), followed by Project Development Outcome (31% of E and 38% if S) and IDB Additionality (69% of S).

Table 4. General Performance of the Projects\*

OVE ratings/General Performance (%)	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	31%	38%	23%	8%
IDB INVESTMENT PROFITABILITY	15%	62%	8%	15%
IDB ADDITIONALITY	0%	69%	31%	0%
IDB WORK QUALITY	23%	61%	8%	8%

OVE ratings/General Performance (%)	Excellent	Satisfactory	Partially Unsatisfactory	Unsatisfactory
PROJECT DEVELOPMENT OUTCOME	31%	38%	23%	8%
<i>Contribution to Company Business Performance</i>	46%	23%	0%	31%
<i>Contribution to Economic Development</i>	31%	31%	23%	15%
<i>Environmental and Social Performance</i>	15%	77%	8%	0%
<i>Contribution to Private Sector Development</i>	8%	61%	31%	0%
IDB INVESTMENT PROFITABILITY	15%	62%	8%	15%
IDB ADDITIONALITY	0%	69%	31%	0%
IDB WORK QUALITY	23%	61%	8%	8%
<i>Screening, Appraisal and Structuring Work</i>	0%	61%	31%	8%
<i>Monitoring and Supervision Quality Work</i>	30%	54%	8%	8%
<i>IDB Role and Contribution</i>	0%	85%	15%	0%

(\*) Based on the OVE's validated ratings of the XPSRs.

3.2 The current exercise inaugurated the XPSR's preparation for financial market projects. The analysis shows that the financial-market operations performed slightly better (2.90) than non-financial market operations (2.78). Specifically by dimensions, financial market operations outperformed non-financial market operations in IDB investment profitability and IDB Work Quality, while underperformed in Development Outcome and Additionality Dimensions.

#### A. Project Development Outcome

3.3 For the Project Development Outcome dimension, the overall rating is constructed by measuring four standard indicators: (i) Project Contribution to Company Business Performance; (ii) Project Contribution to Economic Development; (iii) Project Environmental and Social Performance; and (iv) Project Contribution to Private Sector Development. Each standard indicator was rated following specific benchmarks.

3.4 Table 5 shows that regarding Project Development Outcome, the most part of projects performed satisfactorily (38%) and excellent (31%). More specifically, the projects achieved better results on Environmental and Social Performance (15% of E and 77% of S), followed by Business Performance (46% of E and 23% of S), Contribution to Private Sector Development (8% of E and 61% of S) and Contribution to Economic Development (31% of S and 31% of E).

**Table 5. Development Outcome Performance\***

<b>OVE ratings/General Performance (%)</b>	<b>Excellent</b>	<b>Satisfactory</b>	<b>Partially Unsatisfactory</b>	<b>Unsatisfactory</b>
<b>PROJECT DEVELOPMENT OUTCOME</b>	31%	38%	23%	8%
<b>Contribution to Company Business Performance</b>	46%	23%	0%	31%
<b>Contribution to Economic Development</b>	31%	31%	23%	15%
<b>Environmental and Social Performance</b>	15%	77%	8%	0%
<b>Contribution to Private Sector Development</b>	8%	61%	31%	0%

(\*) Based on the OVE's validated ratings of the XPSRs.

3.5 The projects' performances on Contribution to Company Business Performance were evaluated mainly by comparing SCF's calculations of ex post FRR with the weighted average estimated cost of capital (WACC) of the company. Alternatively, for projects that did not target specific CAPEX projects, the ECG Guidelines accepted the calculation of real Return on Invested Capital (ROIC)<sup>7</sup>. Five projects achieved E ratings because their FRR exceeded WACC in more than 700 basis points (bps) in real terms. This was also the case of another project, for which a ROIC calculation was provided. Otherwise, three projects were rated S in this dimension because their FRR or ROIC were lower than required for an E rating. Finally, four projects were rated U in this dimension for three reasons. First, one of them clearly explains that "the company is currently in a situation of financial insolvency proceeding. Second, for another one, neither FRR calculation was provided nor is there evidence that the project achieved other than U rating since the loan was impaired and the company was facing bankruptcy. Finally, two projects achieved, respectively, FRR and ROIC below their WACC.

3.6 The projects' performances on Contribution to Economic Development were assessed mainly by the calculation of ex post ERR. Likewise in the case of Business Performance dimension, the ECG Guidelines alternatively accepted the calculation of real economic return on invested capital (EROIC). four projects rated E because their ERRs (or EROIC) were higher than 20%. One project project was rated S because it violated ECG's requirements for provision of ERR calculation for CAPEX projects, providing, instead, EROIC above 20%. Three projects achieved S ratings since their ERR or EROIC was lower than the benchmark for E. In turn, three projects rated PU. One of them rated PU based on evidence that financial distress affected its economic results (See Box 2). The second one (ERR

<sup>7</sup> The ROIC is calculated only when OVE is convinced that the FRR on the project cannot be calculated. It implies that even when the evaluated project did not targeted specific CAPEX projects, the calculation of FRR is possible if ex-ante mechanisms were designed at this purpose. Unfortunately, it was not the case of any project that did not targeted specific projects. Without any other feasible alternative, the calculation of proxy was accepted by OVE. The same happened with the calculation of economic return on invested capital (EROIC) instead of ERR (see p. 4.5).

of 5%) and the third one (EROIC of 8.2%) performed PU because of their overall rates. Finally, two projects performed U. While for one of them, its EROIC was negative, for another one, its business model failed and there is neither ERR calculation nor evidence that quantified benefits were provided by the project.

**Box 2: the Inadequacy of ROIC/EROIC to Assess Project's Results**

Based on the ECG Guidelines, the utilization of ROIC and EROIC as a proxy for respectively assessing Project Business Success and Project Contribution to Economic Development could lead to "S" ratings. Indeed, for one financial market project the ex-post real ROIC was 10.21% against a real WACC of -1.08% meanwhile the EROIC was 11.43%.

Notwithstanding, these proxies fell short to capture both the business and economic performance of the project. An in-depth analysis of the information provided by SCF shows that, "the company is currently in a situation of financial distress" and "MF is under insolvency proceeding under insolvency Law". Besides, "the financial performance of the Company has affected expected economic results set at approval; in particular, it has affected long-run expected results in terms of the number of houses financed and the volume of MBS placed";

Hence, OVE suggested and SCF agreed that the most adequate ratings should be "U" regarding Project Contribution to Business Success and "PU" regarding Project Contribution to Economic Development.

- 3.7 Relative to the other Development Outcome performances, it was in Contribution to Economic Development that the projects' results worsened. By assessing the original and additional information provided by SCF, the highly rated projects provided a wide range of project benefits regarding the boost of productive activities and the expected positive impacts on improving overall local living conditions. However, the projects generally need to improve their evaluability. In this sense, the lack of tracked outcome indicators, the screening flaws in the definition of benefits and beneficiaries, and, the lack of ERR calculation instead of EROIC hindered the Economic Development and Business Performance ratings of some projects.
- 3.8 As for the Environment and Social Performance, the majority of the projects achieved the ratings of S (77%) and E (15%). i.e., they are in compliance with all the Bank's safeguard policies regarding environmental and social impacts and risks procedures. In particular, two projects achieved the best results among all projects. There is evidence that, from one of the project's implementation, its developed and implemented the IESHSM<sup>8</sup> and, in the case of another project, the company went beyond the IDB requirements including US\$1 million for Social Fund for Development of Local Communities (the "Social Fund") supporting local community activities in the project's affected areas. Otherwise, another project achieved PU rating in this benchmark because they were in non-compliance with some environmental issues during the project execution. They are mainly related to TCD of CAP, which requires construction of temporary storage of hazardous wastes in the substations that are shared with third parties. This project did not obtain such authorizations from third parties. The principle impacts in linear projects like this one are those related to potential fragmentation of habitats and new access to protected areas or indigenous lands.

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<sup>8</sup> Integrated Environmental and Social and Health and Safety Management System.

3.9 Finally, regarding Private Sector Development Contribution and likewise Environment and Social Performance, the majority of the projects achieved S ratings (61%). However, lack of evidence of project contribution was the main reason behind PU ratings for four projects. For instance, one of them introduced a financial innovation that was not accepted by the market. Furthermore, despite the fact that another project introduced high-speed internet in the local market, its contribution was constrained by the failure of the company's business model, leading to negative demonstration effects.. Finally, one project also had an attribution problem, since there is no clear evidence of project contribution to the expansion of the local housing market. In addition, the project did not address any other private sector development issue.

### **B. Project Investment Profitability for IDB**

3.10 The rating for Project Investment Profitability for IDB is based on the project's Gross Profit Contribution to IDB, by comparing the amount of fees and interests collected by IDB during the life-cycle of the project with the amount expected to be received by IDB at the time of project approval.

3.11 As previously shown by Table 6, most of the projects (62%) performed S in this dimension. There are five exceptions to this pattern. On the plus side, two projects achieved E, since their projects' loans performed very well (loan credit risk classified as RC1) and there is clear evidence that they are expected to be paid as scheduled. On the other hand, one project achieved PU because the transaction has been classified in Watch List due to the higher repayment risk of the project after the approval of the Nationalization Decree. Finally, two projects achieved U because, while the former project was impaired, the latter has accrued a net loss to the Bank by the time this report was written.<sup>9</sup>

### **C. IDB Additionality**

3.12 Regarding IDB Additionality, most projects achieved S ratings (69%). The exceptions were four projects, which achieved PU ratings. For the first cohort of projects (S ratings), most evidence was of financial additionality followed by some evidence of environmental additionality, and/or better allocation of risks only possible because IDB was supporting the project. For the second cohort of projects (PU ratings), there is no evidence of project additionality. Indeed, OVE could not find information in the XPSRs about the clients' cost of borrowing and average tenor of debts at the time of approval, undermining the understanding of both financial market conditions and the Bank's financial additionality.

3.13 The analysis of XPSRs underscores that financial additionality was the most important contribution of the projects, followed by the environmental, corporate governance and regulatory additionality. Indeed, there are a plentiful number of

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<sup>9</sup> The loss generated in the company corresponds to the loss estimated applying the Investment Net Profit Contribution Criteria, e.g., interest income minus financing costs, administrative costs and loss provision. "

projects that provided financial additionality by offering better terms and mobilizing B-lenders, for example, in the case of four projects. In terms of environmental additionality, the XPSR found evidence that three projects provided environmental additionality by requiring compliance with higher environmental and social standards than those that prevailed at the time of project approval.

- 3.14 On the other hand, OVE has not found evidence that four projects provided other than better terms and tenure, which is one of the components of financial additionality. This was the case for one particular project in which no project structure was developed to reduce project risks and no resource mobilization was verified involving several B-loans and local trustees.
- 3.15 Finally, despite the fact that the majority of the projects included covenants to ensure prudent management practices, the XPSR forwent better analysis of the corporate governance feature in order to provide evidence of projects' achievements.

#### **D. IDB Work Quality**

- 3.16 For IDB Work Quality, the rating is constructed by measuring three standard indicators: (i) Screening Appraisal and Structuring work; (ii) Monitoring and Supervision Quality and; (iii) IDB Role and Contribution.
- 3.17 Table 6 shows the projects' overall performance on Work Quality. It underscores that 23% of the projects were rated E, 61% S, 8% PU and 8% U. This overall performance hides mixed results related to the three indicators that comprise Work Quality. Indeed, the projects achieved better results in Monitoring and Supervision (30% E and 54% S) than in IDB Role and Contribution (none E and 85% S) and Screening, Appraisal and Structuring Work (none E and 61% S). It was in Screening that the projects rated the highest in combined PU and U ratings (39%), followed by Monitoring (16%) and IDB Role (15%). It is worth noting that no U ratings were earned by the projects in the latter dimension.

**Table 6. IDB Work Quality Performance\***

<b>OVE ratings/General Performance (%)</b>	<b>Excellent</b>	<b>Satisfactory</b>	<b>Partially Unsatisfactory</b>	<b>Unsatisfactory</b>
<b>IDB WORK QUALITY</b>	23%	61%	8%	8%
<b>Screening, Appraisal and Structuring Work</b>	0%	61%	31%	8%
<b>Monitoring and Supervision Quality Work</b>	30%	54%	8%	8%
<b>IDB Role and Contribution</b>	0%	85%	15%	0%

(\*) Based on the OVE's validated ratings of the XPSRs.

- 3.18 Regarding Screening, Appraisal and Structuring performance, the observed problems are related both to the underestimation of risks that affected the project's implementation and higher-than-average processing times for SCF transactions. Four projects were rated as PU and one as U.
- 3.19 Regarding the PU ratings, one project's XPSR stresses that the project's main risks were related to the quality of the financial system's portfolio (credit risk) and the housing sector performance in the local market (market risk), both of which were

not clearly identified. Likewise, the project's design overestimated the potential of the proposed new instrument to develop the local capital market. In the case of two other projects, the LDs recognized the possibility of occurrence of spills. In fact, mitigation measures were activated during the project's execution in order to address spills. However, there is no evidence that these measures were proposed during the preparation phase. Finally, in the case of one project, the XPSR emphasized that the low market liquidity risk was not analyzed and some of the proposed mitigation risk mechanisms did not work.

- 3.20 Regarding the only project rated U in the Screening dimension, its loan document notes, "...even though all the major risks were identified the mitigants in place proved not to be adequate. The reliance on cash flow as a part of the financial plan was much too risky of a structure, at least for a project at such an early stage of operational ramp-up. The team instead relied on very detailed market assessments and cash flow projections and structures rather than ensuring that adequate back up financial support was available in the case that the project implementation was too slow or if the initial cash flows were too low." In addition, the project took 32 months from initial contact to first disbursement. The Bank was not primarily responsible for the long delay. Changes to the project and project sponsors required amendments to project approval documents; and there were delays in sponsor provision of information. However, these delays could have alerted the Bank that the project was not worth pursuing given the lack of sponsor commitment
- 3.21 Regarding Monitoring and Supervision Quality indicators, most projects achieved E (30%) and S (54%) due to the Bank's prompt corrective action during implementation to respond to issues that arose during the appraisal phase. This was also the case of one project, which modified financial covenants or took timely action when needed, and of another project, which resolved non-compliance issues.
- 3.22 The exceptions were two projects that achieved U and PU. In the case of former, its loan document cites, "Disbursement authorization is part of monitoring work and the Bank failed in authorizing the first disbursement, equivalent to 60% of the Bank's loan even though it was linked to the achievement of market penetration milestones, which were not accomplished at the time of the first disbursement. Finally, the second disbursement was approved even though there were indications that the buildup was delayed and the borrower was not fulfilling loan agreement's precondition."
- 3.23 The following reasons explained the PU rating for the latter project.. The XPSR mentioned that during the implementation there were issues related to tariff adjustments, reorganization of the Sponsor/Borrower's corporate structure, as well as borrower's new debt issuance, and the Bank took required actions adequately. However, the report does not provide any evidence in this respect. Furthermore, the XPSR stressed that the project has been non-compliant with reporting covenants since November 2006.

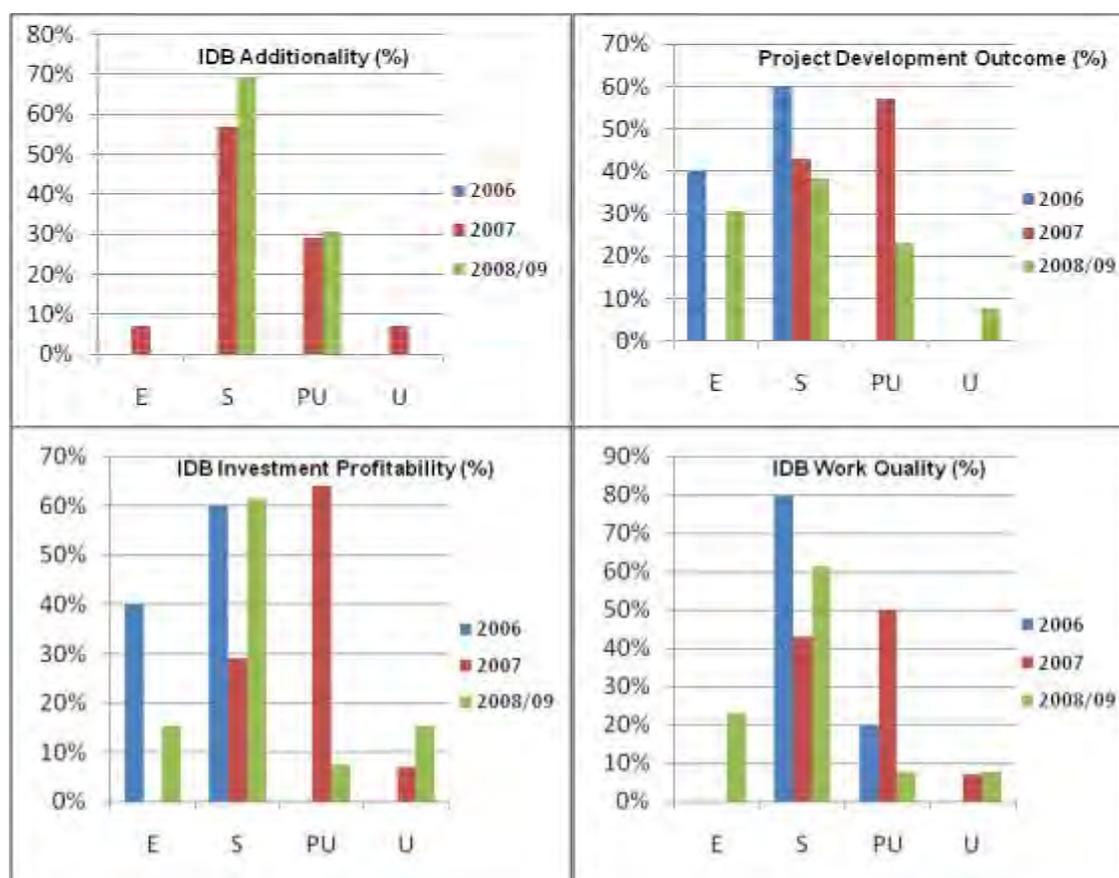
3.24 It is worth noting that most projects' screening work did not develop Results Framework (RF) with measurable outcome indicators in order to gauge results. In particular, the projects neither defined beneficiaries nor quantified expected benefits. By doing so, they hindered the ex post calculation of their economic development results. In addition, the monitoring and supervision work could correct these flaws verified during the appraisal phase. However, this task was not conducted in any of the projects self-validated by the XPSRs.

3.25 Regarding IDB Role and Contribution, the majority of projects (85%) rated S, as a result of consistency with the Bank's country strategy and satisfactory feedback from client surveys. The exceptions to this path were two projects, which achieved PU. Both lacked client surveys to assess satisfaction. Additionally, one of them did not quote the country strategy in the LD, evidencing lack of consistency with the country strategy, while the another one lacked coordination with other Bank departments.

### E. Trend Analysis of the Projects General Performance

3.26 Figure 3 shows the evolution of the general performance of the projects among the three XPSR exercises (2006, 2007, 2008-09) regarding the overall ratings of each dimension.

Figure 3. Three Exercises Project's general performance



- 3.27 Regarding Project Development Outcome, Figure 3 shows that the projects in the first exercise reached the best performance in this dimension (40% E and 60% S), followed by those projects included in the current exercise (31% E and 38% S). The second exercise attained the worst performance with 0% E and 43% S.
- 3.28 The performances regarding IDB Investment Profitability dimension followed a similar trend. Figure 3 shows a decreasing evolution of the E and S rating from the first exercise (40% E and 60% S) to the second (0% E and 29% S). On the contrary, an improving performance was verified between the second and current exercise (15% E and 62% S).
- 3.29 Because the second exercise did not include IDB Additionality dimension as a specific evaluative performance, the relevant comparison is between the groups of projects gathered in the second and third reports. In this case, the second exercise (7% E and 57% S) performed better than the third (0% E and 69% S). It is worth noting that the projects gathered in the current report registered the worst performance in the IDB Additionality dimension.
- 3.30 Finally, regarding IDB Work Quality, Figure 3 shows that the projects included in the current exercise reached the best performance in this dimension (23% E and 61% S), followed by those projects gathered in the first exercise (0% E and 80% S). The second exercise attained the worst performance with 0% E and 43% S.

#### **IV. LESSONS LEARNED FROM THE XPSRS**

- 4.1 This section presents lessons identified by SCF Offices from implementation of the 13 operations addressed by this sampling of projects. These lessons were made for each of the four general categories of indicators, as follows: (i) project development outcome; (ii) project Investment Profitability for IDB; (iii) IDB Additionality; and (iv) IDB Role and Contribution. OVE bunched these lessons learned into 20 lessons related to both IDB Screening and Monitoring Works detailed in the following sections. Most part of the lessons raised by SCF's officer also identified recommendations. In addition, Peer Reviews were conducted for 12 out of 13 projects,<sup>10</sup> for which SCF's staff made suggestions for XPSR clarifications and improvements.

##### **A. Project Development Outcome**

- 4.2 The XPSRs underline issues in their lessons learned regarding the project development outcome performance, which lean to improvement of the *Bank's screening, appraisal and structuring work*. Some of them corroborate OVE's recommendations addressed in previous reports, such as (i) enhancement of project evaluability and (ii) inclusion of affirmative covenants in the Loan Agreement

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<sup>10</sup> SCF did not conduct Peer Review for one impaired project.

regarding the provision of either development outcome indicators or information about sub-projects. The recommendation to replicate successful experiences in achieving results (demonstration effect) was also addressed in several XPSRs.

- 4.3 *Enhancing Project Evaluability.* This recommendation is stressed a third consecutive time in this XPSR exercise, highlighting the importance of the issue. As highlighted by OVE in previous sections, the lack of tracking measurable indicators after the project's implementation impaired the assessment of several projects' development objectives.

**Box 3: Strengthening Project Evaluability**

"The development impact indicators were set for measurement in 2010 and 2012 and yet the XPSR is being carried out in 2009 so there should have been better synchronization of these dates. Also, the goal level indicator of trying to measure the market share of middle market banks should have been better defined in advance as well as plans for how to measure it. Particular characteristic of the financial system should be taken into account when setting expected performance indicators. (...) an assessment of the indicators used in the log frame for this project points out again the need for indicators that are clearly defined and that the sources for verifying the information are also made very clear ex-ante and not by using general statements like "information from the Central Bank."

"During structuring phase, the project team should propose performance indicators that can be monitor during the life of the project".

- 4.4 *Affirmative Covenants regarding Bank's results.* Corroborating with OVE's recommendation addressed in the previous exercise, SCF's staff stressed the importance of design of contractual mechanisms in order to ensure both tracking and measuring of projects' results.

**Box 4: Affirmative Covenants regarding Bank's results**

"IDB does not know much about the performance of subprojects. Information requirements on sub-projects need to be included for future similar projects".

The project team should also ensure that the project company will be able to provide upfront reports to facilitate the evaluation on how the project achieves its expected outcomes".

Without a reporting requirement feature in the loan agreement (that requires ongoing reporting of the necessary information), evaluation is extremely difficult. So, it goes without saying that, for those expected development benefits described as a key reason for project support; a "SMART" indicator needs to be specified and the legal documentation and monitoring plan must specify how the information needed to track those indicators is going to be collected prior to financial closing. (...) If and when possible, the costs and their funding source related to special surveys and data collection (that are needed to measure development outcomes) should be identified in advance. In this case, even though a client survey was anticipated (to assess the time & cost savings to clients from the company's products), means for covering the future cost of such a survey were not considered. Once the company began to have financial problems there were no resources available to the client or the Bank to carry out this useful exercise".

- 4.5 *Screening and Monitoring of Outcome Indicators that capture the project expected development objectives.* Some XPSRs addressed the need of efforts at screening and execution phases to, respectively, design outcome indicators that capture the expected project benefits and monitor projects' achievements.

#### **Box 5: Screening and Monitoring of Outcome Indicators that capture project development objectives**

“It is very important to implement clear mechanisms to ensure that royalties paid from extracting activities actually reach local communities. In the case of one project, the design of a Trust Fund to manage part of the royalties received by local governments seems to be a good alternative to guarantee the design and implementation of projects in favor of communities in the area of influence of the project.”

- 4.6 *Enhance Project Business Model Success.* As one of the Development Outcome sub-dimensions, some XPSRs stressed increasing in-depth understanding of the client’s business model needs during the Bank’s structuring work.

#### **Box 6: In-depth Due Diligence on the Client’s Business Model Needs**

“Structuring the Company transaction, while presenting its own challenges, greatly benefited from the experience with previous project, approved in 2004, especially in regard to legal issues and documentation. Thus, the Bank was able to "capture" the opportunity by providing a time-sensitive response, adjusted to market practice, partly because the Bank built on the "previous project" learning curve. Even with a project that looks similar to another one at the outset the Bank should never assume that it can take a “cookie cutter” approach by just repeating things the Bank learned in the previous one. Each client has a different market niche and business model that needs to be fully understood in order to fully address their financing needs appropriately. Thus, the Bank should probably spend a bit more time at the outside on learning the underpinnings of the business model, which may imply frontloading some of the due diligence, as well as providing some training to the IO early on. This would be money well invested as it can help to save time and resources later during structuring and negotiations.”

“ The Bank relied upon cash from operations as a funding source from a company that still needed to gain market share in order to get to the positive cash flow stage for the very first time. The national market was very dynamic and the assumption that a good and detailed projection, using a high quality model, was a substitute for caution in the financial plan proved to be a faulty one.”

- 4.7 *Enhance ESHS risk mitigation mechanisms of environmental impacts from infrastructure projects.* Some XPSRs highlighted the need for establishment of detailed environmental, health, social and safety contingency plans in order to mitigate the impacts of infrastructure projects.

#### **Box 7: Enhance ESHS risk mitigation mechanisms on infrastructure project.**

“...It is important to incorporate environmental and social aspects in the general planning of infrastructure sector projects. When these projects can affect the ecosystem and isolated communities, it is highly necessary to highlight how the responsibilities should be shared among the public and private entities, and between the various public agencies and the private sector companies. (...) to establish a detailed environmental, health, social and safety, and contingency plans, and systems for rigorously implementing these plans. It is also important to plan, prior to construction phase the monitoring of erosion in the pipelines, health and safety of the workers, and compensation for use of the right-of-way....”

- 4.8 *Better Dialogue with Stakeholders and Involvement of Civil Society.* Likewise, some XPSRs raised the importance of institutional communication strategies and collaborative relationships with the main project stakeholders. These issues are addressed as an adequate solution in order to overcome the difficulties arisen from the structuring and implementation of very complex projects with important environmental impacts.

### Box 8: Better Dialogue with Stakeholders and Involvement of Civil Society

“...It is important the creation of reliable and effective communication systems that should be adapted to the needs of different interest groups involved (with extensive information). Unclear information may trigger distrust and give rise to unexpected situations. It is also important to build collaborative relationships among the key actors in the project and to guarantee sufficient resources for effective institutional communication strategies to minimize reputation risks. It is important to consider the important role of the civil society, in particular, when it is open to understand and participate in the project and to contribute with constructive ideas and solutions. A clear understanding of the civil society needs will be useful to overcome the challenge of introducing effective mechanisms to respond to demands of local communities...”

The success of the resettlement program owes much to the participatory approach that encouraged the formation of municipal-level negotiating commissions and the Negotiating Council, and led to a formal agreement on the terms and criteria for the compensation and resettlement programs. Although this was not an easy process it helped to build up trust and facilitated individual negotiations over compensation and the definition of the families that were eligible for resettlement. The compensation procedures were relatively simple, easy to understand and transparent”.

4.9 *Demonstration effect and Replicability of Successful Experiences.* Some XPSRs address positive experiences that could be implemented by similar projects (development funds for hydro plants; full-wrapped guarantee bonds; partial credit guarantees and competitive bidding process for IDB co-guarantors for the development of local markets). Notwithstanding, it is worth noting that OVE could not assess empirical evidence of these successes due to the lack of project metrics and outcome indicators.

### Box 9: Demonstration Effect and Replicability of Successful Experiences

*“The Rural Development Fund and the Regional Development Fund are some models that can be replicated in other hydropower projects.* The social and technical assistant program has helped the families that were resettled to establish themselves and diversify their production, while the Fund – along with improvements to the local network roads – has created new economic opportunities for people living in the affected municipalities and has done much to mitigate the long-term cumulative impacts of the various hydropower projects that have been implemented in the region”.

*“Full-wrapped guarantee* bond can be used as a tool to develop local capital markets. The full-wrapped guarantee bond was successfully applied to improve credit ratings of bonds placed to finance infrastructure projects, and therefore it contributed to attract local investors to finance long-term infrastructure projects in the country. (...) Credit guarantee could contribute to solve currency mismatch of local infrastructure projects. A full-wrap guarantee seems to be a tool that can be used to reduce currency mismatch for both local infrastructure projects and local investors, reducing currency risk on projects which main flow of income are local currency. Guaranteed local currency bond issuance seems to be a highly efficient alternative to traditional hard currency lending. Furthermore, local issuance also provides a natural hedge to foreign exchange risks that are often difficult and expensive to mitigate in emerging markets, thus enhancing the long-term financial viability of the project.

*“Partial Credit Guarantees* can be an important tool to develop local capital markets by introducing new issuers and a new highly rated asset class to investors. The transaction was the first bond issue with multilateral credit enhancement.(...) The IDB role in credit enhancing securitization bonds allows first time issuers to cost-effectively raise capital amongst local investors and to access to markets that otherwise would not normally be able to access. Due to its complexity and the fact that this project was the first transaction of its type in Peru, the processing time and cost were higher than originally expected. However, in overall, it seems that these “cost” are compensated by the fact that this transaction has some positive demonstration effects on similar projects that follow this transaction.”

*“This project was one of the first projects that established a competitive bidding process for IDB co-guarantors.* The setting of a competitive bidding process for an IDB co-guarantors was important to expand the number of monolines available for future projects. A competitive bidding process set to choose the IDB co-guarantor was important to attract other monolines to the market, increasing the number of monolines available to guarantee other infrastructure projects, contributing to improve the borrower’s conditions related to the transaction”.

- 4.10 *Enhancing Feasibility Studies during Appraisal Work.* Like the previous exercise, the XPSRs also highlighted the need for better identification of risk mitigation mechanisms and project sensitivity analysis during the project’s appraisal work, in order to evaluate whether expected outcomes could be met.

**Box 10: Enhancing Feasibility Studies during Appraisal Work**

Market circumstances and competition matter when the Bank intends to support the introduction of new financial instruments. When the Bank intends to support the introduction of a new financial instrument in the domestic market, it is important to assess market conditions in the country and the level of competition from alternative financial instruments. This case showed that market circumstances can limit the project expected outcomes of SCF projects.(...) The Bank capacity in terms of creating demonstration effect can be limited by market conditions and government incentives. This project demonstrate that the Bank capacity to develop the local capital market and create demonstration effects by the introduction of a new financial instrument can be limited by pre-existing market conditions and government incentives. In the case of the country, the previous utilization of MBS and government incentives to its application (tax incentives), made more difficult the introduction and acceptance of a new financial instrument in the market.

When the IDB provides guarantee to MBS or other types of securities for the purpose of developing local capital market, we need to take into consideration that favorable market conditions could make the Bank’s guarantee less attractive.

**A. Project Investment Profitability for IDB**

- 4.11 The XPSRs stressed lessons for avoiding IDB losses in overall operations by the inclusion of contract and mitigation mechanisms.
- 4.12 *Covenants should be adequate to project characteristics.* Learning from positive and negative experiences, some XPSRs highlighted that covenants should be adapted to the characteristic of each transaction carried out by the Bank.

**Box 11: Covenants should be adapted to project characteristics**

“ Definition of Covenant “Since “Total Debt to EBITDA” and “Total Debt and Total Debt and Equity” ratios had always been well below the covenant level during the project implementation, appropriate level of financial covenants for corporate transactions in specific sector need to be analyzed. “Senior unsecured corporate loans to financially sound commercial banks can be carried out relatively quickly and at a low cost to the Bank and to the client. Not only can this be an efficient way to reach smaller middle market clients (by working through a commercial bank) it can also lower processing costs for the IDB as well”. “It should be evaluated the feasibility of applying project finance type ratios such as: D/E and DSCR to financial market type transactions. These ratios do not seem to make a lot of sense and in fact can hamper the borrower’s growth capacity. The company is a non-bank financial institution and some of the ratios applied to the Company were really infrastructure ones and not ratios particularly applicable to these kind of institutions” The financial plan for covering costs of investment included a partial dependence on internal cash flow. This approach is used successfully in corporate finance projects when there is relative certainty and history of positive cash flow. It is not a good idea for an early stage company that is not yet at cash flow break even and which faces substantial ramp up risk /market risk and no sponsor support.

- 4.13 *Enhance Technical Diligence and Construction Risk Mitigation.* Some XPSRs stressed the value of these enhancements, in particular in Greenfield projects, even when they lead to higher contract prices for the borrower.

#### **Box 12: Enhance Technical Diligence and Construction Risks Mitigation**

“In projects with a certain degree of construction risk and in Greenfield projects in general, risks related to construction delays, cost overruns and technical performance shall be carefully assessed, and mitigated by clear and effective mechanisms of Liquidated Damages. The obligations for the contractor to pay Liquidated Damages in case of delays, cost overruns or underperformance shall be in an amount sufficient to cover substantial losses, confirmed to be satisfactory by the lenders’ independent Engineer, even if that results in a higher contract price for the borrower. In parallel to the above, the project’s support structure shall ensure that, in case the aforementioned risks materialize, there will be support mechanisms solid enough to ensure that the Borrower will honor its payments obligations under the financing documents”.

4.14 *Collateralization for financial operations.* From project implementation, the XPSRs addressed mixed experiences of collateralization of financial operations.

#### **Box 13: A Case of Adequate Design of Collateralization for Financial Operations**

“As was structured, the facility was fully dependent on collateral levels, so overcollateralization levels can keep showing a positive picture even though there was a reduction in the cash flows into the Trust account. For this reason, for similar transactions, cash flows – as a portion of total outstanding obligations under the collateral pool- should be also tracked. (...)

A back-up servicer agreement didn’t work when it was intended to put in into practice since the back-up servicer was also having financial issues and such a transfer had never been done before in the country.(...) Risk-sharing mechanisms should be considered to reduce moral hazard from other participants of the transaction. In this transaction the IDB was exposed on a second-loss basis (overcollateralization being the first layer) to negative fluctuations of the underlying mortgage loans with the beneficiary of the guarantee benefiting from two layers of protection. Under these circumstances, the beneficiary of the IDB PCG has less incentive to have a more strict control of the trustee and the trust.

The Bank put much attention on its own facility but it did not factor in the correlation/interaction of other facilities. For this reason, even though the Bank was able to protect its interest in the transaction, the unsatisfactory performance of the company and other vehicles (i.e. trusts) impaired the value of the collateral.(...)

“What it seemed to be two additional layers of control and date consistency check (by the trustee and the beneficiary of the PCG) in practice did not work for this transaction. In this case, the trustee did not have a way to verify independently that the Trust is the sole assignee of the mortgage instrument pledged into the trust and as well, the trustee was not able to determine the actual outstanding amount under each mortgage instrument. (...)(...) In practice, the mandatory replacement of mortgages after remaining for a certain period in the facility worked against IDB interest since MF was forced to replace existing mortgage with other out of which a big portion were newer-vintage ones which, if for the only reason on higher LTV (loan-to-value), ended having a sensitivity to the macro-economic crisis”.

4.15 *Low risk and high profitable instruments for the Bank.* The XPSRs stress two particular experiences that were low risk and highly profitable for the Bank.

#### **Box 14: Low risk and high profitable instruments for the Bank**

“*Partial Credit Guarantee* demonstrates to be a low risk and high profitable financial instrument for the Bank. The IDB partial credit guarantee corresponds to the fourth layer of credit support within the Company’s mortgage bond structure. This structure makes this product attractive to the Bank in terms of profitability and level of risk assumed”.

*Minimum Revenue Guarantee (MRG)* offering by the national government in exchange for a share-revenue mechanism was important to reduce the market risk of the project. MRG government mechanism contributed to reduce the project market risk and to mitigate the project dependency of accurate traffic models. It was also important to attract project sponsors that were more willing to offer better conditions in order to gain the concession ”.

4.16 *Appraisal Work Improvement.* Some XPSRs also raised the importance of an in-depth regulatory and market analysis in order to better define collateral and other

transaction risk mitigation mechanisms to preserve the Bank’s profitability with transactions.

**Box 15: Appraisal Work Improvement**

“(…) In financial market transactions, a close monitoring of the market should be performed in order to identify problems during early stages. In this case, the trustee was effective in monitoring the Bank’s underlying portfolio but not the company itself and the adverse effects of the market developments on the industry/sector”.

“(…)A trust as bankruptcy remote entity is very important to isolate the trust risk from the company risk. During structuring an adequate review of legal framework of these vehicles is very important to prevent problems in the future.”

4.17 *Monitoring Work Improvement.* Likewise in the Appraisal Work, some XPSRs stressed the need for close monitoring of the market conditions in order to identify potential problems during the project execution.

**Box 16: Monitoring Work Improvement**

“(…) In financial market transactions, a close monitoring of the market should be performed in order to identify problems during early stages. In this case, the trustee was effective in monitoring the Bank’s underlying portfolio but not the company itself and the adverse effects of the market developments on the industry/sector.”

“(…) It is important to arrange independent mechanisms to monitor the performance of underlying loans of trusts. For instance, in this case, the company reported directly to the beneficiaries and the trustee, however, there was not an independent mechanism or third party to assure the quality of the information submitted.(…) The use of a “Master servicer”, an entity which would oversee and audit the processing of collections and allocation of payments would be of great value “.

“The lesson here is the importance of the watch list activities of the Bank and the importance of a dedicated Special Assets Unit. Back to office site visit reports note the potential for irregularities in management and potential collusion by some shareholders among each other and with regulators against other members of the shareholder group”.

4.18 *Enhance Due Diligence of Sponsors and Mitigation Risk Mechanisms.* From negative experience with small sponsors, some XPSRs shared lessons about the need to enhance the Bank’s diligence and mitigation risks during the appraisal phase of the contract.

**Box 17: Enhance Due Diligence of Sponsors and Mitigation Risk Mechanisms**

“No amount of “conservative” cash flow modeling, even with help of a recognized independent market consultant (and certainly not with the help of a model based on sponsor group assumptions), is a satisfactory substitute for a sponsor willing and able to help (financially and operationally) a project though its early operational stage. Underestimation of the impact of a change of ownership on the operations at the stage of a critical stage of expansion proved to be a flaw. Analysis of management and sponsors should always take into account the history of those parties working together in the past. Without ample project completion guarantees, ventures that involve relatively small sponsors working together for the first time should be structured very conservatively.(…) The lesson is that attention should be given to sponsor action during project appraisal and even during project approval to see if investments are being made to maximize the business plan. If a sponsor is not willing or able to advance funds to a project (and such funds are desperately needed) in anticipation of a Bank disbursement then that should be considered as one important indicator how the sponsor will react after the disbursement as well and this ought to at least be factored into the equation when setting final disbursement tests and negotiating final credit enhancements.

(…) Although the workout effort was successful given the circumstances, it should be noted that work out efforts are costly including both staff time and external resources. In the recovery process, \$2.8 million had to be spent in external costs, primarily legal expenses. This point is a reminder that quality due diligence up front (and at the point of disbursement) saves the Bank from future losses and that even successful work out efforts are likely to be costly. The Bank perhaps should have spent more money and time on cash flow

contingency plans rather than on how to manage cash when it had already come in. Teams should carefully assess the cost effectiveness and the practicality of complex legal and trust structures, especially for smaller early stage companies when the sponsor group does not include a multinational firm (it did at one time but ultimately did not).”

#### **A. IDB Additionality**

4.19 Regarding this dimension, the lessons learned stressed the need for enhancing both the project’s appraisal phase and mitigation risk mechanisms.

4.20 *Financial Additionality regarding resources mobilization.* Some projects addressed the need to clarify the cost and operational effectiveness of B-lenders’ mobilization vis-à-vis transaction costs.

##### **Box 18: Clarification of the cost-effectiveness of B-Lenders Mobilization**

“The inclusion of a national development bank and other lending Banks as secured lenders and pari passu with IDB during the loan administration, changing their status as lenders with the guarantee from the Sponsor, needed substantial amount of work, including the execution of new national law documents, the inter creditor agreement, and certain amendments to existing New York law documents. Potential cost and work implication would need to be made clear from the outset [in] similar situations [that could] occur in the future deals.”

4.21 *Non-financial additionality regarding the provision of client’s comfort against regulatory risks* was highlighted by some projects.

##### **Box19: Regulatory comfort brought by IDB projects**

“Pre-determined tariff adjustment could be arbitrary changed and some action from the company and the Bank may be warrant”;  
“Coordination among the governmental entities and the Bank was very important in this case to prevent the collapse of the company and the escalation of a systemic risk in the mortgage warehousing/RMBS business”  
“Political instability may affect borrower repayment capacity. The management has changed after the government decision to nationalize the company. The unilateral decision to change the borrower/sponsors changes the long-term objectives of the project company and therefore, it can jeopardize the borrower repayment capacity and the Bank profitability on this project. Compromise of governments to respect contracts signed could mitigate this risk”.

4.22 *Non-Financial Additionality: Corporate Governance.* The importance of adequate incentives on corporate governance for the overall company (vs. only the project itself) was also addressed by the XPSRs.

##### **Box 20: Enhance the Corporate Governance of the Overall Company**

“Corporate governance recommendations and subsequent monitoring should consider the overall company instead of the individual transaction. In this transaction, the IDB was more concerned on securing its transaction and therefore, it did not place sufficient emphasis on improving the company’s corporate governance practices”.

4.23 *Non-Financial Additionality Environmental Additionality.* The XPSRs underscored several aspects related to projects’ provision of environmental additionality.

##### **Box 21: Environmental Additionality provided by the projects**

“Since the Bank’s positive contribution can be applied to a corporate wide level, corporate transaction can provide opportunities for the Bank to provide greater non-financial additionality by leveraging the Bank’s financing to a specific program to the company”  
“The Project’s ESHS management had improved significantly mainly due to the contribution of one experienced operator, who is IDO 14001, OSHA 18001 and ISO 9002 Certified, and currently follows the

best practice. This confirms the importance of having qualified operators for the proper ESHS management.” (...) “The Bank provided TC to support the client’s assessment on the ESHS aspect as well as economic analysis. This support may have been one of the reasons why the client returned to the Bank to seek another financing for another project. As such, TC can play an important role to strengthen the Bank’s client base, and it is critical that the Bank continues to have access to the TC resources “Community participation is important to guarantee the project company compliance with environmental and social standards Projects related to transportation of liquefied and natural gas should involve communities that live in the ROW of the pipeline. Public consultations and adequate environmental and social plans and safeguard policies are also important to avoid issues that can affect the environment and communities around the ROW of the pipeline”.

#### **D. IDB Role and Contribution:**

4.24 *Improvement of Coordination intra-IDB areas.* Like the previous exercise, the XPSRs stressed the importance of coordination among the private and public sector branches of IDB Group in order to achieve project results.

##### **Box 22. Improvement of coordination intra IDB areas**

“It is important to well communicate and cooperate with the Country Office, particularly when dealing with complex projects”.

“Evaluating the institutional capacity of the government to carry out its responsibilities and obligations with respect to the project approval and its consequent supervision and monitoring. Government activities should include the implementation of efficient mechanisms to ensure that the private sector abides the rules. A technical cooperation can be considered to enhance the government capacity to supervise complex projects”.

#### **E. The Role of the Peer Reviews**

4.25 The analysis of the minutes from SCF’s 12 peer reviews about the prepared XPSRs highlighted two main contributions of these reviews to XPSR quality control. The first was their request for information and/or clarifications about XPSR assessments on the project’s performance dimensions. The second was their identification of lessons learned from the project’s implementation in order to improve similar Bank operations in the future.

4.26 Indeed, some peer reviews identified points that were stressed by OVE in the XPSR-As, as follows: (i) clarifications about ERR calculation methodology; (ii) inconsistencies of ROIC and WACC estimations; (iii) better explanation about IDB Financial and Non-financial Additionalities; and (iv) additional information in how the team dealt with non-compliance.

4.27 Moreover, some peer reviews also addressed recommendations for similar projects in the future, as follows: (i) adequate financial market project’s performance indicators; (ii) better assessment of Bank’s contribution to company’s corporate governance standards; and (iii) addressing of liquidity risks in the screening work of financial projects in highly volatile markets.

4.28 In general terms, OVE verified that both these requests and recommendations were incorporated in the XPSRs, evidencing an important quality control role for the Peer Reviews. On the other hand, challenges remain. OVE did not find evidence, in the Reviews’ minutes analysis that reviewers identified all of the problems underscored by OVE in some XPSRs (e.g. ratings adjustments and the need of

FRR or ERR calculations). Continuing implementation of Peer Reviews could enhance XPSR quality.

## V. IMPLEMENTATION STATUS OF OVE’S RECOMMENDATIONS

5.1 Table 7 provides a summary of the implementation status of OVE’s recommendations made during previous XPSR Exercises. The Table has two components. The First refers to the implementation status of OVE’s recommendations made on the Second Exercise. The second component refers to the OVE’s recommendations on the First XPSR Exercise, which were pending until the Third exercise was concluded.

**Table 7. Implementation Status of OVE’s Recommendations**

<b>I. OVE’s Recommendation (Second Exercise)</b>	<b>Implementation Status*</b>
1. SCF should conduct a case study aimed at identifying the causes of the high incidence of prepayments in the SCF project portfolio.	<i>Not Implemented.</i> Management disagreed with OVE’s recommendation. It argues that the large incidence of prepayment resulted from temporary improvements in equity and lending conditions in the region at the time (see RE-332-3). There is no evidence that the case study was prepared in 2010.
2. SCF should address measures to improve its Work Quality. In particular, the SCF should identify whether the recommendations raised by staff in the XPSR reports have been implemented and what their results have been, in particular the issues related to improving appraisal work and reducing legal costs.	<i>Partially Implemented.</i> SCF promoted two presentations, the first one was prepared for the SCF Department and was held on 04.20.2010, and the second was prepared for SCF, Legal, Risk Management and ESG Managements and was held on 08.05.2010.
3. SCF should enhance project’s evaluability. In so doing, SCF may require reinforcement of contractual mechanisms in order to ensure both tracking and measurement of its projects’ economic and financial indicators, even for those projects that end up being prepaid.	<i>Not Implemented.</i> From the analysis of the cohort of projects that are part of the current exercise of XPSRs, there is no evidence that contractual mechanisms were introduced in order to ensure both tracking and measurement of SCF’s results.
<b>OVE’s Pending Recommendations (First Exercise)</b>	<b>Implementation Status*</b>
4. SCF should comply with the ECG Guidelines based on a predictable schedule agreed between OVE and SCF.	<i>Implemented.</i> OVE and SCR agreed on schedule in order to full address the ECG Guidelines recommendations of project’s validation at the same year that the projects will reach EOM in 2011
5. SCF should implement a systematic effort to fill the data gap presented in the XPSRs, especially those related to the IDB Work Quality, such as client prepayment, project fee analysis and client survey links.	<i>Partially Implemented.</i> SCF provided substantial information to justify ratings as well as presented analysis of IDB interests, fees and prepayment premium in all XPSRs. However, some XPSRs’ client surveys were missing.
6. SCF should stress whether some of the recommendations raised by the staff have been implemented and what their results have been.	<i>Implemented.</i> SCF provided a status of implementation of lessons learned on the first exercise (RE-322-2) and some of them were implemented.

(\*) The implementation status of the OVE’s recommendations was rated based on: (i) fully implemented; (ii) partially implemented; (iii) not implemented.

- 5.2 Table 7 shows that, regarding the first cohort of OVE's recommendations for the Second Exercise, SCF did not implement the recommendation regarding identification of causes of prepayment and how other multilateral institutions are dealing with the issue. If there is evidence that incidents of prepayments reflected a particular context on the financial market, awareness of these root-causes could bring important lessons when dealing with an eventual repetition of these circumstances. Likewise, the recommendation regarding improvement in Work Quality was partially implemented because there is no evidence that issues raised by the staff were implemented. Finally, there is no evidence yet of improvement of project evaluability and, in particular, that additional contractual mechanisms were introduced in order to ensure both tracking and measurement of SCF projects.
- 5.3 For the First Exercise, SCF implemented OVE's recommendations to fill the data gap, except in the case of some missing client surveys and economic calculations (e.g. project's ex-post ERR). In the same vein, SCF fulfilled OVE's recommendation for the implementation of summarizing lessons learned and results. Likewise, SCF implemented OVE recommendations to set up a predictable schedule for XPRS implementation.
- 5.4 ECG Guidelines require that OVE assess evidence that lessons learned from previous exercises have been incorporated in most recent operations. However, due to the mismatch between the period in which the sampling of projects was prepared and the time that the previous reports were prepared, it is too soon for this assessment. Reason being, ECG requires OVE to evaluate EOM projects that may have been designed before the XPSRs produced their lessons learned. Indeed, all projects included in these three XPSR exercises were approved before the XPSRs were completed.

## **VI. CONCLUSIONS AND RECOMMENDATIONS**

### **A. Conclusions**

- 6.1 The Third XPSR Exercise was the first in which the Third Edition of ECG-Guidelines was fully implemented. As a result, OVE introduced the XPSR-As, which included formal comments on each one of the sections and dimensions of the XPSRs submitted to OVE from SCF. The overall context was a step toward validating the XPSR in same year in which they achieved EOM - the ECG's requirement which is implied in the retroactive evaluation of 13 projects related to 2008 and 2009. Based on an agreed schedule between OVE and SCF, this goal should be achieved in 2011 by preparing two more exercises and therefore matching the exercise implementation with the year the projects reached EOM.
- 6.2 As in the previous exercises, the XPSR validation was an interactive process. OVE and SCF expended several working sessions discussing ratings and analyzing evidence from the project documents. It is worth noting SCF's efforts to fulfill the requirements stressed by OVE, in particular regarding ex post calculation of FRR

and ERRs and provision of information about both sub-projects and project monitoring works.

- 6.3 As a result of both the interactive and extra efforts toward producing new evidence, the level of disagreements shrank systematically as the exercise progressed. This exercise presented the lowest historical level of disagreements between OVE and SCF, with only seven downgrades recommended by OVE (5% of the total ratings). Notwithstanding these ex post efforts, the assessment of project results was limited by ex ante project deficiencies, in particular the lack of an adequate definition of development objectives with measurable indicators and of beneficiaries. This aspect is particularly relevant, since, as stated in the Bank's Operational Guidelines (GN-2400-7, part IV) for non-sovereign guarantee operations, "projects to be financed must have a positive development impact". It is worth noting that the ECG Guidelines defines the development dimensions clarifying that they are "applicable only to institutions that seek to contribute to economic development and poverty reduction", as IDB does. Likewise, at the design phase, the projects also lacked clear diagnostics and definition of market failures, limiting the degree to which project additionality could be validated at the XPSR's level.
- 6.4 The overall analysis of project performances underscored that the projects performed better regarding both IDB Investment Profitability (15% E and 62% S) and IDB Work Quality (23% E and 54% S), followed by Project Development Outcome ( 31% E and 38% S) and IDB Additionality (69% S). This exercise also introduced for the first time financial market operations (38% of total). Broken down by type of operations, financial market operations performed slightly better (2.90 on a 5 point scale) than non-financial market operations (2.78). Financial market operations outperformed non-financial market operations in IDB Investment Profitability and IDB Work Quality while underperforming in Development Outcome and Additionality Dimensions.
- 6.5 Regarding Project Development Outcome, the most part of projects achieved satisfactory (38%) and excellent (31%) ratings. Breaking down by the four sub-dimensions of the Project Development Outcome general performance, the projects achieved better results on Environmental and Social Performance, followed by Business Performance, Contribution to Private Sector Development and Contribution to Economic Development.
- 6.6 Regarding IDB Investment Profitability, most projects performed S (62%). On the plus side, the exceptions were projects that performed very well (loan credit risk classified as RC1) and provided clear evidence that they are expected to be paid as scheduled. On the other hand, some projects achieved PU because the transaction has been classified in Watch List due to the project's higher repayment risk. Finally, two projects achieved U because one was impaired and the other incurred a net loss to the Bank.
- 6.7 In terms of IDB Additionality, the analysis of the XSPRs underscores that financial additionality was the most important contribution of the projects, followed by the

environmental, corporate governance and regulatory contributions. Projects generated financial additionality by offering better terms and mobilizing B-lenders. In terms of environmental additionality, some projects provided additionality by requiring compliance with higher ESHS standards than were prevailing at the time of project approval. However, despite the fact that the majority of the projects included covenants to ensure prudent management practices, the XPSRs lacked adequate analysis of the corporate governance feature that would provide evidence of the project's achievements.

- 6.8 Finally, regarding IDB Work Quality, most projects achieved S as well (62%), followed by E (23%) and PU and U (both with 8%). This overall performance masks mixed results related to the three indicators that comprise the Work Quality indicator. Indeed, the projects achieved better results in monitoring and supervision (31% E and 54% S) than in IDB role and contribution (none E and 85% S) and screening, appraisal and structuring work (none E and 62 % S). It was in Screening that the projects rated the highest rate of combined PU and U ratings (39%), followed by Monitoring (16%) and IDB role (15%). It is worth noting that no U rating was observed by the projects in the latter dimension.
- 6.9 ECG-Guidelines also require that OVE assess evidence that lessons learned from previous exercises have been incorporated in most recent operations. However, due to the mismatch between the period in which the sampling of projects was prepared and the time that the previous reports were prepared, it is too soon for this assessment. Reason being, ECG requires OVE to evaluate projects that may have been designed before the XPSRs produced their lessons learned. Indeed, all projects included in these three XPSR exercises were approved before the XPSRs were completed. However, it is important to note that the problems identified in the previous OVE's reports remain present in the current cohort of projects..
- 6.10 It is worth noting that recommendations previously made by both SCF staff and OVE appeared again in the analysis of lessons learned by the SCF's staff in the current exercise. These recommendations refer to the need of improvement of the Bank's screening, appraisal and structuring work in order to guarantee better assessment of project development objectives, such as (i) enhancing of project's evaluability and (ii) inclusion of affirmative covenants in the Loan Agreement regarding the provision of both development outcomes indicators and information about sub-projects.
- 6.11 In addition to these recommendations shared by OVE and SCF's staff, the latter highlighted others regarding enhancement of appraisal and monitoring work. First, the XPSRs underscored the need for improved risk mitigation mechanisms of environmental impact from infrastructure projects, and project sensitivity analysis during the project's appraisal in order to insure that expected outcomes could be met.
- 6.12 Second, the XPSRs also recommended improvements in Screening and Structuring work aimed at avoiding negative effects on IDB Investment Profitability in overall

operations, by doing the following: (i) adopting covenants adapted to the characteristic of the transaction carried out by the Bank; (ii) enhancing due diligence of Sponsors; and (iii) improving Technical Diligence and Construction Risk Mitigation, in particular of Greenfield projects. Likewise, in the Monitoring Work, some XPSRs stressed the need for close monitoring of market conditions in order to identify problems during the project execution.

- 6.13 Third, regarding IDB Additionality the XPSR's recommendations highlighted the Bank's need, at appraisal phase, to clarify the cost-effectiveness of B-Lenders Mobilization and of introducing adequate incentives on corporate governance. In addition, regarding IDB Work Quality, the XPSRs underscored the importance of coordination among the private and public sector branches of IDB Group to achieve project's results.
- 6.14 Finally, specifically regarding XPSR's preparation, OVE had made previous recommendations related to the provision of client surveys and project economic calculation that remain not fully addressed. On the other hand, the XPSR's peer reviews conducted by SCF hold increased relevance in XPSR quality control. Indeed, the XPSRs benefited from Peers' requests of additional information and clarification about assessments. However, OVE did not find evidence, from the Reviews' minutes analysis, that the Reviews identified the problems underscored by OVE in some XPSRs (e.g. ratings adjustments and the need of FRR or ERR calculations). It is expected that the continuing replication of this procedure will enhance its role of overseeing XPSR quality.

## **B. Recommendations**

- 6.15 Based on the analysis of the XPSRs, OVE has three overall recommendations, as follows. First, for a better assessment of project's performance in the XPSRs, **SCF should improve project's evaluability** in both the screening and monitoring phase of the project cycle, by doing the following: (i) enhance the project's design by identifying project's development objectives with measurable outcome indicators as well as clear diagnostic with identification of market failures the project aims to address; (ii) design contractual mechanisms in order to: a) ensure both tracking and measurement of project's economic and financial indicators and financial and non-financial additionalities; b) monitor information about financial market transactions subprojects, in order to identify indirect effects of the Bank's intervention; c) define monitoring and evaluation system as well as the need of client's participation in SCF surveys.
- 6.16 Second, **SCF should better identify project intervention models, by conducting impact evaluation studies regarding the most relevant type of interventions** supported by SCF non-financial and financial market operations. In these studies, SCF should collect and organize effectiveness evidence of its intervention model measuring development impact on beneficiaries, going beyond to individual project analysis, and by doing so, learning about Bank additionality and Bank results.

6.17 Third, SCF should *continue improving XPSR preparation*. Specifically, SCF should (i) continue on-going efforts to assure the availability of more accurate information in the calculation of ex ante/ex post FRR/ERR for all projects and for a sampling of sub-projects, if necessary; (ii) produce measurable assessment (i.e. providing measurable indicators with complete metrics, i.e. with baselines targets and final results achieved) of project contribution to private sector development and financial and non-financial additionality; (iii) improve the quality of XPSR Lessons Learned, by addressing prescriptive recommendations of IDB operational improvements and linking them to the evidence of the intervention model; (iv) identify if recommendations raised by its staff in this report have been implemented and what their results have been; and (v) enhance the Peer Reviews' role in XPSR quality control by encouraging objectivity and evidence-based requests from participants.