

A Regional Public-Private Financial Sector Modernisation Program

"It is crucial to be aware that market-led progress does require co-operation among economic (public and private) agents. The driver of co-operation should be, as much as possible, moved by the private sector, i.e. by an enlighten perception of the private interest. But we cannot be blind to the fact that the necessary co-operation among private market participants does not materialize unless public authorities play an important role in promoting it" (Tommaso Padoa-Schioppa, former Executive Board Member, European Central Bank and former Minister of Economy, Italy)

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Dynamic Montenegro knows well that economic progress results from coordinated actions by Government, business community, other public authorities and civil society.

Public-private co-operation is necessary also for financial sector modernization, even though responsibility for financial and monetary stability stays solely with the Central Bank of Montenegro. Financial sector modernization builds on stability, but goes well beyond stability. "Modernization is the process of financial innovation and organizational improvements that add possibilities to engage in financial transactions with reduced costs in a competitive environment", says the European Central Bank. Modernization creates the conditions for the financial community to deliver products and services adapted to the development needs of the country – and its citizens. The financial community must play its part in this complex process – and so should also the users of financial services.

How could authorities and the financial community expand their collaboration to build a modern financial sector in Montenegro?

The experience of the World Bank's

Convergence Program¹ in Romania and, more recently, in Albania shows that the banking community can undertake a much larger modernization program if the traditional collaboration between central bank and banking association evolves towards a more modern framework based on the following principles²:

- unanimous public-private agreement on a modernization program with strong public and private benefits;
- comprehensive analysis and careful recommendation of possible solutions prepared by teams of local public and private experts with occasional international help;
- unanimous public-private agreement on how to implement the recommendations; and strong implementation discipline to reach the intended public and private benefits.

SPI ROMANIA

In March 2006, the Convergence Program promoted the launch of a public-private financial sector partnership in Romania: SPI Romania (www.spi-romania.eu). SPI

stands for "Special Projects Initiative". SPI Romania is placed under the oversight of the SPI Committee which gathers top level representatives of National Bank of Romania, Romanian Banking Association, Ministry of Economy and Finance, National Authority for Consumer Protection and Convergence Program.

In its first meeting in September 2006, the SPI Committee decided to undertake 14 modernization projects. The selected projects were relevant to both authorities and market participants as they reflected a mix between "public good" objectives (e.g. potential reduction in costs of bank products and services; improved access to bank products and services; improved regulatory and enforcement environment; enhanced tools for monitoring financial stability) and "industry" objectives (e.g. improvement of market infrastructure, accounting and reporting systems; diversification and growth of market opportunities; reduction of costs).

Importantly, these projects were additional to the regulatory activity programmed by the National Bank of Romania and required therefore additional resources to be processed.

In order to handle these projects, a SPI Secretariat was formed consisting of two persons: one with banking experience acting as Director for Bank Products and Services, and one with analytical background gained in a central banking context, acting as Director for Analytics and Policy. The SPI Secretariat mobilized the best expertise available in Romania, from financial authorities, the banking community and from other organizations, forming Project Working Groups. As of December 2007, there have been more 60 Project Working Group meetings, gathering more than 120 professionals from 33 institutions, of which 17 public institutions and 16 private institutions.

The SPI Secretariat supported the analyses formulated by the Project Working Groups with qualitative and quantitative evidence

¹ Established in 2003 to explore how financial authorities could incorporate feedback from market participants and financial product users in the design of market-building regulatory measures.

² Principles are drawn from the EU Better Regulation, which promotes banking community involvement in the design of regulatory and self-regulatory measures.

**EUROPEAN CENTRAL BANK
FINANCIAL SECTOR MODERNIZATION CRITERIA**

Italian Banking Association CRITERIA	Asymmetric information	Completeness of the market	Increased opport. to engage in fin. transactions	Reduced transaction costs	Increased competition
Business development	Expansion of positive credit information sharing	Rural lending Credit rating agencies	Law on bank letters of guarantee	Less given default estimator	Vintage loan serving database
Industry competitiveness	Credit reporting stress test techniques	MiFID implementation		Anti-money laundering law, Law on goods safeguard values and persons protection, Electronic processing of debit instrument, IFRS provisioning	
Industry reputation			Confusion in financial consumer education		
TOTAL	2	3	3	5	1

SPI Romania 2007 Activity Program

and added an international perspective to the documents submitted for SPI Committee endorsement. Foreign expertise was used only on punctual cases to offer solutions, to deliver independent opinions on disputed issues or to peer-review the recommendations.

After one year of hard work, these projects led to several law or regulatory proposals (AMI law, electronic processing of debit instruments, rural lending, IFRS provisioning), self-regulatory measures (Banking Ombudsman, Expansion of Positive Credit

Information Sharing, MiFID Implementation and the two database projects) and two studies on international experience and best practices.

In conclusion, the innovative SPI public-private governance and analytical structure, supported by a small Secretariat, enabled the Romania financial community to register big progress on key modernization priorities – over and above those that the analytical resources of the Central Bank and other authorities could have processed.

A STUDY CASE: ELECTRONIC PROCESSING OF DEBIT INSTRUMENTS

In Romania the electronic payment system established in 2005 didn't include the processing of debit instruments (checks, drafts and promissory notes) as the banking community couldn't get to a common opinion in this respect. For some of the banks this wasn't a big issue due to the non-relevant volume of debit instruments processed each year, other opted for not using checks anymore (most frequent debit instruments) due to the risks attached and other banks considered that even a sort of "intermediary" solution could be preferred to the manual processing of debit instruments. The SPI project objective was to formulate an evidenced-based recommendation for the banking community. The project working group gathered representatives of banks, central bank, TransFond (the company operating the payment system in Romania), Ministry of Economy and Finance and National Authority for Consumer Protection. Its recommendation was to maintain the use of the debit instruments but to integrate their processing in the electronic payment system and the main arguments were brought by consumers' representatives (the advantages of using them and the lack of a perfect substitute) and the figures evidencing the potential net cost savings generated by the electronic processing – about EUR 27 million per year at the banking system level. The project working group proposed also to continue the SPI project with the implementation phase consisting of formulating law amendment proposals, as the legislation on debit instruments needed to be changed in order to allow the electronic presentation of debit instruments, and then the secondary regulations amendment proposals together with the technical requirements. After SPI Committee endorsement, SPI Secretariat prepared, based on the PWG report, documents for consultation and followed up for clear decision. The recommendations being agreed by the main stakeholders, the PWG continued with the following two stages of the project. The law amendment proposals were finalized by the end of April 2007 and were enacted, in March 2008, after being endorsed by the National Bank of Romania, European Central Bank, Ministry of Economy and Finance and Ministry of Justice.

THE MAIN STEPS TO LAUNCH SPI MNE

- Central Bank of Montenegro, Association of Montenegrin Banks and other potential members of the public-private partnership discuss the initiative;
- If invited, Convergence Program is available to help raise awareness on SPI program and organize its launch activities. Among these, the most important are:
 - ▷ Convergence Program helps Central Bank of Montenegro and Association of Montenegrin Banks build up a modernization program;
 - ▷ Convergence Program organizes Regulatory Impact Assessment training seminar to build evidence-based policy design skills;
 - ▷ Once funding sources are identified for a two-year program, the Convergence Program could help recruit and train the SPI Secretariat.
 - ▷ SPI Secretariat prepares modernization program proposal for SPI Committee approval;
 - ▷ After SPI Committee approval, SPI Secretariat mobilizes launches Project Working Groups and supports their activities;
 - ▷ Three months later, first Project Working Proposals are ready for SPI Committee endorsement.
 - ▷ If launched, SPI Montenegro would join a growing regional network of SPI platforms that would operate as SPI South East Europe.

SPI SOUTH-EAST EUROPE

Regione Puglia, with technical support from the World Bank's Convergence Program, is promoting SPI South-East Europe (SEE), an initiative aligned with the objectives of the European Territorial Co-Operation Programme South-East Europe. SPI SEE will catalyze large-scale financial sector modernization programs in several South East European countries. SPI SEE informs its activities on the experience of building the EU Single Financial Market which shows the importance of a long-term programmatic approach ("Financial Sector Action Plan") and the use of evidence-based analysis supported by market consultations ("Better Regulation") to effectively handle a large volume of growth-enhancing regulatory changes over a protracted period of time.