

A World Bank Proposal

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“Convergence”

*To improve financial sector policy-making
through public-private dialogue*

A Pilot in South-Eastern Europe

(Albania, Bosnia-H, Bulgaria, Croatia, Macedonia, Moldova, Romania, Serbia and Montenegro)

An EU, EBRD, WB joint-venture

Together with other partners

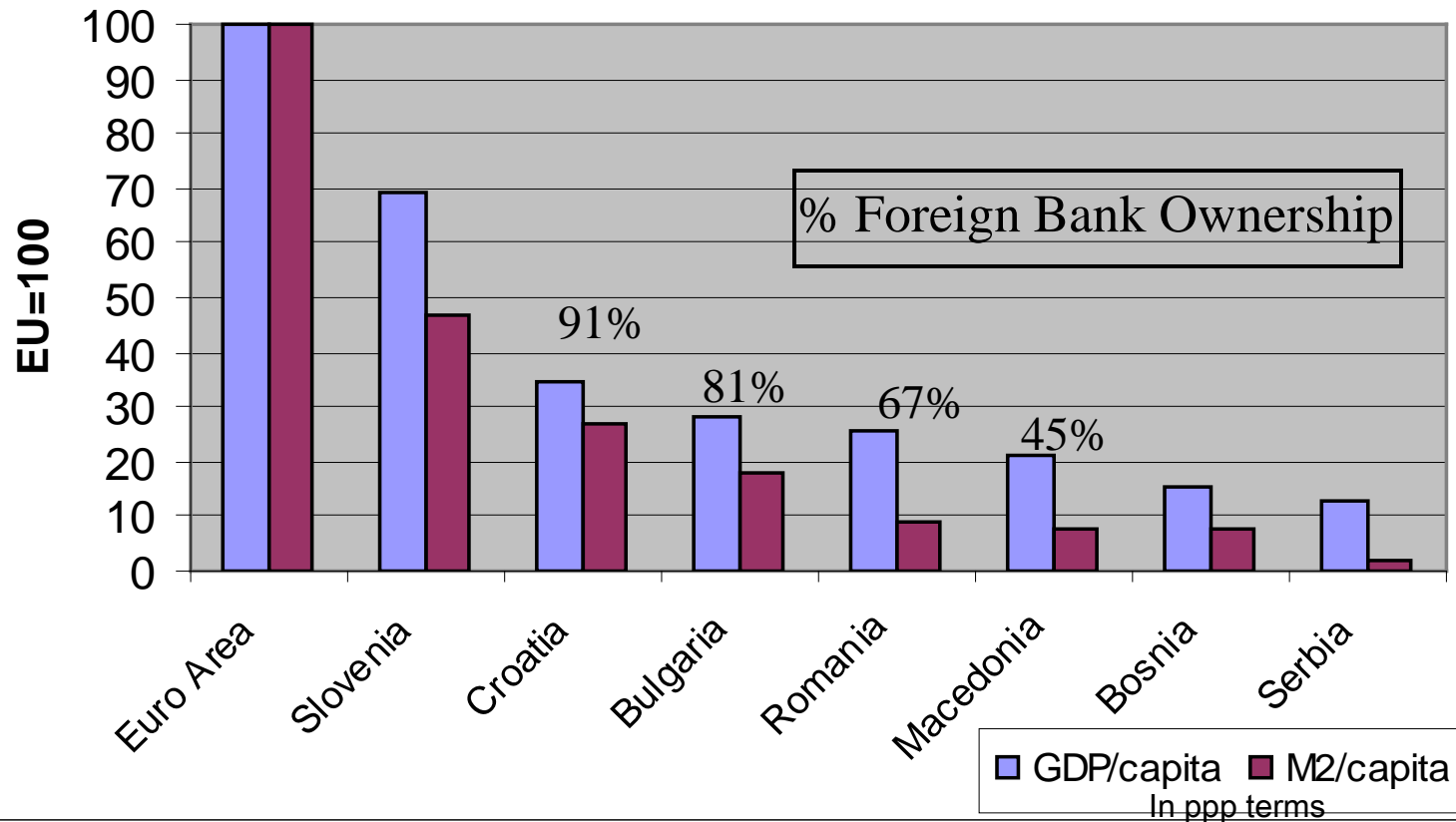
Summary

This Initiative is about assembling a multilateral and bilateral group which will help organize a framework for an effective dialogue on financial sector reform between the public and the private sectors (“*Convergence*“) in South-Eastern European countries:

- Small and time-bound: \$[3]m over 3 years
- Catalytic: small WB contribution (10% of total)
- European-led implementation
- Initial focus: banking (90% of financial assets)
 - but expanding to other sectors as soon as feasible
 - » securities, leasing, asset management, insurance,...

The Context

South-Eastern Europe: Financial Sector Depth: Large Gap With The EU



Summary

- World Bank Role in the Region
- Why Public-Private Co-operation?
- Other World Bank Public-Private Partnerships
- The Issue
- The Vision
- The Instrument
- The Overall Structure
- Risks and Mitigations
- Annex

The World Bank Role in the Region: The Strategic Context

- The Middle-Income Countries Task Force
- Framework for WBG Support to EU Accession Countries
 - MoU between Bank and EU
- Preliminary Strategy For A Knowledge Economy in EU Accession Countries
- The WB Program For Business Partnerships with the Private Sector

Focus: Knowledge and Advisory Work With Partners

A Public-Private Cooperation: Conceptual Framework

- “The traditional role of the financial sector in underpinning investment and realizing growth potential through its intermediation and governance functions is still very limited in most EU accession countries”.

Eugenio Domingo Solans, ECB Executive Board Member

- “Further financial integration can only result from the an effective interplay between competitive market forces, co-operative efforts among market participants and the action of public authorities. Market participants should be able, in some circumstances, to achieve solutions of common interest that go beyond the pursuit of their own immediate benefit. Public authorities should act as both catalyst – fostering co-operation among market participants, whenever needed – and as regulators.”
- “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”.
- “Regulators and policymakers have much in common with teachers. A teacher should be friendly to pupils – just as regulators need to be industry-friendly – but like teachers, regulators always have to remember who they are and exercise the necessary discipline when needed.”

Tommaso Padoa-Schioppa, ECB Executive Board Member

A Public-Private Cooperation: Conceptual Framework(2)

- “First, market participants need to have sufficient information to reach informed judgments. Second, they need to have the ability to process it correctly. Third, they need to have the right incentives. Finally, they need to have the right mechanisms to exercise discipline.”

-Andrew Crockett, General Manager, BIS

- Without motivated owners, bank supervision alone will in all likelihood be ineffective.....A fundamental element in [building safer and more sound banking systems] should include aligning incentives of bank owners with the goals of the country and the national authorities (that is, making the system “incentive compatible”).

– Jerry Caprio, Director, World Bank

Other World Bank Public-Private Experiences

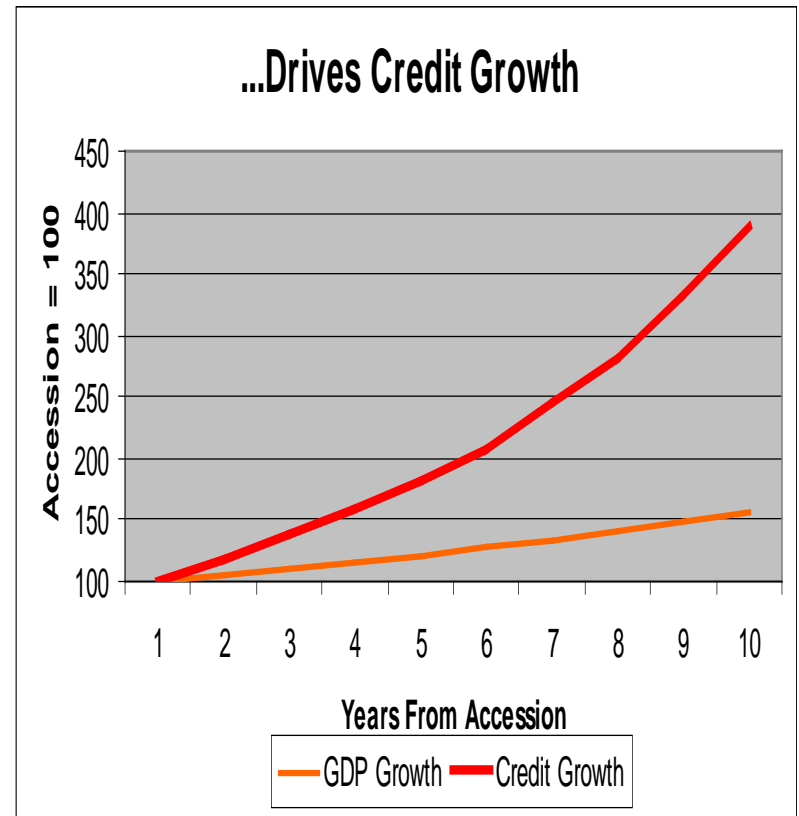
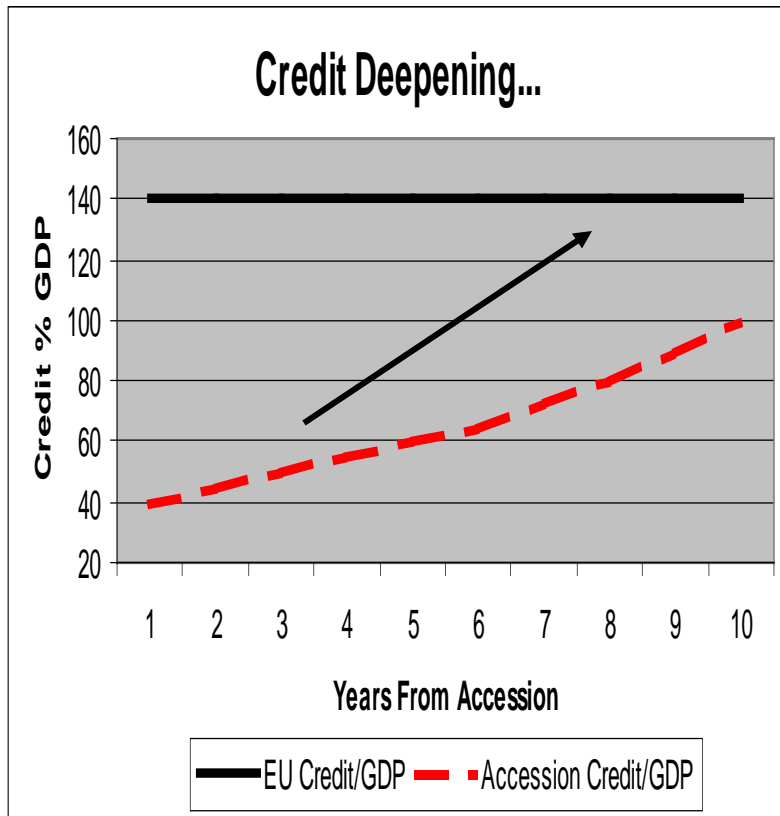
- FIRST supports projects with bankers' associations
 - Without a dialogue framework with government
- SEED supports business associations in the Balkans
- GlaxoSmithKline-WB Partnership in Strategic Communications in Africa
- Clean Air and Road Safety Public-Private Partnerships
 - Many big corporations contribute
 - Ford, Daimler-Chrysler, Shell, BP, Microsoft, HP, Siemens, Toshiba, etc.

The Issue

- Financial sector overhauled in SEE countries
 - Right incentives now: privatization and foreign entry
- But size and depth still small: 1/4 EU level (% GDP)
- Financial sector development is key contributor to economic growth
 - Given tight fiscal and monetary policies per EU requirements
- Large reform agenda outstanding
 - (incl. adoption of EU regulatory framework)
 - Legal infrastructure
 - Banking efficiency and safety
 - Capital markets development

➤ Quality and Speed of Implementation Matter!

The Vision



A public-private cooperation can help make this happen!

A Missing Link (1)

Bankers' Associations Are "Hollow" Bodies

Some Growth Constraints

Substantive

- Small size (1-2 staff)
- No stature
 - reacting to authorities' requests on small matters
- Significant knowledge gap on policy issues
- Few financial sector reform consultants available
- EU Bankers' Association know-how not easily transferable abroad

Organizational

- Who takes the leadership?
 - The President?
 - The Managing Director?
 - The Board?
- Membership co-ordination problems
 - Outdated membership representation often
 - New foreign owners not well connected with local institutions

The Missing Link (2)

An Enabling Environment For Private Sector Participation

1. To demonstrate it is possible for the private sector to have a voice in shaping reforms
 - In agreement with authorities
2. To start building reform analysis and advocacy capabilities within the local financial sector
 - Knowledge economy
3. To make financial sector reform a participatory topic
 - Not only with bankers, but also with business associations and other financial sector groups

Encouraging Private Sector Response

- Seven largest bank investors in Central Europe
 - Comparing notes on financial sector reform issues that hamper the long-term growth of their businesses
 - A possibly emerging “Vienna Group” (first plenary meeting: January 2003)
- Willing to work together to promote reforms
 - Through local bankers’ associations
 - Through other channels, if necessary
 - Feasible? Desirable?
 - Desirous to engage with IFIs
 - “Country risk” mitigation
- Open issues
 - How can they create local “momentum”
 - Building trust among all banks
 - How can they interface with authorities in a constructive way
 - Essential for results – otherwise Vienna Group disbands

Authorities Are Open-Minded

- Bosnia-Herzegovina
 - Strong need for a new Federation-wide dialogue with bankers
- Bulgaria
 - Dialogue needs to expand to SME lending and fiduciary money payments
- Croatia
 - New ownership opens new opportunities for collaboration to increase lending
- Macedonia
 - Need for private sector dialogue framework, now absent
- Romania
 - Professional skills of bankers' working groups should be strengthened for an effective dialogue
- Serbia and Montenegro
 - DG encouraged bankers' association to help him strengthen the banking sector

Why *Convergence*?

- Time-bound: Max 36 months
 - Maximum catalytic leverage of public money
- To help capture the “public good”
 - Financial sector development stimulates economic growth
- With a strong public legitimacy component...
 - Credit access for individuals and SME fosters social cohesion
 - Possible topics for public support:
 - » establishment of a credit bureau for retail and SME clients
 - » how to increase non cash retail payments
 - » mortgage loan instruments
 - » securitization
 - » collateral law reform
 - » a coordinated approach to NPL resolution

Private and Public Sector Complementary Roles

Bankers

To identify issues of concern

Biggest market growth impact

Likely to lead to early government
action

To build consensus within
national bankers'
associations

To organize working groups

Results-oriented

To engage with authorities
constructively

With a public good focus

International Institutions

To help national authorities organize
private sector dialogue

Creating appropriate space and comfort

To provide strategic perspective

To support dialogue with policy
analysis, knowledge sharing and
training resources

Helping consensus-building among
banks and with authorities

To act as an honest broker between
the parties when necessary

International Financial Institutions

Possible Contributions

EBRD

- Lead role in the region
- Large bank investment portfolio
- Valued co-investor to provide country risk comfort
- Excellent knowledge of business conditions



To help create “momentum” and trust among local bankers

World Bank

- Global perspective
- Government advisor on financial sector reform
- Credibility to act at the public-private interface
- Convening power



To help create dialogue between authorities and business partners

Implementation Arrangements (1)

The Architecture

- Sponsors launch *Convergence Initiative (CI)*
 - ECB technical support
- *CI Funding (\$[3]m):*
 - EU, Greece, Italy, FIRST (co-financier)
 - WB: small financial contribution (DGF – 10% of total)
 - Co-funding by local bankers' associations
 - Open to commercial bank contributions (collectively, as minority partners)
- *CI Governing Council:*
 - Independent Chairman, EU, EBRD, WB, Bilaterals, private investors, an EU Bankers' Association
- *Proposed CI Trustees (2-3 former policy makers):*
 - To advise CI on perception of regulatory capture risk

Implementation Arrangements (2)

The Kick-Off

- Financial sector reform program public-private brainstorming
 - Facilitated by the World Bank (e.g., based on FSSA)
 - With EBRD and EU
 - Identification of key reform priorities
 - Authorities invite bankers' association to take the lead in preparing background studies on one or two items

Implementation Arrangements (3)

Details

- CI Implemented by a Secretariat
 - Based in the region (e.g., Austria, Slovenia)
 - Two financial sector professionals
 - Paid with *Convergence* funding
- Secretariat brings in technical partners and financial sector policy experts
 - Successful EU Bankers' Associations (EBA)
 - European Banking Federation
 - Former WB/IMF staff and other policy experts
 - Interacts with FIRST
- Secretariat chairs local project steering committee
 - Authorities, bankers association, IMF?

Implementation Arrangements (4)

- WB Role
 - As project incubator
 - With small financial contribution
 - As an honest broker between authorities and bankers' associations at inception
 - Oversees *Convergence* as part of Governing Council
 - Without chairing it
 - Will continue regular dialogue with authorities
 - May undertake CI follow-on work, as requested by the authorities

Convergence: Risks and Mitigants

- Legitimate role for public institutions?
 - Catalyzing private sector dialogue benefits authorities with weak capacity
 - it makes reform implementation quicker
- Reputational risks?
 - Focus: public good issues, as endorsed by authorities
 - Discussion of public good issues can turn bankers' associations into a powerful driver for market deepening
 - Harnessing owners' incentives: return on investment through market size growth, not short-term profit maximization
- Effective use of public money?
 - “Subsidy” has a higher return on development effectiveness than if used for direct government support, if it helps align private sector behavior with public good objectives
- Need for and extent of WB involvement?
 - WB has unique experience to structure public-private partnerships for effective results on-the-ground
 - Role at inception, not in implementation.

An Illustrative Business Plan

	<u>Phase 1</u>	<u>Phase 2</u>	<u>Phase 3</u>	<u>Total</u>
Time Frame	0-6 month Launch	6-24 month Expansion	24-36 month Consolidation	0-36 month
Donors	X	X, Y	Y, Z	
	<u># Projects</u>	<u># Projects</u>	<u># Projects</u>	<u># Projects</u>
<u>Project Size</u>				
Large	1	2	0	3
Medium	2	1	0	3
Small	0	2	2	4

Project	Country						Total
	1	2	3	4	5	6	
Large		X		X	X		3
Medium	X		X			X	3
Small	X		X	X	X		4

Work executed in a regional context to maximize operational synergies

Lead Role

International Institutions
WB ↔ EBRD

Bankers

Execution

Government

Dialogue

National Bankers' Association

- BA
- BI
- Erste
- KBC
- RZB
- SG
- UCI

Policy experts

Regional Secretariat
2 staff

EU Bankers' Associations

**“Vienna Group”
+ IIF?**

Donors

<i>Convergence</i> Trust Fund					
EU	Italy	Greece	Austria	WB	Vienna Group

Governing Board

Independent Chairman

Members: EU, EBRD, Bilaterals, WB, Vienna Group, One Lead EU Bankers' Association

Next Preparatory Steps

- Goal: to improve financial sector policy-making
 - Through an effective public-private dialogue
- Dialogue can be strengthened in many ways
 - Also more neutral knowledge sharing and training
- How will the regional secretariat be organized?
 - Sponsorship, organization, activities and relationship to the Bank
 - Selection of issues and link to Bank activities (benefit-driven)
- What are the public funds used for?
- How to measure success of this initiative?
 - Permanent local capacity building?
- Are reputational risks well understood and can they be managed?