

A World Bank Draft Proposal For A
Joint Venture With EBRD
Supported by EU and Italy
with other partners

March 2003

Convergence

*To promote economic growth
by deepening the financial sector
through a structured public-private dialogue framework*

South-Eastern Europe

Bulgaria, Romania

Albania, Bosnia-H, Croatia, Macedonia, Moldova, Serbia and Montenegro

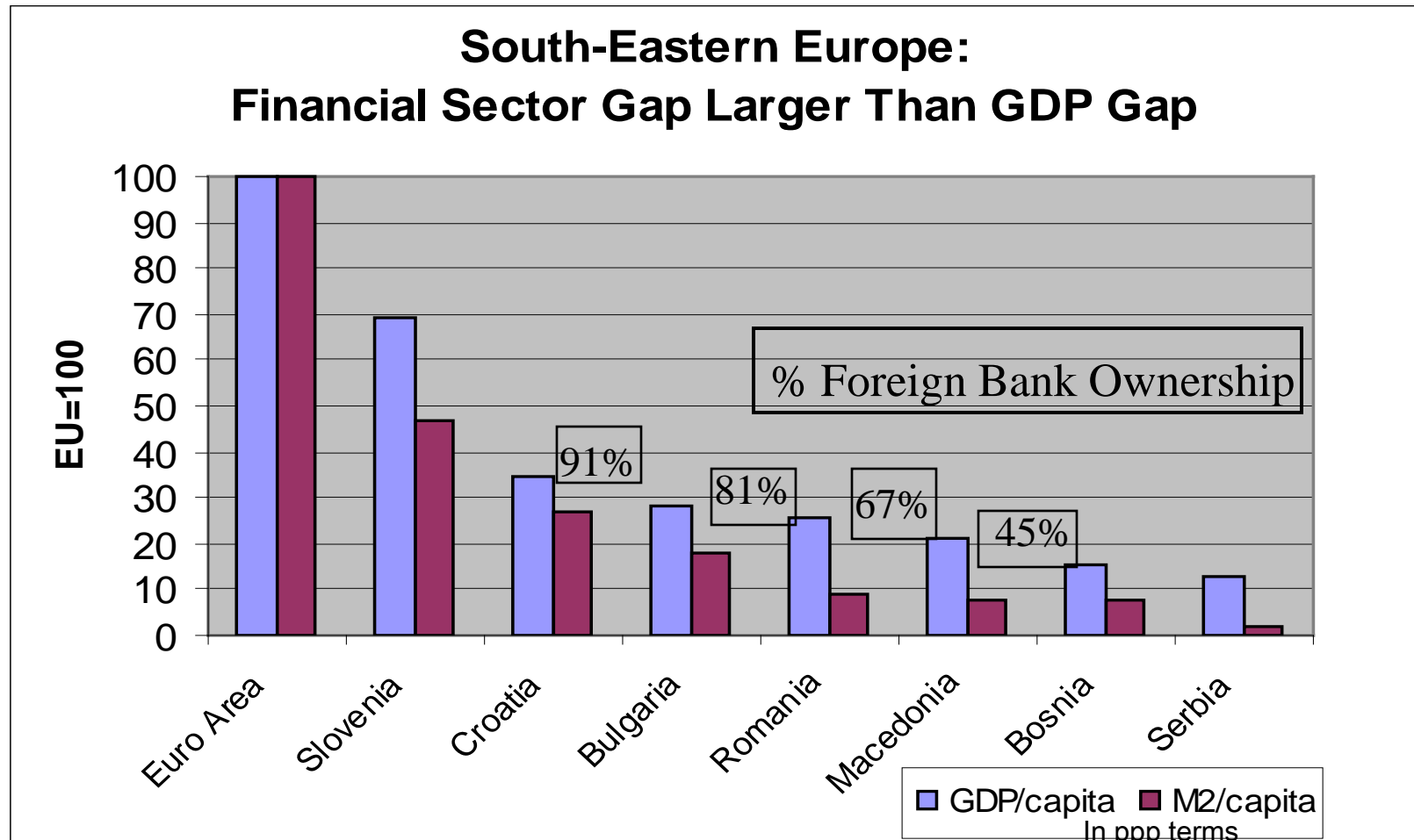
The Purpose

This initiative aims at assisting the authorities in deepening the financial sector by undertaking policy analysis, recommendation, and outreach work in a structured public-private dialogue framework (“*Convergence*”):

- Small and time-bound: Euro[6]m over 3 years
 - EU: Euro[2]m
 - Italy: Euro[1.5]m
- Catalytic 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,...

An Example: The Lamfalussy Commission On EU Securities Markets Regulations

The Context



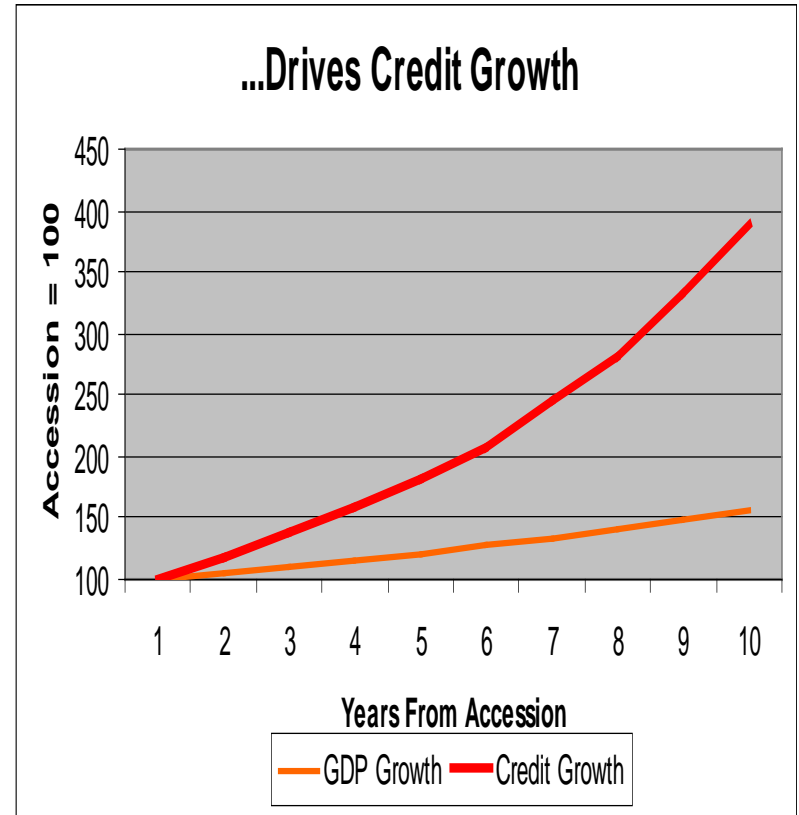
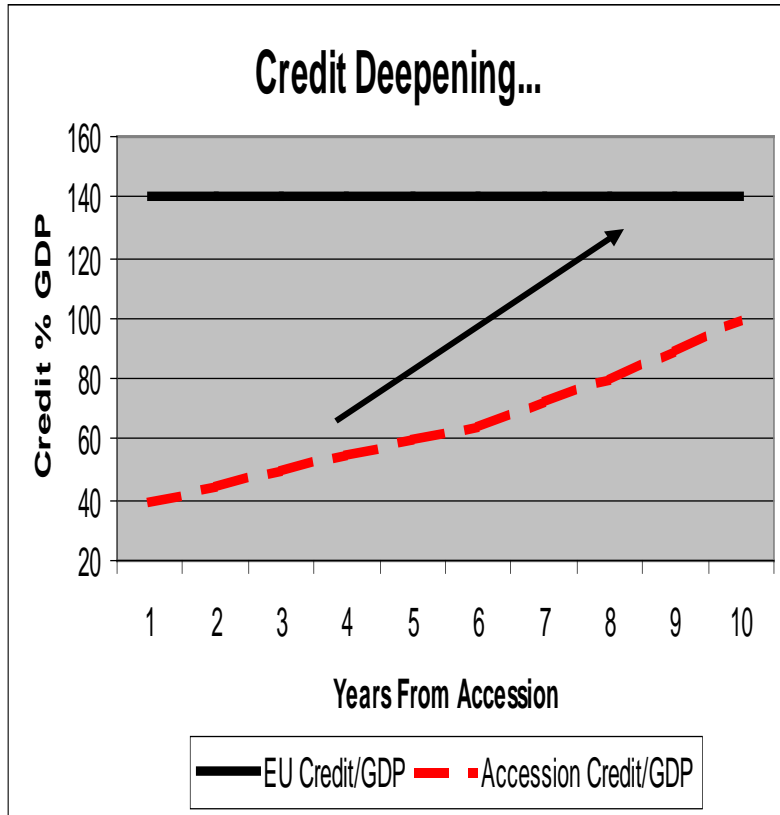
“The traditional role of the financial sector in underpinning investment and realizing growth potential through its intermediation and governance functions is still very limited in most EU accession countries”.

Eugenio Domingo Solans, ECB Executive Board Member

The Issue

- Financial sector overhauled in target countries
 - Right incentives now: privatization, foreign entry and improving prudential framework
- But size and depth still small: 1/4 EU level (as % GDP)
- Yet, financial sector development is key contributor to economic growth
 - Made possible by successful (and costly) macro stabilization
 - Fiscal and monetary policies almost in line with tight EU requirements
- Large reform agenda outstanding
 - (incl. adoption of EU regulatory framework)
 - Legal infrastructure
 - Banking efficiency and safety
 - Capital market development

The Vision



Whoever, as I do, holds the view that freedom and responsibility should pervade the economic life, is inclined to let market forces do as much as they can to *transform* the structure of the market in an optimal way, not only carry on activities within a *given* market structure.

Tommaso Padoa-Schioppa, ECB Executive Board Member

Why Public-Private Cooperation?

The Conceptual Framework

- “It is crucial to be aware that market-led progress does require co-operation among economic (public and private) agents.”
- “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”.
- “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.”

Tommaso Padoa-Schioppa, ECB Executive Board Member

- “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

But No Policy Dialogue Role For Market Participants

Bankers' Associations Are Weak, Others Do Not Exist...

Barriers to Growth of Associations

Substantive

- Small size (1-2 staff)
- Low 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

International Institutions

Can Help Organize Engagement With Private Sector

International
Institutions

Private Sector

Convergence

- 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 market
participants and with authorities
- To act as an honest broker between
the parties when necessary
 - Providing independent technical opinions

Market Participants

- To identify issues of concern
 - Biggest market growth impact
 - Likely to lead to early government
action
 - Building consensus among members
- To organize working groups
 - Strategic result orientation
- To engage with authorities
constructively
 - With a public good focus

International Institutions

Can Help Organize Engagement With Private Sector (2)

Illustrative Contributions

Immediate Objectives

- To help authorities connect with (weak) bankers' and other associations
- To set the standards for public-private dialogue
- To feed intellectual content into public-private dialogue
- To help create a good investment climate
 - Perception of regulatory uncertainties holds back new product development

Medium-Term Objectives

- To demonstrate public-private dialogue helps to build a performing financial sector
- To help build policy analysis capabilities outside the official sector
- To make financial sector development a participatory topic
 - With banks, other financial intermediaries, business and consumer associations

Convergence

Main Features

- Time-bound: Max 36 months
 - Maximum catalytic leverage of public money
- To help capture the “public good”
 - Financial sector development stimulates economic growth
 - Credit access for individuals and SMEs fosters social cohesion
- Focused on topics with a strong public legitimacy component...
 - 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
- Building reform momentum and private sector ownership

Implementation Arrangements (1)

The Architecture

- WB and European partners launch *Convergence*
 - EBRD/EU/ECB, countries and personalities
- *Convergence* (Euro[6]m):
 - EU, Italy and FIRST (co-financier)
 - WB: small contribution (10% of total)
 - Co-funding by local authorities
 - Matched by contributions from local financial sector associations
 - To cement public-private co-operation
- *Convergence* Governing Council:
 - Independent Chairman, EU, Italy, EBRD, WB and one EU Bankers' Association
 - Chairman: An eminent policy-maker acting in his/her personal capacity

Implementation Arrangements (2)

Kick-Off Details

- *Convergence* supported by a lean Regional Secretariat
 - One senior financial sector professional
 - Anchored in a suitable organization
 - Based near the region (e.g., Austria, Italy, Slovenia)
- Secretariat facilitates public-private brainstorming on financial sector development
 - Based on FSSA or equivalent
 - With EBRD, ECB, EU and WB
 - Identification of key development priorities
 - Authorities invite Secretariat to help prepare groundwork on selected reform items
 - Similarly to role played by Lamfalussy Commission in preparing proposals for a coordinated European securities market regulations
 - Method now being extended to banking and insurance regulations

Implementation Arrangements (3)

Execution

- To work on selected reform items, Secretariat brings in financial sector policy experts and technical partners
 - Local/regional experts supported by former WB/IMF staff and other world-class policy experts
 - Successful EU Bankers' and other Associations, if necessary
- Secretariat undertakes outreach activities to increase awareness of financial sector development issues
 - General policy seminars, professional training, public outreach
- Secretariat chairs country project steering committee
 - Authorities, national associations, EBRD, IMF?
 - Interacts with business and consumer associations

Goal: To help authorities enact appropriate reform measures at sustained pace and ready for smooth implementation

Convergence

Expected Benefits

Authorities

- The system may grow faster by drawing on the energy and building on the incentives of market participants
 - *Convergence* will help authorities include market participants' views on policy options under consideration as well as assess their reactions to reform suggestions
- The system may also become more stable, as market participants may align more accurately their incentives to the goals of national authorities
- The system may grow more harmoniously as *Convergence* will help various financial sector authorities coordinate their policy actions with financial sector, business and consumer associations

Market Participants

- They may accelerate their business expansion plans
 - The authorities' long-term plans are clearer to them
 - They have greater comfort that their regulatory risk concerns may be taken into constructive account going forward
- They may operate within a more efficient financial infrastructure
 - Achieved more quickly through effective co-operation among themselves and with authorities
- New entrants may join with new products and in new segments
 - A result of a good investment climate in the financial sector

A Win-Win Situation

An Illustrative Business Plan

	Year 1	Year 2	Year 3	Total
Countries of operation	3	5	7	
Large	2	4	5	
Small	1	1	2	
<u>Programs</u>				
<u>Public Outreach Projects</u>	<u>7</u>	<u>14</u>	<u>18</u>	<u>39</u>
General Policy Seminars	2	4	4	10
Professional Training	3	5	7	15
Civil Society Outreach	2	5	7	14
<u>Financial Sector Development Projects</u>	<u>4</u>	<u>8</u>	<u>7</u>	<u>19</u>
Large	1	2	1	4
Medium	2	4	4	10
Small	1	2	2	5

Work executed in a regional context to maximize operational synergies

Lead Role

Country Authorities

International Institutions

Market Participants

Execution

Authorities

Dialogue

National Bankers' Association

Insurance Association

Securities Brokers Association

- Bank
- Bank
- Bank
- Ins.
- Ins.
- Broker
- Broker

Policy experts

Regional Secretariat
1 senior staff

Business Associations

Consumer Associations

Donors

<i>Convergence Trust Fund</i>				
EU	Italy	Host Country	Target Countries	WB

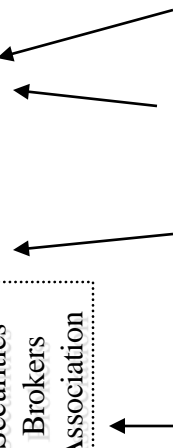
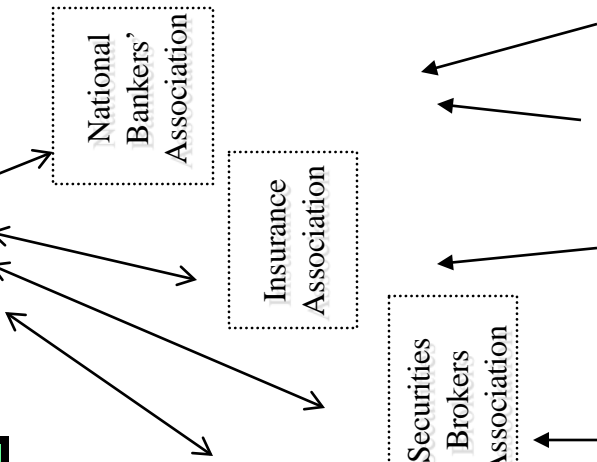
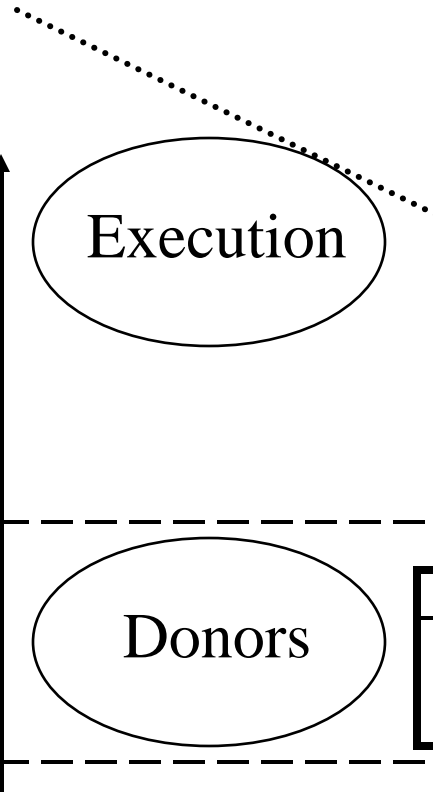
Country Work

Governing Board

Independent Chairman

Members: EU, Italy, WB, EBRD,
One Lead EU Bankers' Association

Regional Structure



Convergence: Risks and Mitigants

- Legitimate role for public institutions?
 - Catalyzing private sector dialogue benefits authorities with large reform agenda compared to implementation capacity
- Effective use of public money?
 - “Subsidy” can have a higher return on development effectiveness than if used for direct government support, if public money helps also align private sector behavior with public good objectives
 - Discussion of public good issues can turn private sector into a powerful driver for market deepening
 - Harnessing owners’ incentives: return on investment through market size growth, not short-term profit maximization
- Reputational risks?
 - *Convergence* engages only with adequate demonstration of authorities and private sector commitment to working together for financial sector deepening
- 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.

Conclusion

Convergence will help the authorities reap the public good benefits of the new ownership incentives that have changed the financial sector landscape in South-Eastern Europe.

If properly harnessed, these incentives can have a powerful effect on the pace and depth of financial sector development, accelerating economic growth and personal income convergence with the EU.

Convergence will help catalyze these positive forces for quicker results and a lasting impact on societies.