



Public-Private Financial Sector Modernization in South-East Europe

The World Bank's Convergence Program SPI Platform

European Banking Federation
Informal Seminar

Brussels, 3 December 2008

Luigi Passamonti

Head, Convergence Program, World Bank

The Convergence Program

Launched in 2005 by the World Bank with support from Italy's Ministry of Economy and Finance, the **Convergence Program** promotes **financial sector modernization** in South-East Europe through public-private sector cooperation.

Under a "BOT" concept (Build-Operate-Transfer), the Convergence Program helps authorities and market participants set up and operate a partnership (**SPI Platform**), whose governance, organization and "Better Regulation" analytical methods enable the pursuit of a broad-based modernization program largely executed by local public-private teams.

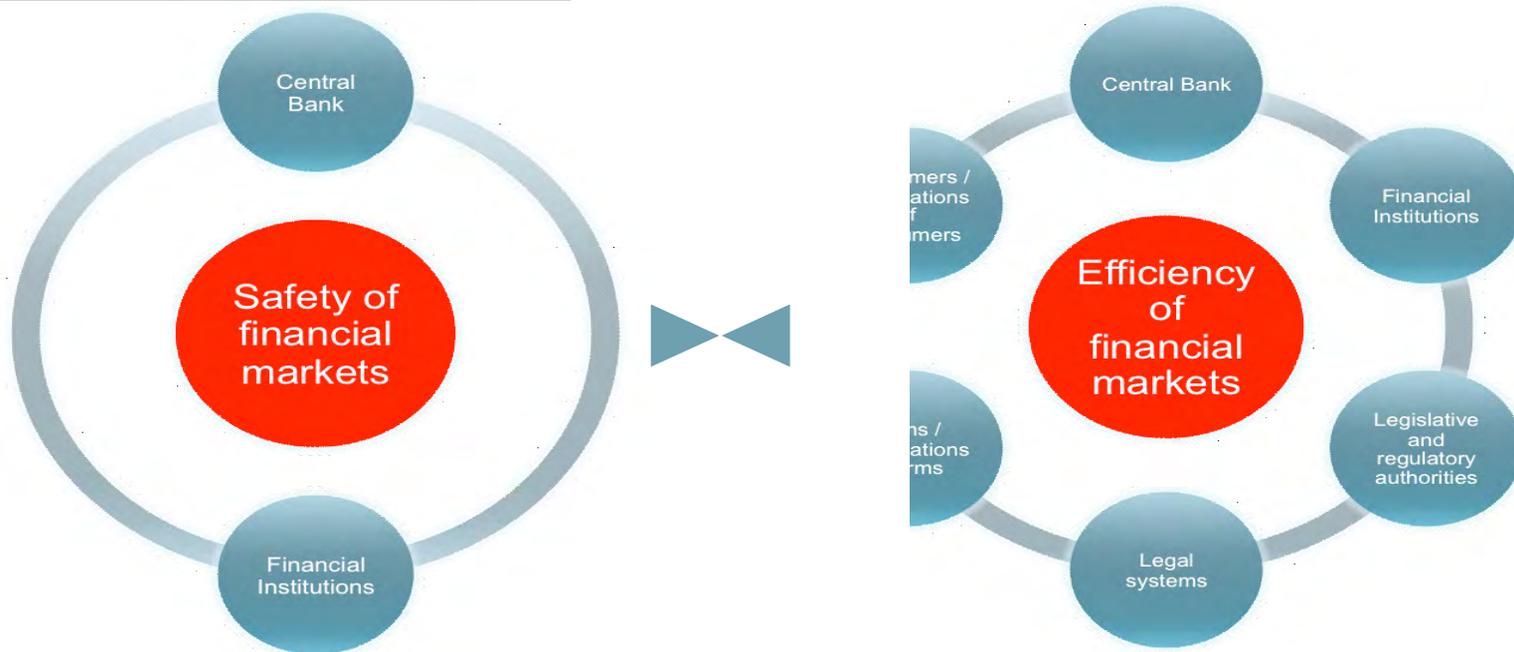
It is intended that local stakeholders take operational and financial responsibility for the **SPI Platform** after a two-year Convergence Program involvement.

The Convergence Program has been active in Albania, Bulgaria, Croatia and Romania. It has ongoing discussions in Moldova and Serbia. Its mandate, renewed in December 2007, ends in 2009.

The Financial Modernization Challenge

SAFETY VS EFFICIENCY OF FINANCIAL MARKETS: MAIN ACTORS

Given the complexity of efficiency issues in financial markets, pursuing efficiency and modernization involves many actors, not only central banks and financial institutions



A Financial Modernization Framework

	SOURCES OF MARKET EFFICIENCY GAINS				
ILLUSTRATIVE MARKET SEGMENTS	Decrease in asymmetric information	Completeness of the market	Increased opportunities to engage in financial transactions	Reduced transaction costs	Increased competition
Corporate Lending					
Retail Lending					
Savings Products					
Payment Services					

Large Number of Regulatory Change Opportunities

FINANCIAL MODERNIZATION OPPORTUNITIES

Informational asymmetries

- Harmonize country accounting standards with international ones
- Make financial statements' certification mandatory for SMEs
- Create professional accountants' registries
- Setup credit bureaus
- Define credit bureaus' governance
- Allow credit bureaus to contain both positive and negative information
- Allow banks to provide personal information to credit bureaus without consent
- Allow banks to effectively monitor the activities of the borrower
- Setup tailored scoring systems for SMEs
- Setup tailored scoring systems for micro firms
- Certify bank internal rating procedures for SMEs
- Build a Corporate Banking Information dataset
- Allow banks to share information about customers
- Allow information flow among banks belonging to a group
- Allow cross-border exchange of information between bureaus
- Setup public guarantees for SMEs
- Develop microcredit guarantee schemes
- Allow credit sales
- Regulate letters of credit schemes
- Provide investment banking services to SMEs
- Provide technical assistance to SMEs
- Provide access to non-bank lenders' and creditors' data set
- Soften personal data protection
- Setup land registries
- Define land registries' access policies
- Allow personal bank guarantee
- Allow personal wage assignment
- Setup public guarantees for consumption credit
- Allow tax and utilities bank payments
- Certify real estate assessors
- Harmonize real estate assessment procedures
- Setup public guarantees for young people
- Setup public guarantees for women clients
- **AND MANY MANY MORE**

Incompleteness of markets Lack of access to financial transactions

- Allow access to international funding markets
- Provide up-to-date regulation of OTC markets
- Favor competition among market providers
- Create new network facilities
- Update existing network facilities
- Remove IT constraints
- Include new geographical areas
- Include new population segments
- Regulate financial innovation
- Build public authorities' skills on advanced products
- Allow project financing
- Allow group lending
- Design microcredit schemes
- Allow bank secured corporate bonds
- Design standardized payment procedures
- Provide training to potential market participants
- Develop leasing market
- Develop factoring market
- Develop venture capital services
- Develop private equity services
- Develop derivatives markets
- Develop asset management services
- Develop P/L insurance markets
- Develop life insurance markets
- Develop pension funds
- Allow securitization
- Setup and develop stock markets
- Allow students' loans
- Allow mortgages bond
- Allow mortgage insurance
- **AND MANY MANY MORE**

- Provide technical assistance to firms
- Provide training to bank officers
- Provide financial skills to public authorities
- Provide training to judges about advanced financial issues
- Increase the number of bank branches
- Increase the number of ATMs
- Increase the number of specialized courts
- Reform bankruptcy law
- Allow simplification / standardization of financial contracts
- Allow international contractual forms
- Allow contracts specifically tailored for financial products
- Increase investors' / creditors' protection
- Favor better interface between real and financial markets
- Implement simple / standardized legal procedures
- Implement efficient credit recovery procedures
- Favor arbitration procedures (previously agreed upon by counterparts)
- Support pre-trial settlement procedures
- Favor the interaction between firms / associations of firms and financial institutions / association of financial institutions
- Provide technical assistance to consumers
- Favor the interaction between associations of consumers and association of financial institutions
- **AND MANY MANY MORE**

FINANCIAL MODERNIZATION OPPORTUNITIES

Transaction costs

- Adopt international core principles for payment systems
- Favor the development of new payment instruments (mobile phones)
- Simplify payment orders' procedures
- Harmonize payment orders' procedures to international standards
- Reduce documentation for international payments
- Simplify reporting and registration procedures of international loans
- Improve IT infrastructures
- Setup an efficient network for credit cards
- Setup an efficient network of electronic branches (ATM)
- Harmonize local networks to international standards
- Design computer purchasing incentives
- Provide computer science education
- Design user friendly bank websites
- Develop network security
- Define cooperation schemes with Police
- Design insurance schemes for on line transactions
- Increase remuneration on mandatory provisions
- Design bank governance rules consistent with company law
- Harmonize financial markets' rules across products and services
- Modernize documentation flows
- Simplify bank account opening procedures
- Remove filters non-consistent with Basel II
- Standardize corporate contractual forms
- Avoid payment of insurance fees on deposits by corporate clients
- Reduce stamp duties on forfeit businesses
- Reduce stamp duties on loan contracts
- Adopt international standards on working week days
- Optimize consumer protection laws
- Avoid duplication in mandatory documentation for consumers
- Standardize mortgage contractual forms
- Reduce stamp duties on mortgage contracts
- **AND MANY MANY MORE**

Lack of competition

- Setup an antitrust authority, with the power to investigate financial institutions and enforce antitrust regulation, and veto power over M&A operations in the financial sector
- Enhance Antitrust Authority independence
- Set international standards on antitrust regulation
- Define transparent criteria to identify abusive dominant positions
- Favor the interaction between the antitrust authority and the national associations of banks and firms
- Design quick and efficient licensing procedures for prospective national financial institutions
- Soften limits on interest rates
- Liberalize commissions on payment instruments
- Support competitive risk / lending policies
- Separate lending from account opening
- Link deposit insurance premiums to risk profiles
- Design quick and efficient licensing procedures for international financial institutions
- Design competitive market procedures for the acquisition of distressed national banks / financial institutions
- Sign bilateral agreements to allow foreign licensed institutions to operate in the national market
- Harmonize antitrust law to international standards regarding advertisement
- Provide correct information to the public
- Liberalize mortgage insurance market
- **AND MANY MANY MORE**

Modernization Challenges

Illustrative Comparative Dimensions

Financial Stability

- Authority vested in a small number of institutions
- “Risk prevention” focus
- Codified best practice (international standards & codes)
- “Super-equivalency” approach
- Regulation and supervision mutually reinforcing
- Core sovereignty responsibility
- “Better Regulation” creates more accountability

Financial Modernization

- Authority dispersed across many institutions
- “Enabling” focus
- No established conceptual framework
- Close institutional coordination
- Limited monitoring feedback
- Users’ bottom-up advocacy necessary
- “Better Regulation” necessary but not sufficient to capture available efficiency gains

How To Catalyze Modernization?

Catalyzing Modernization

Options for Public Action

1. “Do Nothing” Option

- Authorities will launch modernization program
 - Lack of accepted analytical framework
 - E.g, “Basel Core Principles for Banking Supervision”
 - Modernization ranks lower than stability
 - Most used proxy: “Regulatory Guillotine”
- Market participants will recognize modernization opportunities are within reach of collective action
 - They will overcome coordination problems and initiate strengthening of analytical and advocacy activities to engage with authorities
 - Long process (governance obstacles, poor track record of value for investment in ideas, weak dialogue framework)

Catalyzing Modernization

Options for Public Action

2. Help authorities undertake modernization

- Peripheral objective to core mandates
- Market needs are broad, diverse and minute

3. Help strengthen Banking Associations

- Investment in analytical capacity unsustainable unless quick results accrue through dialogue

4. Help shape public-private dialogue

- Joint undertaking of a modernization program
- Governance suited to inter-institutional cooperation
- Banking Associations grow as trusted dialogue partners
- Authorities could outsource analytics on most steps of non-core decisions based on “Better Regulation”

South-East Europe Context

- Why did WB look at modernization in SEE?
 - Large investment and trade links and convergence with EU acquis made financial modernization a more compelling proposition than elsewhere
 - Polls confirmed existence of large obstacles to integrate SEE operations of international banks into group platform
 - Authorities had priority focus on complex safety issues
 - Banking Associations with limited influence
 - SEE modernization challenges and opportunities similar to those of EU financial integration
 - EU institutional framework and analytics relevant

Three Prongs To Jump-Start Dialogue

1. Governance and Execution: the SPI Platform^{1/}

- Public-Private Steering Committee
 - To gather & prioritize modernization projects
 - To monitor progress and implementation
- Program Secretariat (2-3 members)
 - To manage projects conducted by Working Groups of public-private local experts

2. “*Financial Sector Modernization Program*”

- Legitimacy: Fit with 5 ECB modernization criteria
 - 1) Info asymmetry, 2) Market completeness, 3) Engaging in financial transactions, 4) Cost efficiencies and 5) Competition

3. International technical support

- World Bank Group, EBRD, Eurosystem, ...
- EBF national members
- Private firms and experts

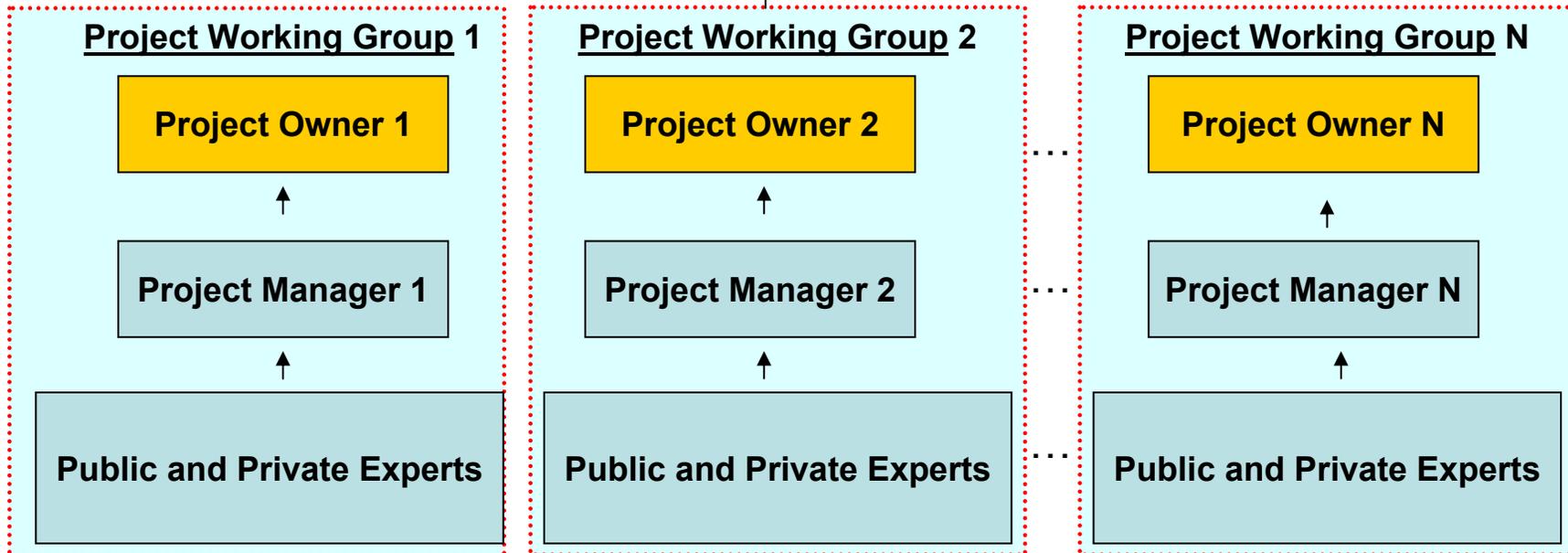
^{1/} SPI stands for Special Projects Initiative; Details: www.spi-albania.eu and www.spi-romania.eu;

Governance: The SPI Platform

PROGRAM SETTING, SOLUTION ENDORSEMENT AND ENACTMENT MONITORING



PROJECT MANAGEMENT AND CONSENSUS-BUILDING



SOLUTION FINDING (Through RIA-based public-private consultations)



ROMANIA

CONVERGENCE FINANCIAL SECTOR MODERNIZATION

Public-Private Special Projects Initiative



SPI Romania Has Mobilized > 120 Experts

- **National Bank of Romania**
- **National Authority for Consumers Protection**
- **Ministry of Economy and Finance**
- **Ministry of Agriculture and Rural Development**
- **Ministry of Interior and Administration Reform**
- **Anti-Money Laundering Office**
- **TransFond**
- **Credit Bureau**
- **National Authority for the Supervision of Personal Data Processing**
- **Rural Credit Guarantee Fund**
- **Grading Commission for Comestible Seeds**
- **Romanian Commodities Exchange**
- **Romanian Stock Exchange**
- **National Securities Comission**
- **The National Association for Consumers' Protection and Promotion of Programs and Strategies from Romania**
- **Italian Banking Association**
- **OECD**
- **International Finance Corporation**
- **World Bank**
- **Romanian Banking Association**
- **Raiffeisen Bank**
- **Raiffeisen Banca pentru Locuințe**
- **OTP Bank**
- **Banc Post**
- **CEC**
- **BCR**
- **Alpha Bank**
- **BRD-GSG**
- **UniCredit Țiriac Bank**
- **RIB Romanian International Bank**
- **Credit Europe Bank**
- **ING Romania**
- **Citibank**
- **ABN AMRO**
- **ATE Bank Romania**
- **Coface Romania**
- **Cargill**
- **KPMG**
- **Deloitte**
- **Clifford Chance**
- **Algoritmics**
- **Bearing Point**
- **Financial Ombudsman Service, UK**
- **Goodwood Financial Consulting**



ROMANIA

CONVERGENCE FINANCIAL SECTOR MODERNIZATION

Public-Private Special Projects Initiative



Romania's 2007 Modernization Program

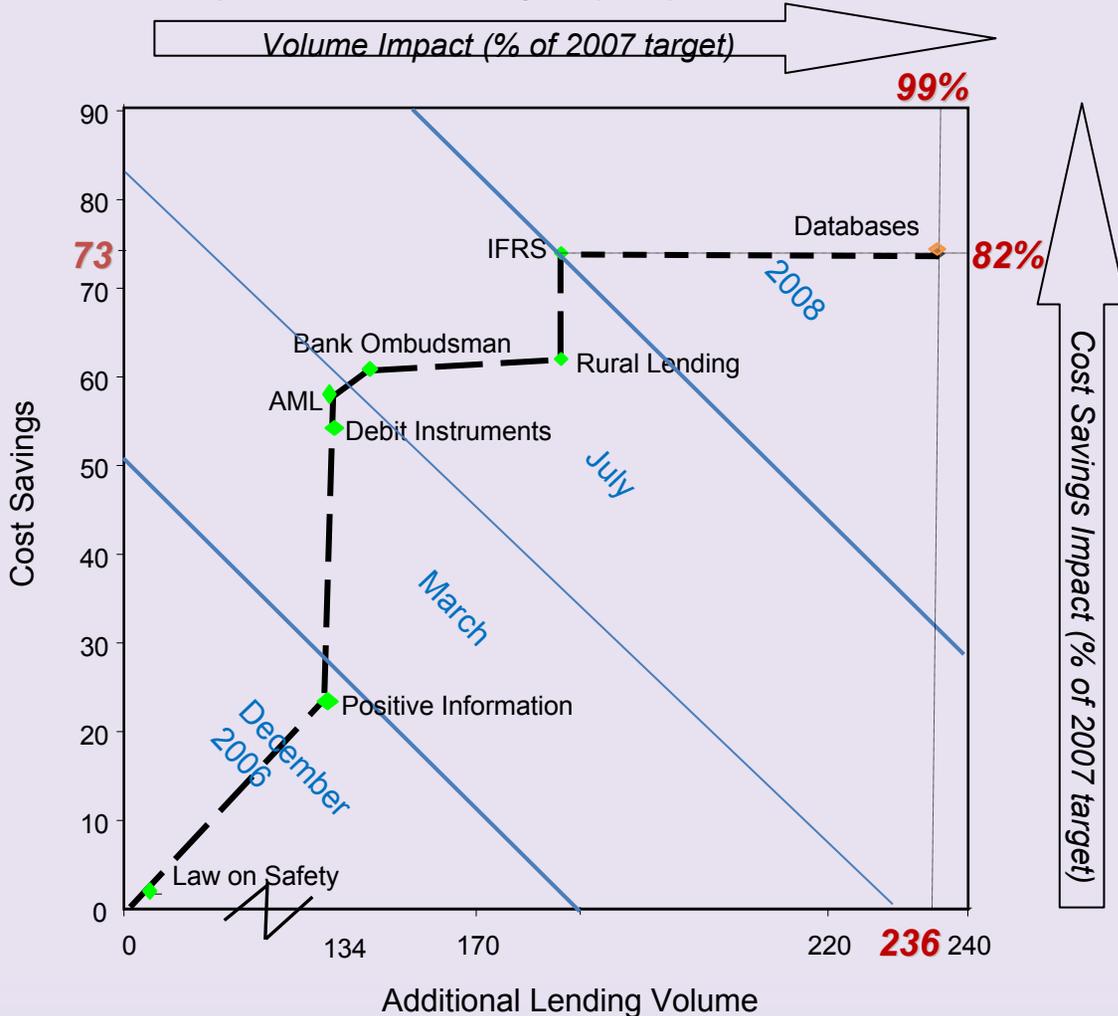
Italian Banking Association	European Central Bank					
	FINANCIAL SECTOR MODERNIZATION CRITERIA	Asymmetric information	Completeness of the market	Increased opportunities to engage in financial transactions	Reduced transaction costs	Increased competition
	Business development	Positive credit information sharing	1. Rural lending 2. Credit Rating Agencies	Law on bank guarantees	Loss-Given-De fault Database	Mortgage Loan Database
	Industry competitiveness	Stress testing	MiFID implementation		1. Prudentia IFRS 2. Debit Instruments E-Settlement 3. AML Law 4. Law on Safety	
	Industry reputation			1. Ombudsman 2. Consumer education		
Total	2	3	3	5	1	

BOLD BLUE: NBR Proposals; **BOLD RED:** RBA Proposals; Black: Other Proposals

2007 SPI Romania Activity

<http://www.spi-romania.eu/spi-secretariat/activity-reports/>

Financial Impact of Finalized SPI Projects (€ Mln) – First Full Year



Total number of projects: 14
(updated October 2008)



Self regulatory actions completed

1. Expansion of positive information sharing
2. Ombudsman
3. Mortgage loan servicing and loss given default databases
4. Consumer financial education
5. MiFID
6. Credit exposures stress testing techniques



Regulatory changes completed

7. E-processing of debit instruments
8. AML Law Amendments
9. Rural Lending



Regulatory changes underway

10. Law on goods safeguard, values and persons protection
11. IFRS loan loss provisioning



Proposals to be completed in 2008

12. Law on bank letters of guarantee
13. Roland Berger study



Abandoned

14. Credit rating agencies

Launch Steps: The SPI Albania Example

January 2008	Bank of Albania and Association of Albanian Banks send Joint Commitment Letter to Convergence Program
January	SPI Seminar with banking community
Jan-Mar	Regulatory Impact Assessment Program
Feb-Mar	Consultations to build Activity Program SPI Secretariat recruitment
<hr/>	
15 May	SPI Secretariat starts working
10 June	First SPI Committee meeting Approved SPI Albania 2008 Activity Program (6 projects) Approved SPI Committee Operating Guidelines
19 June	4 Project Owners appointed
25 June	More than 50 Project Managers and Project Working Group members appointed
3-4 July	First PWG Meetings
October 2008	Three regulatory proposals completed

Other SPI Platform Activities

Romania

- Regulatory Impact Assessment Capacity Building for regulatory community
 - April-November 2007 (20+ participants from 6 institutions)
- Managed Romanian consultations on EU Green Paper on Retail Financial Services
 - Questionnaire, Consultations, DG Markt Submission, Participation in EU Public Hearing, domestic debriefing of EU Public Hearing

Albania

- Regulatory Impact Assessment Capacity Building for regulatory community
 - January-April 2008
- Organizing analytical process to address policy priorities raised by Governor of Bank of Albania in two Banking Fora
- Discussing MoU with European University Tirana
 - Technical cooperation on Impact Assessment activities

SPI Platform Impact

- Efficient processing of large modernization program
 - 10-15 key projects/year (€20k/project)
 - Operating costs: 0.5% of annual gains for banking sector
 - SPI Platform domestic sustainability is possible
- Public-private governance and “Better Regulation” tools extend country’s reform capacity
 - SPI Committee becomes country’s reform “champion”
 - Inter-agency coordination
 - A “Better Regulation” Technical Secretariat
 - SPI Examples: Prudential IFRS, stress-testing, capital adequacy,.....
 - Analytical reform teams draw on industry expertise
 - Authorities associated throughout analytical process
 - Market participants acquire “right of initiative”
 - Subject to authorities’ non-objection

A EU Neighborhood Financial Modernization Initiative

EU Neighbors Modernization Public-Private Steering Committee

SPI Operator

International Technical Assistance

EU N Country 1

SPI

EU N Country 2

SPI

EU N Country 3

SPI

Banking
Association

Financial
Authorities

Consumer
Protection

Complementary Vantage Points

EU institutions

- Support local authorities extend engagement beyond stability into market efficiency issues
 - With transparent and cost-efficient arrangements
 - Fostering “Better Regulation” practices

European Banking Federation

- Contribute banking and policy analysis expertise to help solve under-attended efficiency issues
 - Complementing EU institutions assistance in area of comparative advantage

Issues For Discussion

1. How large could the efficiency gains to financial sector players and users be if operating conditions in EU neighboring countries convergence more rapidly towards EU practices?
2. Does pursuit of market efficiencies justify adoption of innovative institutional instruments?
3. Can these institutional instruments reinforce the effectiveness of prudential regulatory activities?
4. Would an explicit “Better Regulation” SPI Platform mandate catalyze faster financial integration?
5. How best to encourage EU neighboring countries to take steps to establish SPI Platforms?

Proposed Next Steps

1. Seminars with relevant EU institutions to deepen understanding of SPI Platform capabilities
 - Fit with own mandates and strategies
 - Adaptability to future needs
2. Evidence from market participants of unmet modernization needs in EU neighboring countries
 - Input from EBF Associate Members very useful
3. Summary of EBF members' technical assistance capabilities
4. Note on possible EU public-private coordination mechanism
 - Respective roles and contributions
5. "SPI Operator" invited to prepare implementation plans
 - Under oversight of a "coordinating" committee