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SECOND DRAFT FOR CONSULTATIONS
October 21, 2002

Stronger Financial Sectors In Central and South-Eastern Europe[1]

A Capacity Building Initiative For Local Bankers' Associations –
To catalyze private sector cooperation for financial sector reform

Issue

The financial sectors of Central and South-European (CSE) countries have been overhauled during the last decade with large scale privatization and foreign bank entry. This notwithstanding, the domestic private sector credit and stock market capitalization ratios to GDP in these countries are still very low -- about a fourth of their EU equivalent.

There remains a large unfinished legislative and regulatory reform program to build a performing financial system infrastructure, including adequate arrangements for non-bank financial institutions and market-based financial products. The legislative reform agenda extends to areas outside financial services that have a bearing on the efficiency of financial services delivery such as company, cadastre, collateral, bankruptcy and privacy laws.

Within the context of this large reform agenda, market participants lack an organized forum to elaborate a common approach to market development and regulatory reform based on an assessment of clients' needs and to effectively interface with authorities. Compared with international practices, local bankers' associations do not play yet a meaningful role in steering financial sector development. The authorities in the region welcome the strengthening of the local bankers' associations as they recognize the value of banking sector involvement in helping design and implement reforms.

Financial sector development will be a significant policy lever for these countries to generate economic growth (their GDP per capita levels are about a fifth of the EU level), while keeping a conservative stance on fiscal and monetary policies pursuant to EU stability requirements.

Rationale for the Initiative

Despite the strong public good case for a larger role for bankers' associations, the upgrading of their functions faces a number of obstacles, both of a substantive and an organizational nature.

Substantively, the current activities of most banking associations do not provide a natural platform for expansion. First, the associations, which typically have only one full time professional staff, focus their present activities on providing feedback to authorities on narrow technical issues. Second, member banks and also civil society (except for former policymakers) lack the detailed technical knowledge about implementation options for broad financial sector reform topics so as to be recognized as credible and constructive

[1] The countries being considered are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania and Yugoslavia. Other countries may be added if appropriate.

interlocutors of the authorities. The latter have been the predominant if not exclusive beneficiaries of technical assistance and capacity building efforts of the international community. Third, compared to sources of technical advice on corporate finance and management issues which are plentiful worldwide, the international supply of financial sector regulatory reform advice is much more narrow, less organized and is targeted at policy makers even by non-public providers. Fourth, successful bankers associations that have developed specific know-how about financial sector reform advocacy do not have strong incentives to transfer their expertise abroad as their mandate rarely includes international capacity building activities.

Turning now to organizational obstacles, given their present narrow operational platform, it is difficult for the executive leaders of the associations, for their boards and also for the membership at large to initiate and pursue a consensus-building process that would lead eventually to an expanded mandate of the association. Second, many of the member banks are now controlled by foreign majority shareholders whose immediate objectives are to upgrade the operations of the banks.

Objectives of the Initiative

The difficulty (or perhaps failure) of market forces to generate an adequate response to capture the public good benefits of a broad-based financial sector reform effort "owned" by the private sector justifies the launching of a time-bound public-sponsored and funded initiative with the following two limited objectives:

1. To demonstrate to local banks (and their international shareholders) through successful pursuit of selected reform projects that there is scope for a strengthened local bankers' association to promote financial sector reform for the benefit of the financial system as a whole.
2. To start strengthening the capabilities of local bankers' associations: a) to analyze legislative and regulatory reform needs; b) to assess their impacts on different components of the economy and c) to assist the authorities in addressing such reform needs on behalf of their members.

Measurement of Success

By providing evidence of successes in reform analysis and advocacy and by building some limited professional capacity, the ultimate goal of the initiative is to catalyze the decision of local banks to strengthen the role of their associations so that they have the mandate, public legitimacy, leadership, professional skills and budgetary resources to become a recognized player in financial sector development in their respective countries.

Accordingly, the success of the initiative will be measured on two criteria:

1. The degree to which the tasks undertaken in each country have led to actual legislative or regulatory reform with a quantifiable net present value impact on the P/L of the financial system.
2. The degree to which each local bankers' association will expand its role in financial sector reform advocacy as measured by a substantial increase in its budgetary envelope voted by its members in the financial year starting after the beginning of this initiative.

Participants in the Initiative

It is proposed that the World Bank promotes and structures the capacity building program with designated bankers' associations with a view to achieve success as defined above.

It is proposed that the World Bank seeks the involvement of a banking association with a demonstrated track record in reform advocacy in the EU to provide technical assistance to the bankers' associations with its own staff and with consultants engaged as necessary.

It is proposed to seek the support of several Trust Funds (e.g., EU, Greece, Italy, Netherlands, Switzerland) to cover the cost of the overall management of the initiative as well as the costs of professional consultants. For more details please see table on page 4.

Rationale for Participation

For the World Bank this initiative aims at the strengthening of a key institutional counterpart and partner to local banking and supervisory authorities. A satisfactory cooperation between authorities and market participants is necessary to strengthen the design and enforcement of the regulatory framework.

For the selected EU bankers' association (EBA) this initiative would leverage its ongoing institutional activities where it has gained a unique experience given the profound changes in the EU financial sector over the last decade.

For the donor authorities, this initiative represents an opportunity to address a systemic development need in a key geographical area.

Implementation Modalities

In consultation with local authorities, each local bankers' association and the World Bank with EBA support will identify one or two topics where an investment in knowledge, analysis and public outreach is likely to accelerate the pace of reform for the benefit of the financial system as a whole.

For each selected topic, EBA will assist the local bankers' association devise the most appropriate approach/methodology, hire the required consultants to carry out the tasks, monitor work-in-progress, identify a desirable final outcome and articulate the most effective outreach strategy to reach the objective. The World Bank will refrain from having a direct involvement in any of these activities other than to host or facilitate consultations between the authorities and the bankers' association, if either party so requires. The World Bank will monitor the overall progress of the initiative through EBA.

Scope, Duration and Cost

It is intended the initiative will cover no less than three countries and up to six. EU second wave accession countries (e.g., Bulgaria and Romania) will receive priority attention. The initiative will consist of a range of projects of different size so as to

maximize country impact and operational relevance at a regional level. The table provides an illustrative indication of the minimum number of projects to be undertaken.

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

The initiative will have a proposed duration of up to 18 months from commencement of the first project. It may be extended to 24 months to allow the conclusion of projects already underway.

It is proposed to organize the initiative in three consecutive phases: 1) to test the viability of the approach, 2) to scale it up and lastly 3) to complete the sample of pilot experiences.

Table: Illustrative Business Plan

	Phase 1	Phase 2	Phase 3	Total
Time Frame	0-6 month	6-12 month	12-18 month	0-18 month
	Launch	**Expansion**	**Consolidation**	**Overall**
Donors	X	X, Y	Y, Z	
	# Projects	# Projects	# Projects	# Projects
Project Size				
Large	1	2	0	3
Medium	2	1	0	3
Small	0	2	2	4

An Action Plan

November 2002: Discussions among World Bank, CSE authorities and bankers' associations, EBA and donor authorities

Identification of possible countries and pilot topics.

January 2003: Launch of first country pilot.