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# THE WORLD BANK – FinSAC

## Financial Sector Advisory Center – Vienna

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THE WORLD BANK



**THE WORLD BANK – FinSAC**  
**FINANCIAL SECTOR ADVISORY CENTER – VIENNA**  
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**THE WORLD BANK**  
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# CONTENTS

- FOREWORD .....V**
  
- I. FINSAC STRATEGIC RATIONALE AND THEMATIC/GEOGRAPHIC FOCUS ..... 1**
  - Regional Strategic Priorities in the Financial Sector – Implications of the European Banking Union .....1
  - Assessment of Needs and Priorities in FinSAC Target Countries .....2
  - FinSAC Thematic Pillars .....5
  - FinSAC Geographical Focus .....6
  - FinSAC Staffing and Results Framework .....7
  
- II. FINSAC ACTIVITIES DELIVERED (OR UNDERWAY) IN 2013 ..... 9**
  - Pillar I: Financial Stability and Macroprudential Frameworks .....9
  - Pillar II: Microprudential Frameworks ..... 10
  - Pillar III: Bank Recovery and Resolution Frameworks ..... 13
  - Pillar IV: Financial Consumer Protection and Financial Literacy ..... 14
  - 2013 Operating Expenditures ..... 15
  
- III. FINSAC WORK PROGRAM IN 2014–2018 ..... 17**
  - Expansion of Sectoral Focus ..... 17
  - Expansion of Geographical Coverage ..... 17
  - Indicative Annual Work Program for 2014 ..... 17

<b>ANNEX I. FINSAC STAFFING.....</b>	<b>19</b>
Current Staffing: Alignment with Thematic Pillar and Country Priorities .....	19
Future Staffing Plans .....	20
<b>ANNEX II. RESULTS FRAMEWORK.....</b>	<b>21</b>
FinSAC Objective: Regional Center of Excellence for Financial Sector Reform Implementation .....	21
Strategic Results Framework .....	22
Operational Results Framework .....	22
Project Result Monitoring .....	22
Stakeholders' Feedback .....	24
<b>FIGURES</b>	
Figure 1: Four Thematic Pillars of FinSAC activities.....	6
Figure 2: FinSAC Geographical Focus .....	6
Figure 3: FinSAC Objectives .....	21
Figure 4: FinSAC Strategic Results Framework.....	22
Figure 5: FinSAC Operational Results Framework.....	23
Figure 6: FinSAC Project Result Monitoring.....	23
<b>TABLES</b>	
Table 1: FinSAC 2013 Expenditures .....	15
Table 2: FinSAC's Expected 2014 Work Program.....	18

# FOREWORD

FINANCIAL SECTOR DEVELOPMENT AND STABILITY is critical to the growth and shared prosperity of the Europe and Central Asia (ECA) region. The World Bank's regional strategy, reconfirmed with the Board in January 2013, revolves around interventions in the Competitiveness area (where financial sector work features among the Bank's key delivery channels), in addition to interventions in adjoining pillars on social inclusion and climate change.

A broad financial sector reform agenda is also pursued by European Union (EU) institutions, with immediate impact—both via direct and indirect channels—on most ECA countries, and particularly so among EU member states and candidate countries. One of the most visible initiatives is the design and implementation of the European Banking Union, including a series of EU Directives on Capital Requirements, Bank Recovery and Resolution, and Deposit Insurance, which will require adoption by all EU member states. In addition, a number of mechanisms are to be implemented at the eurozone level for banking supervision and resolution, which will be optional for non-eurozone members, posing a number of challenges for client countries in the ECA region.

In order to further reinforce the World Bank ECA region's focus on financial sector work, and to respond to the needs derived from financial sector reforms taking place in the region, the Financial Sector Advisory Centre (FinSAC) was established in late 2011 as a dedicated Vienna-based technical unit of the ECA Region Private and Financial Sector Development Department (ECSPP)<sup>1</sup> to deliver technical advice and

implementation assistance services to client countries in the ECA region, with financial help from Austria's Federal Ministry of Finance<sup>2</sup> (Donor).

In order to achieve its objectives, FinSAC identified a programmatic approach based on four thematic pillars: i) Financial Stability, Crisis Prevention, and Macroprudential Frameworks; ii) Microprudential Regulatory and Supervision Frameworks; iii) Bank Recovery and Resolution; and iv) Consumer Protection and Financial Literacy. FinSAC provides advisory and analytical services in relation to these four strategic thematic choices through three distinct channels: (a) undertaking of client-specific technical assistance assignments; (b) organization of technical workshops, conferences, and seminars, and (c) execution of regional research projects with corresponding outreach activities. Through these activities, and within its programmatic focus, FinSAC aims to become a leading regional "knowledge center" over time.

FinSAC's geographical focus is expanding according to three key priority groups: i) EU candidate and potential candidate countries (Albania, Bosnia and

<sup>1</sup> Going forward from July 1, 2014 and following the restructuring of the World Bank Group along global practices, FinSAC will be managed by the Finance and Markets Global Practice.

<sup>2</sup> According to the Trust Fund Agreement signed in April 2011 and amended in December 2013, the Austrian Trust Fund will finance the establishment of the Vienna Center for Financial Sector Advisory Services (FinSAC) and the implementation of the program, consisting in the provision of advisory and analytical services on policy, technical, capacity building and institution building issues in the financial services sector to the financial authorities in World Bank member countries in the Europe and Central Asia. The Bank will manage and administer the program through FinSAC, which will: (a) coordinate the activities under program and administer the Trust Fund; and (b) implement the program at the regional level in support of financial sector development at the country level. FinSAC will be headed by a Program Coordinator reporting to a World Bank Sector Manager.

Herzegovina, Kosovo,<sup>3</sup> FYR Macedonia, Montenegro, and Serbia); ii) EU member states as active non-graduated World Bank clients (Bulgaria, Croatia, Poland, and Romania); and iii) EU neighborhood countries (Belarus, Moldova, Ukraine, Armenia, Azerbaijan, and Georgia). The expansion to Central Asia is envisaged in future consultations with the Donor.

Through the combination of its strong integration and coordination with ECSPF's work and its decentralized physical location, FinSAC has emerged as a key strategic institutional initiative in the delivery mechanism of impact-oriented financial sector technical assistance to the region. In the context of client relationship strategically managed by ECSPF staff, FinSAC builds on ECSPF's analytical and assessment work to engage in technical work that helps countries implement concrete legislative, regulatory and institution-building initiatives that strengthen the resilience and efficiency of financial systems.

In its first two years of operation, FinSAC has started 15 client assignments in 10 ECA countries<sup>4</sup> (eight of which have been completed), delivered three major regional conferences, and undertaken three research projects with its initial staff of five. FinSAC has, therefore, progressively developed outreach, impact and influence within the region.

Since FinSAC began operations experience has highlighted solid client demand for financial sector technical assistance. FinSAC's geographical proximity to prospective clients in ECA countries has allowed it to provide flexibility and effectiveness in its responses. Added to this, FinSAC's distinct comparative advantage vis-à-vis other technical assistance providers is the unique combination of its implementation-oriented multi-pillar thematic focus and its long-term funding

structure. This allows FinSAC to undertake complex engagements, which can be seen through to their actual implementation by country authorities.

Based on the success of the program to date, and to meet the strong demand from client countries, the World Bank and the Donor agreed in 2013 to extend the closing date of the Trust Fund Agreement to June 2018, to increase the amount of the grant by an additional €8 million,<sup>5</sup> and to include additional activities to be carried out by FinSAC.

In accordance with the current work program, it is envisaged that FinSAC should be able to engage in eight client assignments and deliver four technical conferences/seminars and regional research projects across the four thematic pillars, every year for the period 2014-2018. This will require a substantial increase in the number of full-time staff and the availability of project-specific technical expertise. Much of this scale-up effort is well underway.

FinSAC has now moved beyond the initial phase of being a vision, positioning itself as a recognized brand, capable of delivering timely and expert financial sector technical assistance to the region. In its second phase of operation, it will need continued dedicated management attention, and continuing strategic support from both the World Bank's management and the Austrian Government, in order to maintain the common vision of its two founding partners to roll out an effective, results-focused advisory program and to become a well-recognized regional "Center of Excellence" for financial sector reform implementation. In this regard, the World Bank appreciates the generous financial support provided by the Austrian Authorities and the vote of confidence in the success of the second phase of FinSAC.

<sup>3</sup> This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo Declaration of Independence.

<sup>4</sup> Including South-East European countries, EU Member States, and EU Neighborhood countries.

<sup>5</sup> Taking the total amount of the grant under the Trust Fund Agreement to €13.2 million.

# Chapter 1

## FIN SAC STRATEGIC RATIONALE AND THEMATIC/GEOGRAPHIC FOCUS

### REGIONAL STRATEGIC PRIORITIES IN THE FINANCIAL SECTOR – IMPLICATIONS OF THE EUROPEAN BANKING UNION

The global financial crisis unveiled weaknesses in supervisory structures and institutional arrangements for financial sector supervision and regulation. In Europe, the rapid financial integration experienced in the past decades was not accompanied by integration of the legal and regulatory framework, which, during the eurozone crisis, allowed uncoordinated actions which led to deleveraging of banks, causing adverse cross-border externalities. Fragmentation of the legal and regulatory framework prevented an integrated approach to systemic risk. The systemic weakness highlighted the need to create an integrated architecture to improve financial stability that could bring a uniform and high standard of enforcement, remove national distortions, and mitigate the buildup of risk concentrations.

The EU is following a multi-stage approach toward the completion of a full Banking Union, based on a consensus about the essential elements that such a framework should have. Any banking system or full Banking Union requires the following elements: (i) a well-defined supervisory mechanism; (ii) a lender of last resort, to provide liquidity in case of distress, but not insolvency; (iii) a well-defined and effective resolution regime to allow for the direct recapitalization of banks, spelling out clear rules for the orderly exit of non-viable institutions, including bail-in rules to share losses among shareholders and creditors; and (iv) a single resolution/common deposit insurance system. Initially, the European Banking Authority (EBA) was

created as a forum to bring together financial supervision stakeholders at the national and at the EU level to act as a network. This has been followed by the development of a harmonized regulatory setup and, subsequently, by the creation of a single supervisor. A single resolution institution and (industry-funded) funding mechanism is still being debated.

The key elements of the European Banking Union are to be implemented through a combination of entities already established and mechanisms which are currently under discussion (see Box 1). The European Central Bank (ECB) provides liquidity as lender of last resort to Eurozone banks, and will perform micro and macroprudential supervisory functions for banks in the region. The EBA will have a coordination and mediation role between the authorities of participating and non-participating Member States, and would retain responsibility for the development of technical standards in banking and ensure convergence and consistency of supervisory practice. The European Systemic Risk Board (ESRB) will keep its mandate as the macroprudential oversight body for EU financial systems (which will require coordination with the ECB). While a provisional agreement on the Single Resolution Mechanism (SRM) was reached in March, a common deposit insurance is still being debated.

Three EU Directives provide the legal foundation for this new framework, along with a number of Regulations. The Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD IV) were approved and are being gradually implemented. The final compromise text of the Bank Recovery and Resolution (BRR) Directive was agreed upon in December 2013, and is pending the formal adoption

by the EU Parliament and the European Council. It will be in effect as of January 1, 2015, (bail-in rules contained in the proposed Directive will start to be applied in 2016). The proposed Directive on Deposit Guarantee Schemes (DGS) has been under discussion since 2010, but no decision has been made pending the adoption of the BRR Directive.

This new framework has different applicability across the European Union. While the directives outlined in the previous paragraph are applicable to all 28 member states, the Single Supervisory Authority (the ECB), Single Resolution Authority, and common deposit insurance are applicable to Eurozone members and non-Eurozone members who opt to join. Institutions such as the ESRB and EBA will work mostly as coordinators and mediators between participants and non-participants.

ECA countries, particularly EU member states and EU candidate and potential candidate countries, are facing the regulatory uncertainty in the region with the implementation of the European Banking Union. The EU Directives covering capital requirements, bank recovery and resolution, and deposit insurance will have to be implemented in the future, and national authorities will need to adjust their supervisory practices as a consequence. In addition, non-Eurozone countries must consider if it is in their interest to join the Single Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM), but the current uncertainty makes this decision difficult. Conditions under which opt-in countries join the SSM and SRM should be discussed with all actors involved and agreed upon in a timely manner, allowing non-Eurozone countries to make an informed decision.

In addition, the latest developments in the European Banking Union pose questions about the extent of participation of EU candidate and potential candidate countries. The banking systems of those countries are closely tied to parent banks in EU-countries, and therefore will be impacted by the implementation of the SSM and SRM. Questions remain about the consideration given to the financial stability of non-EU countries in the supervision and resolution of a EU bank with subsidiaries in such countries. In this regard, formal procedures for the participation of non-EU countries in the banking union process should be developed and the institutional setup for a mediation to handle conflicts of interest should be established.

Finally, the asset quality review (AQR) to be undertaken by the ECB on the banks over which it will assume supervisory authority is a key risk

event for EU member states and EU candidate and potential candidate countries, given its potential to identify significant balance sheet weaknesses in parent banks. The AQR will be an assessment of all asset classes, including on and off-balance sheet positions, conducted on the basis of harmonized definitions. Results will feed into a new round of stress tests conducted by the ECB and the EBA, with banks required to adopt corrective measures if capital shortfalls are identified. These could create volatility in the markets, and subsidiaries of affected banks could suffer new rounds of deleveraging, as parent banks seek to shrink assets to reduce their capital needs. Therefore, authorities in these countries need to be prepared to face potential adverse effects derived from the AQR results.

### **ASSESSMENT OF NEEDS AND PRIORITIES IN FINSAC TARGET COUNTRIES**

The annual program discussions, diagnostic assessments through the World Bank's regular regional financial sector monitoring (including Financial Sector Assessment Program (FSAP) diagnostics and recommendations), as well as regular policy dialog carried out by the World Bank ECSPF financial sector staff help to put together a framework of technical assistance (TA) advisory needs and potential sources of TA providers including other bilateral and multi-lateral sources. However, there are still areas which need specific implementation focus over a longer term horizon. These are usually the focus areas of FinSAC TA activities, which often coincide with what is requested by country authorities from FinSAC. Well within FinSAC's four thematic pillars, client demand includes, but is not limited to the following:

- Client institutions such as Central Banks, Financial Supervisors, and Ministries of Finance are extremely interested in keeping abreast of and implementing the latest regulatory proposals, and are keen to develop the capacity to do so. For example, the Bank Resolution Conferences in Vienna created a forum for ECA countries to participate in discussions of regulatory issues and generated demand for best practice implementation through country-specific follow up.
- Ministries of Finance, financial sector authorities, and other high level policy makers in the region have shown a high level of interest in banking regulatory issues to ensure sound financial and

credit systems and allow for the speedy recovery of their economies by ensuring that banks and the financial system in general adhere to sound solvency, liquidity, governance, risk management, and other regulation.

- The EU Directives covering capital requirements, bank recovery and resolution, and deposit insurance will have to be implemented in the future by all EU member states, and national authorities will need to adjust their supervisory practices as a consequence. In addition, other globally-led initiatives on Basel III, home-host supervision, consumer protection, and other matters are of high interest to non-EU clients. Regulators in many countries are keen to receive guidance on how to implement them.
- Several countries are interested in regulatory methods and mechanisms for dealing with troubled bank assets and nonperforming loans using efficient workout mechanisms under sound principles, with the objective of restoring the conditions for growth.
- Countries are keen to explore bank resolution mechanisms, including active bank recovery and resolution planning, an area started up in Europe (specifically in the UK), as a contingency planning

## BOX 1

### KEY BUILDING BLOCKS OF A EUROPEAN BANKING UNION\*

As a response to the weaknesses and shortcomings identified after the onset of the global financial crisis, and particularly of the sovereign debt crisis of some of the peripheral Eurozone countries, the European Union is in the process of improving its regulatory and supervisory framework, toward the goal of creating an integrated architecture for financial stability, that is, a European Banking Union. Some building blocks of the banking union are already in place or are in the process of being implemented, while others are still under discussion. Moreover, some elements of the banking union are applicable only in the Eurozone (with non-Eurozone members having the option to participate), while others are EU-wide.

1. *Liquidity Provision*: performed by the ECB for all Eurozone banks.
2. *Macroprudential Regulatory and Supervisory Functions*: performed by the European Systemic Risk Board (ESRB), applicable to all EU Member States.
3. *Microprudential Regulatory and Supervisory Functions*:
  - a. *Regulatory Framework*: the CRD IV/CRR package, which transposes Basel III capital requirements standards into EU laws. It came into force in July 2013, and implementation began in 2014, phased in gradually until 2019.
  - b. *Supervisory Functions*: performed by i) the European Banking Authority (EBA), ensuring effective and consistent prudential regulation and supervision across the EU, by contributing to the creation of a single set of harmonized prudential rules for banks (the “European single rulebook”) and promoting the convergence of supervisory practices; and ii) the Single Supervisory Mechanism (SSM), transferring supervisory functions to the ECB, which will perform direct supervision of banks in the eurozone with over €30 billion in assets or 20 percent of national GDP, and those considered systemically relevant. The ECB will assume its supervisory tasks on November 2014.
4. *Bank Resolution*:
  - a. *Regulatory Framework*: the Bank Recovery and Resolution (BRR) Directive, seeking to ensure that national authorities in the EU have strong preventative powers, including those in relation to recovery planning, along with early intervention powers and resolution tools. It includes a set of bail-in rules forcing shareholders, bondholders, and some depositors to contribute to the cost of a bank failure. The final compromise text of the Directive was agreed upon in December 2013, and pending the formal adoption by the EU Parliament and the European Council, it will be implemented as of January 1, 2015 (bail-in rules contained in the proposed Directive will start to be applied in 2016).
  - b. *The Single Resolution Mechanism (SRM)*: creation of a centralized resolution authority to manage the failure of any bank in the Eurozone. The current proposal—under discussion—stipulates the following procedure to resolve a bank: i) ECB or national supervisor notifies that a bank is failing; ii) a Single Resolution Board (SRB) assesses if there is a systemic threat and no private sector solution, and adopts a resolution scheme including the use of the Single Resolution Fund; iii) the European Commission endorses or objects to the resolution scheme; and iv) national resolution authorities implement the approved resolution scheme, under the supervision of the SRB.
  - c. *Funding*: a proposed Single Resolution Fund would be capitalized with contributions from the banking sector, but would not have a sizable level—one percent of covered deposits—until 2023.
5. *Deposit Insurance*:
  - a. *Regulatory Framework*: the Deposit Guarantee Schemes (DGS) Directive, aimed at harmonizing national deposit guarantee schemes, including their funding and mutual borrowing. The proposed Directive has been under discussion since 2010, and a final decision has not yet been made pending the adoption of the BRR Directive.
  - b. *Common Deposit Insurance*: the most controversial element of the banking union, with preliminary discussions raising concerns regarding the amount of risk-sharing involved. To date, no proposal has been made on the matter.

\* This is a summary of the latest ECA Financial Sector Outlook (Issue N° 19, October 2013), a special edition dedicated to the European Banking Union.

and moral hazard mitigating tool to lessen the fiscal cost of rescuing banks if that were necessary.

- Regulators of several countries are also interested in improving and benchmarking their supervisory practices for the validation of regulatory capital inputs generated by internal models of commercial banks.
- Supervisors continue to be interested in new comprehensive stress-testing approaches and quantitative impact assessments, as well as linking these to macroprudential triggers related to credit growth and the resulting activation and depletion of macroprudential capital buffers and other associated prescriptions for macroprudential policy response.
- Regulators in many countries are keen to implement better regulation for financial consumer protection. ECSPF's experience in this area, acquired through work in many EU member states, will enable useful knowledge transfer in this regard.

Considering the geographical focus outlined before, the challenges and priorities of **EU candidates and EU potential candidate countries** are of particular interest. Authorities in these countries have made progress in implementing banking reforms over the past year with the aim of improving their resilience and supervisory capacity. Macroprudential frameworks were strengthened to varying degrees, home-host relations improved, and several countries are making efforts to reduce their elevated non-performing loan (NPL) levels (with FinSAC's technical assistance in the cases of Albania and Montenegro), but challenges remain. Crisis preparedness frameworks are not in full accord with best practice; a specific bank resolution regime is lacking in some cases, while in other instances, there is no legal framework in place for the use of public funds in times of systemic distress. In addition, the operational aspects of the framework need strengthening. The utilization of modern resolution tools for systemic banks (i.e., bridge bank, purchase and assumption transaction authority, good bank/bad bank, etc.) is untested, and deposit insurance schemes are mostly simple pay boxes, with evident gaps. Moreover, most deposit insurance schemes lack operational readiness, which undermines their potential effectiveness to contain contagion effects. Amongst the most pernicious of challenges banking authorities face is reducing the stock and flow of NPLs, which requires advancing a number of key dimensions: (i) developing a clear, objective grasp

of the legal and regulatory impediments; (ii) the introduction of voluntary debt restructuring frameworks, along with a judiciary prepared to expedite resolution for those uncooperative borrowers; (iii) a willingness to set achievable interim and longer-term NPL reduction goals; (iv) the robust and sustained engagement of key local stakeholders—well beyond the banking authorities—to see through the adoption of needed measures; and (v) a recognition that earlier asset classification and provisions relaxation measures, adopted by all authorities in the past two years, will in time have to be unwound, impacting banks' provisioning, and thus, capital levels. All of which should be carefully sequenced in accord with an agreed upon, time-bound strategy.<sup>6</sup>

Regarding **EU member states**, the priorities remain focused on financial sector stability, as the countries continue to recover from the global crisis, with a longer-term view directed toward strengthening the supervision of non-bank financial institutions. On financial sector stability issues, the priorities identified are aligned with the EU Bank Recovery and Resolution Directive. In particular, the World Bank identified a number of challenges in Bulgaria, Croatia, Poland and Romania, such as adopting modern bank-resolution regimes, adopting sound macroprudential policies, enhancing supervision and monitoring of banks and the nonbanking sector to extend the regulatory perimeter, strengthening consolidated supervision, revamping deposit insurance systems, addressing insolvency and creditor rights, continuing pension reform, addressing weaknesses in other subsectors like insurance, and managing foreign currency risks.<sup>7</sup> During FY14, a programmatic approach to financial sector technical assistance in EU member states has been developed by ECSPF, with the objective of assisting individual countries in (i) upgrading the regulatory frameworks and standards of client countries in accordance with the latest international practices and EU norms, and (ii) addressing specific financial sector vulnerabilities in order to maintain financial sector stability and contribute to economic growth.

In **EU neighboring countries**, the main priorities are the implementation of risk-based supervision of the banking sector, crisis preparedness, banking resolution framework, NPL workouts, building

<sup>6</sup> These issues were identified in the second Western Balkan Financial Sector Outlook (June 2013), prepared by ECSPF.

<sup>7</sup> These challenges are also based on the recommendations of the latest FSAP Updates in these countries.

financial sector infrastructure, consumer protection and financial literacy, and non-bank financial institutions and capital markets development. A particular feature of some of these countries is the high level of participation of the state in the financial sector. Therefore, a mid-to-long term goal in this region is to evaluate the role of state in the financial sector especially with a view to reducing the state's stake. There is also a keen interest in these countries on creation of a development bank to mobilize medium-to long-term finance for exporters and SMEs, and they are looking for advice on the proper institutional and governance structure for such institutions.

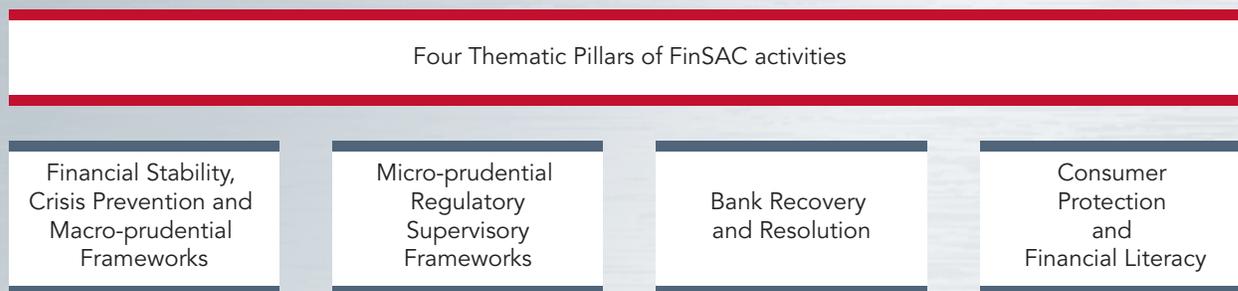
### FINSAC THEMATIC PILLARS

Under this new paradigm in financial regulation and oversight, the Vienna-based Financial Sector Advisory Centre (FinSAC) was created as a dedicated technical unit of the World Bank's ECA Region Private and Financial Sector Department to deliver technical advice and reform implementation assistance services to client countries in the Emerging Europe and Central Asia region. FinSAC delivers services through three distinct channels: (a) undertaking of customized client-specific technical assistance assignments; (b) organization of group technical assistance activities such as workshops, conferences, and seminars; and (c) execution of regional research projects with corresponding outreach activities. Through these activities, it aims to become a leading regional "knowledge center" over time.

FinSAC's guiding principles are the execution of specific policy and institutional changes, improving financial stability and intermediation efficiency, with a medium-term implementation timeframe and with a proactive division of labor with authorities, local experts, and other stakeholders. There are three comparative advantages of FinSAC. First, integration with ECSPF operational activities, this ensures that the TA provided is leveraged. Second, high specialization of its staff. Third, geographical closeness to clients in ECA countries and to the main financial sector policy makers in the region, which enhances delivery efficiency.

In order to achieve these goals, four strategic thematic choices for FinSAC were identified in its initial stage (see below). FinSAC has accumulated experience in the practical implementation of thematic pillars in the two years since it started. The global and European regulatory environment has evolved as well. These changes have resulted in the refining of some aspects of FinSAC's implementation approach.

- **Pillar I – Financial Stability, Crisis Prevention, and Macroprudential Frameworks:** To promote development of institutional capacity to monitor and manage systemic risk, and develop crisis management frameworks. The initial motivation of this pillar originated from the international response to the 2008 crisis, and FinSAC's experience working with clients in the past two years has unveiled the need to nurture client country preparedness to implement analytical and institutional strengthening measures in the macro stability area. Therefore, FinSAC has defined an implementation path for macroprudential strengthening measures, with necessary institutional conditions (in line with ESRB guidelines) for effective macroprudential framework, and is developing institutional analytical capacity to monitor and manage systemic risk as a catalyst for further institutional strengthening initiatives. FinSAC's initial experience suggests that there is also a strong demand in the region for crisis simulation exercises, another well-established World Bank product, which help ECA countries to test their crisis management frameworks and to identify potential improvements.
- **Pillar II – Microprudential Regulatory and Supervisory Frameworks:** To upgrade banking sector legislation, regulatory standards and supervisory frameworks and practices, putting in place more robust microprudential measures including effective home-host supervision, NPLs workout, regulatory capital requirements, institutional structures, etc. With an international regulatory development agenda in constant change, largely driven by EU developments, and NPL resolution acquiring much stronger operational relevance than what was expected in the initial stage, FinSAC's operational focus will be to assist prudential supervisors with: a) prudential regulation and supervisory practices to promote NPL recovery and resolution and help prevent future surges; b) making best use of home-host supervision arrangements to fulfill their domestic mandates; and c) implementation of local solutions compatible with the forthcoming CRR/CRD IV-prudential regulations and international best practice
- **Pillar III – Bank Recovery and Resolution:** To strengthen bank recovery and resolution frameworks, including Recovery and Resolution Plans (RRPs) for Domestic Systemically Important Financial Institutions (DSIBs), and incorporation

**FIGURE 1** FOUR THEMATIC PILLARS OF FINSAC ACTIVITIES

of modern resolution tools to deal with struggling institutions. Also in this area, international regulatory developments are in rapid flux. Operationally, FinSAC will work with authorities to strengthen their bank recovery and resolution frameworks, downstream from the forthcoming adoption of the EU Directive in this area.

- Pillar IV – Consumer Protection and Financial Literacy:** To improve market conduct regimes for financial institutions, building a consumer protection and financial literacy framework, and strengthen corporate governance, truth in lending practices, transparency, accounting standards, and payment systems, as well as other mechanisms. This area is a very vast one and a critical one for broadening financial inclusion. It is therefore an area where FinSAC can play a strong leadership role, especially the area of consumer protection and financial literacy is governed by less developed international norms than those applicable to the other three pillars. FinSAC will prioritize work to improve market conduct regimes, in

the context of comprehensive reform strategy that identifies early wins for tangible consumer benefits.

### FINSAC GEOGRAPHICAL FOCUS

FinSAC's initial geographic focus was on EU candidate and potential candidate countries. In 2013, FinSAC has gradually expanded its geographical operational footprint, according to the following Key Priority Groups:

**Group 1: EU candidate and potential candidate countries:** These include Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro, and Serbia. To date FinSAC is active in all countries except Macedonia.

**Group 2: EU member states as active non-graduated World Bank clients:** Bulgaria, Croatia, Poland, and Romania. FinSAC is currently active in Romania and Croatia. However, since the Austrian Government wishes to restrict the utilization of the their trust funds

**FIGURE 2** FINSAC GEOGRAPHICAL FOCUS

to only official development assistance(ODA)-eligible countries (excludes EU members), it has been agreed upon that within this Group 2, FinSAC will cap the cost of its involvement to 10 percent of the Donor resources (leaving the possibility open for additional involvement through funding arrangements other than those provided by Donor).

**Group 3: *EU neighborhood countries*:** Belarus, Moldova, Ukraine, Armenia, Azerbaijan, and Georgia. FinSAC is already active in Moldova, Ukraine, and Georgia.

## **FINSAC STAFFING AND RESULTS FRAMEWORK**

FinSAC's current staffing consists of a core team of five staff members based in Vienna, supported by staff from WB headquarters and international consultants. FinSAC is in the process of doubling its capacity, by adding another set of five staff. Details on current and future staffing plans can be found on Annex 1.

A brief description of FinSAC's results framework is found in Annex 2.



## Chapter 2

# FIN SAC ACTIVITIES DELIVERED (OR UNDERWAY) IN 2013

### PILLAR I: FINANCIAL STABILITY AND MACROPRUDENTIAL FRAMEWORKS

**a. Moldova Liquidity Stress Testing:** The objective of this project was to help the Central Bank of Moldova improve its capabilities in liquidity stress testing, strengthening the authorities' ability to monitor emerging financial stability stress. The project was carried out through the following sequential activities: i) building a liquidity stress testing model for the Moldovan banking system, together with the central bank's Financial Stability Department (FSD) staff; ii) presentation of the model to the Banking Supervision staff, the Deputy Governor and senior managers, and the Financial Stability Working Group (an interdepartmental body); and iii) training FSD staff on the model's operation. A technical note on the model was delivered to the client, and a template for a regular internal report on the model's results was prepared by FSD staff under FinSAC supervision.

**Status: Delivered.**

**Achieved Result:** The objective was achieved with the implementation of a liquidity stress testing model by the Financial Stability Department (client intermediate outcome). FinSAC's output was the delivery of a technical note and various presentations on the topic.

**b. Croatia Crisis Simulation Exercise:** The overall goal of the project was to examine how the Croatian authorities respond to distress in the financial system and to explore the adequacy of existing laws, regulations, policies, and procedures in order to strengthen supervisory cooperation and

coordination. For this purpose, a crisis simulation exercise organized by FinSAC, was held in February 2013. The exercise tested information analysis and sharing, decision making, home-host cooperation, and communications between the Croatian National Bank and other authorities with primary responsibility for financial stability and crisis management. Three teams were created to carry out the exercise: i) the Croatian National Bank (CNB), ii) the State Agency for Deposit Insurance and Bank Rehabilitation (DAB) and the Ministry of Finance (MoF), and iii) the Croatian Financial Services Supervisory Agency (HANFA). An additional team was created comprising members of the World Bank, CNB, DAB, and HANFA. The scenario revolved around three banking entities and related asset management companies as well as four smaller banks in the Croatian financial system. FinSAC delivered a report to the client exploring the gaps in the current frameworks for resolution, liquidity assistance, and coordination, and provided recommendations to address these gaps. This was followed by a dissemination seminar for the participants of the exercise, in which they had the opportunity to give feedback on the findings and provide the rationale for their actions and decisions. Presentations by FinSAC staff were made on the key themes of the exercise: emergency liquidity provision, resolution of failing banks, and supervision of a banking system predominately owned by foreign banks. **Status: Delivered.**

**Achieved Result:** The objective was achieved through a crisis simulation exercise that exposed the Croatian regulatory and decision-making authorities to the demands, stresses, and implica-

tions of a systemic crisis event, thus raising their awareness about the weaknesses of their crisis management and resolution framework, and identifying the areas in need of further strengthening. FinSAC's output was the delivery of the report with the findings of the exercise and recommendations to bridge the gaps identified, and the organization of a dissemination seminar for the participants of the exercise.

**c. Bosnia and Herzegovina Financial Stability Institutional Building:**

The objective of this project is to strengthen the financial stability framework in Bosnia and Herzegovina, following a request from the Central Bank (CBBH), in order to enhance the analytical capabilities of CBBH's Financial Stability Unit (FSU) for them to play its supporting role in the Standing Committee of Financial Stability (SCFS), and identify institutional solutions by which the functioning of the current SCFS framework can be improved and gradually moved toward international best practices. The project is being carried out through the following activities: i) a benchmarking paper (technical note) delivered to the client on the emerging post-crisis national financial stability frameworks, to help authorities identify a suitable path for institutional strengthening from the perspective of converging to EU practices; ii) the development of a credit growth forecasting model for FSU, including training FSU staff on its operation (a technical note on the model was delivered to the client); iii) the development of a credit risk model tailored to the Bosnian financial system, with the aim of bringing CBBH's stress testing framework closer to best practice; iv) the development of early warning systems jointly with CBBH's staff; and v) a presentation to CBBH officials exploring ways to expedite the production process of Bosnia's Financial Stability Report, in order to reduce the significant lag with which it is published currently. **Status: Underway.**

**Expected Result:** The objective of a strengthened financial stability via the enhancement of the analytical capabilities of CBBH's Financial Stability Unit and the improvement of SCFS's framework toward international best practices is being gradually achieved with the activities that have been completed and currently ongoing. Two FinSAC outputs, one technical note on benchmarking macroprudential institutional arrangements and another one on a credit growth forecasting model,

have been delivered to the client; two more modules on analytical capacity building relating to credit risk models and early warning systems are under preparation.

**d. Montenegro Crisis Management Simulation:**

The overall objective of the exercise was to analyze and enhance the tools and processes related to the management of potential financial distress and systemic crisis by simulating a "crisis event" and assessing the decision making and response of Montenegrin authorities to the "crisis event." For this purpose, a crisis simulation exercise organized by FinSAC was held in November 2013 at the Central Bank of Montenegro (CBCG), with the participation of around 30 staff from the CBCG (including its Governor and Deputy Governor) and the Ministry of Finance (including its Deputy Minister). **Status: Delivered.**

**Achieved Result:** The objective was achieved through a crisis simulation exercise that exposed the regulatory and decision-making authorities to the demands, stresses and implications of a systemic crisis event, thus raising their awareness about the weaknesses of their crisis management and resolution framework and identifying the areas in need of further strengthening. FinSAC's output was the delivery of a comprehensive report with the findings of the exercise and recommendations to bridge the gaps identified. The draft version of the report was prepared and sent to the CBCG for comments in December 2013 and a final version of the report was delivered to the client in January, 2014.

## **PILLAR II: MICROPRUDENTIAL FRAMEWORKS**

**a. Montenegro NPL Resolution:** The objective of this project was to help the CBCG and the Ministry of Finance develop and implement a Montenegro-specific strategy to reduce the level of NPLs. FinSAC scoped its intervention around three main diagnostic areas: i) core operations, looking at the nexus between prudential and supervisory actions and banks' debt restructuring efforts; ii) enabling environment, through an assessment of legal, regulatory, and tax issues that may hamper debt restructuring; and iii) analytics, to develop a policy action-oriented corporate debt mapping and a framework to assess the macro-implications of NPL resolution.

Following the completion of an assessment phase, and on the basis of a mandate from the Government of Montenegro and CBCG, FinSAC prepared the Law on Voluntary Financial Restructuring to facilitate the resolution of NPLs, which was enacted by Parliament. FinSAC also helped the CBCG organize a review of the restructuring prospects of eight nonperforming borrowers, involving pro-bono professional experts from eight international management consulting firms, who acted as a proxy credit committee. To create deeper awareness of the operational implications of NPL restructuring, FinSAC also organized a “Montenegro NPL Day” where eight Vienna-based experts delivered a briefing to the Governor and Chief Economist of CBCG.

The Governor of CBCG committed in early 2013 to carry out a set of steps and actions to implement the so-called “Podgorica Approach” (the term under which the NPL resolution program is called), and to “put the reduction of the NPL ratio on a downward trajectory to return to its pre-crisis level.” This was followed by an official request for FinSAC’s assistance to organize a NPL Recovery Mapping assessment of four banks with the largest corporate NPL portfolio, in order to help banks prepare exit strategies (and relative costs) to work out the entire NPL portfolio in the 2014–15 period. The assessment was launched in the third quarter of 2013, and concluded in the last quarter of 2013.

Finally, FinSAC helped Montenegrin authorities mobilize involvement of the European Bank of Reconstruction and Development (EBRD) and the European Investment Bank (EIB) in raising post-restructuring financing for banks and corporates, in the context of the IFI Joint Action Plan. **Status: Delivered**

**Achieved Result:** The objective of developing and implementing a Montenegro-specific strategy to reduce the level of NPLs was achieved with the completion of a series of activities aimed at facilitating the reduction of nonperforming loans through voluntary restructuring, including a new Law on Voluntary Financial Restructuring, and assistance in NPL restructuring for authorities and banks. The NPL Recovery Mapping assessment will help Montenegrin banks to work out their NPL portfolio in the next two years, and the involvement of EBRD and EIB will help mobilize resources for the post-restructuring financing needs of the banking sector.

- b. **Albania NPL Resolution:** The policy objective of this project is to help the Bank of Albania (BoA) and the Ministry of Finance develop and implement an Albania-specific strategy to reduce the level on NPLs. FinSAC scoped its intervention around three main diagnostic areas: i) core operations, looking at the nexus between prudential and supervisory actions and banks’ debt restructuring efforts; ii) enabling environment, through an assessment of legal, regulatory, and tax issues that may hamper debt restructuring; and iii) analytics, to develop a policy action-oriented corporate debt mapping and a framework to assess the macro-implications of NPL resolution.

On the basis of the mandate received from the BoA in October 2012, FinSAC completed an assessment of the obstacle to efficient NPL resolution in the Albanian legal and regulatory environment. In addition, FinSAC prepared specific re-drafting suggestions for nine articles of the Civil Procedural Code and three articles of the Civil Code, jointly with a technical note to facilitate legislative activities. Following the suggestions made by FinSAC, the Civil Procedural Code and the Civil Code were amended in order to facilitate the execution of creditor rights. In April 2013, the Parliament of Albania approved the proposed changes.

FinSAC also completed an assessment of the supervisory stance and prudential framework governing BoA’s monitoring activities of banks’ NPL resolution efforts. A set of possible instruments was identified, including potential technical assistance services from FinSAC. This was followed by a policy letter from the BoA to launch this policy design, leading to an agreement with FinSAC for a NPL Recovery Mapping exercise that will involve a review of the NPL portfolio of most banks in Albania, launched in the last quarter of 2013 and to be concluded in April 2014. **Status: Delivery expected by June 2014**

**Expected Result:** The objective to develop and implement an Albania-specific strategy to reduce the level of NPLs is being gradually achieved with the amendment of the Civil Procedural Code and the Civil Code, and the launch of a policy design to strengthen BoA’s supervisory powers in order to counteract the strong disincentives by banks to reduce their NPL stock. The future launch of the NPL Recovery Mapping assessment will help Albanian banks to workout their NPL portfolio in the medium-term.

- c. NPL Business Development and Regional Outreach:** The objective of this project is to initiate discussions with client countries on NPL management, seeking to secure client advisory mandates. To date, discussions have been initiated with the authorities of Kosovo and Macedonia, and efforts have started to engage authorities in Serbia. In particular, a seminar on NPL resolution was held at the National Bank of the Republic of Macedonia after the invitation of its Governor. In addition, a regional NPL resolution workshop was held in Vienna with the collaboration of senior staff from the Central Bank of Ireland. **Status: Underway**  
**Expected Result:** To secure client advisory mandates on NPL resolution through delivery of seminars and workshops on the topic, discussions with authorities, and scoping missions.
- d. Report on Asset Classification and Provisioning in Europe and Central Asia:** The objective of this project is to prepare a report on asset classification and provisioning regulations and practices for NPLs in Western Europe and Central and Eastern Europe countries. The paper provides a discussion on the main drivers for loan classification and provisioning by performing a review of the range of regulation and practices. The different criteria used by jurisdictions worldwide, the effectiveness of its implementation, as well as the decision to use such criteria for accounting purposes can be significantly difficult and/or distort comparisons between banks in terms of profitability and the soundness of their loans portfolios. Different criteria for classifying a loan as nonperforming, for accruing interest (in case of non-payment), and also for provisioning make comparisons between banks a challenge. More importantly, the actual effectiveness of implementation, encompassing the robustness of the supervisory approach toward the enforcement of proper implementation cannot be underestimated. Therefore, proper implementation of asset classification and provisioning rules, particularly in what refers to qualitative criteria and recognition of problem assets, is a key element in ensuring comparability of portfolios. For the purposes of the paper, regulations and practices in 26 countries of the region were analyzed. The paper is currently under internal review. **Status: Delivery expected by June 2014**  
**Expected Result:** To create awareness among relevant ECA policy makers about gaps and areas for harmonization in prudential regulation regarding loan classification and provisioning through the dissemination of the paper and its findings, with a view to initiate discussions with client countries on potential advisory services for the development and improvement of related regulation, and strengthening of the supervisory approach for enforcement.
- e. Georgia IFRS Implementation – Prudential Interactions:** The policy objective of this project was to help the National Bank of Georgia (NBG) assess the prudential implications of the banking system implementing International Financial Reporting Standards (IFRS) for prudential reporting purposes. The project consisted of a review of the legal framework, prudential regulations and practices, and an analysis of the areas where IFRS differs from prudential reporting instructions. **Status: Delivered.**  
**Expected Result:** The outcome of sound implementation of IFRS for prudential purposes will be gradually achieved with the findings and recommendations identified in the assessment, and the next steps agreed upon with the authorities.
- f. Ukraine CRD IV Assessment:** The objective of this project is to help the Ukrainian authorities to evaluate the potential impact on financial stability of implementing the EU CRD IV package, and to decide if, and how, regulatory amendments need to be made. The main activity under the project was the preparation of an assessment of the regulatory consistency of the existing capital adequacy regulation and the liquidity regulation of the National Bank of Ukraine (NBU) with the EU CRD IV package, including the identification of areas that diverge from the European regulatory requirements. A detailed draft report was delivered to NBU in the last quarter of 2013. **Status: Delivered (pending final face-to-face discussion with client).**  
**Expected Result:** The outcome of evaluating the potential impact on financial stability of implementing the EU CRD IV package will be achieved with the delivery and discussions with authorities of the assessment report on regulatory consistency (FinSAC output). If regulatory amendments are suggested and agreed upon, potential advisory services for the development and improvement of related regulation can be envisaged.

**g. Serbia NBS Operational Risk/IT Supervision:**

FinSAC, in partnership with FDIC, is assisting the Supervision Department of National Bank of Serbia (NBS) to establish a new unit responsible for the supervision of IT-related operational risk. The assistance started with a comprehensive training program on the IT architecture of banks along with its attendant risks and supervision modalities. It also included assistance in i) drafting the regulation that will establish the powers of NBS in this new area; ii) preparing a three-year institution-building plan; iii) helping to design a suitable questionnaire of off-site supervision and the procedures manual for on-site supervision. It also included assistance in reviewing the results of the first off-site and on-site inspections. **Status: Dropped.**

**Achieved Result:** After a good start in 2011 and 2012, the project stalled in 2013 during the reorganization of the NBS Supervision Administration. The client stopped seeking technical assistance for implementation activities, and subsequently the project was dropped.

### PILLAR III: BANK RECOVERY AND RESOLUTION FRAMEWORKS

**a. Second Regional Banking Resolution Conference, December 2013:**

A Bank Recovery and Resolution (BRR) seminar was held in Vienna in December 2013 with around 50 participants from 11 countries, to promote and refresh awareness among ECA policy makers about this essential piece of financial regulatory framework, incentivizing client countries to strengthen their bank recovery and resolution frameworks. The seminar received significant positive feedback from participants, with increasing interest from client countries in similar events in the future. **Status: Delivered.**

**Achieved Result:** The objective to maintain awareness about the importance of a comprehensive and credible legal and institutional framework to deal with the failure of banks was achieved. The seminar also served as a tool to engage clients in potential advisory services delivered by FinSAC, as demonstrated by the interest of some client countries to work on topics related to bank recovery and resolution (see below).

**b. Albania Recovery and Resolution Plans (RRPs) and Resolution Regime for Savings and Credit Associations (SCAs):** The objective of this

project is to design a regulatory framework for the implementation of RRP for Domestic Systemically Important Banks (DSIBs). In addition to the enhancement of the legal and regulatory framework, the scope of the project will include the integration of the RRP assessment within the supervisory review process and improving supervisory capacity in the DSIBs' RRP review. **Status: Under development.**

**Expected Result:** Recovery plans aim to reduce the likelihood of a systemic bank failure by requiring senior management to identify options to achieve recovery that can be implemented when a crisis occurs. This conceptually minimizes the requirement for state intervention as the recovery plan will set out in advance the essential actions a bank will take to restore its viability in the event of a crisis without the support of fiscal resources. Ultimately, well maintained recovery plans should lessen the probability of resolution. The Recovery Plan regulation has been drafted by FinSAC and has been submitted for approval at the February central bank's Supervisory Council Board meeting.

**c. Bank Recovery and Resolution Strengthening in Croatia and Serbia:**

The objective of these projects is to help authorities strengthen their bank resolution framework, in preparation of the future implementation of the EU Directive on Bank Recovery and Resolution (for EU member states), or in line with such Directive and best international practices (for EU candidate and potential candidate countries). The project has been carried out through an assessment of the current bank resolution framework, and a definition of specific areas of potential further assistance by FinSAC. To date, assessments have been carried out in Croatia and Serbia. **Status: Delivered.**

**Achieved Result:** The objective to strengthen bank resolution frameworks was achieved through the completion of the corresponding assessments.

**d. Report on Bank Recovery and Resolution in the Western Balkans:** The purpose of this project is to prepare a regional study on the institutional and legal frameworks for bank recovery and resolution in EU candidate and potential candidate countries **Status: under preparation**

**Expected Result:** To create awareness among relevant policy makers about caveats and gaps in country bank recovery and resolution frameworks

through the dissemination of the presentation and its findings, with a view to the initiation of discussions with client countries on potential advisory services for the development and improvement of the framework.

#### **PILLAR IV: FINANCIAL CONSUMER PROTECTION AND FINANCIAL LITERACY**

The following projects are part of a broader initiative to strengthen the consumer protection and financial literacy framework in Kosovo to ensure that fairer outcomes are achieved for consumers, and achieve sustainable and long-term improvement for Kosovar consumers.

##### **a. Kosovo Consumer Protection and Financial Literacy Diagnostic Review:**

The policy objective of this project was to help the Central Bank of Kosovo (CBK) identify policy and institutional-building measures that will increase the confidence of retail clients in the services provided by financial institutions in Kosovo. The main activity under the project was a diagnostic review developed by the World Bank that has been implemented across several countries including many within the ECA region. The diagnostic is based on international best practices, assessing the following five key areas: i) laws, regulations, and practices; ii) transparency and disclosure of information; iii) retail business practices of financial institutions; iv) complaints and dispute resolution mechanisms; and v) consumer awareness and education. The scope of the work included the dominant banking sector, as well as insurance and non-bank credit institutions. **Status: Delivered**

**Achieved Result:** The objective to identify policy and institutional-building measures to increase the confidence of retail clients in the services provided by financial institutions was achieved through the delivery of a FinSAC output, namely, a comprehensive diagnostic review with a set of detailed findings and customized policy recommendations to strengthen Kosovo's legal, regulatory, and institutional consumer protection, along with its financial literacy framework.

##### **b. Kosovo Consumer Protection and Financial Literacy Implementation:**

Following the diagnostic review outlined above, the next step consisted of the implementation of remedial activity to ensure

financial consumers reap early benefits from an expedited execution of the measures proposed in the diagnostic review. The sequential activities under the project included i) an implementation plan including a list of priority implementation actions, discussed with the Governor of the CBK; ii) the approval and launch by CBK's Board of a Consumer Protection Strategy prepared by FinSAC; iii) the preparation of Memoranda of Understanding between the CBK and the Ministry of Economy and the Ministry of Trade & Industry (with FinSAC assistance); iv) introduction and implementation of market conduct supervisory tools (designed by FinSAC) in the CBK's insurance on-site inspections; and v) review of the draft microfinance law and inclusion of consumer protection aspects into the proposed MFI legislation. **Status: Delivered**

**Achieved Result:** The objective to implement remedial activity to ensure financial consumers reap early benefits from an expedited execution of the measures contained in the diagnostic review was achieved through the implementation activities outlined above (client intermediate outcomes). The CBK's Consumer Protection Strategy was launched in July 2013 at a dissemination event in Pristina attended by 100+ participants including the Governor of CBK and the Deputy Prime Minister. The event received wide coverage by the local media and obtained positive feedback from the financial industry. FinSAC's output included a technical note on the implementation of a legal and regulatory review, preparation of the CPFL strategy and implementation plan, drafting of the Memorandum of Understanding, and the design of a market-conduct supervision tool for on-site assessments.

##### **c. Kosovo Consumer Protection and Financial Literacy Complaints Handling:**

The objective of this project is to help the CBK in strengthening its framework for complaints handling. The activities under this project include the drafting of the regulation on complaints handling, and a technical note on the implementation approach for complaints handling, both of which have been finalized and circulated to the industry for comments. In addition, a Central Bank of Kosovo Complaint Form was designed, and input was provided for the design of a complaints leaflet. **Status: Delivery expected by June 2014**

**Expected Result:** The objective to strengthen Kosovo's framework for complaints handling is gradually being achieved through the activities outlined above. Two FinSAC outputs have been delivered to the client, which, combined, will impose minimum requirements for financial institutions' complaints handling procedures, and make it easier for Kosovar financial consumers to raise complaints and expect redress, taking the pressure off the Kosovar authorities in handling individual consumer complaints.

- d. Kosovo Financial Education:** The objective of this project is to develop a financial education strategy for the CBK. Activities under this project include identifying key financial education issues through complaints analysis and drafting financial education articles based on this research for publication on the CBK's website. **Status: Underway**  
**Expected Result:** The objective to strengthen financial education in Kosovo will empower financial consumers with knowledge about their rights and

obligations when purchasing financial products and services to enable them to manage their individual and household finances. This a long term policy program. The outputs from the first phase of implementation will be a series of Q&A articles published on the central bank's website providing information about issues identified through the identification analysis.

## 2013 OPERATING EXPENDITURES

The cost of FinSAC 2013 activities was less than €2 million (US\$2.5 million equivalent), entirely covered by the Austrian Ministry of Finance Trust Fund. About 30 percent of the professional costs are represented by consultant fees, in line with the high technical content of FinSAC deliverables. Staff and consultant costs account for almost 90 percent of FinSAC total expenditures, including travel, which shows the high cost efficiency level of a decentralized professional team (see Table 1).

**TABLE 1** FINSAC 2013 EXPENDITURES

EURO thousand	Jan-Jun 13	Jul-Dec 13	2013
World Bank Staff	598	571	1168
Consultants	159	298	457
Travel Expenses	82	111	193
Other	11	13	25
Total	850	993	1843



## Chapter 3

# FIN SAC WORK PROGRAM IN 2014-2018

### EXPANSION OF SECTORAL FOCUS

After consolidation of FinSAC's program delivery capabilities across the four pillars in its core banking focus, it can be envisaged that limited operations in an amount to be jointly defined with the Donor may be possible around a second sectoral focus on "Non-Bank Financial Institutions." This work addresses financial stability issues through the complementary channel of improving resilience of funding sources for the real economy through efficient non-bank intermediation. Work in this area spans issues of pension systems, insurance products, and capital market intermediation among other. The premise for FinSAC's envisaged engagement in this area is the centrality of these topics in the international regulatory agenda, expected strong client demand and availability of strong technical capabilities already present in the World Bank Group. If the opportunity to expand the sectoral focus were to materialize and prove desirable in order to augment the overall impact of FinSAC's activities, FinSAC will detail its strategic rationale in the context of its annual reporting obligations to the Donor and will present it in its periodic activity plan consultations with the donor.

### EXPANSION OF GEOGRAPHICAL COVERAGE

FinSAC does not wish to convey an immediate commitment to plan operations in Central Asia. However, successful delivery of operations in the current geographical coverage may prompt us to consider further leveraging our track record in reform implementation assistance in selected Central Asia countries. If this were the case, FinSAC will discuss the proposed

activities in the context of its annual business planning discussions with the Donor.

It is also possible that FinSAC may engage in fee-based technical services to graduated World Bank members, if this is deemed useful for the purpose of strengthening FinSAC's professional credentials as a knowledge center capable to deliver state-of-the-art reform implementation assistance.

### INDICATIVE ANNUAL WORK PROGRAM FOR 2014

At time of writing this Annual Report, the inventory of committed (or highly likely) activities is presented in Table 2. This includes new engagements in the area of financial stability and macroprudential frameworks in Albania, Kosovo, FYR Macedonia, and Moldova. New work on NPL is likely to be undertaken in Serbia and Romania. Work on bank resolution will continue and expanded in Albania, while new activities under this pillar are expected to take place in Bulgaria, Croatia, Romania, Moldova, and Ukraine. Finally, consumer protection work is expected to be carried out in Belarus and Ukraine.

More projects are being and will be identified in the course of the year, as a result of ECSPF policy dialogue with client countries. The present pipeline of projects more than adequately absorbs the new staff that is expected to join FinSAC in the course of the summer of 2014. New programmatic directions for FinSAC activities will also result from the operational roll-out of the World Bank Finance and Markets Global Practice which will succeed ECSPF as managing unit for FinSAC effective July 1, 2014.

**Project Teams:** FinSAC activities will be delivered by project teams comprising both FinSAC-based staff and other ECSPF staff, based both in headquarters and

country offices, in order to secure synergies and integration between the FinSAC and overall ECSPF program. The overall cost of projects led by non-FinSAC staff (including external consultants) will not exceed one-third of the FinSAC resources provided by the Donor.

All FinSAC projects, regardless of the organizational base of their project leaders, should comply with the FinSAC objectives and be accounted for as FinSAC deliverables, and be executed under the day-to-day coordination of the FinSAC Program Coordinator.

**TABLE 2** FINSAC'S EXPECTED 2014 WORK PROGRAM

**A. Workshops**

Country	Date	Theme/Topic	Partnership
Croatia	May	NPLs resolution: Best Practices	n.a.
Croatia, Poland, Bulgaria, Romania	June	Deposit Insurance International: Funding, Investment Practices and Corporate Governance	Poland Deposit Guarantee Scheme
Bulgaria, Croatia, Poland, Romania, BiH, Serbia, FYR Macedonia, Albania	July	Consumer Protection: (i) Responsible lending and debt counseling; (ii) Approaches to Alternative Dispute Resolution; (iii) Technology and its impact on consumer protection; (iv) Compliance and supervision	Bulgarian Financial Services Commission—comprising representatives from the Bulgarian National Bank (BNB), Financial Supervision Commission (FSC), Consumer Protection Commission (CPC), and Ministry of Finance (MOF)

**B. FinSAC and Overall WB Engagement**

Country	WB Engagement	FinSAC Potential Engagement
Albania	The WB is preparing a US\$100 million budget support operation with an aim to (i) strengthen regulation and supervision of the banking sector and financial safety net; (ii) expedite resolution of non-performing loans (NPLs); and (iii) strengthen regulation and supervision of Nonbank Financial Institutions (NBFIs). The budget support operation is built on the findings of the FSAP that was completed in 2014.	<ul style="list-style-type: none"> <li>• Bank Recovery and Resolution</li> <li>• Crisis Simulation Exercise</li> </ul>
Kosovo	No current WB engagement	<ul style="list-style-type: none"> <li>• Crisis Simulation Exercise</li> </ul>
FYR Macedonia	No current WB engagement	<ul style="list-style-type: none"> <li>• Crisis Simulation Exercise</li> </ul>
Serbia	The WB has engaged with the Government of Serbia with a Results Based Investment Project Financing (IPF) for an amount of €145.3m to strengthen the financial and institutional capacity of the Deposit Insurance Agency (DIA)	<ul style="list-style-type: none"> <li>• NPL Resolution</li> </ul>
Bulgaria	No current WB engagement	<ul style="list-style-type: none"> <li>• Asset Classification and Provisioning</li> <li>• Bank Recovery and Resolution</li> </ul>
Croatia	No current WB engagement	<ul style="list-style-type: none"> <li>• BRRD Directive Implementation</li> </ul>
Romania	The WB is preparing a €500m budget support operation with an aim to: i) strengthen fiscal management and SOE performance; and ii) improve the functioning of property, energy, and financial markets. Under the second pillar, improvements in the functioning of the Deposit Insurance Fund is included.	<ul style="list-style-type: none"> <li>• Deposit Insurance Reform</li> <li>• NPL Resolution</li> </ul>
Belarus	FSAP completed in March 2014	<ul style="list-style-type: none"> <li>• Consumer Protection and Financial Literacy</li> </ul>
Moldova	The WB is preparing a series of budget support operations amounting to \$60m with an aim to: i) improve business enabling environment; ii) strengthen financial sector stability; and iii) create greater efficiency in public investment. In addition, an FSAP update was completed in April 2014.	<ul style="list-style-type: none"> <li>• Macprudential Frameworks</li> <li>• Microprudential Regulation and Supervision</li> <li>• Bank Recovery and Resolution</li> </ul>
Ukraine	The WB is preparing a series of US\$500 million budget support operations with the aim of the implantation of a comprehensive bank restructuring program	<ul style="list-style-type: none"> <li>• Systemic Bank Diagnostic and Subsequent Enforcement Action</li> <li>• Bank Recovery and Resolution</li> <li>• Consumer Protection and Financial Literacy</li> </ul>

# Annex 1

## FIN SAC STAFFING

### CURRENT STAFFING: ALIGNMENT WITH THEMATIC PILLAR AND COUNTRY PRIORITIES

FinSAC's staffing has been guided by the strategic pillars outlined above. Currently, the team consists of a core team of five staff members based in Vienna supported by a set of senior staff from WB headquarters and international consultants.

#### Staff based in Vienna

- **Luigi Passamonti: FinSAC Coordinator and Program Leader, NPL Reduction.** His contribution to FinSAC's objectives is to coordinate day-to-day program activities and to lead the delivery of technical assignments with client countries. In addition, he is involved with products related to NPL reduction. Luigi played a central role in orchestrating the preparation of FinSAC's 2014–2017 Program Document, with its specific Result Framework articulation. Luigi brings to the table three decades of professional experience in banking, financial markets, technical advisory and policy areas both inside and outside the WB.
- **Attila Csajbok: Senior Financial Sector Specialist – Financial Stability and Analytics.** With a long career in central banking, working in various areas such as financial markets, monetary policy, financial stability, and crisis prevention in the past 15 years, Attila was the former Deputy Director of Financial Stability Department in the Central Bank of Hungary.
- **Katia D'Hulster: Senior Financial Sector Specialist – Microprudential Banking Regulation.** With an extensive career in banking regulation and supervision in the Australian Prudential Regulation Authority (APRA), the Bank for International Settlements (BIS), and PriceWaterhouseCoopers,

as well as within the World Bank, she is involved in products related to the microprudential supervision area.

- **Tamanna Talukder: Senior Financial Sector Specialist – Banking Recovery and Resolution and Consumer Protection and Financial Literacy.** In her time at the Bank of England working as a supervisor implementing regulatory programmes for UK banks, and previous experience in the UK banking sector, she developed the skills required to engage in crisis management framework activities. She is involved in products related to bank recovery and resolution, and to consumer protection and financial literacy.
- **Nurgul Irsalieva: Program Assistant.** She is responsible for organization of all FinSAC events, and for the administrative and budget parts of team activities. Prior to joining FinSAC, Nurgul worked for five years as Executive Assistant to the Country Manager in the World Bank Country Office in Bishkek, Kyrgyz Republic, gaining operational experience in support of complex World Bank activities.

#### Staff from World Bank Headquarters

In addition to the core staff, senior staff from World Bank HQ with strong experience in the financial sector have been involved in providing technical support to FinSAC projects on a regular basis. These include one Sector Manager (Lalit Raina), four Lead Financial Sector Specialists (Michael Edwards, John Pollner, Aquiles Almansi, and Samuel Munzele Maimbo), two Senior Financial Sector Specialists (Valeria Salomao Garcia and Ji Hoon Jeong), one Financial Sector Specialist (Yejin Carol Lee), and two Financial Analysts (Elena Kantarovich and Raquel Letelier).

### **International Consultants**

Besides the Vienna and HQ-based staff, FinSAC manages a roster of experienced consultants specializing in some of the above technical areas. These include three firms: Adastra Business Consulting (Prague), Karanovic & Nikolic (Belgrade), and TJP (Vienna) (NPL Reduction); and six individuals: Gordon Johnson and Danijela Vukajlovic-Grba (NPL Resolution), Peter Nicholl and Adam Gersl (BiH Financial Stability

Institutional Building), Ivo Jenik and Tomas Prouza (Kosovo Consumer Protection and Financial Literacy Implementation ).

### **FUTURE STAFFING PLANS**

FinSAC is in the process of increasing its staffing numbers, by adding another set of about five staff, thus effectively doubling FinSAC capacity.

# Annex 2

## RESULTS FRAMEWORK

### FINSAC OBJECTIVE: REGIONAL CENTER OF EXCELLENCE FOR FINANCIAL SECTOR REFORM IMPLEMENTATION

FinSAC’s mission to contribute to financial sector stability and sustainable deepening of financial intermediation in its region of operations will be fulfilled through operational interventions across its four thematic pillars. Figure 3 summarizes FinSAC’s objectives, framed around the overarching strategic

objective to become a well-recognized regional “center of excellence” for financial sector reform implementation.

While each of FinSAC’s engagement is client-driven to ensure successful implementation of proposed reforms, it can be anticipated that FinSAC’s impact will be optimized through coordinated country interventions in several of the thematic pillars, and supported by public-good activities in terms of technical conferences and research projects,. For instance, in a specific

**FIGURE 3** FINSAC OBJECTIVES

FinSAC Objectives				
<b>Strategic</b>	FinSAC to become a recognized center of excellence for financial sector reform advice and implementation assistance in eca countries by client authorities, ifis, eu authorities and international community			
<b>Operational</b>	Strengthened financial stability and sustainable deepening of financial intermediation in eastern europe			
	Financial Stability, Crisis Prevention and Macro-Prudential Frameworks	Micro-Prudential Regulatory Frameworks	Bank Recovery and Resolution	Consumer Protection and Financial Literacy
<b>Overall impact</b>	Strengthened financial stability through more Effective preventive policies	Strengthened safety and soundness of individual supervised entities through forward-looking supervision and sound regulations	Strengthened financial stability and protection of insured depositors and taxpayer resources	Sustainable deepening of financial intermediation via increased consumer protection and financial literacy for retail financial consumers
<b>Client outcomes</b>	Improved macroprudential institutional framework and enhanced analytical capacity of the macroprudential authority	Establishment and implementation of sound prudential regulations that are in line with international standards and best practice.	Introduction of bank recovery and resolution frameworks customized to the local environment which protect insured depositors and tax resources	Improved financial consumer protection framework and increased financial literacy for retail consumers
<b>FinSAC outputs</b>	Technical Notes, Draft Legislation and Regulations, Draft Memorandum of Understanding, Workshops, Internal procedures and manuals			

country, fulfillment of FinSAC’s mission may require interventions in financial stability, micro-prudential regulations, and financial consumer protection. It can also be envisaged that interventions in each pillar may occur in stages, ranging from systemic to technical and vice-versa, depending on opportunities for impact and policy priorities.

### STRATEGIC RESULTS FRAMEWORK

FinSAC activities (the “Program”) are designed to pursue the strategic objective of providing relevant client advisory services through the establishment of a dedicated technical unit in Vienna recognized as a regional “Center of Excellence” in supporting financial sector reform implementation. Accordingly, Figure 4 illustrates the chain of activities through which this **strategic objective** will be attained, starting from the bottom box of FinSAC activities and moving up to the top box with the overall impact.

### OPERATIONAL RESULTS FRAMEWORK

Downstream from this *strategic* results framework, Figure 5 shows the expected additional *quantitative operational* results of FinSAC’s planned interventions in its second phase of operations, moving from FinSAC outputs to client intermediate outcomes, as framed in their respective policy objectives context. The client intermediate outcomes are outside FinSAC (and World

Bank)’s direct sphere of operational control, particularly in the context of voluntary technical assistance activities devoid of financial or policy conditionality. They will, however, be considered by FinSAC in the context of the results framework as indicative factors aimed at helping FinSAC establish a high level of ambition and a very strong discipline for the choice of FinSAC activities and for how they are conducted so as to maximize their impact.

### PROJECT RESULT MONITORING

Additionally, in order to further strengthen the micro-foundations of the result orientation of its projects, FinSAC will carry out a result framework analysis for new projects to be undertaken, followed by an ex-post assessment at project closing, in the format shown in Figure 6. These project-specific result framework analyses, **which can be run only in the concrete context of a specific project once it is identified and endorsed by client authorities**, will be discussed during each annual business review session and will be monitored via the regular quarterly activity reports. This assessment will ensure that the portfolio of FinSAC’s proposed project activities contributes maximally to both program operational and FinSAC strategic results framework, as described in Figure 5 and 4 respectively. Similarly, the stock-taking of the ex-post achievements will help build the evidence for FinSAC’s actual policy impact through its various project activities.

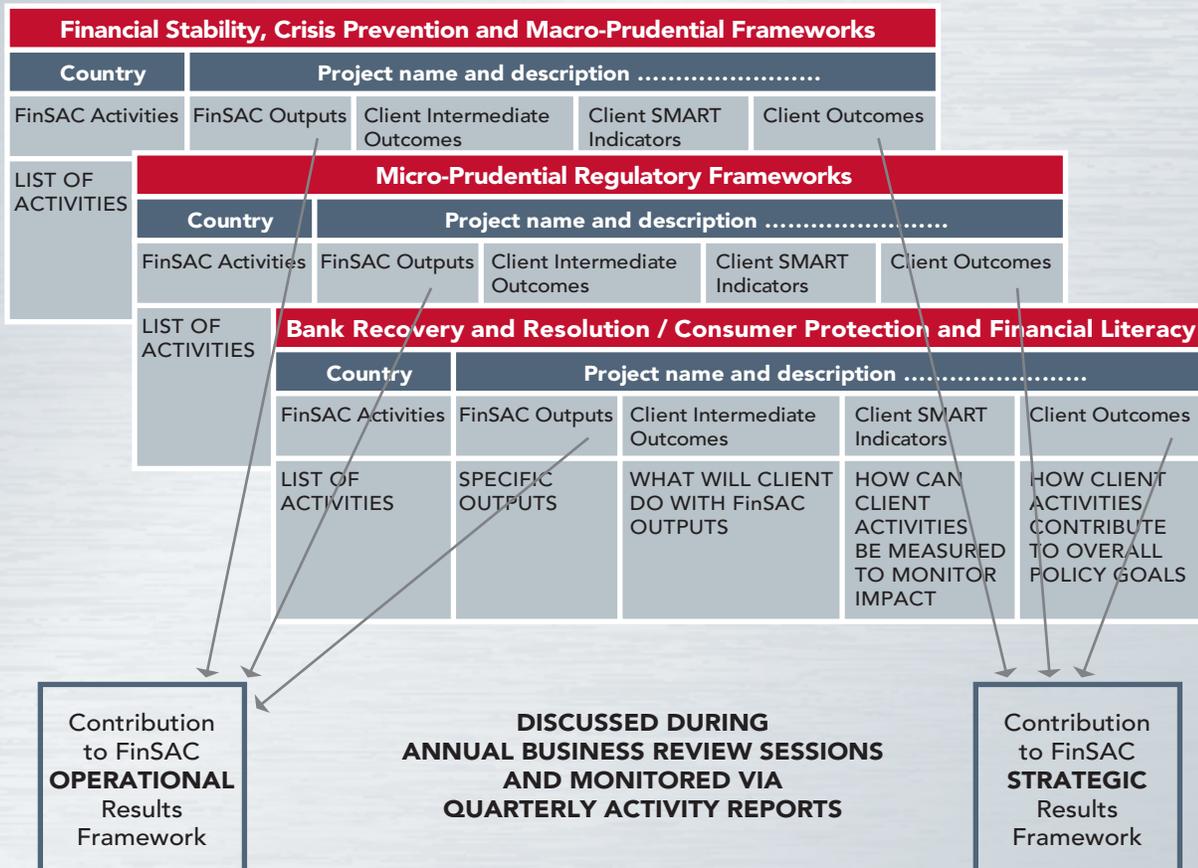
**FIGURE 4** FINSAC STRATEGIC RESULTS FRAMEWORK

FinSAC Strategic Results Framework (2014–2017)	
Overall Impact	Stronger IFI support platform for financial sector reform in Eastern Europe
FinSAC Strategic Outcome	FinSAC recognized as the place-to-go, by client authorities, IFIs, EU and international community (e.g., Vienna Initiative), for advice and implementation assistance on financial sector reforms that strengthen financial stability and enhance sustainability of financial intermediation in Eastern Europe
Intermediate Outcomes	Reforms took place in client countries with FinSAC’s contribution in areas considered critical for financial stability and/or deepening of financial intermediation
FinSAC Outputs	Contributions to draft legislation and regulations; Technical Notes; Conferences, workshops and seminars; Publications
FinSAC Activities	Client work ; IFI networking ; Professional Networking

**FIGURE 5** FINSAC OPERATIONAL RESULTS FRAMEWORK

FinSAC Operational Results Framework (2014–2017)	
Financial Stability, Crisis Prevention and Macro-Prudential Frameworks	Micro-Prudential Regulatory Frameworks
Bank Recovery and Resolution	Consumer Protection and Financial Literacy
CLIENT FINAL OUTCOMES	STRENGTHENED FINANCIAL STABILITY AND SUSTAINABLE DEEPENING OF FINANCIAL INTERMEDIATION
EXPECTED CLIENT INTERMEDIATE OUTCOMES	[ 3 – 6 ] LEGISLATIVE CHANGES ; [ 16 – 20 ] REGULATORY CHANGES ; [ 8 – 12 ] NEW FUNCTIONS ESTABLISHED ; [ 10 – 18 ] NEW TOOLS/ACTIVITIES STARTED ; [ 4 – 8 ] MEMORANDA OF AGREEMENT SIGNED ; [ 4 – 8 ] NEW/STRENGTHENED REPORTS
FinSAC OUTPUTS	Contributions to draft legislation and regulations; Technical Notes; Conferences, workshops and seminars; publications
TOTAL # OF CLIENT ADVISORY PROJECTS ONGOING/COMPLETED	APPROXIMATELY EIGHT PROJECTS/YEAR - TOTAL 32 PROJECTS
TOTAL # OF REGIONAL KNOWLEDGE ACTIVITIES	APPROXIMATELY FOUR PROJECTS/YEAR—TOTAL 16 PROJECTS

**FIGURE 6** FINSAC PROJECT RESULT MONITORING



**STAKEHOLDERS' FEEDBACK**

In addition to the Results Framework described above, feedback from relevant stakeholders will be taken into account to assess the success of FinSAC in achieving its strategic objective. This could include feedback from the Donor, regional stakeholders, as well as client

countries and partners. Media attention, measured for example by the traffic to FinSAC's website, to gauge the relevance of the research products and outreach activities carried out, may be included. Finally, further measures of success may be the amount of resources leveraged from other donors.





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