

A World Bank and EBRD Program  
With Italian Financial Support

*Center of Excellence in Finance*  
*4<sup>th</sup> Meeting of the Supervisory Board*

Brdo (Slovenia), 21 May 2004

# *Convergence*

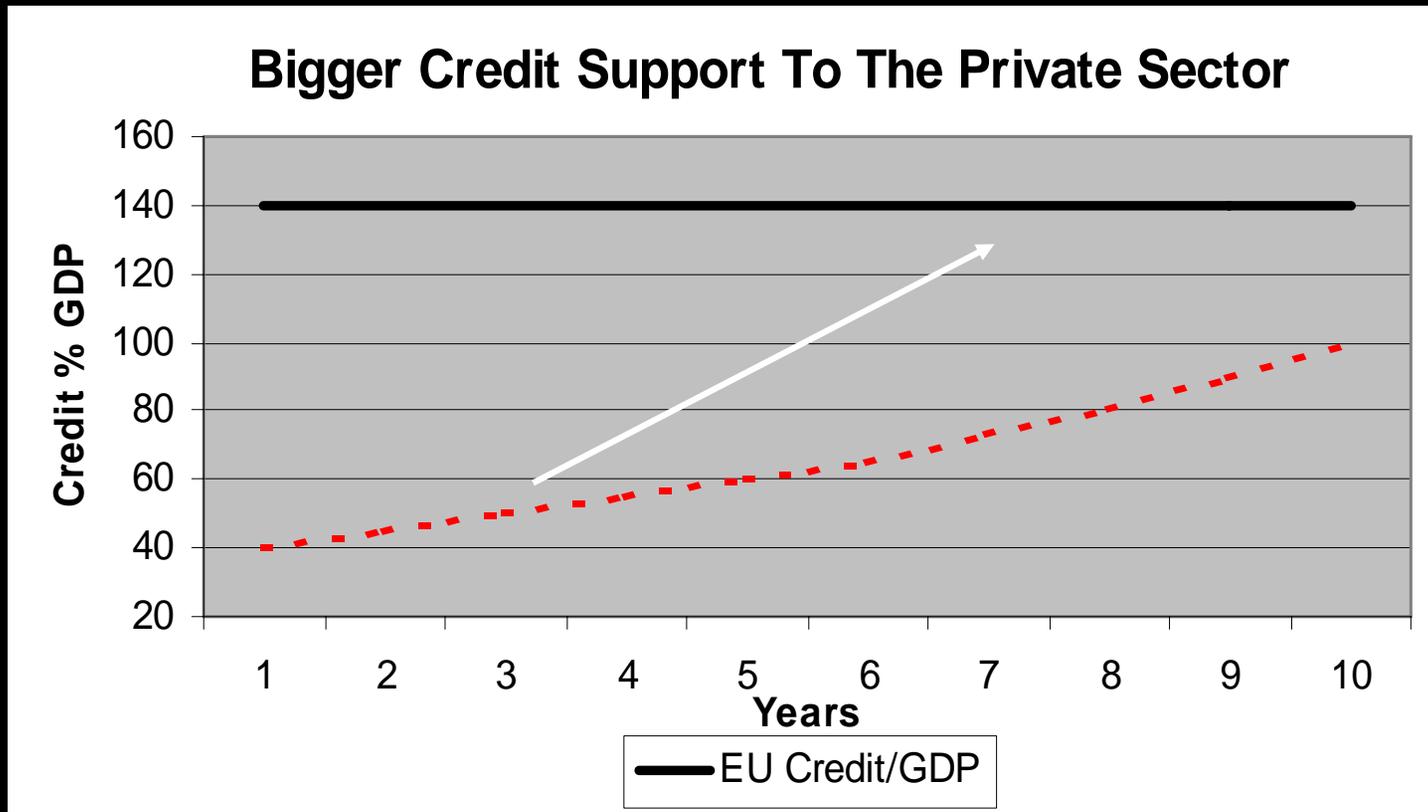
*Supporting Financial Sector Development  
and Better Bank Governance*

Western Balkans

Albania, Bosnia and Herzegovina, Croatia, Macedonia, Serbia and Montenegro

Bulgaria, Romania

# The Vision



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

**Eugenio Domingo Solans, ECB Executive Board Member**

# Public-Private Cooperation

## The Conceptual Framework

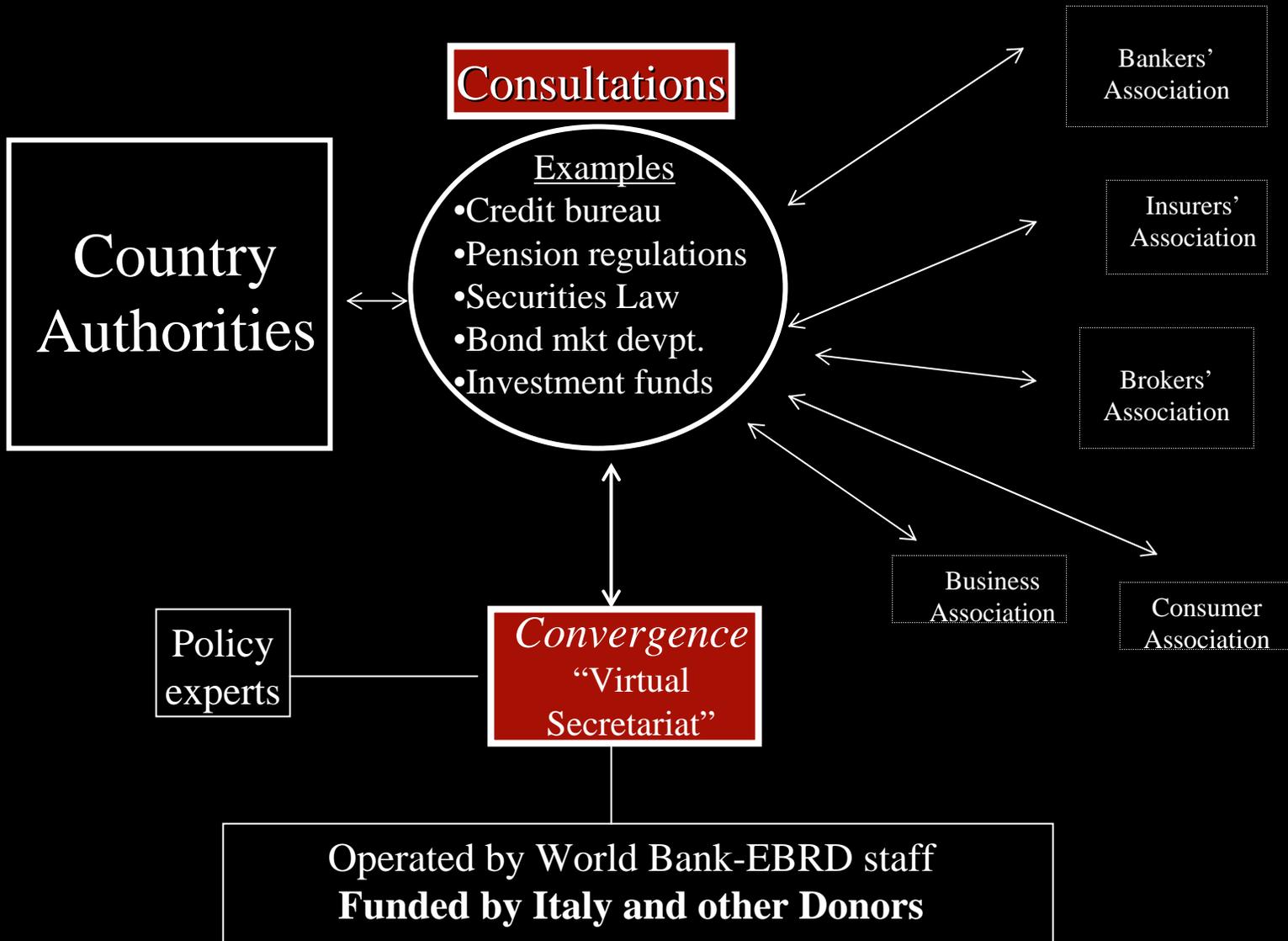
“Where public policy issues were involved, we established a tradition of extensive consultation right across the relevant sections of the market.

We recognized early on that where intervention was judged to be necessary – in the interest of market transparency or of prudential or behavioral conduct – it needed to be informed by those who properly understood the subtleties of the market if we were to reduce the risk of unforeseen consequences which could either frustrate the purpose of the intervention or unnecessarily obstruct market innovation.

In some instances this approach involved encouraging the market itself to address the particular issue in question as a preferable alternative to official action.”

**Sir Edward George, (Fmr)Governor, Bank of England**

# Convergence



# *Convergence's Role*

## 1<sup>st</sup> Step

Help authorities prepare a consultation strategy w/market participants

Why is new Law necessary

What are its intended benefits

What are the expected changes in products and behaviors

## 2nd Step

Run the consultations as an honest broker

Helping market participants form their views

Helping authorities respond to feedback

Ensuring final text meets needs of both authorities and market participants

## 3rd Step

Help authorities fine-tune implementation

Correcting unintended consequences

Helping authorities and market participants organize an ongoing productive dialogue

By using experts and organizing workshops

# The Bank Governance Module

- Credit deepening: desirable but risky
- Bank supervision: necessary but not sufficient
  - Transition countries more than 50% non compliant with relevant Basel Core Principles (IMF 2004)
- Shareholder and market discipline to be enhanced
  - Largely good quality shareholders in the region
- Where to start: discipline at home!
  - Independent and knowledgeable supervisory boards
    - Bank supervisors need to start interfacing with boards – not only with management

# How To Improve Bank Governance?

- Two principles:
  1. Supervisory board members are the first line of defense against financial risks
    - Grounded in strong technical skills
    - Aware of supervisors' concerns
    - Capable to collaborate with supervisors
  2. Supervisors need to assess supervisory board effectiveness
    - Person-to-person knowledge can be important
    - Common "language" is key
    - Possible performance feedback to chairman or shareholders

# *Convergence's* Bank Governance Program: “Assessing, Managing and Supervising Risk”

- Practicalities:
  - Governors *suggest* supervisory boards to enroll in 18-month program -- together with senior bank supervisors
  - Topics:
    - Credit, market, liquidity risk
    - Operational risk, legal compliance,...
  - Class: 2-3 boards plus bank supervisors
  - Sessions: 3-4 in each country plus 1-2 in Ljubljana
  - Instructors: bank supervisors, bankers and academics
  - Economics: full charge-back to bank board participants
- Groundwork for next policy steps:
  - How best to define supervisor-board engagement
  - How best to increase board effectiveness

# Center of Excellence in Finance

## *A Convergence Partner?*

- Is *Convergence*'s “bi-partisan” focus attractive to the Center's Supervisory Board?
  - Innovative, ... but consistent with development dynamics
- A potential approach:
  - Short-term: Design and delivery bank governance program
    - Assisted by technical partners (FSI, JVI, TIB, WB, IMF,...)
  - Medium-term: Secretariat/hub for entire program?
    - Virtual network of regional experts
      - Working for both authorities and associations of market participants