

**REPORT OF THE EXTERNAL EVALUATION**

**OF THE**

**SPI ROMANIA – CONVERGENCE PROJECT**

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March 7, 2007

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<sup>1</sup> As full disclosure warrants evaluator's bio (and contacts) are given in the Appendix V. Evaluator is not part of SPI Romania, nor has worked on SPI Romania. However, in the past, he was involved in two short term projects for the Convergence Program. First, on a short evaluation of Deposit Guarantee Fund Project for Romania and second he participated at the conference in Tirana, Albania on deposit guarantee schemes organized by Convergence Program.

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## List of acronyms

EFMLG	European Financial Markets Lawyers Group
EU	European Union
FSAP	Financial Sector Assessment Program
IIF	Institute of International Finance
MoPF	Ministry of Public Finance
MoU	Memorandum of Understanding
NBR	National Bank of Romania, central bank
OECD	Organization for Economic Cooperation and Development
PPP	Public Private Partnership
RIA	Regulatory Impact Assessment
RBA	Romanian Bankers' Association
SPI	Special Project Initiative
TOR	Terms of Reference

## **Executive summary (goals, main findings and recommendations)**

### **Goals and main findings:**

- 1. Romania needs a structured framework to speed up financial sector modernization.** Romanian financial sector (as many others in the region) needs to speed up its modernization to catch up with EU and follow global dynamic developments. Efficient financial markets are crucial for functioning of modern economies. Part of financial sector modernization regards regulation. Regulatory authorities alone cannot always supply optimal regulation (due to regulatory failure). The Convergence Program (hereinafter Convergence) and SPI are excellent ideas that can help in the complex process of financial sector modernization. Actively promoting constant interaction and dialogue between financial services industry and financial authorities can significantly improve financial intermediation and thus economic development.
- 2. SPI is neither a regulator, legislator nor is an executive body, but it can promote financial sector modernization.** Regulatory power always lies with regulatory authorities in a country (as this is delegated to them by Law). Preparation of optimal regulation is a time consuming process which requires a lot of specialized knowledge, experience from the “field”, understanding of best practices around the world, respect for international (especially EU) standards, etc. SPI has a potential to become an important part of the regulatory.
- 3. SPI Romania so far is a success.** In 6 months of its life span, SPI has started 15 projects (out of which some were initiated before) and one project is finished. It involves more than a hundred domestic experts who work diligently in *ad hoc* working groups, with ample assistance from the SPI Secretariat. SPI has created a framework for a professional dialogue between public and private sector in banking and has brought the interaction between stakeholders to a new level.
- 4. Effectiveness of SPI.** Extent to which the intended objectives of the SPI Romanian financial sector modernization program (hereinafter SPI or the Program) are achieved (effectiveness) cannot be fully evaluated as yet because the project is in its very early stage. So, this has to be more a process

evaluation with main goals to: a) evaluate the adequacy of organization of SPI, b) evaluate the nature of activities undertaken (projects) and c) evaluate the depth of partnership with all stakeholders to achieve the mandate of the Program with the ultimate aim of having a sustainable Program without Convergence. Evaluation will assess *ex ante* risks for the sustainability of the project (without Convergence support) and it will give some recommendations to manage those risks. Risk assessment will be qualitative and speculative in nature.

5. **Adequacy of SPI organization evaluation.** Adequacy of organization can be assessed via the following elements: a) mandate, b) governance structure and c) model of long term financing.
6. **SPI mandate.** The broad goal of financial sector modernization via constant interaction and dialogue between financial services industry and regulators on regulatory best practices is clear. From interviews all stakeholders in Romania understand and “own” the general idea well.
7. **Present organizational structure of SPI.** It relies on three pillars: a) SPI Steering committee, b) SPI Secretariat and SPI *ad hoc* working groups and c) time-bound Convergence Program support of SPI work (*via* Rome and Washington WB office). Stakeholders are pleased with organization and not a single person interviewed mentioned any problem with organization. Many pointed out very high professional standards of SPI Secretariat. However evaluation has shown that: a) institutional form of SPI secretariat and steering committee organization is not clear, b) SPI documents based on which secretariat and committee function are not consistent and complete c) the work is not fully transparent (e.g., lack of a website) and d) there is no agreed upon post-Convergence involvement governance structure and therefore there are risks for future smooth operations of the SPI. However, stakeholders do not seem to consider this a problem and are pleased with the present informal character of organization.
8. **Cost efficiency and cost effectiveness of the SPI project.** For the evaluator, cost efficiency (how well are inputs turned into results) of SPI is a non-issue. First, because there are no output as yet (no regulatory change and thus no assessment of outcome is possible). Second, estimated SPI costs for the World Bank-Italian Government /Convergence project (from PowerPoint

presentation Dec 20, 2006) for the period July 2006-June 2007 are US \$ 417 thousand. Locally born costs are estimated at about US \$ 100 thousand. On the other hand, preliminary RIA undertaken on thirteen projects states that for the first full year on profit and loss account alone the banking sector financial impact is estimated at US \$ 140 million. Even with assigning a relatively low probability of success to projects, the financial impact is amazingly high. Cost effectiveness (answering the question: Could the same goals be achieved with less financing?) is very difficult to assess as there are no benchmarks to compare with. However, based on available information the project looks cost effective.

9. **Long term sustainable model of financing SPI.** WB will exit financing of SPI very soon (July 2007), so there is a need to rely on domestic sources and donors other than WB. There is no well defined financing model for the future as yet. Several interviewed stakeholders (commercial banks) in Romania mentioned that they are willing to finance projects that will bring them (tangible) benefits. Two main risks may materialize here. First, if there is too much reliance on commercial bank financing, there is a risk of capture (i.e. that regulators will be captured by industry they are supposed to regulate) -- either real or perceived capture by public. If there is no "equitable" financing model (with long term sources of funds) SPI will not be able to play the role of an "honest broker" between public and private sector, but can mutate either into an industry lobbying organization or in an official think-tank (both of which are legitimate functions, but it is not a public private partnership). Second risk is if the funds available are not sufficient for high level of work, this may result in negative selection of both SPI staff and external (domestic and international) experts lowering the quality of output. This in turn can significantly lower the reputation of SPI.
10. **Nature of activities.** So far SPI did not result in any regulatory change. One position paper was completed and sent to relevant ministry. But, it seems that the projects in the SPI pipeline are the relevant ones for Romania. The selection process has been thorough and stakeholders selected 15 projects out of 50 proposals. None of the interviewed persons had any complaints on selected projects, on the contrary, they were full of praise for the selection process and projects selected. But, some projects may not fully reflect the

public private partnership character of SPI<sup>2</sup>. Furthermore, there are some future risks that the balance between projects of predominantly private interest and those of broader public sector interest could be biased toward private oriented ones endangering the public private partnership and therefore SPI reputation.

**11. Depth of Partnership between industry and regulators and the role of**

**Convergence.** All interviewed said that the quality of dialogue and interaction between industry (banking) and regulators has greatly improved when compared to the pre-SPI period. This is a big success. In SPI there are many local experts involved (about a hundred) in working groups that meet regularly and work diligently, there is a new framework for discussions, and projects are analyzed, for the first time, based on numbers and studies (RIA), not just ideas. However, there are risks for the sustainability of this dialogue. First risk is that WB announced funding withdrawal from the project. If the project is to become sustainable, more ownership by Romanian stakeholders is needed. Second risk is that once the project (position paper) is completed, it may not result in a changed regulation/law and momentum for reforms may be lost.

**12. SPI main asset is its reputation and instruments to change regulation are professionally done projects and moral suasion (advocacy).** SPI main output should be changes in regulation or legislation. Therefore, its main asset is its reputation and main instruments to achieve output are highest professionalism in proposed projects (honest broker) and moral suasion. Presently part of its reputation is borrowed from the World Bank's professional standards. Therefore the main challenge for the future is how to substitute WB reputation.

**13. Romanian SPI is at the crossroads.** The SPI program's initial phase is ending with the end of WB financing. First initial results are there as position papers will be completed very soon. Therefore Romanian stakeholders need to decide if and how they want to proceed with the Program. If they do, than facing the challenges (risks) is a reasonable strategy. Recommendations are primarily focused to address these challenges.

**Recommendations**

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<sup>2</sup> Arguably some projects have a predominant public or private focus.

**Immediate implementation:**

14. **Recommendation #1:** Work on: a) increasing reputation of SPI by completing several successful projects (position papers) as soon as possible, at least three<sup>3</sup>, b) increasing domestic ownership and awareness of present successes and future potentials of SPI with domestic outreach activities toward targeted audiences. Start own web site and use media to gain support. Be careful about local sensitivities in public relations.
15. **Recommendation # 2:** Start a project on long term sources of finance for SPI primarily from domestic stakeholders, but from other donors as well (other than WB). Beware of capture risks that can be generated by dominant financing by commercial banks and of risk of insufficient funds which will result in negative selection of staff and experts and thus lower quality of output and outcome.

**Short term implementation (end 2007)**

16. **Recommendation # 3:** Start a separate SPI project that will clarify all legal, organizational and governance structure aspects of SPI to increase institutional development impact. Use the existing structure and prepare: legal documents, book of rules or regulations and detailed organizational scheme with flows of information and governance. Pay special attention to leadership role in SPI Secretariat and Steering committee.
17. **Recommendation # 4:** WB, Convergence and domestic stakeholders should continue and speed up domestic capacity building (like the proposed RIA knowledge transfer project). In SPI Secretariat work Convergence should delegate more tasks to local stakeholders. They must be adequately empowered, get clear tasks with deadlines and be held accountable for their work.

**Medium term implementation (end 2008)**

18. **Recommendation # 5:** SPI should find a framework to follow track of its recommendations/finished products (position papers) and actively help in their enactment once they leave SPI and are send to relevant authorities. Due to

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<sup>3</sup> This goal seems within reach by June 2007, given the state of advancement of projects (Appendix III).



general legal inertia and possible negative lobbying by different interest groups (which do not want regulatory change), there is a risk that a good proposal (position paper) will not be translated into changed law/regulation. Changes in regulation are the result of both analytical work (primarily working groups) and advocacy (which should be done by local SPI Committee members working in concert).

19. **Recommendation # 6:** Pay special attention to public-private balance in SPI projects and activities in general. To maintain reputation of the project, especially once the WB financing is gone and Convergence gradually fades away it is important that SPI should not at any moment be viewed as a simple industry advocacy (lobbying) group, but should retain its highly professional “honest broker” role. Without WB, this will be more difficult than it is now.

## 1. Introduction. SPI Romania: its Origins and Mandate.

Romania, as other transition economies, started its reforms from socialism toward market economy less than two decades ago. Romania became EU member just two months ago. Its financial sector, in spite of its very rapid development<sup>4</sup>, leaves room for significant modernization and restructuring not only to catch up with its EU peers, but to follow very rapid changes in the world. Furthermore, with EU membership, Romania has to adopt the Euro. For this not only nominal but real convergence is needed, which means a lot of structural reforms in the financial sector as well. For various reasons good regulation is a necessary ingredient in this modernization process. Regulatory authorities alone cannot always deliver optimal regulation. First it is almost impossible to be up to speed with new developments and second, authorities cannot fully grasp consequences of regulation for the industry (regulatory failure). In other words, regulation, unlike many other goods and services, is not supplied *via* the market, but by legally given power from elected politicians (i.e. from principal) to regulator (agent in this model)<sup>5</sup>. Suboptimal regulation can be costly and those costs are ultimately always born by final consumers. Therefore a well structured dialogue between the public and private sector on financial modernization is not only warranted but is becoming a necessity by attempting to overcome (some of) information asymmetry in the regulatory process.

In spite that this dialogue is very much needed, the ultimate responsibility for regulation always lies with the regulatory and supervisory authorities as usually the law empowers them with this function and they should be held accountable if there is any problem with regulation (not the industry they regulate). If Romania wants to continue with its large scale financial sector modernization it needs a well structured framework for this dialogue. And SPI has the potential to “deliver” this framework.

SPI Romania is a new product. Officially it was “born” on September 14, 2006 with the first meeting of the SPI Steering committee taking place. Serious discussions about this project started within WB and later on preparations in Romania started before 2005 and especially from March 2006. The idea has been analyzed for some time within the Convergence Program and the WB. At the initial phases of SPI

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<sup>4</sup> Romania had a financial sector examination by World Bank and the IMF in 2003 (FSAP). Latest IMF document indicate that its financial system seems to be stable. See at <http://www.imf.org/external/pubs/ft/scr/2006/cr06168.pdf>

<sup>5</sup> For more details on those problems see: Llewelyn (1999).

the role of Messr. Mihai Bogza from Romania and Shkelqim Cani from Albania (together with Mr. Passamonti from WB) was instrumental to develop the concept and start its implementation. But, at the time of writing this evaluation, there is less than a year (actually less than half year) of formal SPI life span.

SPI can be regarded as a spin-off of World Bank Convergence Program. Convergence program started in July 2005 as a partnership between the World Bank and Italian government to promote financial sector modernization in South East Europe. The main mission of Convergence Program is to speed up financial modernization reforms in South East European countries by aiming to overcome two main problems: a) a knowledge gap of local authorities on micro aspects of sophisticated financial markets and b) a coordination failure by market participants to provide this knowledge to authorities. Convergence tries to create a sustainable framework for both market participants and authorities to work together with the goal of financial modernization which benefits all (“win-win” situations). Therefore, it is a kind of public private partnership (PPP<sup>6</sup>).

World Bank deserves credit for supporting this innovative product from the start. Convergence has a status of a pilot project, but WB institutional support was instrumental for the kick-off (as we will see during the evaluation) and this need to be acknowledged. Furthermore Italian Government bold decision to support this new and therefore risky idea has to be recognized as well. Both initial donors indicated that their support has a limited time span, but without it, we would not be in a position to evaluate SPI at all.

Finally the Romanian authorities as well should be praised for their bold support for this novel approach (especially in transition economies). National Bank of Romania and Ministry of Public Finance have both significantly contributed to the development of SPI so far. Banking community (both via RBA and individually) have considerably added to the work of SPI, by mobilizing several dozens of their professionals throughout their ranks, starting from several CEOs or equivalent.

In a modern world of today, PPP takes different forms and modalities, but its main aim is to bring together public and private sector in a long term partnership for mutual benefits. This is the main driving force for Convergence Program as well. Financial sector modernization and more broadly financial development (including

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<sup>6</sup> More info on PPP can be found on HM Treasury: The Stationary Office report.

financial sector stability) is a public good<sup>7</sup>. Usually authorities are its “main” producer *via* financial sector regulation, licensing and supervision. But, with exponentially increasing complexities of financial sector, it is very difficult, almost impossible, for authorities alone to be up to speed with new developments. What is especially difficult for authorities is fully grasping the industry’s perspective and all consequences of new regulation. Therefore so called “regulatory failures” are common. And, just like market failures (and they are the prime justification of regulation in the first place), they result in suboptimal equilibrium and costlier than necessary financial intermediation. Furthermore, firms (including banks) are subject to regulatory risk, i.e. a risk by private-sector companies that regulatory changes will hurt their business. Thus the need for partnership with market participants i.e. all stakeholders in this regulatory “game”. The ultimate aim of Convergence to enable sustainable modernization of the financial system with local ownership and leadership is justified on both theoretical and practical grounds.

At the time of writing this evaluation, Convergence project is present in four countries in the region: Albania, Croatia, Romania and Serbia. Its Romania activities are the largest and Special Project Initiative (SPI) Romania is so far (February 2007) the only active SPI in the region. Romanian authorities and market participants were the first and most active ones to absorb the idea and work on its implementation.

According to official SPI documents, the main purpose of SPI Romania is the modernization of the Romanian banking (financial) sector by: a) identifying regulatory fine-tuning needs, b) promoting the dialogue between authorities and market participants on technical aspects regarding financial intermediation, c) forming a consensus among stakeholders before official action is initiated, d) monitoring implementation of measures and e) fostering local analytical and implementation culture.

Finally SPI Romania and Convergence in general not only follow, but in some regards are at the forefront of modern regulatory practices. So, SPI is fully in line with growing trend of more effective and efficient regulation promoted by EU, for example<sup>8</sup>, or by Financial Stability Forum<sup>9</sup>. Furthermore, Convergence and SPI have

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<sup>7</sup> Public good is a good exhibiting: a) non rivalry consumption and b) non-excludability principle. Public goods are considered market failures, therefore government intervention is (sometimes) warranted.

<sup>8</sup> For a EU wide project on better regulation in general see the following web site: [http://ec.europa.eu/enterprise/regulation/better\\_regulation/index\\_en.htm](http://ec.europa.eu/enterprise/regulation/better_regulation/index_en.htm)

preceded the reputable Institute of International Finance's initiative called: "Proposal for a Strategic Dialogue on Effective Regulation".<sup>10</sup>

## **2. SPI Romania External Independent Evaluation: Terms of Reference, Methods and Caveats**

### **a) Terms of reference**

SPI Program declared it want to measure its success in the following ways : a) short term success should be assessed by the number and value of regulatory changes (value of changed measured through RIA technique), b) medium term success should be assessed by "progressive outsourcing of analytical activities" to local experts (i.e. more and more analytical and technical work is done by local experts) and finally its c) long term success should be measured through the continuation of SPI program "without Convergence membership in the SPI committee" (i.e. the Program should be sustainable on its own).

This evaluation is done at the request of Luigi Passamonti (World Bank Senior Advisor and Head Convergence Program) to consider the effectiveness of the SPI Romania and Convergence Program on delivering on its mandate within SPI. So, focus of evaluation should be SPI and the role of Convergence in it. According to Terms of Reference (TOR) for this evaluation<sup>11</sup>, the SPI evaluation should: a) evaluate the adequacy of organization of SPI, b) evaluate the nature of activities undertaken (projects) and c) evaluate the depth of partnership with all stakeholders to achieve the mandate of the Program with the ultimate aim of having a sustainable Program without Convergence (meaning fully locally owned, managed and implemented). This will be a process evaluation, as effectiveness of the SPI (i.e. degree to which it fulfills its goal) cannot be assessed due to the fact that it has not generated any regulatory change as yet.

Furthermore, according to TOR the evaluation should briefly prepare a short evaluation of the effectiveness of the Convergence Program set-up in support of the SPI Program (i.e. evaluate the role of Convergence in SPI).

### **b) Evaluation methods used**

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<sup>9</sup> See [www.fsforum.org](http://www.fsforum.org) on dialogue between regulators and industry.

<sup>10</sup> IIF's paper was published in December 2006, while Convergence is almost two years older.

<sup>11</sup> Full TOR is given in Appendix I.

As far as evaluation methods used are considered, the main two ones were: first, desk work (i.e. reading of available documents of SPI Romania and Convergence Program) and second, visiting Romania twice, conducting semi-structured interviews<sup>12</sup> with as many stakeholders as possible and participating at meetings in Romania with stakeholders. Interviews were conducted in several ways. The first ones took place in Romania in the period December 27-29, 2006 and the second one during January-February 2007, mostly by phone. Finally, during the second visit to Romania (March 1, 2007) evaluator participated in the work of two working groups and had an extensive meeting with main members of the SPI Steering committee. He presented his initial findings to them and got the reaction from stakeholders on the findings. The total number of interviewed stakeholders was 15. The broad list of questions for interviews is attached to this report as Appendix II.

The evaluator wants to sincerely thank all those that he interviewed during this evaluation. Absolutely all participants were very open, helpful and devoted their time to this evaluation. However, he has to specially mention great support from Ramona Bratu and Oana Nedelescu as well as Luigi Passamonti, whose support in explaining the details and providing additional information was crucial throughout this evaluation.

### **c) Caveats on this evaluation and its main goal**

Usually: “The role of evaluators is to feed lessons back to the institution as to how effectively it is achieving its goals so that the Management... can take measures to strengthen the institution’s effectiveness” (Lissakers et al. 2006). This is a legitimate goal, but it will not be possible to achieve it fully primarily because of constraints:

- The first constraint is the very short life span (time period) of SPI Romania. This resulted in scarce evidence (actually no regulatory change has happened by end-February 2007 and only one position paper was completed by January 2007). So, there are no completed projects of SPI Romania which can fully be attributed to SPI and its effectiveness cannot be assessed<sup>13</sup>. The successful Deposit Guarantee Fund project for Romania was done as the Convergence project, and was completed before SPI creation, so no attribution to SPI is possible (though this Convergence project opened doors for and shaped the

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<sup>12</sup> For more on interview technique see: GAO (1991).

<sup>13</sup> For more details on evaluation terminology see a very useful guide OECD (2002).

SPI approach). This project had high impact on financial intermediation in Romania and increased significantly the Convergence reputation in Romania. Not even short term success can be adequately evaluated at this stage. Even if some of the projects in the pipeline<sup>14</sup> will be completed soon (March 2007) their impact on financial modernization cannot be evaluated that soon. Steering Committee had only two meetings so far (September and December 2006) which is a small sample to reveal possible organizational problems and SPI Secretariat is still not completed (resident secretary is missing). In other words, there is almost no hard evidence on impact of SPI Romania that can clearly be attributed to this project. Therefore some of the findings will necessarily be speculative in nature and conclusions of this evaluation preliminary.

Even when more than one SPI project (as is the situation on March 7, 2007, date of finalizing this report) will be completed, we will not have evidence on output (regulatory change) and even less on final outcome (effects of regulatory change-output). In different words, within the “results chain” of evaluation methodology, completed SPI project (“position papers”) should be regarded as input only. Output could be adopted changes in regulation (or new regulation) based on SPI study (position paper) and SPI Committee endorsement and communication. Outcome should be effects of changes in this regulation on the economy (which is very difficult to assess in any case).

- Second constraint in this evaluation stems from relatively limited resources for this evaluation. Relatively short period of time required for its completion and only one evaluator necessarily limit the scope and quality of output of this evaluation.
- Third constraint is that there is a relative lack of written documents that explain creation, legal status etc. of SPI Romania. There are PowerPoint presentations, there are documents for SPI Steering committee meetings, extensive communication with stakeholders. Furthermore, there is evidence that *praxis* (how things work in real life) are not fully reflected in written documents, which makes the evaluation harder.

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<sup>14</sup> For a full list of projects for SPI Romania see Appendix III.

- Fourth, SPI Romania is an almost unique product. Public private partnerships in financial regulation are just starting as an idea<sup>15</sup> (see for example IIF, 2006). Therefore, to the best of evaluator's knowledge, there are no benchmarks, no similar projects to make adequate comparisons with this one. For those reasons neither cost effectiveness nor cost efficiency cannot be adequately evaluated (as costs cannot be compared with something similar and there is no output), but only value judgment and speculative conclusions can be given.

Therefore, this evaluation cannot “feed back lessons” or fully assess impact of SPI Romanian on more efficient financial intermediation. Neither can it second-guess numbers given in documents (for example on RIA), nor can it propose micro-organizational structures or definite models for financing SPI as this is not the role of evaluations in general.

But what it intends to do is to summarize findings from interviews, visits to Romania and documents and assess possible general risks for the sustainability of the project (without Convergence support). Furthermore it will give some guidance in risk assessment and risk management (but not detailed blueprint). Risk assessment will be qualitative and speculative in its nature, but evaluator hopes that it will help all stakeholders build a sustainable and efficient SPI and have a framework for dynamic financial sector modernization. Evaluator sincerely hopes that this document will help all stakeholders first of all understand the importance of SPI, second that there are risks for its future and third that more serious work is needed to ensure its sustainability and high quality of output to fully explore its potential.

### **3. Is the organization of the SPI program adequate for long term sustainability?**

If SPI Romania wants to fulfill the mandate of Convergence and SPI (and this is financial modernization which should proceed under local leadership and ownership) one needs: a) clear mission, b) clear institutional set-up for the project (for example knowing what is its legal status, accountability etc.), operational and working procedures and other organizational/governance issues (“who does what”, how are projects selected, analyzed, completed, etc) and c) known financing sources for the medium term (the last point will be examined in more details in the next chapter).

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<sup>15</sup> Similar idea is followed in [www.efmlg.org](http://www.efmlg.org) as explained later on.



Succinct answer to the question from the title of this chapter is that SPI mission is clear, but organizational structure needs clarification and better governance (with special attention to leadership). Financing model does not exist yet, and this will be analyzed in the next chapter<sup>16</sup>.

**a) SPI mission.** The main mission of financial sector modernization in Romania via constant interaction and dialogue between financial services industry and regulators on regulatory best practices is clear. We already explained that it is very much needed as well. This constant dialogue between industry and regulators is superior to only regulators (authorities) adopting regulation without consultation with the industry (primarily due to regulatory failure<sup>17</sup>). What is even more important is that from interviews all stakeholders in Romania seem to understand and “own” the general idea well and support it.

**b) Organizational structure of SPI Romania.** Organization of SPI Romania has three main pillars: 1) SPI Steering Committee, 2) SPI Secretariat with *ad hoc* working groups and 3) Convergence which, *via* World Bank office in Rome and Washington DC office, supports the work.

- SPI Steering committee's work is defined in SPI Operating Guidelines.<sup>18</sup> Committee's role is to: “...initiate, oversee and act upon analytical projects that hold the greatest potential for their contribution to financial sector deepening...” within the Convergence plan. It is a partnership formed initially among National Bank of Romania (NBR), Ministry of Public Finance (MoPF), Romanian Banking Association (RBA) and the Convergence Program<sup>19</sup>.

This is the only written document on the nature, legal status, rules of operation and mandate of SPI Steering Committee.

The Operating Guidelines were adopted at the first meeting of the SPI Steering committee on September 14, 2006. The Steering committee is the main body in the governance structure of the SPI Romania. Therefore its role (mandate), legal status, membership, etc. should be very precise and clear to all. This is especially

<sup>16</sup> More details on governance can be found in Mintz (2007) and Edgar et al. (2006)

<sup>17</sup> Regulatory failure is defined broadly as a situation when regulation creates more economic costs than benefits.

<sup>18</sup> Guidelines are a short document which has five articles, some with several sections.

<sup>19</sup> The SPI Committee members invited the Chairman of the National Association for Consumer Protection to join the Committee in October 2006, following the first SPI Committee meeting.

true when SPI Romania should be able to “walk the walk” alone, without any WB/Convergence support.

- Institutional/legal status of the Steering committee is not clear<sup>20</sup>. The institutional form, legal status and registration are very important for the sustainability of the project in the future. For local ownership institutional set up is very important as SPI Committee is supposed to be: “...vocal and visible in creating and communicating a shared vision...” (Section 2. Article 1 of Operating Guidelines). However, Romanian stakeholders were pleased with the informal organization so far<sup>21</sup>.
- Status of SPI steering committee members could be clarified. According to available document (operating Guidelines), members are selected not as persons, but functions from institutions. This selection by “functions” is somewhat contradictory to the following statement of the same article: “The SPI Committee Members operate in their personal capacity ...” and “... actions and decisions in the SPI Committee cannot be deemed having being taken pursuant to the general powers and authority that are vested with each of them...”. Furthermore, membership should be clearly defined (number and function). From minutes of meetings two Convergence persons attend Steering Committee meetings, but Article 2. Section 1. states that four is a total number of members (and with two from Convergence it should be five in total). Finally at the 2<sup>nd</sup> SPI committee meeting a president of the national authority for consumer protection was the member. This is not amended in documents. Furthermore, from governance viewpoint, evaluator thinks that chairmanship of the Steering committee should be better defined. Rotating chairperson for every meeting may not be optimal once WB is out of the picture as it will raise the leadership question (a yearly mandate for chairmanship could be better for ownership). Rules of SPI steering committee should allow for broadening of membership as SPI intends to move to non-bank financial institutions. The number of members should not be too large, but should well represent other segments of financial market, both regulators and market participants. For governance clarity, voting at the Steering committee could be better defined.

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<sup>20</sup> Evaluator is neither a legal expert nor is he familiar with the public administration regulations in Romania. His views in this part are therefore simple indication of possible problems.

<sup>21</sup> Feedback from the March 1, 2007 meeting.

Another problem: who can participate at Steering committee meetings as observers? Only SPI directors are explicitly mentioned as observers. But from agenda others participated as well.

- SPI Secretariat: Memorandum of Understanding (MoU) between RBA and Convergence defines creation, status, financing and the role of SPI secretariat. During interviews in Romania not a single stakeholder mentioned any problems with SPI Secretariat. On the contrary, all were very pleased with organization and most have praised very high professional standards by secretariat. However, available documents do not reveal the clear governance structure of SPI Secretariat, its leadership arrangements, in short it does not give enough information on the role of SPI secretariat. This does not seem to be a problem as long as Convergence is involved in the work of Secretariat on a daily basis. For the sustainable future without Convergence, additional clarifications are warranted.
- Working groups. Persons interviewed (project managers) were full of praise for them. Working groups work hard, there is good communication between industry and authorities, SPI Secretariat (Directors) give them all support they need. The other very positive thing about working groups is that only at those levels are problems and issues visible (and not at high level strategic discussions at the Steering committee). Evaluator participated at two working group meetings while in Bucharest. His impression of their work is very positive.
- Convergence, which via World Bank Rome and Washington DC offices supports the work, represents the third organizational pillar of the SPI Romania (besides SPI Steering committee and SPI Secretariat with ad hoc working groups). Convergence project is involved at the following levels in SPI Romania: first, by participation in SPI Steering Committee (active role, consensus building etc), second, in supporting project management activities (Secretariat) and third in (co)financing the SPI Romania via financing Convergence role, two SPI directors and finance external experts (when needed) in different projects. Convergence project and SPI contributed greatly to the building of new regulatory culture in Romania and started a serious institutional development impact.

Presently the role of Convergence in SPI Romania is multi-faceted. On the one hand it is the “glue” that sticks together the first two pillars and it seems to be an important ingredient in both Steering committee and in daily work of Secretariat. Working groups (which are very important for the overall success) function very well without direct Convergence involvement. But Convergence is supposed to disappear, i.e. SPI functioning should be able to continue without Convergence. So, Convergence has to balance its active role in all processes while having an exit strategy. The main risk for the future will be how to successfully continue the SPI process without Convergence.

When thinking about future sustainable organization, experience of relatively similar projects could be useful in future work. One example worth mentioning is the European Financial Markets Lawyers Group (EMLFG). In 1999 The European Central Bank established EFMLG with the aim to discuss the possibility of promoting initiatives that would lead to harmonization in EU financial markets activity and facilitate the integration of financial markets after the introduction of the Euro. So, this group was established at the central bank initiative with the aim to discuss (legal) issues with private sector participation<sup>22</sup>.

**Main recommendation # 1<sup>23</sup>:** Start a separate SPI project that will clarify all legal and institutional aspects and governance structure of SPI. Work out all the details with adequate legal and regulatory support and prepare: book of rules (statutes) and detailed organizational scheme with flows of information and governance. This is institution-building to ensure sustainability of good practices. Pay attention to leadership role in SPI Secretariat and Steering committee. Furthermore, strike a balance between institutional build-up and needed flexibility in organization. Use existing experience in similar organizations like with EFMLG.

#### **4. Financing of SPI: present structure and issues for the future**

##### **a) Is the present financing of SPI efficient?**

<sup>22</sup> More details on European Financial Markets Lawyers Group can be found on [www.efmlg.org](http://www.efmlg.org) with links to similar organizations in London, New York and Tokyo.

<sup>23</sup> Recommendations in the main text are not ranked according to their urgency (as in executive summary and conclusion), but match the main identified risks in a chapter.

Cost efficiency (how well are inputs turned into results) cannot be assessed for the simple reason that there is no SPI output. However, based on available information, estimated SPI costs for the World Bank-Italian Government /Convergence project (info from PowerPoint presentation Dec 20, 2006) for the period July 2006-June 2007 are US \$ 417 thousands. This comprises core staff, experts, Rome office support and head of Convergence. Some costs from the part of Romanian stakeholders should be added to have an estimate of total costs (premises of SPI secretariat, time of staff in working group, domestic experts, etc). There is no precise accounting of those costs but when both cash and in kind expenses are added up, annual Romanian costs of SPI can be estimated to about US \$ 100 thousands. Total costs for a year are of the magnitude of order of half a million US \$. This should be compared with preliminary RIA undertaken on 13 projects (RIA was done for initial 13 projects) which states that for the first full year overall impact on balance sheet of commercial banks can be estimated as US \$ 154 million in released capital and further impact of US \$ 308 million on increase in lending. Finally total impact on profit and loss account of commercial banks is estimated at US \$ 140 million. Those numbers seem to be on the optimistic side and probably should be taken with a grain of salt (without attempting to second guess the RIA)<sup>24</sup>.

With the risk of oversimplification, if an investment of about half a million US \$ create profits of US \$ 140 million this is great investment by all accounts. Even if not all projects are successful (so we assign the probability of their success to less than 1) this is fantastic result.

**b) How should future financing of SPI be organized and what are the possible risks?**

Presently, large part (about 80%) of SPI project financing is done via Convergence where sources of funds are: World Bank and Italian Trust Fund. Soon the WB money will stop. At this point, there is no long term sustainable model of financing future SPI activities. And this is a serious risk for the sustainability of the project. There is a need to rely on domestic sources and other donors. More reliance on domestic sources is not only needed but warranted as

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<sup>24</sup> According to Financial stability report of NBR profits of commercial banks were RON 2 113 million for 2005. At the official exchange rate of 2.9 US\$/RON (NBR) for 2005 profits are US \$ 725 million. So US \$ 140 million is about 20% increase in profits.

well. The willingness of domestic stakeholders to financially support the idea will be the ultimate test of their true belief in this project.

Several interviewed stakeholders (commercial banks) in Romanian mentioned that they are willing to finance projects that will bring them (tangible) benefits. Stakeholders have to understand that this problem cannot be resolved by either a single idea or from the outside, but needs deep thinking and careful analysis<sup>25</sup>. Future income model for the SPI would need to pay special attention to the following risks:

- First risk is that future projects will be captured by commercial banks if the whole project is exclusively financed by them. Commercial banks are financially the strongest. And they have obvious interest to finance projects that bring largest and fastest returns to them specifically. So, if they are the main contributors to projects they will focus on projects that bring narrow benefits to them. This may “violate” the principles of mutual benefits to public-private partnership. For example, financial modernization is a broader concept than cost-cutting (or profit maximizing) projects of special interest to banks. Future projects bear the risk of a selection bias and therefore could lead to perception of crowding out of broader issues. If the broader public good function is to be maintained (via public-private partnership) there is a need for equal participation in long term financing from both private and public sector in Romania. Donor’s money (to the extent available) should be regarded as representing public interests in this distribution<sup>26</sup>. If there is too much reliance on commercial bank financing there is a genuine risk of capture (i.e. that regulators will be captured by industry they are supposed to regulate) -- either real or perceived capture by public. Risks of capture should not be taken lightly (although Romanian authorities do not see them as a problem). Furthermore, if there is no “equitable” financing model (with long term sources of funds) SPI will not be able to play the role of an “honest broker”

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<sup>25</sup> IMF recently asked a Committee of Eminent Persons to give options for a stable revenue stream, long term income model for the IMF financing. See the so called Crockett report (2007).

<sup>26</sup> Evaluator would suggest that commercial bank sources should never represent more than 49% of financing, but it is up to domestic stakeholders to determine the financing model.

between public and private sector, but can mutate into an industry lobbying organization<sup>27</sup>.

- Second risk in financing may come if there are no sufficient funds for the normal activities in the future. The risk of adverse (negative) selection and decreasing quality of output is genuine. If there are not enough financing flows for the future, financing of SPI Secretariat and experts (both domestic and foreign), the quality of output will decrease. The only way to avoid this problem is to pay them competitive market wages.

**Main Recommendation # 2:** Start a project on long term sources of finance for SPI primarily from domestic stakeholders, but from other donors as well (other than WB). In financing model pay attention to the risk of capture and dominant financing profit oriented industry. This could be avoided by making sure that public sector (including external donors) participates with 51% in total financing. Furthermore make sure there are enough funds in the medium term to avoid negative selection of staff and experts (domestic and foreign).

##### **5. Nature of activities. Have the projects addressed the right issues?**

Have the projects that are in the pipeline in SPI addressed the relevant issues for financial sector modernization in Romania? Selection was made according to some principles. First, all stakeholders had the opportunity to present to the SPI Secretariat what they consider as most relevant projects. Second, the SPI Secretariat prepared a proposal for SPI Committee consideration including only those projects that were acceptable to all (consensus). Third, to facilitate SPI Committee consideration, the SPI Secretariat described the proposals with a set of criteria highlighting the public-private partnership nature of the SPI Committee.

Another element that complicates the assessment of SPI in addressing the “right” issues is that due to the short life span of SPI, all projects that are in the pipeline cannot be attributed to SPI framework alone. Some were initiated before (RBA), some were started individually, and a successful Deposit Guarantee Fund was completed before SPI started.

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<sup>27</sup> Lobbying for industry is legitimate, but cannot label lobbying as PPP, „Honest broker“ or a neutral dialogue.

However, the fifteen selected projects (for a full list of projects see Appendix III) do seem important to the external evaluator. Furthermore, there is no evidence to show to the contrary, i.e. that irrelevant projects are being pursued and more important ones were left out. Evidence for this is that during interviews with Romanian stakeholders no one complained that an important topic was avoided. In one case the interviewed party admitted that the proposed project is not something that could be labeled a public-private partnership, but they address this to lack of their initial understanding of the project and something that will not be repeated.

In line with the goal the evaluation and that is assessing the balance of risks in the future life of the project (and in particular the selection of topics) the evaluator sees a possible risk that in the medium term projects may be biased toward the ones of narrow and immediate financial interest to commercial banks. This risk is derived from answers of several commercial banks that they are willing to finance future SPI activity as long as it is profitable to them. There is a risk of unbalanced selection of projects, biased toward commercial banks (profit) interests.

**Main recommendation # 3:** In projects (as well as in other activities) make sure to keep the right balance between public and private interests. If the projects are too dominated by private sector interests, this will undermine SPI reputation and it can have negative consequences for the project as “honest broker”.

## **6. Depth of partnership between local stakeholders and between Convergence and local stakeholders**

In a nutshell, from all available evidence it is clear that SPI has created a new quality of professional dialogue between financial services companies and regulators in Romania, so depth of partnership has increased. And this should be considered a success.

This can be documented by the following evidence:

- From interviews one can see that all those interviewed are very pleased with the new (public-private) partnership. It seems that the mere fact that SPI Romania brought all relevant stakeholders for the modernization of the Romanian (in particular banking) system around the same table in an organized and systemic way is a great contribution. This is something that has



never happened before. It is unique to have them discuss projects at the same time and prioritize (according to some rules and well prepared documents).

- Many Romanian professionals are involved in this process. At the beginning of 2007 there were almost a hundred persons involved in SPI projects in all working groups. More precisely 94 of them, including project management groups like project managers etc. Those persons came from various institutions, like: commercial banks, central bank, four different ministries, and different funds, in short from eight institutions plus commercial banks and have different professions (lawyers, project managers, accountants, economists etc). This in itself, so many professionals from different institutions communicating, should be considered a success. All working groups are mixed, communication in all groups is good and this creates the necessary depth of partnership.
- Quality of professional discourse has increased due to SPI. Industry and banks communicated before as well. Usually if a bank had a problem they would simply contact NBR and try to resolve their problem. It was “incident management” as one participant called it, not in-depth dialogue on a more general level about the problem. As another of the interviewed persons said: “SPI has raised the standard of professional discussion in Romania.”
- For the first time economic issues are jointly analyzed by private and public sector from the very start. For example, according to an interviewed commercial banker, before SPI, NBR would send draft regulation to banks. But more often than not, when suggestions for changes to draft regulation were made, the reply was that it is too late and the process is already well under way. So, joint dialogue from the very start of the idea is something new and relevant. This enables not only intervening in regulation when it can still be effective, but gives a much better understanding of the views of the “other side”. It is worth noting that this dialogue from the start is not the case in more advanced economies. For example, Italian banker’s association usually sends an elaborate proposal to the central bank, but they do not participate jointly in the creation of the document.
- SPI created a well defined framework and a professional structure for a dialogue. So, new framework and technique to present issues is another element that indicates increased depth of partnership created by SPI.

Preparation of future projects (before they start) is something very new in the Romanian regulatory practice. Several interviewed persons said that with SPI for the first time new projects are discussed based on some estimates, numbers, economic analysis and not simply identification of a problem. In this context, RIA is definitely an enormous step forward with its goals, methods, etc. For the time being RIA are done in collaboration with WB/Convergence office Rome, but it is very probable that the transfer of technology is successful and SPI Romania is able to do it all in-house. Actually the SPI knowledge transfer and capacity-building program for RIA in Romania is presently being pursued and is an excellent example for future work (to ensure building up of local analytical skills).

- Consensus building, which may have bad sides, has positive side as well and contributes to the depth of partnership and building of joint responsibility between the private and public sector for financial sector modernization. Both the private sector and public sector in this PPP have to work more together to increase mutual respect and understand both divergent but joint goals as well. Those elements are evidence of new quality of dialogue between regulators and the industry. But this partnership is not without risks.

First risk, as many interviewed stressed, that this partnership is very fragile and that there is still a lack of reputation. Actually a lot of reputation of the overall SPI is “borrowed” from WB (and Convergence) so the main challenge will be how to continue without WB involvement in the future – first funding and later also operational. According to interviewed persons involvement of WB in the project provides: “audit based on international standards”, “provides neutrality and objective views”, “they have credibility and reputation with authorities”, “WB provides technical expertise”, etc. Therefore most of interviewed requested as long as possible WB presence in SPI.

One way to manage this risk is to increase the present reputation of SPI and the sense of its ownership by Romanian stakeholders. This can be done by quick delivery of more successful projects. Interviewed bankers repeatedly said that there is need for “more results”, more changes in regulation. They are tired of opening up questions and discussing issues. They want results i.e. changes in regulation (output) not only position papers. It is very difficult to give an exact number of successful projects that would represent a critical mass for the

sustainability of SPI. Several of interviewed stakeholders mentioned at least three additional projects that would give the necessary minimum reputation to the overall project and “cement” the present good partnership (or be considered a critical mass for continuation of reforms)<sup>28</sup>.

Second risk, is the follow up upon completion of position paper and mechanism to get the output (changes in law/regulation). What happens once a position paper is finished? For example, the project called: „Amendments of the law on good safeguards, values and persons protected“ was send to the relevant Ministry of administration and Internal Affairs on January 10, 2007. So far there was no reaction from them (end February 2007). A letter signed by two institutions, NBR and RBA, supporting a certain project should definitely have its weight on the authorities, but it is far from certain that it will work. The real challenges lie with their adoption in Parliament (legal changes) or other institutions. The overall idea could be undermined by the postponement of adopting the changes (either legal or regulatory).

In general any regulatory change requires two aspects, first highly professional analytical work to prepare well the regulatory change and second advocacy for changes to be adopted. High level professional preparation of proposals of new regulation is a necessary but not a sufficient ingredient to result in a regulatory change. We have to keep in mind that regulatory changes (like any other reform) actually eliminate rents from some economic agents. Therefore they will fight for them and any change usually faces opposition from some interest groups. SPI has to factor in other interest groups that may resist changes.

Third risk is that some of domestic stakeholders lack ownership of projects. From interviews some domestic stakeholders do not feel full ownership of the projects. Several interviewed stressed this as the main challenge for the future is how to increase domestic ownership (which is closely related to WB/Convergence role and their exit policy). Without broader domestic ownership, it will be difficult to have enough support for continuation of SPI within Romania.

Fourth risk for the depth of partnership is loss of momentum for reforms in general and especially for regulators (i.e. loss of their interest for future cooperation in this area). Romania is probably subject to general reform fatigue (if not it will be soon

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<sup>28</sup> As mentioned before, this target seems within reach by June 2007.

as the post EU membership blues or hangover is common for new members). EU entrance has definitely taken its toll.

**Main Recommendation # 4:** Romanian stakeholders in SPI in particular should work on: a) increasing reputation of domestic stakeholders (to substitute WB) by completing several successful projects (position papers) soon, b) increasing domestic ownership of SPI by raising awareness of present success and future potentials of SPI with planned domestic outreach activities toward targeted audiences. For example, start own web site, pamphlets and use media to gain support. Be careful about local sensitivities in public relations (based on some negative experiences). The goal is to build a perception of a successful project with gradually minimizing WB role and increasing the one of domestic stakeholders that can competently take over and produce the same results.

**Main Recommendation # 5:** WB and Convergence should work more on capacity building and start delegating more and more tasks to Romanian authorities and give them more decision-making power. But this process needs to be gradual, local stakeholders must be adequately empowered and get enough knowledge (transfer) to smoothly keep the process going. Continually increasing local capacities (managerial and analytical) will enable substituting WB role with local staff and international experts with domestic ones. RIA transfer of knowledge project is an excellent example of such effort.

**Main Recommendation # 6:** SPI should think and find a framework to keep track of its recommendations/finished products (position papers) once they leave SPI and are sent to relevant authorities and to organize SPI Committee follow-up (active advocacy). SPI is neither a legislative body nor a regulator. Its main asset is its reputation and tool is active advocacy (together with professionally prepared position papers). There is a risk that a good proposal (position paper) will not be translated into changes of law/regulation automatically. If this is a case, first, low acceptance rate of proposed regulatory changes could decrease SPI reputation. Second, if regulation is not changed, morale of those working on projects may decrease (why work hard if there is no change?). SPI Committee should act as a bridge between professional proposals and actual changes of regulation.

## 7. Conclusion

Romania and its financial sector need SPI in their quest to speed up financial sector modernization. Both a rapid catch up with EU and swift global changes impose that Romania needs to embark on a series of significant structural reforms in the financial sector. Regulatory authorities alone probably cannot supply optimal regulation, so structured dialogue and interaction with industry is needed.

So far SPI has functioned well. It has addressed relevant topics for Romania (and financial sector) and it seems to be cost efficient (when costs are compared with RIA estimated benefits). Present SPI has the support of main stakeholders. Challenges are in the future, especially with WB exit factored in.

SPI is neither an executive nor a regulatory body and cannot be a legislator. However its main output should be changes in regulation or legislation. Its main asset is its reputation and main instruments are high professionalism and international standards in projects and moral suasion (advocacy). Presently part of its reputation is borrowed from the World Bank (Convergence Program). Therefore the main challenge for the future is how to substitute WB reputation with domestic stakeholders' one and further enhance SPI reputation to make it both effective and sustainable.

This evaluation has identified a certain number of risks that could (does not mean they will) undermine the present success. Recommendations that follow are an attempt to manage and minimize the downside risks. They are presented in the order of urgency:

➤ **Immediate implementation:**

**Increase reputation and domestic ownership.** Intensify work on: a) increasing reputation of SPI by completing several (at least three) successful projects (position papers) soon and b) on increasing domestic ownership and awareness of present success and future potentials of SPI for financial sector modernization in Romania.

**Develop a detailed financing model.** Start SPI project on long term income model for SPI primarily from domestic sources, public and private (other than WB) with the appropriate balance of public and private funds.

➤ **Short term implementation (end 2007):**

**Work on future organization model of SPI.** Start a separate SPI project that will clarify all legal, organizational and governance structure of SPI with the aim

to increase the institutional development impact. Pay attention to leadership role in SPI Secretariat and Steering committee.

**Speed up capacity building and delegation.** Convergence should continue and speed up a) domestic capacity building (like the present knowledge transfer of RIA project) and b) delegate more and more tasks to Romanian stakeholders in SPI especially in SPI Secretariat.

➤ **Medium term implementation (end 2008)**

**Develop advocacy and follow up framework.** SPI should device a framework to keep track of its recommendations/position papers and organize its follow-up (advocacy) once they are completed and are sent to legislature or other institutions for adoption (to make sure final output is completed). In other words, once the project is completed, the SPI Committee should act as a bridge toward legal and regulatory authorities.

**Keep public-private balance in projects.** In the selection of projects (and in all other activities as well) SPI should keep in mind to retain a public-private balance to increase its reputation of an honest broker and non-partisan professional body.

Finally, it is worth repeating that SPI has a great potential for financial sector modernization in Romania (and in other countries as well). To materialize this potential, stakeholders in Romania have to: first, realize the present and future benefits of the SPI model, second, understand the possible downside risks to the sustainability of the project and third, manage the risks. A sustainable SPI model with net benefits for the economy is doable, but without additional efforts its success is not automatically guaranteed. It is up to Romanian stakeholders to decide how they want to proceed.

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## Appendix I:

**Special Projects Initiative and Convergence Program**

## An Independent Evaluation

**Context**

In July 2005 the World Bank and Italy joined in a partnership to promote financial sector modernization in South-East European (SEE) countries through micro-regulatory reforms designed in partnership by authorities and market participants, under the aegis of the “Convergence Program” (Convergence).

As recently defined by an ECB Executive Board member, “*Financial modernization refers to the process of financial innovation and organizational improvements in the financial system that reduces asymmetric information, increases the completeness of markets, increases opportunities for agents to engage in financial transactions through (explicit or implicit) contracts, reduces transaction costs and increases competition*”.

Financial modernization requires a set of sophisticated analytical, organizational and consultation skills as found in high-performing societies.

Mandate

Convergence’s mandate is to stimulate the development of these analytical, organizational and consultations skills in selected SEE countries so that financial modernization can proceed sustainably under local leadership and ownership.

Approach

From its inception, Convergence has strived to design its approach based on the following principles: a) *practical* focus (targeting regulatory changes that make a tangible difference on financial intermediation, measured via extensive use of regulatory impact assessment analysis); b) *strong implementation orientation* (success



measure is regulatory changes enacted - not studies); c) *market-friendliness* (sourcing micro-regulatory reform issues from both authorities and market participants); d) *flexible cooperation arrangements* with several technical partners; and e) *long-term sustainability* of the activities it promotes.

### Activities

To fulfill its mandate, Convergence has promoted the Special Projects Initiative (the SPI Program), to begin with in Romania. The SPI Program is delivered by the interaction of two bodies: a) a high level public-private country committee (the SPI Committee) that considers analyses of possible micro-regulatory changes prior to the initiation of official regulatory action; b) a technical secretariat (the SPI Secretariat) that helps orchestrate the analytical activities of public-private working groups, supported when necessary by local and international experts, that prepare the studies for SPI Committee consideration. Convergence supports the SPI Program in two major ways: 1) it supports the project management activities of the SPI Secretariat and pays for two of its staff as well as for the international experts; 2) it supports the deliberations of the SPI Committee through its active membership and preparation of summary opinions on the studies prepared by the SPI Secretariat, if necessary with the help of specific experts.

### Success

Convergence defines the success of the SPI Program along three dimensions: 1) its *short-term* success is measured by the number and value of regulatory changes, as measured through RIA techniques, enacted through this public-private consultation mechanism; 2) its *medium-term* success is measured by the progressive outsourcing of analytical activities within the local professional service community; 3) its *long-term success* is measured by the continuation of the SPI Program after consolidation of its medium-term success, in the institutional form that local stakeholders will want to adopt, without the need for Convergence membership of the SPI Committee.

- The value of regulatory changes enacted, measured through RIA, is a proxy for the materiality, both in volume and cost terms, of their impact on financial intermediation.
- The outsourcing of analytical activities, measured by the amount of financial resources that local public and private stakeholders will wish to invest to hire local experts for the purpose of conducting analytical studies, aims at capturing the sustainability of the SPI Secretariat as an analytical hub underpinning the SPI Program. Convergence expects that this *capacity-building mandate* could be largely accomplished over a three-year term, given strong private and public pay-offs from regulatory fine-tuning.
- The Convergence withdrawal from the SPI Committee will witness the ability of local stakeholders to initiate analytical tasks, conduct dialogue and reach satisfactory outcomes in conditions of mutual trust, transparency and professionalism equivalent to those observed in societies where financial sector modernization is a widely accepted public policy goal.

## **The Evaluation**

In this context, with the Convergence Program approaching its mid-term and additional SPI Programs being considered for roll-out, *an evaluation of the SPI Program* set-up will allow beneficiary countries, the Italian Ministry of the Economy as donor and the World Bank as program administrator to consider the effectiveness of the Convergence Program in delivering on its mandate. An evaluation is particularly relevant as contractual partnerships with beneficiary countries are being considered.

The evaluation of the SPI Program activities should be performed from the perspective of beneficiary countries – as represented primarily by both regulatory and supervisory authorities and market participants interested in financial sector modernization. The consumer point of view is part of the SPI Program's mandate but not much work has been done so far to incorporate this dimension in its activities.

The SPI Program evaluation should consider the adequacy of the SPI organization set-up, the nature of the activities undertaken and the depth of the partnerships shaped with local and international stakeholders in order to accomplish the mandate of the Program as defined above.

- The SPI Program set-up has to be congruent with the objective of making the SPI Program succeed in the longer-term.
- Its project activities have to be selected, conducted and concluded so as to secure the commitment of local stakeholders to become the full owners of the SPI Secretariat, without financial and managerial support from Convergence. In this context partnerships with local stakeholders (authorities and professionals) are key to building local ownership.
- Partnerships with international stakeholders enable the integration of local professionals into a wider professional community to facilitate exchange of expertise.

The evaluation should suggest organizational and other operational adjustments, including its present support from the Convergence Program, for the SPI Program to increase its impact and cost effectiveness, within the financial resources allocated by the Convergence Program.

Although the evaluation will focus as described above on the SPI Program, it will also include a separate short evaluation of the effectiveness of the Convergence Program set-up in support of the SPI Program.

*The Convergence Program evaluation* should be performed from the perspective of the donor and the administrator. It should shed light on two key issues:

- a) The reasonable timing for scaling-up the SPI Program, both in terms of number of projects in each country and of number of countries of activity. The aim is to create awareness of the Program potential to help build its own momentum, within available Convergence resources;
- b) Whether it is practical (and desirable) to separate the support of the SPI Secretariat from the support of the SPI Committee. It is presently under consideration to assign the responsibility for the former activities to the technical assistance arm of the IFC, while the latter activities will continue to be performed by the World Bank.

## Method

The SPI Program and Convergence evaluation will be undertaken by an eminent person (the Evaluator), possibly assisted by one or two peer reviewers. Evaluator and peer reviewers need to have recognized financial policy experience, from both an official and business angle, in South-East Europe.

The Evaluator will have access to Convergence and SPI Program material without limitations to establish an issues paper with relevant evaluation questions. The Evaluator will need to interview relevant Convergence management and staff before undertaking an external validation of the Convergence activities with local stakeholders, primarily located in Romania. The Evaluator will write up a draft evaluation that will be discussed with Convergence management and local stakeholders (and the peer reviewers). The respondents will be allowed to send written observations. The Evaluator will then prepare the final report in total independence and send it to Convergence management, Romanian stakeholders and the Italian Ministry of Economy directly.

#### Governance, Reporting and Administrative Arrangements

The Evaluator will undertake this assignment in total independence. From an administrative point of view, he will report to the Head of Convergence. His/her work contracts will be issued by the World Bank, the administrator of the Convergence program, according to its applicable guidelines.

#### Timeline

It is useful if the field visit could take place in December.

The preliminary evaluation report should be completed in January.

The final report should be completed by the end of February.

## Appendix II

### **External independent evaluation of the**

### **SPI Romania (Convergence)**

(Modernization of the Romanian financial system)

By:

Marko Skreb

Framework for interviews with stakeholders

For the mission to Bucharest, Romania, December 27-29, 2006 and interviews in  
January-February 2007

#### *Introduction:*

- a) The role of the evaluation of SPI Romania is to assess the effectiveness of Convergence and SPI Romania in its mid-term life span (which is actually partially true as SPI was established in September 2006). How efficient were activities in the past, and what are the suggestions for the future? Evaluation is done from the perspective of the beneficiary country, Romania and its stakeholders.
- b) To stakeholders. Please be frank, be critical. We need to have an objective view. Your answers are strictly confidential. There will be no attribution on answers, no quotation etc. Goal is to improve the efficiency of the program, not continue something which is either not useful or is inefficient.
- c) There will be five groups of questions: adequacy of organization, nature of activities, depth of partnership, financing and phasing out and finally your own suggestions.

#### *Questions:*

1. **Adequacy of organization of SPI Romania.** How familiar are you with SPI in general and its organizational structure? What do you think about the organization of SPI, in particular on SPI Secretariat with working groups and SPI Committee? Would it be possible to separate SPI secretariat and SPI committee organizationally and with separate financing? What are your views on SPI committee without Convergence? How do you value support from Convergence in the SPI committee? Initial organizational set-up, vision, strategic approach, selection of projects, managerial support? What possible improvements can be made there? Is the organization flexible enough now and for future changes? Once in EU do you need SPI at all? Will modernization not proceed without SPI and Convergence on its own once in EU?

2. **Nature of activities. Projects of SPI and convergence.** In how many projects are you involved or familiar with? What do you think about the selection process for projects? Did you participate? Are there others that might be more relevant? Would you prefer projects with immediate, short term impact, or longer term is fine as well? How well are SPI projects coordinated with EU membership and requirements? What is Convergence's value-added in this? How many projects and of what type (several big, a lot of small) do you think is needed for SPI to be self sustained i.e. to continue without Convergence? In other words, what is needed that the financial modernization projects in Romania continue in motion without additional external force applied to it? The emphasis should be on long term sustainability (of modernization framework).
  
3. **Depth of partnership (two levels, first Romania vs. Convergence and second private-public relations within Romania).** A) Evaluate the depth and quality of relations with Convergence program i.e. SPI Romania (both on the level of SPI Committee and SPI secretariat including working groups)? B) What is the degree of private-public partnership within Romania (banks and central bank for example)? On different levels (secretariat, committee). Has Convergence and SPI promoted dialogue with regulators? If you are a regulator, are you concerned with discussing regulation with market participants ("capture" hypothesis)? Do you see this dialogue as beneficial for both parties? Would this dialogue happen without Convergence? If Convergence would exit Romania now, how would this dialogue continue? Don't you think that EU is enough as an external partner? Is the present partnership helping in capacity building in Romania and how? Can this capacity building be improved?
  
4. **Financing of the SPI Romania and phasing out (for domestic stakeholders).** Would you be willing to finance SPI on your own actually with other participants from Romania i.e. to have it fully locally financed? When? If not, why not? How long and what should be the path of exit? Again, pay special attention to timing (final exit by Dec 2008) and scaling down (at what speed can Convergence be out and the SPI program continues to be

financed locally) and can SPI secretariat financing be separated from SPI committee? Is this practical and desirable?

5. **Your views.** How to increase the impact of the SPI Romania? How to make it more efficient? Any other suggestions on the SPI? Any other suggestion on how to improve financial sector modernization in Romania with respect to SPI?

Thank you very much for your time and support. In case you would like to add something, please do not hesitate to contact me later on.

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## Appendix III

**Summary of projects undertaken under the SPI Committee auspices**

	<b>Project</b>	<b>Objective</b>
1	Expansion of Positive Credit Information Sharing	The achievement of a broad endorsement of positive credit information sharing based on a system of market based and / or regulatory incentives.
2	Electronic Processing of Debit Instruments	A document presenting the solution for electronic processing and clearing of debit instruments acceptable to all stakeholders together with the technical and functional specifications, as well as the proposals for amending the relevant legal and regulatory framework.
3	Amendment of the anti-money laundering (AML) law	The AML law amendment proposal agreeable to all relevant stakeholders, supported by an economic assessment of the regulatory framework already in place and of the proposed changes.
4	Study on the costs of bank products and services	A document identifying the areas where the costs of bank products and services can be brought down, closer to EU member states, over the 7-year period covering the post-EU accession.
5	Loan loss provisioning in view of IFRS application	A summary document presenting a set of principles commonly agreed by stakeholders on a feasible update of the prudential requirements that would meet supervisory objectives and reflect the IFRS and Basel II standards.
6	Mortgage loan servicing database	A set of recommendations on the consensus-building, practical, and technical steps (including “governance” of the actual development and management of the database) that the banking system will need to take, to make the proposed database a reality in a useful timeframe.
7	Warrants-deposit certificates	A detailed study, outlining a set of specific recommendations for the “secondary” rules and regulations that will need to be enacted for a market in agricultural warrants-backed lending to develop (addressed to the banking industry and to the specific agencies and departments charged with the issuance of such rules).
8	Law on bank guarantees	The RBA law amendment proposal supported by a legal comparison of similar laws in other EU countries and RIA so as to facilitate the enactment of a domestic regulation on bank guarantees.



	<b>Project</b>	<b>Objective</b>
9	Loss given default database	A set of recommendations on the consensus-building, practical and technical steps that the banking system will need to take.
10	Rating Agencies Development	To submit the draft regulations prepared by the ad hoc Working Group with particular emphasis on implementation constraints and criticalities, requiring SPI Committee membership guidance and attention.
11	Methodological aspects of stress test for households and firms	A proposal for risk scenarios that would inform the stress testing exercise of households and corporate.
12	Ombudsman	A formal recommendation to the banking industry that a Banking Ombudsman is created in Romania, backed by evidence of benefits for banks and consumers in the experience of other countries.
13	Consumer education	A white paper on the benefits of financial education, including a public endorsement for a nation-wide financial literacy campaign.
14	Amendment of the law on goods safeguard, values and persons protection	A law amendment proposal supported by benchmarking with existing international practices together with a RIA highlighting lower costs and higher risks arising from the proposed regulatory changes.
15	Improving the banknotes structure for ATM use	A proposal for an improved calibration of the structure of banknotes provided by NBR to banks that would meet both the business needs of banks and the objectives of the central bank pertaining to its currency issuance function.

## Appendix IV

## Presentation for SPI Steering committee

Slide  
1&2

**External Evaluation of  
SPI Romania**

Marko Škreb  
Bucharest  
March 1, 2007

**Content:**

1. Introduction
2. SPI Organization
3. Financing of SPI
4. Nature of Activities
5. Depth of Partnership
6. Conclusions
7. Main Recommendations

Slide  
3&4

**1. Introduction**

- Why SPI and PPP?
- TOR evaluate: a) organization, b) nature of activities and c) depth of partnership all regarding sustainability and WB exit
- Evidence from interviews and documents
- Constraints: a) limited resources and b) no output (in results chain), thus a "process" and *ex-ante* risk evaluation

**2. SPI Organization**

- Mission is clear and very much needed
- Status of Committee is less clear
- Governance structure of Committee and Secretariat needs additional formalization
- Important role of Convergence (LP)
- No complaint from stakeholders
- **Risk** of fading away after WB exits (within general reform fatigue)

Slide  
5&6

**3. SPI Financing**

- Cost efficiency evaluation is not possible
- Preliminary results are fantastic
- No long term sustainable model of future financing yet (with WB exit)
- **Risks:** a) capture and/or dominance of private sector and b) non sufficient and non stable funds = negative selection

**4. Nature of Activities**

- Preparation and selection of projects is elaborate and professional
- Present projects seem fine
- Not all initiated *via* SPI
- No complaints from stakeholders
- **Risk** of more projects biased toward private, less to public sector interests

Slide  
7&8

**5. Depth of Partnership**

- SPI = new quality of professional dialogue
- Evidence: large number of persons, dialogue from the start, professional preparation (RIA) and clear framework
- **Risks:** a) fragile partnership (reputation from WB), b) "weak link" from position paper to changes in regulation and c) insufficient domestic ownership

**6. Conclusions**

- Romania needs SPI for large scale modernization of financial sector
- SPI is a modern, professional framework
- SPI has shown results and has potential
- SPI has support of stakeholders
- **Risks** needs to be addressed to ensure sustainability with local stakeholders stepping in after WB exit

Slide  
9&10

**7. Main Recommendations**

**Immediate:**

1. Increase domestic reputation and ownership of SPI by more successful projects and outreach (awareness)
2. Start a separate SPI project on long term financing model of SPI (without WB)

**7. Main Recommendations (cont.)**

**Short term (end 2007)**

3. Start a separate SPI project to optimize legal, institutional and governance structure and future leadership of SPI
4. Continue and speed up local capacity building among other by delegating more and more tasks from Convergence to local stakeholders

Slide  
11&  
12

**7. Main Recommendations (cont.)**

**Medium term (end 2008)**

5. Develop a framework for follow up (advocacy) from finished project to enacting regulatory change
6. Pay constant attention to retain the private-public balance in SPI projects (and other activities)

**Last thought!**

SPI main asset is reputation and main tools of operations are:

- professional, relevant projects and
- moral suasion (advocacy) toward regulators and legislators

## Appendix V

**Bio-data of Evaluator****MARKO SKREB****(Feb 2007)****CONTACT:**

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**CAREER DETAILS:**

- Sept 2005 – present. Central Banking Consultant, working mostly for the IMF and WB on different projects and countries, mostly on central banking issues (including Albania, Bosnia and Herzegovina, Kosovo, Montenegro, etc.). Participated on structural conditionality evaluation for the IMF in Madagascar.
- July 2004 – Sept 2005, IMF consultant, Independent Evaluation Office, IMF, Washington DC. Working on the evaluation of the Financial Sector Assessment Project (FSAP). During that time participated in a short term mission to Ukraine for the WB (on monetary policy and liquidity).
- Jan 2001 – July 2004. IMF Expert on long-term assignment. Advisor to the governor of the Central Bank of Bosnia and Herzegovina, advisor to the governor of the Bank of Albania and advisor at the Banking and Payments Authority of Kosovo. During that assignment participated in short term missions to Georgia and Russia for the IMF and the WB.
- July 2000 – Dec 2000 Chief advisor to the governor, Croatian National Bank.
- March 1996 – July 2000. Governor of the Croatian National Bank. Croatia's governor at the IMF and regularly participated at BIS Governors' meetings.
- July 1997 – Dec 2000. Associate Professor at the University of Zagreb, Faculty of Economics, Department for Macroeconomics and Economic Policy.
- Dec 1995 - March 1996. Economic advisor to the President of the Republic of Croatia.
- Nov 1992 – Dec 1995. Director of research and analysis department in the central bank.
- Dec 1981 – Nov 1992. Teaching and research at the University of Zagreb, Croatia. Fulbright fellow in 1987/1988 academic year at the University of Pittsburgh, Department of Economics.

**EDUCATION:**

March 1990	Ph.D. in Economics, University of Zagreb;
Sept 1987 - July 1988	Doctoral Student, University of Pittsburgh, Department of Economics; Pittsburgh, PA, USA (Fulbright fellow);
July 1987 - Aug 1987	Certificate from Economics Institute, Boulder, CO, USA, (Fulbright fellow);
March 1984	Master of Arts in Economics, University of Zagreb;

July 1984 – Aug 1984 Certificate from Salzburg Seminar in American  
Studies, Salzburg, Austria;  
April 1980 BA in Economics, University of Zagreb.

Foreign languages:

English (fluent), French (fluent), German (passive), Croatian (native).

**FURTHER INFORMATION:**

Personal:

Born on May 8, 1957 in Zagreb, Croatia. Married, two children (16 and 22 years of age).

Professional:

- Edited six books in English and wrote numerous articles (in books and journals).
- Participated in numerous international conferences with papers or as discussant.
- Organized six international conferences in Dubrovnik, Croatia (Croatian National Bank Annual Conference), together with Mario I. Blejer
- Member of the International Advisory Board of the Unicredit Group
- ECB Shadow Council member (from Nov 2003 to Feb 2006)

Awards and Honors:

2000 Jacques de Larosière Lecture: "The Transition process: It's All About People, Isn't it?" EBRD Ninth Annual Meeting in Riga, Latvia,  
1997 Central European Annual Awards for Excellence - Best Central Bank Governor,  
1997 Euromoney Publications - Best Eastern European Banker.