BUILDING A SUSTAINABLE COUNTRY PLATFORM FOR FINANCIAL SECTOR MODERNIZATION
SPI ROMANIA CASE STUDY

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Wouldn't it be useful to have a dynamic public-private institution in your client country that is solely devoted to the modernization of the financial sector? An institution that is capable to help execute IFC Access to Finance advisory activities on a larger scale, in the context of the World Bank's general financial sector development strategy?

In this note, I will describe an innovative country platform for financial sector advisory services that has been fully operational in Romania under the "SPI Romania" brand since September 2006 (SPI stands for Special Project Initiative; learn more at www.spi-romania.eu/index.php). **SPI Romania** resulted from work I did under the aegis of the "Convergence Program," a Southeast Europe public-private financial sector dialogue program I have been running since July 2005 out of the World Bank's Financial and Private Sector Vice Presidency. The note will also summarize the initiative's first implementation steps, and distill ten principles that can be used to design similar institutions in other countries.

Where Did the Idea Come From?

In June 2002, I happened to be invited by our World Bank colleague Michael Fuchs to launch his book "*Building Trust: Developing the Russian Financial Sector*" in a high-profile event hosted by the Central Bank of Russia. Under the crystal chandeliers of their wall-paneled large conference room was gathered a large crowd of Central Bank, Ministry of Finance, and Parliament officials next to our small World Bank delegation and the IMF Moscow Representative. At the end of my opening remarks, under the chairmanship of the Deputy Governor, the late Andrei Kozlov, I could not help but add an extemporaneous invitation to invite bankers to this debate. I remember saying, "Mr. Deputy Governor, you need to have the bankers in this room to impress on them the need, for Russia's economy, to build public trust in their activities. And you also need them around to learn from them what obstacles they face in their day-to-day life in trying to get clients to believe in the strength of the banks and the financial sector."

At the same time as I was exhorting the Russian Deputy Governor to reach out to the bankers on building trust together, I happened to examine the activity plan of the Italian Banking Association (ABI). It was a thick document of more than 200 pages, dense with project descriptions, action plans, and analytical insights. It showed that ABI was handling a pipeline of more than 500 regulatory changes and planning to "close"—that is, to have the regulatory changes enacted by Parliament or other authorities—on about 60 of them. Behind this effort ABI was mobilizing about 300 professionals plus a large number of experts. To establish a dialogue with authorities, ABI prepares position papers on regulatory economics, market structure options, operational requirements that stand out as being comprehensive and rigorous. Lastly, ABI makes itself accountable to its members by publishing an annual activity report that relates the economic value it has generated for its members (in net present value terms over a 5-year period) to its operating costs covered by its members. The latter are about 1 percent of the former!

The ABI Italy 2002 activity plan looked to me as to be an ideal micro-regulatory policy matrix that the Bank could support for market-based modernization programs for many years to come in most of our client countries. And IFC could help execute, with its staff and experts, many of the specific analytical projects. In addition, as it happens in Italy, we could have the banks fund most of the preparatory analytical work and leave the authorities (and the Bank Group) to pay only for the relatively limited final assessment and conclusion work prior to decision-making and enactment.

To broaden my understanding of the public-private approach, I started looking at how the European Commission was tackling the Single Financial Market project to build a harmonized legislative and regulatory framework for the-then 15 EU member countries. The role for the World Bank could mirror the one the European Central Bank saw for itself as catalyst for private sector modernizing initiatives. Its President stated: "*The refinement of the current regulatory framework… will be successful only if the market participants themselves are closely involved and their* *requests are carefully balanced against supervisors' needs … Among the many ways in which we contribute, the ECB will particularly concentrate on our role of catalyst for private sector initiatives.*"

Based on this EU benchmark, I called this program "Convergence" to evoke the process of economic and financial convergence with EU standards and practices of EU candidate member countries in the context of EU enlargement. The choice of the name had an immediate good reverberation as it reflected regional priorities. But the name also evoked more universal convergence between public and private interests.

"Convergence" Gets Going

While the public-private dialogue concept was becoming a routine reform tool in the World Bank Group Business Enabling Environment area,[1] making market participants stakeholders was still somewhat of a heresy in the World Bank's financial sector work. The Bank sees itself as working solely for authorities, often under confidentiality conditions such as in the case of the flagship Financial Sector Assessment Program (FSAP) [2].

Nevertheless, over two years, in 2003-4, I slowly put in place the building blocks of the program. I decided to focus my pilot test on the Southeast Europe region. This was an area where large bank foreign direct investment (FDI) flows created the largest modernization potential if the right public-private dialogue could be created. The ECB arranged for me to present the "Convergence" concept at a meeting of the Governors' Club of the Balkans, Black Sea and Central Asia region where, after my exposition, an EU Central Bank Governor encouraged his peers from the transition countries to adopt this new tool for speeding up the modernization of their financial sectors. With this strong alignment with EU practices and policy objectives and a concrete program objective to generate micro-regulatory changes, I did not have much difficulty to raise a Euro 1.5 million Trust Fund from Italy's Ministry of the Economy.

The Pilot: How Successful Projects Do Not Have Strategic Impact

In early 2005, I was joined by two early supporters of the Convergence concept, Dr. Shkelqim Cani, the former Governor of the Bank of Albania, and Mihai Bogza, the former Vice Governor of the National Bank of Romania, to start designing an operational approach to conduct analytical projects in partnership with authorities and market participants and other technical partners. We were targeting technical or micro-regulatory aspects below the Bank's operational radar screen, where a good understanding of local conditions (brought particularly from market participants) was necessary to make best use of international benchmarks. Our objective was to create interest in authorities and market participants to start collaborating based on the "demonstration" effect of a few pilot projects.

Despite successfully concluding, in collaboration with the Italian Deposit Guarantee Fund, a complex pilot project on the new financial policy of the Romanian Deposit Guarantee Fund (RDGF) with large public and private gains,[3] we realized that local stakeholders would not be able to respond to this demonstration effect.[4] They simply did not have the organizational resources and coordination abilities to make this approach their own.

A sustainable institutional framework was missing for authorities and market participants to join forces to work together beyond our "push."

The SPI Romania Plan

To put the program on track, in March 2006 we approached the National Bank of Romania, the Association of Romanian Banks, and the Ministry of Public Finance (our RDGF partners) with the concept of a comprehensive Romania Financial Sector Modernization Program. To build an identity for the people who would be mobilized for this program, we proposed that these activities be placed under the auspices of a self-styled Romania Special Projects Initiative, managed by an SPI Secretariat under the oversight of a high-level SPI Committee. SPI Romania was an embryonic organization with its own name, mandate, governance, and management arrangements.

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[1] Http://www.publicprivatedialogue.org is the portal of reference for these activities.
[2] Roger Ferguson, Vice Chairman of the Board of Governors of the Federal Reserve, argued authoritatively about the necessity of a public-private approach in "*Financial Regulation: Seeking the Middle Road*"; March 31, 2006 speech in Zurich, Switzerland.
[3] The participatory study concluded with the need to double the Fund's size and the possibility to reduce the member contribution fees by creating a partial ex-post contribution mechanism.
[4] Neither of the other public-private projects we were running (Croatia's securitization law with EBRD and KfW, and a framework to increase bank intermediation of Albanian remittances from Italy with ABI) had the immediate potential to grow into a country program.

Responsibility for project selection and review of enactment proposals is vested in the **SPI Committee**, with senior Central Bank, Ministry of Finance, Banking Association, Consumer Protection Agency (and, temporarily, Convergence Program) representation. Later, we invited the President of the National Association for Consumer Protection to join the Committee to have the consumers' view represented.

The executive capabilities are located in a two-person **SPI Secretariat**, initially funded and supported methodologically by the Convergence Program, which coordinates analytical work done by project working groups.

Hitting the Ground Running

After recruiting the two Secretariat staff (one from a local commercial bank and one from the IMF), we started preparing the program in the summer of 2006. First, we set out the broad parameters of a modernization program. We decided to have three organizing criteria: a) projects that would expand the supply of bank products and services (volume effect); b) projects that would allow banks to manage operational and financial costs (margin effect) as well as use of capital; and c) projects that would enhance consumer protection. On this basis, we invited the central bank and the banking association to give us the list of projects they wanted done. After mapping the projects into a metrics with additional dimensions such as public good and industry drivers, public-private involvement rationale, and expected "actionable" deliverable, the SPI Committee narrowed the program down to 13 projects with delivery dates spread over December, March, and June 2007.

On September 15, 2006, SPI Romania started its operations with a huge analytical agenda to deliver over a nine-month period, and only two staff in Bucharest, one regulatory economist in the World Bank Rome Office, and myself in Washington! The clock was also ticking because I had only 15 months left under the Trust Fund spending authority.

We spent the following 45 days preparing detailed terms of reference for the 13 projects. With these documents available, we set out to assemble the working groups. The SPI Committee members helped mobilize bank CEOs and central bank Directors to act as "project owners." The latter then appointed "project managers" in charge of day-to-day activities. In turn, these appointed project working group members drawing from relevant public and private sector institutions. In a matter of few weeks, we mobilized more than 110 professionals coming from 33 institutions (both public institutions and market participants), with targeted support from international consultants (including IFC experts). A big innovation: local players, who were used to having foreign consultants do the technical, reform advocacy work, were holding the pen this time!

First Results Are Starting to Trickle In

By December, we ran a large-scale Regulatory Impact Assessment of the program to determine the financial impact on the banking industry of the eventual successful conclusion of the various projects underway. The amounts were significant: In the first year of full impact, we estimated that bank lending would increase by almost $300 million, the banking system cost base could decrease by $100 million, and the equity relief would amount to a similar amount. Big value was on the table if the regulatory changes could be enacted! These numbers dwarfed the $500,000 operating costs of the SPI Secretariat.

By April 2007, SPI Romania could claim five successes, with either legislative action initiated in the Cabinet by the Ministry of Finance or self-regulatory decisions endorsed by the Association of Romanian Banks, on key infrastructural improvements such as payment system, credit information (with IFC help), and consumer protection instruments. In most of these cases the SPI Secretariat, with Convergence support, has tabled critical compromise proposals that became acceptable to both authorities and market participants, thus paving the way for unanimous working group endorsement of project proposals. Including projects to be completed by July 2007, the program will have achieved about 80 percent of its total expected financial impact mentioned earlier.

New Horizons Are Opening Up

Recognizing SPI Romania's emerging public-private consensus-building capabilities, the Romanian authorities invited it to lead the Romanian consultations on the European Commission Green Paper on Retail Financial Services and prepare a submission covering the spectrum of local opinions for transmission to Brussels. This process unveiled a range of retail banking issues that will form the basis for the SPI 2008 Program.

Starting in 2008, local stakeholders will be financing 100 percent of its operating costs (about $500,000/year), including the cost of World Bank residual management support. SPI Romania will be incorporated as a not-for-profit institution, with the single mandate of promoting the modernization of the financial sector.

The Convergence program aims to replicate the SPI experience in neighboring countries. The next target country is Serbia, where IFC has its regional PEP-SEE base. This co-habitation, which will allow close coordination between SPI and IFC advisory activities, is an important step in making IFC appreciate the impact of this "country platform" on its access to finance advisory service strategy.

Closing Tips: How to Have Local Stakeholders Build a Country Financial Sector Modernization Platform?

1. With a list of missing products and practices that would make the financial sector more effective, approach Central Bank Governor or Deputy, the most senior Ministry of Finance official in charge of financial sector policy, and the Chairman of the Bank Association to discuss how better to coordinate efforts for market modernization. The senior authority for consumer protection should also be contacted.

2. Explain that they would decide unanimously the issues to study together. They should keep prudential and monetary policy issues off the list. The World Bank Group (WBG) at the beginning would act an honest broker in this project selection process. Download the SPI Committee Operating Guidelines from the SPI Romania Web site.

3. Make it clear to stakeholders that this process will be worth undertaking only if each of them throws its own commitment to a participatory approach and if the authorities will pay extra attention to the prompt enactment of solutions coming from the public-private working groups.

4. Clarify up front that the analytical work will need to be done by local working groups comprising both authorities and market participants, with international consultants called in only to the extent necessary.

5. Add that the WBG will help the process by building a small local secretariat that will support the analytical activities of the working group—and paying for it for a limited time (e.g., 18 months).

6. Once they agree on SPI Committee Operating Guidelines, help them hire the SPI Secretariat members. They should be low-key individuals with strong expertise and analytical skills.

7. Build a large annual program – you need to reach critical scale at take-off.

8. Prepare a Web site to give full visibility to the program.

9. Assign one of your most dynamic and analytically gifted staff members to support the SPI Secretariat half-time for the first year.

10. Ensure that the program is run so that local stakeholders will want to pay for it after the initial WBG incubation. Focus on results and be thrifty with the budget!

If all goes well, you will be rewarded to see local authorities and bankers working hard to implement their ideas, with your technical and managerial support in the background.

About the Author

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"Needless to say, I myself have a public-private professional background! After starting my career in the private sector (JP Morgan, Boston Consulting Group and as Head of an Italian merchant bank), I joined IFC to do financial modernization work in Africa before being appointed Assistant to President Wolfensohn, where I learned the "big picture". In recent years I have been involved in financial sector development policy issues at the World Bank. With the "Convergence" approach I am able to bridge my diverse experience."