

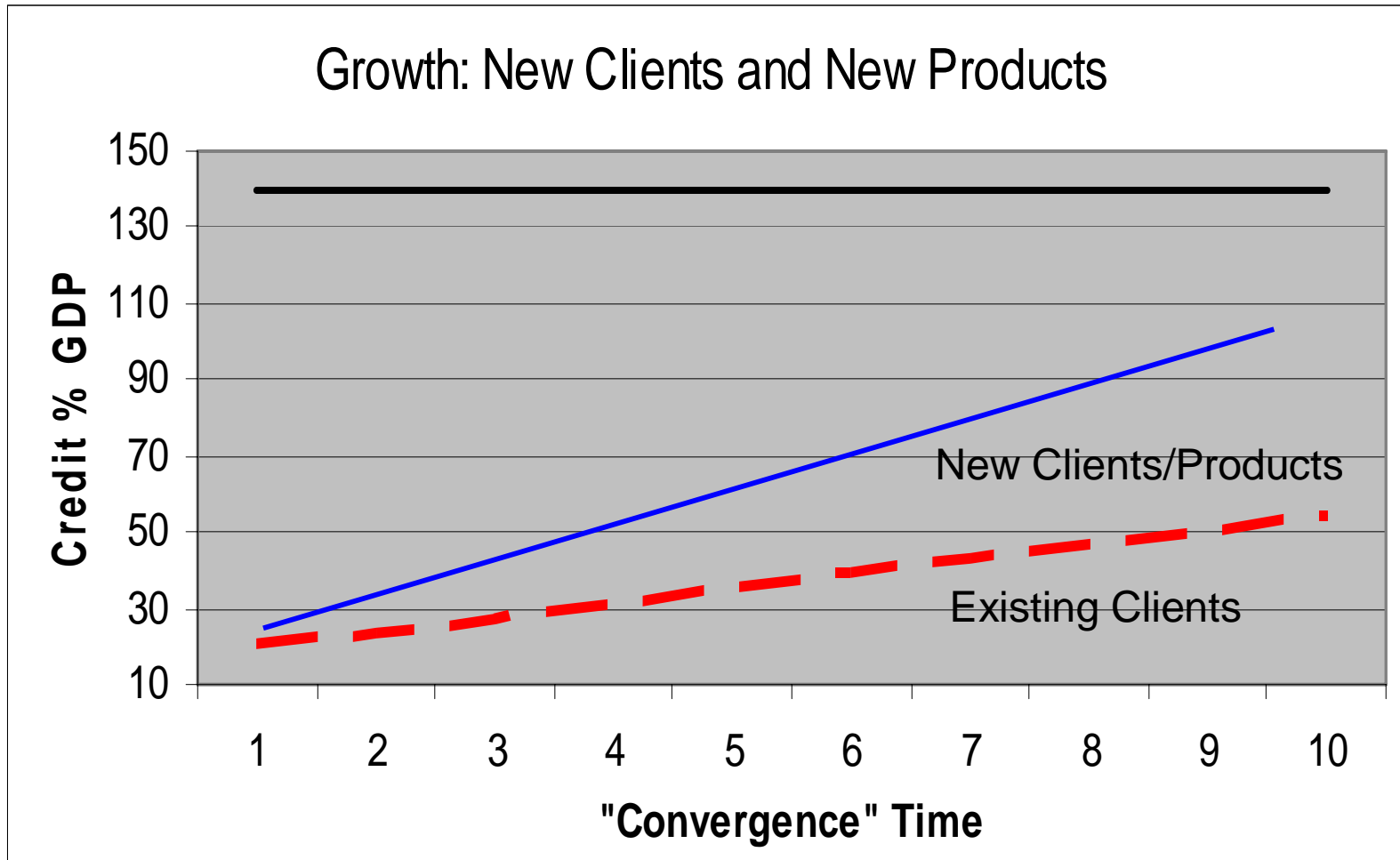


Financial Sector Development:

Why & How To Build a Public-Private Partnership?

Luigi Passamonti
The World Bank, *Convergence* Program
Armenia: Financial Sector Development
– Directions and Challenges
Yerevan, Armenia
May 29, 2005

Does Credit Deepening Happen “By Itself”?



A Useful Benchmark: EU Single Financial Market Development

Vision

“The EU has no divine right to the benefits of an integrated financial market. It has to capture those benefits. The primary beneficiaries will be European SMEs. All actors, governments, regulators, market participants and consumers will need to adapt their positions in order to move forward”.

– *Alexandre Lamfalussy*

Method

“Consult, beforehand, in an open, transparent and systematic way with market participants and end-users (issuers and consumers). Where necessary, open hearings should be held. A summary of the consultation process undertaken should be made available when the final proposal is made”.

– *The Lamfalussy Wise Men Report*

Progressive Authorities Understand Market Forces Well

- “It is crucial to be aware that market-led progress does require co-operation among economic (public and private) agents. The driver of co-operation should be, as much as possible, moved by the private sector, i.e. by an enlightened perception of the private interest. [...] The necessary co-operation among private market participants does not materialize unless public authorities play an important role in promoting it”.

Tommaso Padoa-Schioppa, Executive Board Member, European Central Bank

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

Sir Edward George, Governor, Bank of England

Progressive Bankers Are Learning To Talk “Policy”

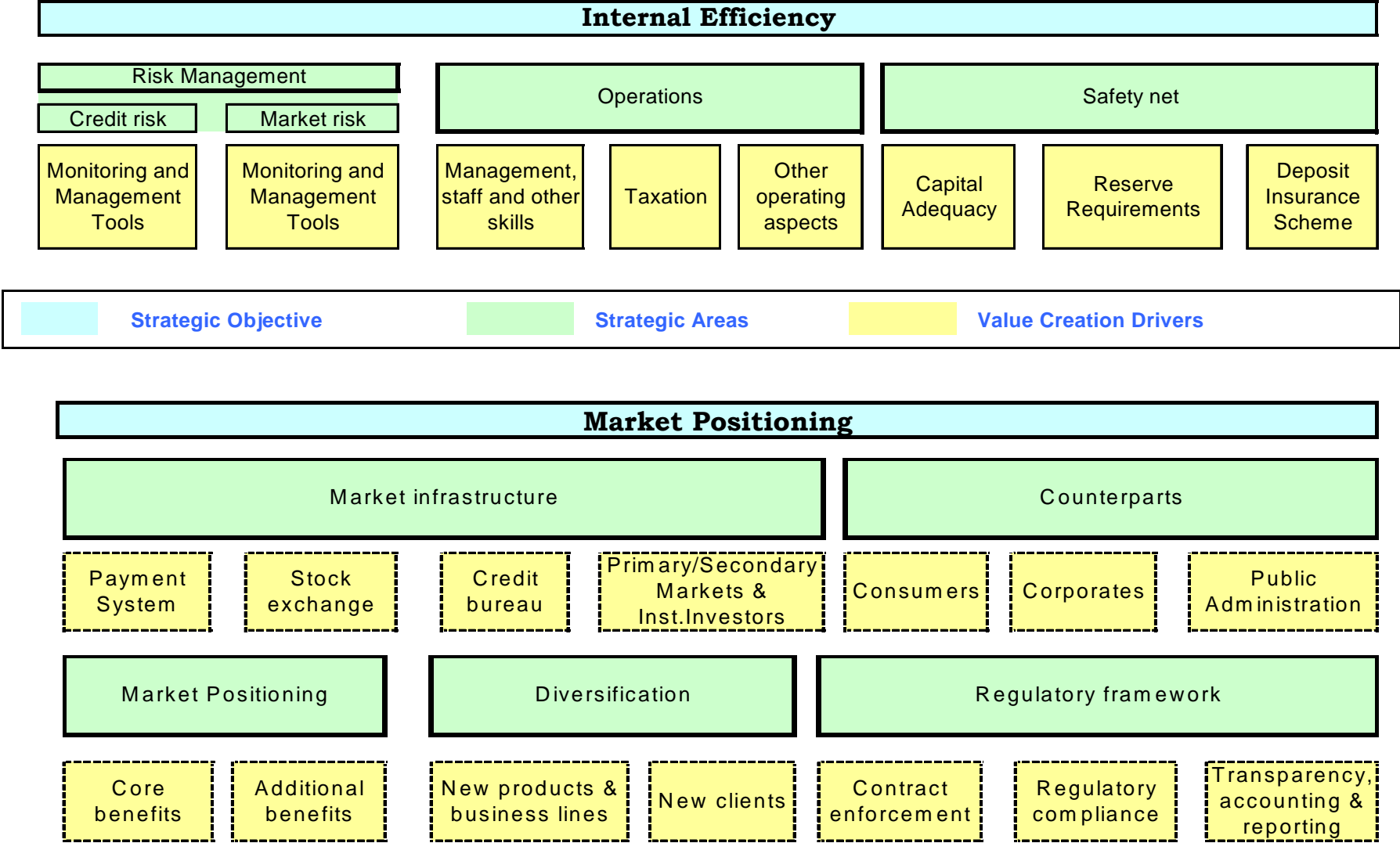
- The traditional mission of “representation” of the interests of the banking industry, focused on responding to public actions, is inadequate to promoting an enabling regulatory environment in support of new business strategies.
- Rapid changes in financial services make it now possible for market participants to pursue a more ambitious mission:
 - To become ACTIVE players in:
 - helping shape the definition and application of rules;
 - producing solutions to enhance the system’s competitiveness and synergies.

Financial Sector Efficiency Has Several Facets

- Not only “usual” prudential requirements
 - Reserve requirements, capital adequacy,...
- Many other issues of public interest
 - General Market Infrastructure
 - Inter-bank, payment & settlement systems, credit bureau
 - Roll-out of New Products
 - Specialized finance, securities based
 - Contract Enforcement and Taxation

...The Devil Is In The Detail...

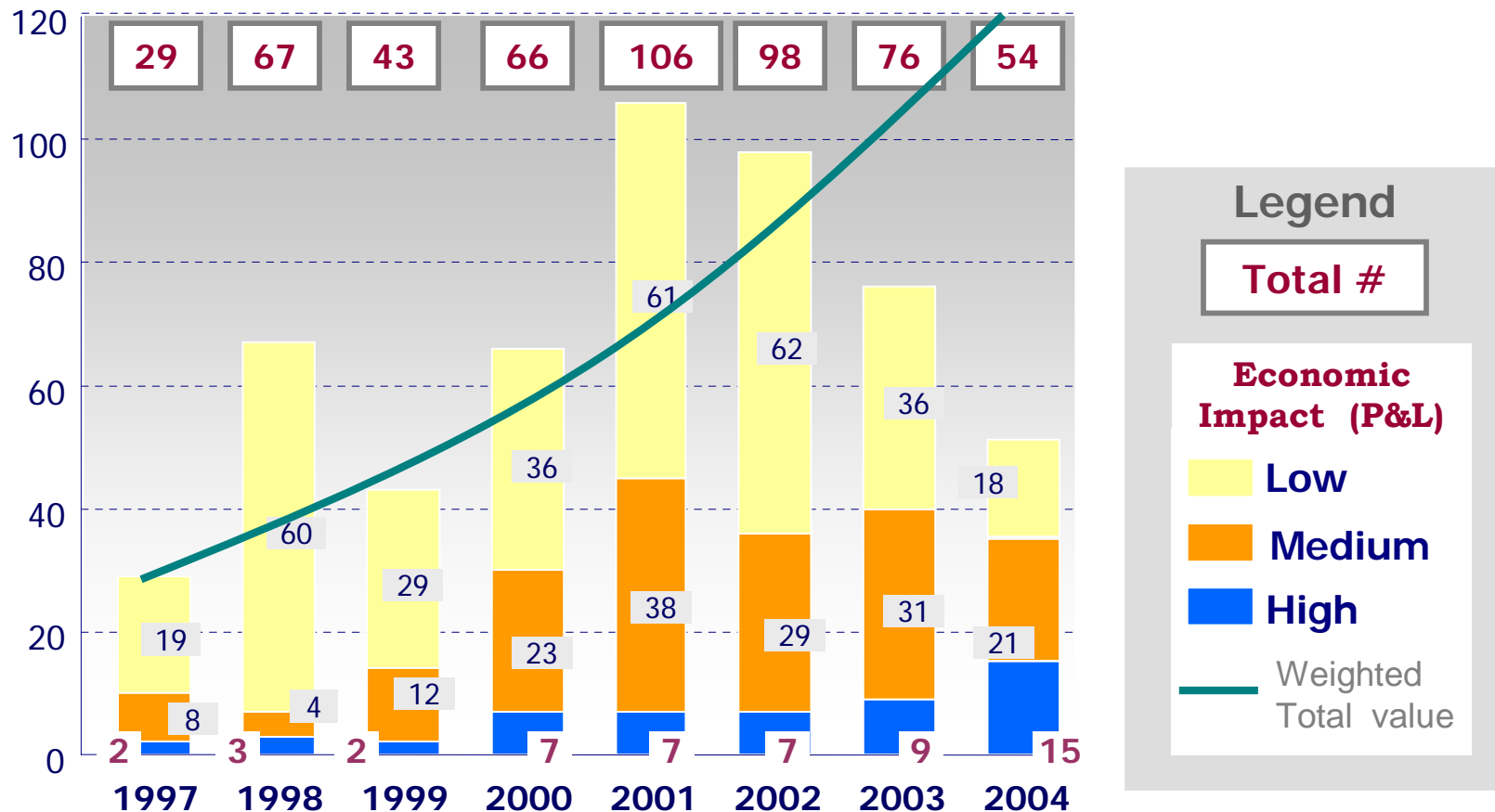
Many Value Creation Ideas For Banks



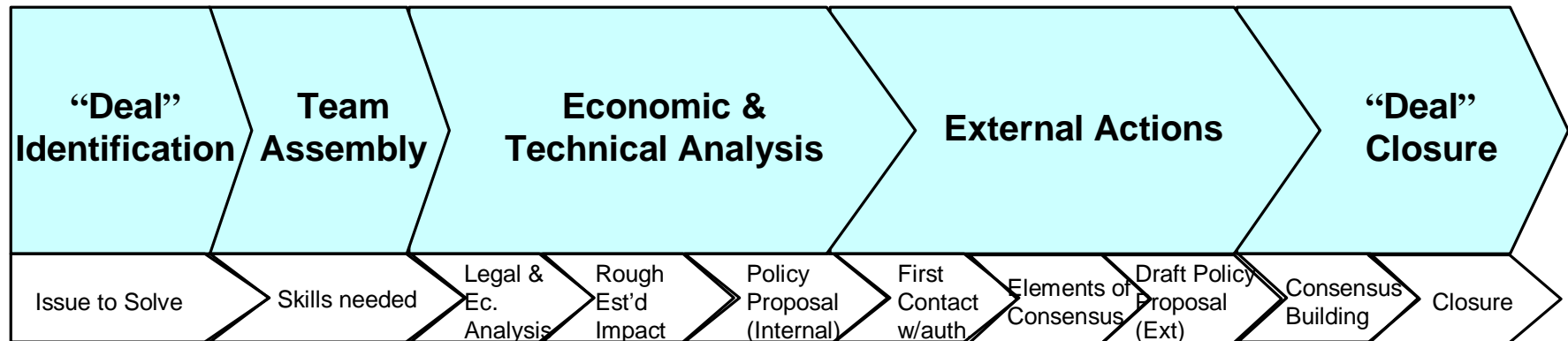
Source: ABI

Constant Regulatory Changes ...Even In Advanced Markets

The ABI Example: Regulatory Changes Successfully Completed in Italy 1997-2004



To Close A Regulatory “Deal”: Strong Analytical and Consensus-Building Capabilities Are Needed

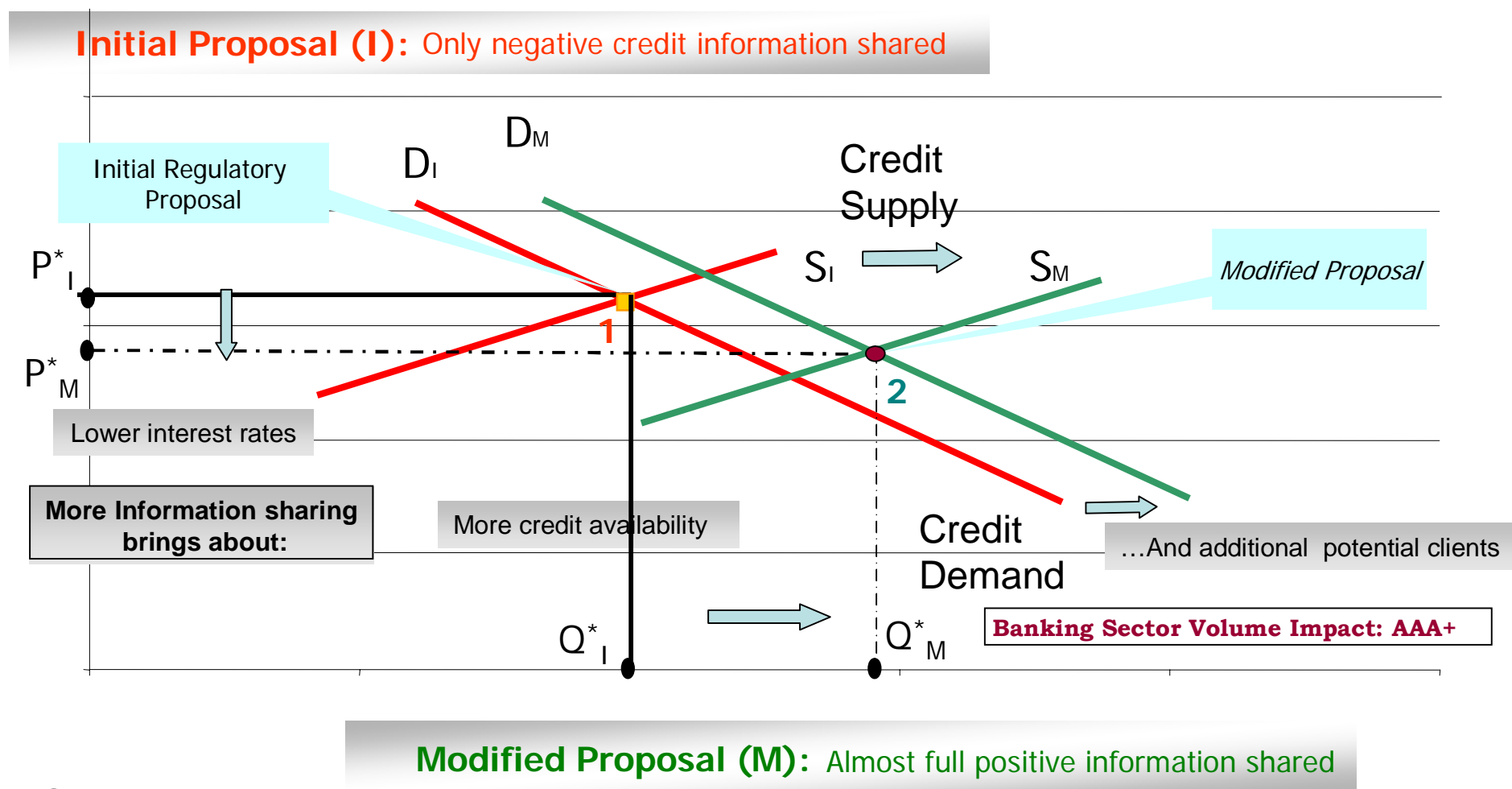


Key Instrument:

Regulatory Impact Assessment is a **decision tool** to:

- (i) systematically and consistently examining selected potential impacts arising from government action and of
- (ii) communicating the information to decision-makers

How Analysis Can Shape Policy: Italian Code of Conduct for Private Credit Registries



Source: ABI

How Can Banks Engage With Authorities?

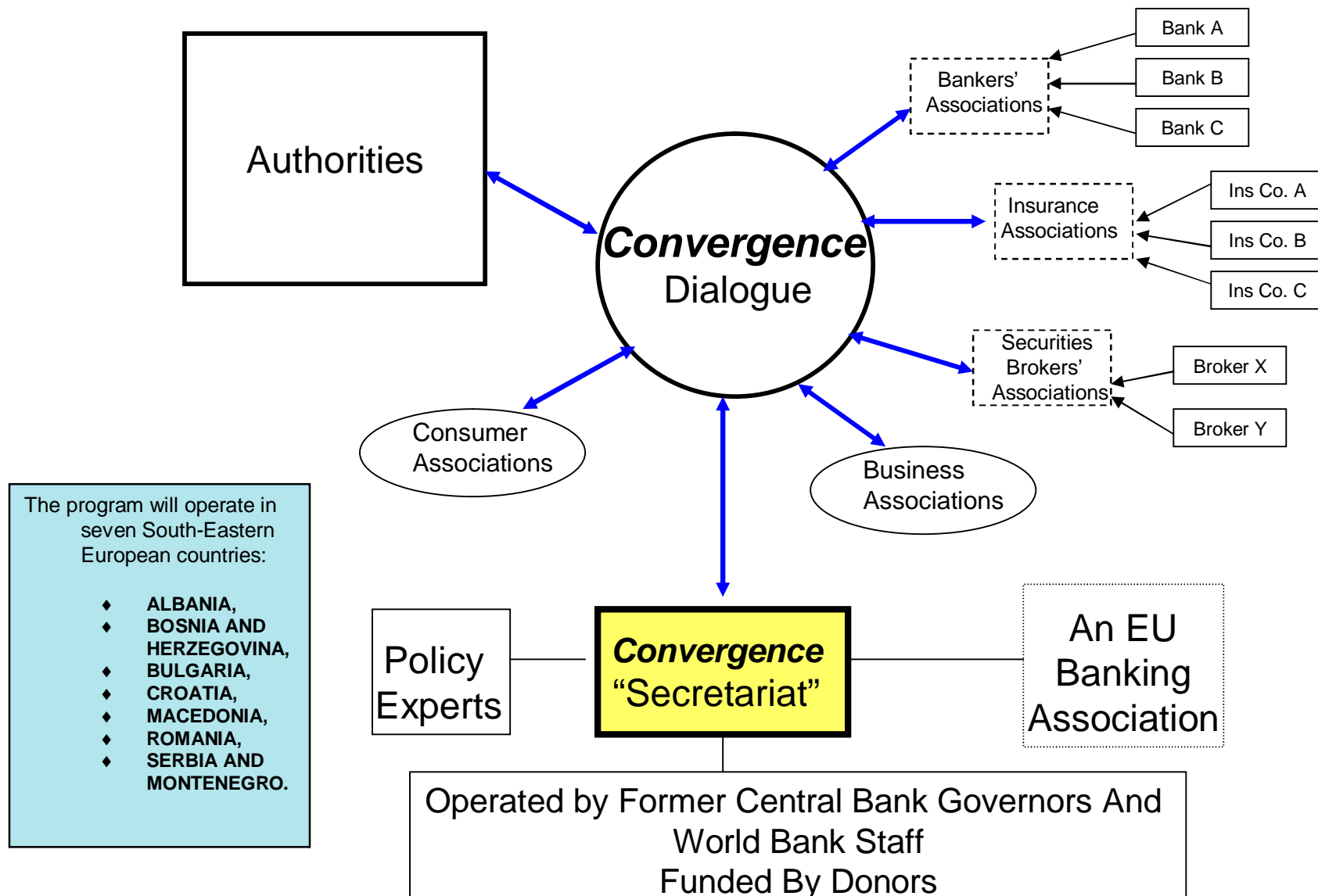
The Do's

- To understand their problems
- To act responsibly
- To speak their language
- To design win-win solutions
- To convince them of benefits of an efficient financial sector

The Don'ts

- Do not bring up (IMF) financial stability issues
- Do not show you are driven by profits alone
- Do not require quick answers on complex issues
- Do not confront them in public

Convergence A New World Bank Tool



How Can *Convergence* Help Banks?

1. Engaging with Authorities
2. Gathering Information
3. Quantifying & Assessing Information
4. Supporting Decision-Making

1. Engaging With Authorities

Convergence will convince authorities to listen to problems banks are facing

- Not a foregone conclusion in several countries
- WB, other IFI partners, senior management team credibility should help

Convergence will operate on the basis of a mandate from authorities

- Their continued commitment is key to exercise

2. Gathering Information

- *Convergence* will help banks come up with list of regulatory obstacles/opportunities
 - Not limited to 3-4 (bad for negotiations)
 - Possibly 40-50/country (to access WB back-up authority)
 - Issues where supervisory authorities are neutral, if not benevolent
 - Opportunities to build efficient industry platforms
 - How?
 - Over a 6/12-month period
 - ABI's database will help
 - WB logistical support
 - First ideas
 - Calibrating deposit insurance contributions
 - Broadening credit bureaus activities
 - Streamlining cross-border supervision issues

3. Quantifying & Assessing Information

- *Convergence* will quantify value to banking system of successful resolution of regulatory obstacles
 - Clear financial target is a good management discipline (e.g., ABI)
 - Authorities can see impact on financial market size and economic growth
- *Convergence* will prepare proposals for regulatory changes
 - In a language understood by authorities

4. Supporting Decision-Making

- *Convergence* will help authorities understand pros and cons of proposed solutions
 - “Honest broker” role is key to preserving long-term credibility and influence
 - Market views will be represented throughout
- Hopefully, authorities will listen
 - *Convergence*’s credibility: IFI origin, management team and strength of market realities

Conclusion

- Development of sound financial activities requires a partnership between authorities and market participants
- Market participants in transition countries are not well organized to capture this opportunity
 - Yet, an investment in a “stronger voice” will have high returns overtime
- A *Convergence* tool can help a local banking association take up this challenge
 - Role for a local think-tank to prepare sound and responsible proposals for the authorities