FINANCIAL SECTOR ADVISORY CENTER
Vienna, Austria

Advisory Services for Financial Sector Stability and Development
Economic growth is critical to ending extreme poverty and boosting shared prosperity. Growing economies create jobs, generate income, produce social benefits and attract investments. To function optimally, economies and markets need strong and resilient banking systems that are well-regulated and well-supervised. Such systems contribute to domestic and international financial stability, reducing the risk and severity of financial crisis and allowing capital and markets to develop and flourish.

National financial sector regulatory and supervisory authorities should design and implement the essential components that build a strong foundation for well-functioning and trusted banking systems. These components include: sound macro- and micro-prudential regulation; good governance; intrusive but effective supervisory frameworks; well-articulated and tested contingency planning and crisis management arrangements; and sound consumer protection and financial literacy measures.

By helping client countries to build strong banking systems and enhance financial stability, the Vienna Financial Sector Advisory Center (FinSAC) promotes and contributes to sustainable and equitable private sector-led growth. Our ultimate aim is to foster institutional development, reduce the frequency with which financial crises occur, and minimize the adverse effects when they do occur. We support the implementation of internationally agreed regulatory reforms, such as Basel III, and policy measures for Systemically Important Financial Institutions (SIFIs), but we go beyond the international standards, working with individual countries to identify issues and develop solutions tailored to their specific needs.
WHY FinSAC IS NEEDED

In the 1990s, facing mature and often saturated home markets, Western European banks entered Emerging Europe on a large scale, chasing growth potential and more attractive financial yields. Bank subsidiaries’ business models were characterized by high dependence on parent funding and high loan to deposit ratios. Host countries benefited from rapid credit growth and financial deepening, while international banks enjoyed high rates of return on their foreign investments.

The global financial crisis put this cross-border banking model to the test. Severe external shocks and contagion resulted in a dramatic contraction of real output and raised unemployment in the region. Corporate bankruptcy rates rose fast and households struggled to service their loans, often denominated in foreign currencies. This quickly translated into unprecedented increases in non-performing loans on bank’s balance sheets and led to severe and often prolonged real credit contraction. The resulting losses eroded parent banks’ consolidated solvency ratios and forced them to seek additional capital.

Western governments and central banks began supporting banks with guarantees, capital and liquidity injections. This eased concerns in home markets, but raised fears of possible rapid and disorderly unwinding of their cross-border financial arrangements and an “uncoordinated rush to the gate” in the region. In response to the crisis national regulators, international financial institutions and global banks launched the Vienna Initiative. This helped ensure the continued commitment to their subsidiaries and to guarantee macroeconomic stability in Emerging Europe. This prevented any large-scale, uncoordinated withdrawal of banks from the region, and deleveraging has since corrected previous excesses.

The World Bank played a key role in the success of the Vienna Initiative and, following the crisis, is well placed to assist client countries build stronger and more resilient banking systems against the background of a complex, fast-paced and wide-ranging regulatory reform agenda.

Comprehensive regulatory and policy reforms have been developed by standard setters, international policy coordination bodies (including the Basel Committee, the G-20 and the Financial Stability Board) and national governments to make banking institutions more resilient and ensure national authorities are equipped to reduce the probability and impact of bank failures. These include higher quality and quantity of capital, the adoption of macro prudential policies and buffers, new minimum global bank liquidity standards, as well as strengthened cross-border crisis management and bank recovery and resolution measures. The EU has broadly embedded many of these reforms in its legal and regulatory framework and has responded to its own additional challenges with new regulatory and structural initiatives, including, among others, the Single Supervisory Mechanism and a new Bank Recovery and Resolution Directive.
A core FinSAC team of specialized staff with key relevant skills and expertise - including in economics, finance, law, supervision and regulation, accountancy, and risk management - was established in 2011 in response to the global financial crisis.

Based in Vienna, with support from the Austrian Federal Ministry of Finance, FinSAC is in close proximity to its client base across Europe and the Central Asia region (ECA). FinSAC’s goal is aligned with the World Bank’s mission of ending extreme poverty and boosting shared prosperity. The team is supported by, and works closely with, staff from the World Bank’s headquarters and international experts.

FinSAC offers a wide range of analytical and advisory services to the authorities of client countries in the following four areas: financial stability and macro-prudential frameworks, micro-prudential regulatory and supervisory frameworks, bank recovery and resolution, and consumer protection and financial literacy.

As a niche player, FinSAC is uniquely positioned to assist client countries in dealing with some of the legacy issues from the crisis - particularly the resolution of non-performing loans and fragmented crisis management frameworks, and the implementation of new regulatory and supervisory initiatives at the international and regional level. FinSAC’s agenda is complex. There is an urgent need to restore credit growth and clean up banks’ balance sheets. There are numerous Basel and EU regulations and initiatives (CRDIV/CRR, cooperation with the SSM, AQR, BRR Directive, Banking Union) to be implemented. We work to put these into practice, aligning them with country-specific institutional development needs and constraints. The new regulatory agenda is being implemented against a backdrop of diminishing bank profitability and higher funding costs, particularly if monetary policy tightens. FinSAC also contributes more broadly to the institutional development of supervisory agencies, the development of national safety nets and advances in consumer protection and financial literacy of the population.

**Where we work**

FinSAC activities have been implemented in eligible new EU members and emerging European client countries, starting with EU candidate countries at an early stage and now gradually expanding our coverage. The beneficiary countries are broken into four country groups according to geography and priority.
We provide independent, confidential and tailored technical assistance to eligible countries. We offer global knowledge such as our analytical reports on important banking regulatory and supervisory issues. We use our convening ability to organize and host knowledge dissemination events, such as conferences, seminars and workshops. We engage with our network to help develop and disseminate good practices that can enrich regional policy debates and cross-fertilize reforms.

**Identifying issues**

FinSAC identifies issues and problems in national financial sectors, at the request of national authorities, and recommends tailored solutions. Financial crisis simulation exercises have, for example, been used in a number of countries to test existing crisis management arrangements. We also help implement World Bank/IMF Financial Sector Assessment Program (FSAPs) recommendations and participate in the Vienna Initiative.

**Providing technical assistance**

FinSAC’s own or third-party in-depth diagnostics form the basis for expert technical advice and implementation support. This includes supporting the development of legislative and regulatory frameworks; encouraging institutional strengthening; and building the capacity of local experts through our targeted technical assistance projects.

**Sharing knowledge**

We promote the dissemination of knowledge and good practices, and the sharing of expertise among client countries in many ways. Regular FinSAC conferences convene central bank governors, deputy governors, directors of supervision departments and other senior policymakers to analyze new and existing regulations and practices and maintain ongoing commitment at the highest levels of government to building stable and resilient banking sectors. We bring central banks, prudential supervisors, resolution authorities and standard-setters from around the region together to share experience and share good practices.

We cooperate closely with our global contacts and cultivate our extensive international, regional, and bilateral partnerships to benefit our client countries. We promote the application of international benchmarks and standards with the support of global and regional organizations such as the Basel Committee, the Financial Stability Board, the Financial Stability Institute, the European Banking Authority and the European Central Bank. We engage with donors to secure funding to support our programs and client countries’ efforts. We develop and build enduring contacts in all client countries. FinSAC also assists in the development and implementation of policy conditionality embedded in World Bank policy loans.

**Building strong regulatory and supervisory environments**

FinSAC maintains momentum in client countries at the national level through bilateral meetings, in country engagements (often in partnership with the World Bank country programs), and technical advice on specific issues. We engage with all levels of government and industry to reinforce the importance of financial stability and strong banking sectors. We convene thematic high-level events and hold regular Senior Officials Workshops for those in charge of financial stability, recovery and resolution, as well as banking regulation and supervision in our partner countries.

We assist newer EU member states and EU candidate countries correctly implement EU requirements in the areas of micro prudential banking regulation and supervision (CRD IV/ CRR), recovery and resolution (BRRD), macro-prudential frameworks, crisis preparedness and contingency planning as well as advancing consumer protection and financial literacy. We also advise countries seeking to join the EU on harmonizing national laws and
regulations to meet EU requirements. FinSAC offer input to the process of drafting and implementing new banking sector laws and regulations, and updating institutional frameworks.

**Building institutional capacity**

We engage with central banks, supervisory authorities and other regulators to raise awareness of the importance of strong regulatory and supervisory environments and encourage reform when needed. We provide tailored policy advice on the broad range of issues falling under our four strategic pillars and advise client countries on the adoption of EU legislation and regulations and other international standards. We help address knowledge gaps by hosting workshops on regulatory updates and specific technical issues.
Develop institutional and analytical capacities to monitor and manage systemic risk, with an institutional culture of regular systemic risk assessments, stress tests, and macro-prudential supervisory response. Assist in testing and developing existing crisis management capabilities through tailor-made financial crisis simulation exercises.

Upgrade banking sector legislation and regulatory standards. This includes implementing BASEL III or aligning regulations to the EU Capital Requirements Directive (CRD IV/ CRR); establishing robust micro-prudential measures, including effective home-host supervision; improved interaction between accounting frameworks and prudential supervision; addressing nonperforming loans (NPLs) work-outs; and developing a more effective supervisory architecture.

Strengthen crisis management frameworks as well as bank recovery and resolution frameworks. This includes enforcement; corrective action plans; recovery and resolution plans; incorporating modern tools to deal with struggling institutions (such as bridge bank, purchase and assumption agreements, “bad bank”/asset segregation and bail-in tools); enhancing deposit insurance schemes; strengthening emergency liquidity assistance/ lender of last resort frameworks; and, more broadly, enhancing safety nets.

Improve market conduct regimes for financial institutions. This is achieved through the development of consumer protection and financial literacy frameworks and strengthening of corporate governance, truth in lending practices, transparency and accounting standards.
FinSAC delivers results

Since its inception, FinSAC has been working towards becoming a recognized center of excellence for financial sector reform advice and implementation assistance in ECA countries.

FinSAC’s engagement is client-driven to ensure successful implementation of proposed reforms. Our dedicated technical unit in Vienna has successfully established strong links with client institutions such as Central Banks, Financial Supervisors, and Ministries of Finance and other high level policy makers in the region.

We have delivered several major regional conferences and seminars – including on non-performing loan (NPL) resolution in Podgorica; on consumer protection and financial literacy in Sofia; on deposit insurance in Warsaw; and on credit risk and IFRS provisioning in Vienna.

Client countries have found our Crisis Simulation Exercises (CSE), which can be followed up with technical assistance in the regulation/resolution of distressed banks, very informative and useful. Early CSE participants were Montenegro, Moldova, Croatia and Romania and the program is ongoing with other countries in the region.

We have supported several countries in developing a strategy to reduce non-performing loan ratios and reverse the contraction of credit. We have also supported countries in reinforcing their bank recovery and resolution frameworks, including Croatia and Serbia.

Other examples of successfully delivered projects include assisting the Central Bank of Moldova to improve its capabilities in liquidity stress testing, crisis-preparedness and bank restructuring; and supporting the National Bank of Georgia with the prudential implications of IFRS implementation and strengthening. Active programs include consumer protection and financial literacy in Kosovo, and bank recovery and NPL corporate recovery mapping in Albania. A new Working Paper Series analysing key bank regulatory and supervisory issues has been launched.

FEEDBACK FROM CLIENTS

MONTENEGRO

It was our pleasure to have the opportunity to work with the World Bank team on this project. The exercise was very beneficial and insightful and has improved our knowledge and understanding of the crisis management arrangements. It will also help the Central Bank of Montenegro to enhance its practical tools for managing potential systemic distress in timely and effective manner. To that end, we sincerely appreciate the continued assistance and support the World Bank has been extending to our institution.

— Milojica Đakić
Governor of the Central Bank of Montenegro
MOLDOVA

On behalf of the National Bank of Moldova, I would like to express my gratitude for the support of the World Bank Vienna Financial Sector Advisory Centre for conducting a Crisis Simulation Exercise (CSE). The CSE has revealed several weaknesses within our crisis preparedness mechanism, thus allowing us to improve and make it more efficient. This might prove invaluable when dealing with a real crisis situation. It was an useful experience and we intend to conduct CSE in the future on a regular basis.

— Dorin Drăgutanu
Governor of National Bank of Moldova

ROMANIA

Romania benefited from the technical support provided by the experts of the World Bank in the context of a Crisis Simulation Exercise. The scope of the CSE was to test the adequacy of the existing legislative framework, including policies and procedures applicable in cases where specific events cause distress in the financial sector. In conclusion, the exercise was regarded as a valuable tool in the context of the continuous efforts by the Romanian authorities to accommodate the crisis management framework to the new financial landscape that has emerged as a consequence of the recent global financial crisis.

— Elena Georgescu
Deputy Director of National Bank of Romania

CROATIA

World bank experts organized in cooperation with the Croatian national bank a one day crisis simulation. The simulation was technically well-prepared and fully customized to the Croatian environment and circumstances. As the CSE also involved other institutions responsible for handling financial crisis, it proved to be a useful exercise for multi-institutional cooperation. Findings of the exercise were useful for further development of regulation and supervisory practices.

— Damir Odak
Vice-governor of National Bank of Croatia

ALBANIA

FinSAC has been a valuable partner to the Bank of Albania in advancing the regulatory reform agenda in bank recovery planning providing a high level of technical expertise and practical implementation experience. With the significant support of FinSAC, the Bank of Albania is the first authority in the region to develop a regulatory framework for the preparation and development of bank recovery plans for systemic banks based on international and European standards. This assistance will help strengthen the resilience of the Albanian domestic banking system.

— Elisabeta Gjoni
First Deputy Governor of the Bank of Albania