

**USAID PARTNERS FOR FINANCIAL STABILITY PROGRAM
Annual Report**

CONTRACTOR: East West Management Institute

COOPERATIVE AGREEMENT #: PER-A-00-00-00003-00

TASK TITLE: Partners for Financial Stability Program

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REPORTING PERIOD: January 1, 2000- December 31, 2000

DATE: March 12, 2001

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INTRODUCTION

On December 22, 1999, EWMI entered into a three-year cooperative agreement with the U.S. Agency for International Development (“USAID”) to fulfill the regional component of the Partners for Financial Stability (“PFS”) program. The PFS program is one of the first significant post-presence activities in USAID graduated countries in Central and Eastern Europe (“CEE”). These countries are the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia. The purpose of the PFS program is to fill the gaps in the institutional development of the financial sectors of the graduated CEE countries through regional integration and the practical application of lessons learned in neighboring countries.

The PFS program recognizes the importance of having a means to provide ongoing limited and discrete assistance in the financial sector (covering accounting, auditing, banking, bank supervision, capital markets, insurance and pension) in the CEE countries. This assistance also supports intra-regional initiatives among the CEE graduated countries to address shared financial sector issues. An additional objective of the PFS program is to facilitate the sharing of the experiences of the CEE countries in the area of financial sector development with the South-Eastern European (“SEE”) countries (Albania, Bulgaria, Romania and the former Yugoslavian countries). Such “North to South” technical assistance will provide CEE experts on a short-term advisory basis to the SEE countries to enable them to benefit from the CEE experience in financial sector reform. There are other PFS partners, such as Financial Services Volunteer Corps (FSVC); the U.S. Treasury Department; and the U.S. Securities and Exchange Commission (US SEC)). These organizations were selected by USAID to provide bilateral rather than regional assistance in the post-presence countries.

Below is a summary of our deliverables during the first year of the EWMI/USAID PFS cooperative agreement.

PFS Mission

EWMI's ultimate goal is to help support, establish, and leave behind organizations that can work together and serve as advocates for change without any assistance from USAID and other donors. EWMI's objective is to facilitate the exchange of information among organizations and work towards ensuring that at the end of the three-year PFS project our assistance in financial sector reform in the CEE graduates is no longer needed.

An important aspect of PFS is to assist relevant institutions in the CEE graduated countries in meeting international standards in areas such as accounting, actuarial analysis, auditing, banking (consumer protection, credit rating, risk management), disclosure of financial and non-financial information, pension plans and professional ethics. One way to encourage CEE financial institution policy and decision-makers to adopt international standards is to create and strengthen regional linkages and organizations. These regional organizations can share lessons learned and exchange information within the region and affiliate with international organizations.

EWMI jointly funds this program with USAID on a 50-50 cost sharing basis and seeks to leverage the funds available for PFS activities with parallel and co-financing

arrangements with other donors, governments in the region, and matching contributions from sub-grantees. PFS is a partnership program and therefore not like other past or current technical USAID-funded assistance programs. Partners will be expected to partially bear the cost of PFS activities.

This project contemplates partnering not just with USAID but also with other PFS partners who are involved in financial sector reform. In the past year, EWMI has collaborated closely with USAID and the other partners implementing the bi-lateral component of the PFS program; Financial Services Volunteer Corps (FSVC); the U.S. Treasury Department; and the U.S. Securities and Exchange Commission (US SEC)).

Information sharing on financial sector topics:

During the period under review, we received inquiries from numerous CEE institutions regarding financial sector contacts in other CEE countries. This is one concrete demonstration of how PFS serves its mandate: by acting as an information clearinghouse and fostering cooperation among similar financial sector organizations that previously worked in isolation from like-minded institutions in the region. The following are examples of the types of organizations we have worked with over the past year in various activities to ensure information sharing and further cooperation on topical areas of interest:

The Organization for Economic and Cooperation and Development (OECD), Paris; Charles University, Prague; the Polish Banking Association, Warsaw; the Polish Securities and Exchange Commission; the Warsaw Stock Exchange, Warsaw; the Polish Association of Brokers and Investment Advisors, Warsaw; the Bratislava Stock Exchange, Bratislava; the Slovak Broker/Dealer Association, Bratislava; the Latvian Securities Market Commission, Riga; the Riga Stock Exchange, Riga; the Banking Association of Central and Eastern Europe (BACEE), Budapest, and the Economic Policy Institute, Sofia.

Coordination with PFS Partners

Throughout the reporting period, the PFS team engaged in ongoing coordination with the other PFS partners through a variety of methods. USAID has indicated that it supports this coordination and encourages even greater cooperation. The PFS team has invited the PFS partners to regional activities throughout the year. Additionally, we were able to travel with PFS partner FSVC and Ms. Wohlsen to Lithuania in order to coordinate our respective efforts in the Baltic States. Thus far we have succeeded in moving forward to create connections on issues such as linking of our websites. By year two, we hope that many of these website linkages will be in place, facilitating information sharing among the partners. This will also be assisted by USAID's Extranet.

During the year, we also began discussing collaborating on various regional projects. The initial collaboration will likely be between EWMI and the US SEC for a training seminar in Budapest, Hungary on issues of disclosure. Discussions and preparations will continue into this year as we attempt to leverage our collective resources in the most efficient manner. We will continue to seek out such collaborative efforts and include FDIC in these discussions as we attempt to find an area of mutual interest for potential projects.

Additionally, we continue to communicate with EWMI's resource partners, such as Foundation for a Civil Society and Chesapeake Associates, to leverage resources and expertise.

Administration:

Prior to being awarded the PFS Program, EWMI had been implementing the highly successful Banking Finance and Assistance Centre Program ("BFAC") from its Budapest office. Following the award of the PFS cooperation agreement, EWMI obtained additional office space and retained the existing local staff to ensure a smooth start to PFS. Budapest's central location in Eastern Europe has made it the ideal location for launching the regional projects of EWMI's component of the PFS program.

In the final quarter of the period under review, the Budapest office experienced a change in leadership. Mr. Guilford left EWMI in early December. Mr. Geoff Mazullo has been the Interim Director of PFS since that time.

PFS Website: www.ewmi.hu

Over the course of the year, EWMI succeeded in designing and launching a dedicated Website facility for the PFS program. The Website enables the easy dissemination of information to the target areas and facilitates the development of an interactive process of communication on new project concepts.

In addition to explaining the background issues about the program, the site invites government and non-government organizations to register their interest in the program. The registration procedure requires applicants to supply all contact and status information. They are also invited to submit their ideas on how PFS can help them resolve regional financial sector issues. During the period under review, EWMI completed its preparatory work on the construction of the fully integrated website commissioned during the second quarter. The site, which is fully operational, contains a dedicated section focused on the PFS program. In addition to explaining the background issues about the PFS program, the site invites government and non-government organizations ("NGOs") to register their interest in participating in the program. The registration procedure requests that they supply all contact and status information. They are also invited to submit their ideas on how PFS can help them resolve regional financial sector issues. During the first quarter of 2001, the PFS team will contact the other PFS partners, such as FSVC, U.S. Securities and Exchange Commission ("U.S. SEC") and U.S. Treasury to ascertain how we can link our respective websites. We will also work with USAID to ensure that the information is also made available through the Extranet.

Beginning in January 2001, interested parties will be able to download the grant application form directly from the PFS website. Furthermore, the website will include research on substantive issues generated by PFS activities. Thus, NGOs and other organizations are able to send in grant proposals, ideas, expert lists, and other information electronically. It is anticipated that chat rooms may be established in year two to allow a free flow of ideas and the sharing of experience and information.

Workplan

EWMI delivered its first annual PFS workplan to USAID on March 15, 2000. This workplan covered the period February 1, 2000-December 31, 2000. It outlined a number of goals and activities for the first year of the PFS program.

PFS Program Activities and Outreach: all financial components

Participation in the EBRD Annual Conference, Latvia 20-22 May

A PFS team member attended the EBRD Business Forum in Riga May 20-22. This annual event provided an ideal opportunity to access the latest market information and meet with many key players in the Eastern, Central and South-Eastern European financial markets. In addition, the theme of this year's regional meeting was investment, trade and cross-border cooperation. The PFS Director met with senior financial officials, NGO's and other financial sector experts and business people to inform them about the PFS program and to seek their ideas about its development and implementation. Overall, there was considerable interest in the PFS program and its potential for jumpstarting more expanded and efficient regional cooperation.

PFS Conference, Budapest 8-9 June

On June 8-9, 2000, EWMI hosted a seminar on financial sector development in the CEE and SEE region. The seminar introduced PFS the Partners for Financial Stability program. The seminar was an opportunity for representatives from government, business, and Non Government Organizations ("NGO's") from CEE and SEE countries to share with each other and representatives of donor organizations their experiences and concerns in the area of financial sector reform. The two-day seminar broke into four panels focused on regional issues related to banking, capital markets, insurance and pension reforms. Each panel was composed of experts in that discipline from CEE countries and Western Europe. The observations and comments of the seminar participants, summarized below, reflect the discussions between the panelists and participants.

An excellent summary of the purpose of the PFS program and its goals and objectives was provided by William Frej, Former USAID Mission Director to Poland and currently Director of the Office of Market Transition, Bureau of Europe and Eurasia. Subsequently, the panel discussions highlighted some of the progress in CEE financial sector reforms, and areas where reform is still needed, as well as the areas where lessons learned from the CEE financial sector reform experience can be shared with SEE countries. SEE participants were quick to share the challenges facing them in these four financial sub-sectors and to outline areas where lessons learned from the CEE experience might be beneficial.

The CEE experience in banking reform was discussed cogently by George Szapáry on the first day of the conference, and by the Banking panel on day two of the seminar. Mr. Szapary, a senior advisor at the National Bank of Hungary emphasized speed as a critical element in the reform process. In addition, he noted that countries still undergoing consolidation should not provide government guarantees to strategic investors but instead should sell the banks at a small discount. This recognizes that there may be bad loans that will turn up after the purchase.

Much of the shared experiences about banking reform by CEE participants and panellists also focused on issues of bank consolidation and privatization, strong supervision, and recapitalization following privatization. Panellists stressed the need to build strong information technology (“IT”) systems and to leap frog to the next generation of electronic banking to rapidly reduce the costs associated with large branch bank networks. Consumer protection issues were also covered. It was also emphasized by both panellists and participants that the banking privatization process of the CEE countries can offer numerous important lessons for the SEE countries.

On the capital markets panel, a lively discussion ensued on the topic of mass privatization and its role in the development of capital markets. Most agreed that mass privatization had serious shortcomings and that a lack of regulation compounded the development of capital markets particularly in the Czech Republic. Not surprisingly, there were widely divergent views on the efficacy of voucher privatization. In addition, both panelists and participants varied on their positions on the amount of regulation necessary in the emerging markets.

Finally, given the interest of the participants in pension reform, we merged the pension and insurance panels into one large panel discussion. The pension section of the panel was composed of an excellent mix of pension reform experts and regulators. The uneven progress of pension reform across the CEE countries was noted. It was expressed that some countries are quite advanced in implementing pension reforms that include the development of fully funded private pension programs while others are just beginning with basic legislation. Poland and Hungary are in the advanced group while the Czech and Slovak Republic are making good progress on the legal framework.

The discussion about pension reforms focused on some of the basic issues of design. The discussion also focused on regulatory issues and a model was suggested on unified regulation or regulation of banking, securities, pension and insurance under one institutional roof rather than separate institutional bodies. Additionally, the former Chief of Insurance Regulation in Hungary provided an overview of the experience of Hungarian insurance regulation, which prompted extensive discussion and a subsequent request from the Macedonian Ministry of Finance for assistance to learn more about the Hungarian experience.

Following the conference, EWMI received expressions of support for the PFS program. There were some criticisms that there was insufficient time to fully explore the topics in question. In general it appeared that a follow-up conference, perhaps focusing more tightly on a fewer number of topics would be beneficial. EWMI is currently in discussions with an NGO to arrange the follow up conference. The proceedings were recorded not only in full but also in an abbreviated form with conclusions.

- EWMI prepared a full overview of the conference proceedings. This is currently available both in hard copy and on the EWMI website at www.ewmi.hu.
- EWMI formally approached all panelists and participants in order to obtain their views on the success and direction of the conference as well as their

constructive criticism towards future improvements. In addition, EWMI asked the same group for their suggestions for future topics to be considered under the PFS Program. The results of this were promising and a copy of the most interesting responses is attached under Appendix I.

Bank Supervision Conference 2000, Warsaw 6-7 July

A member of the PFS team participated in the Bank Supervision Conference in Warsaw, Poland, on July 6 and 7, 2000. The conference was on the subject of financial sector supervision in a global environment, entitled "Implementing International Standards." Jointly sponsored by USAID and the Barents Group, the conference consisted of a series of panel sessions on a number of current bank supervision topics. The PFS team member utilized the opportunity to facilitate connections with a wide variety of implementers and experts in the field of bank supervision and to take part in discussions concerning the most current and relevant issues and approaches under consideration in the Region.

IMF/World Bank Meetings, Prague, 22-24 September

Using the opportunity to discuss regional reform with a varied group of financial sector participants, a PFS team member attended the first three days of the Seminars running in parallel with the IMF/World Bank meetings. The wide range of attendees from all parts of the region gave ample opportunity to discuss on-going future project collaboration with existing counterparts in the "think tanks" and financial institutions from the region. There were also opportunities to promote the PFS program to a variety of new contacts.

Partnership Development Trips

An initial and ongoing task of the PFS program is to identify local counterparts in each PFS country that can be potential partners of the program and to develop joint activities with these partners. Partnership development trips are designed in cooperation with the Economics Officer at the US Embassy in the respective country. This coordination is vital. It enables the Economics Officer to brief the PFS team on the country background for a specific issue. At the end of each trip, the PFS staff member briefs the Economics Officer on the trip, noting contacts made or strengthened, issues discussed and potential projects under development.

Beginning in early February, EWMI organized a series of visits to the target countries. The first such visit of an EWMI PFS team, took place in February to Poland, the Czech Republic and Hungary. The objective of the visit was to meet with USAID, U.S. Embassy officials, financial sector supervisory agencies, think tanks, donors and other potential partners. The team members met with key USAID, State and local counterparts in each country. USAID Mission Directors Bill Frej (Warsaw) and Patricia Learner (Budapest) provided significant insights into USAID country strategy and activities while providing their perspective on developing regional activities based on the experience of Poland and Hungary. In particular, they suggested that the EWMI PFS team should pursue relationships with emerging Polish and Hungarian foreign technical assistance programs that are seeking to provide Polish and Hungarian technical assistance to the SEE countries, Ukraine and other former Soviet Republics. EWMI is working currently to establish a relationship with the Polish Know How Fund in order move forward with joint projects.

The EWMI PFS team also met with the State Department Economic Counselors who have become the contact point for the U.S. government in the graduated countries. In the Czech Republic, Judy Garber, the Economic Counselor at the U.S. Embassy in Prague, has already become involved in the PFS program coordinating activities with Will Elliott, USAID PFS Program Coordinator in Washington, as well as the other organizations under the PFS umbrella (U.S. Securities and Exchange Commission, the Financial Service Volunteer Corps, and the U.S. Treasury Department). The EWMI PFS team also met with Jean Bonilla and Michael Zorrick, respectively the State U.S. Embassy Economic Counselor and Economic Officer in Budapest who will also be the key USG contacts for PFS in Hungary. Similarly, the EWMI PFS team met with John Hoover, the U.S. Economic Counselor in Poland. In all cases the State Economic Counselors were well versed in the USG strategy for financial sector reform and provided key insights about the political environment and players in each country.

In March 2000, the PFS team traveled to the Slovak Republic, where the EWMI PFS team met with a number of public policy organizations that may be potential partners to advance the PFS Program, including MESA –10 (previously led by Ivan Miklos – now Deputy Prime Minister for Economic Reform), and INEKO, the Centre for Economic Development, and Transparency International of Slovakia. EWMI also benefited from introductions to these organizations from its sub-grantee Ms. Wendy Leurs, President of the Foundation for a Civil Society.

During the visit, the EWMI PFS team also met with USAID Mission Director Paula Goddard and Maria Mamlouk at USAID Bratislava to present PFS and to seek advice and guidance concerning important issues in the Slovak Republic. Ms. Goddard recommended that programs developed under PFS should be closely coordinated with the current donor strategy followed by USAID, the World Bank, European Commission and the U.K. Know How Fund. Additionally, it was suggested that EWMI might present PFS at the next monthly meeting of donors. EWMI also met with Charles Hengel, Charge d’Affairs, to discuss PFS and State’s strategy for post presence after USAID departs in September 2000. The meeting was productive and provided a good exchange of ideas as well as an update about the key economic and political issues confronting Slovakia.

Several sub grant proposals were received from various groups such as a corporate governance proposal from INEKO in Bratislava, a financial sector analysis proposal from CASE in Poland, and two proposals on banking and capital market development issues from Financial Research Ltd in Budapest. Several other requests for assistance were also received during this period.

Also in March, EWMI PFS Team member Ms. Colley traveled to Sofia, Bulgaria and met with a number of think tanks. As one of the PFS partners, the Foundation for a Civil Society has been highly involved in working with the NGO community in Sofia, providing PFS with an established network of potential sub-grantees and working relationships.

EWMI met with individuals at two economic think tanks in Sofia, the Centre for Economic Development, and the Economic Policy Institute. Both institutions emphasized the issue of corporate governance and the great potential for experts from the North to share their knowledge in this area. They also highlighted the importance

of teaching the essential elements of corporate governance in the CEE countries. Banking and venture capital were also discussed as additional areas of inter-regional training and assistance. While in Sofia, Miss Colley also met with Bill Foerderer, Acting Mission Director in Bulgaria, to discuss the PFS program.

Also in March, Mr. Guilford visited the European Commission in Brussels, meeting with various sector specialists in the External Relations Directorate General. The primary purpose of the visit was to meet with a cross section of administrators (Country co-ordinators and Financial specialists) to introduce and explain the PFS program. The secondary purpose was to seek out potential areas for cooperation. There was a positive response from all quarters and considerable interest was expressed in becoming involved in appropriate PFS project. A strong interest was also expressed in the PFS web site as a means to faster and more expanded information sharing.

Addressing the accountancy component of PFS, John Gruner visited Budapest and Warsaw in March 2000. Mr Gruner's primary contact points were the national accountancy self-regulatory organizations ("SROs"), who in turn arranged meetings with others in the accountancy sector, including academic institutions, the stock exchanges and regulators, think tanks that deal in accountancy-related issues and practicing accountants and auditors. In addition to describing PFS and seeking information on proposed projects, he also obtained a good cross section of views on how local accountancy standards are being changed to international standards. The meetings produced a series of ideas, which will lead to seminars and conferences (see below) on accounting and auditing issues. The people with whom we spoke confirmed that convening meetings among the CEE countries to share experiences would be of great assistance in the reform process. Further meetings were also held in Brussels with FEE, the European regional accountancy organization and in Paris with the OECD, which co-sponsors a fledgling regional accountancy organization for SEE countries. Since these regional organizations already exist, it would be preferable to work with them and proposals were made to EWMI to work with them to achieve mutual objectives.

Mr. Guilford and Ms. Colley traveled to the Baltic States during the second week of July. As with previous visits, the focus was on presenting the PFS program and developing potential projects in the region. In Lithuania, Estonia and Latvia, the PFS team met with individuals from indigenous "think tanks" as well as with USAID Missions and financial sector institutions. In addition to discussions on potential projects involving local financial sector experts sharing their experience with officials from other countries in the region on a number of financial issues, the team also identified several areas of possible cooperation under PFS. See below our projects that resulted from these meetings and will be under development through the end of the year. Possible areas of collaboration include the following:

In Lithuania, the PFS team had several meetings with Victoria Wohlsen and individuals from the USAID Mission, the Securities Regulatory Authority, various NGO's such as the Lithuanian Free Market Institute, the Lithuanian Banking, Insurance and Finance Institute, as well as financial sector institutions such as the World Bank and the Central Securities Depository. Among the topics raised were the need to develop support mechanisms to assist pension reform, the need for a forum with the participation of regional experts and parliamentarians to open up the issues

related to further modifications to the investment law, the need for mortgage financing development, and assistance in reform of the social security system.

In Latvia, we met with individuals from the Central Bank, the Stock Exchange, the Central Depository and the Social Security and Insurance agencies, in addition to several NGO's. Once again, the issue of pension reform was high on the list as was the training of central bank staff on market risk from a supervision perspective. In addition, the Latvian Insurance Authority raised the issue of development of satisfactory insurance supervisory procedures in preparation for the single authority from July 2001.

In Estonia, we visited the US Embassy, the Banking Association, the Supervisory Authority and the Stock Exchange, in addition to several ministerial departments. The subject of pension reform was again mentioned, as was the topic of a consolidated supervisory body. There was also a feeling that the Estonian Association of Insurance Companies has not achieved its goals, as the people who work in the insurance companies are not receiving sufficient levels of training on substantive issues in the insurance field.

PFS team members traveled to Croatia and Slovenia in the second week of April. As with previous visits, the focus was on presenting the PFS program and the development opportunities it offers in the financial sector. In Slovenia, the PFS team met with individuals from indigenous think tanks, as well as the EBRD, the EU and the Ministry of Finance. In addition to discussion on potential projects involving Slovene experts sharing their experience with officials from other countries in the region on a number of financial sector issues, the team advanced the idea of facilitating a knowledge transfer on the subject of consolidating financial regulatory bodies. As the EU will shortly be funding a study on that subject, there was interest in creating a forum for experience sharing on the issue.

The visit to Zagreb also revealed a number of concepts for potential regional projects. The issues of pension reform and banking supervision, particularly in the area of debt management were raised as potential areas of assistance. During the meeting with the Mission, it was suggested that PFS focus on regional knowledge transfers. This will be particularly useful in areas where bilateral programs are in progress and have actual experiences that could be shared. Furthermore, the PFS team underlined that it will work closely with USAID, other donors, and partners in Croatia. The PFS program will need to closely coordinate its strategy with the Mission's overall strategy to avoid duplication of effort and ensure that it fits into their strategic plan and achieves shared program results.

Fourth quarter partnership development trips included PFS members' trips to Bulgaria, Latvia, Poland and Slovakia.

During the development trip to Latvia in December, the PFS team member sought both to assess current trends in the local financial sectors and to determine whether Latvian counterparts had identified potential areas of regional assistance appropriate for the PFS program. For example, PFS obtained information on governance and shareholders' rights in order to add Latvia to the comparative analysis PFS is preparing on corporate governance and shareholders' rights in Central and Eastern

European (CEE) countries. This study parallels a study of the European Union (EU) countries completed by the German shareholders' association DSW in 1999.¹

Second, based on past requests, PFS determined whether or not there is a need to develop a “Calendar of Disclosure Requirements for Financial Institutions in compliance with the Law on Banks, Law on Securities and Commercial Code.” PFS is currently discussing this idea with institutions in Poland and Slovakia. Given that a new supra-regulatory authority will begin its work in July 2001, it seems prudent to wait until that time to consider such a proposal. At this time, capital markets institutions proposed other priority proposals.

Third, PFS determined whether there is a need to develop a database of management board and supervisory board members of the ten largest banks in each of the countries that fall under the PFS mandate. The database would include all data dating back to 1990 and provide insight into bank ownership, board representation, tenure, overextension of certain individuals, representation of women, representation of foreigners, and other relevant statistical data. PFS is currently discussing this idea with institutions in Poland and Hungary. Whereas there is interest in such a database, there are questions as to which institution would be able to develop and manage it. In early 2001, PFS will continue discussions on this idea with banking sector organizations.

Fourth, PFS followed-up with Latvian institutions that have submitted draft proposals for projects in the accounting sector (Mr. Talis Laizans, Deputy Chairman of the Securities Market Commission - proposal for training seminars on IAS) and banking (Mr. Janis Stabins, Latvian Entrepreneurship and Management Academy – proposal for bank training).

In accordance with the PFS mandate, all grants are regional in nature and support organizations that wish to link together and continue cooperation even after the PFS program closes.

An important component of EWMI’s implementation of PFS includes maintaining a presence throughout the region that permits the PFS team members to gather information about the needs of the region’s financial sector participants. Over the past year, we have seen several common trends shared by the graduated CEE countries. Some of these issues include the varied perspectives on the consolidation of the capital markets, the future of banking in the region, such as e-commerce and risk management, and the issues surrounding consolidating regulatory authorities in the financial sector. As this is a demand driven project we have attempted to address these issues through coordination with our partners and discrete, effective technical assistance.

ACCOUNTING/AUDITING

¹ At present, the study includes data on the following countries: BiH, Croatia, Czech Republic, Hungary, Poland, Russia and Slovenia. We are now in the process of extending the study to all PFS countries. We will post the study on the PFS website in January 2001.

Prior to leaving EWMI, Mr. Gruner established some basic contacts and discussed the objectives of the PFS program with numerous country counterparts. Based on some of these meetings in 2000, EWMI has numerous accounting projects planned for 2001.

BANKING

Administration

Dr. Peter Mihalyi, the former Director of BFAC, will join PFS in January 2001 and be responsible for banking programs.

Grant making activities:

Database of management and supervisory board members of the 10 largest banks in each CEE country

In addition to the fundamental issue of disclosure, accountability of management and board members is a primary concern at financial institutions in transition economies. During the forty-plus years of socialism, managers were not schooled in transparency of financial and non-financial information about the enterprise. Furthermore, in a planned economy, accountability to shareholders did not exist.

In order to promote both greater transparency of information about candidates to managerial and board positions and investigate interlocking board representation on financial institutions, PFS has discussed with several country counterparts (in Hungary, Latvia, Poland and Slovakia) the merits of creating a database of the 10 largest banks in each country. The database would include all data dating back to 1990 and provide insight into bank ownership, board representation, tenure, overextension of certain individuals, representation of women, representation of foreigners, and other relevant statistical data. The Budapest-based Banking Association of Central and Eastern Europe (BACEE) is interested in submitting a grant application to PFS to develop a pilot project to create a database of the 10-largest banks in Hungary and Poland. We expect to receive this proposal in the first quarter of 2001.

Transferring expertise in bank restructuring Workshop.

We made a grant to the Economic Policy Institute in Sofia to develop an expert workshop, whereby the Bulgarian authorities can discuss with and hear from bank experts from neighboring countries, such as Poland, the Czech Republic and Hungary. If approved, this workshop is likely to be held during November 2000 with a follow up conference in March 2001.

International Centre for Economic Development (ICEG), Budapest:

We are discussing the development of a network involving ICEG member organizations in each of the CEE countries, in conjunction with EWMI under the PFS program. The network would be dedicated to the production of critical vulnerability and performance indicators for the banking sector of the CEE countries with potential to expand to the SEE at a later date. The information would be updated on a regular basis and available on the websites of both ICEG and PFS. The perceived risk of dealing with the banking sector in CEE and SEE countries is broad. Within the perceived risk is the real risk. The more information that is available from regularly updated and reliable sources the better and more accurately the real risk can be

separated and assessed. As far as we know, there is currently no similar system in place.

Statistical information would be supplemented by studies on capital adequacy and other BIS indicators. It is likely that this would incorporate a link with institutions such as national banking associations and central banks.

Polish, Czech and Hungarian bank restructuring lessons for the region.

We worked with CASE in Warsaw, Charles University in Prague, and ICEG in Budapest, on the development of a policy paper on bank restructuring based upon the lessons learned from the Polish, Czech and Hungarian restructuring experience. The concepts were presented at the bank-restructuring workshop hosted by the Bulgarian Economic Policy Institute in Sofia, and the papers that result from that workshop will be presented in 2001 at a follow up seminar.

Debt Management.

The Institute for International Relations in Zagreb has proposed a project to compare experiences with neighbouring countries in successful and unsuccessful debt-creating financing of economic growth. This would involve the participation of counterpart “think tanks” in the other CEE and SEE countries. We are looking into the appropriateness of this project for implementation under PFS. During the second quarter of 2001, will discuss this proposal with the USAID Mission in Zagreb and USAID Washington in order to determine whether this fits within the goals of the USAID mission.

Development of a pilot credit rating process:

The Centre for Economic Development in Sofia seeks to establish this project under the PFS program. The subject falls within the scope of the future OECD Network Agreement with EWMI and could also be included within an expanded brief for the ICEG project mentioned above.

The Latvian Entrepreneurship and Management Academy:

Among the several ideas presented to PFS following the team’s visit to Latvia is a project to develop educational programs for the banking sector. This would include a series of workshops, seminars and conferences in order to share experiences on how to organize training programs for bank employees to raise the level of their professional expertise. We also plan to produce printed materials. The subject of the first grant application will be “risk management”.

We were anticipating moving forward with this project during the reporting period but currently expect to receive the grant application from the Latvian Entrepreneurship and Management Academy in the second quarter of 2001. In preliminary discussions, it was expressed that this project is being organised in cooperation with the Commercial Banking Association of Latvia and will involve experts from Hungary as well as Poland and other CEE countries (to be decided). In addition to possible participation from Lithuania and Estonia, some in-put from the US and the UK may be appropriate in order to get a good mix of current issues and relevant experience. The completed Accounting Questionnaire in preparation for the application process has been received.

As mentioned above, the Budapest-based Banking Association of Central and Eastern Europe (BACEE) plans to submit a grant application to PFS to develop a pilot project to create a database of the 10-largest banks in Hungary and Poland. We expect to receive this proposal in the first quarter of 2001.

Corporate Governance Conference, December 2000

In December 2000, PFS sponsored the visit of Polish and Slovak capital markets specialists to a corporate governance conference in Germany. The organizations represented were: the Warsaw Stock Exchange; the Polish Association of Brokers and Investment Advisors; the Bratislava Stock Exchange; and the Slovak Broker/Dealer Association. The conference was organized by the German shareholders' association DSW who invited the PFS Interim Director and two guests to attend free of charge. PFS paid for two guests. The conference provided many practical insights into the current German and EU legislative framework for capital markets.

Disclosure Calendars:

Through a number of trips taken by a PFS team member in the fourth quarter of 2000, a project to create a series of disclosure calendars for the region are under discussion with various counterparts. PFS team members have discussed with securities commissions in several countries the drafting of disclosure calendars. Similar calendars have been developed by USAID-funded projects in other countries (Russia; Bosnia and Herzegovina) and have been very useful analytical, teaching and marketing tools. The calendars outline the legal requirements for joint stock companies to disclose information to the supervisory board, shareholders, the auditor, the Securities and Exchange Commission, court register, the Stock Exchange, the media and other interested parties. The calendars detail which information must be disclosed upon incorporation and then on an annual, semi-annual, quarterly and monthly basis as well as ad hoc (changes in registered capital; issuance of new securities, reorganizations). Each entry in the calendar represents the specific document to be disclosed and is footnoted with the article of the relevant law requiring said disclosure. The calendar also notes under which circumstances said disclosure is required, who is responsible for producing the document, to who it must be disclosed and the time period required for said disclosure.

In several countries in the region, including the Czech Republic, Latvia, Poland and Slovakia, new capital market legislation comes into force in January 2001. As a result, the drafting of a disclosure calendar in each of these countries would fill an informational gap for domestic and foreign investors not yet familiar with the new legislation. When published in the national language and English, the calendar also serves as an effective guide for foreign investors on their rights to obtain information.

Grant making activities:

Capital Market Seminar

On Friday 20 October 2000, EWMI co-sponsored with the Charles University in Prague, a seminar on the developing capital markets of Central and Eastern Europe ('CEE'). The seminar provided an opportunity for representatives from the stock exchanges, supervisory authorities and NGOs from CEE and SEE countries to participate in an open debate on the current issues facing the world's capital markets,

with the active participation of their counterparts from the US and Western European markets, the OECD and the European Commission.

During the one-day seminar, three panels focused on the progress already made towards integration of the capital markets of the CEE countries, the global issues currently challenging the capital markets of the US and Western Europe and the current regulatory and accounting issues facing the global exchanges. Each panel was composed of capital market administrators and capital market experts from CEE countries, the United States and Western Europe. The observations and comments on the seminar reflect the discussions between the panelists and participants regarding reforms in the three areas of focus.

The day commenced with an overview of globalization and liquidity issues being faced by the capital markets in Central and Eastern Europe, followed by a review of current developments in the Western European and US markets. The conclusions of these two panels were then set against the backdrop of the importance of a strong regulatory and accountancy framework, with particular focus on the current US state of play and the development of appropriate European Commission directives for the existing EU member states.

Panel I was composed of representatives from the Prague, Budapest, Ljubljana and Bratislava stock exchanges who began by giving a brief overview of their respective markets. Although CEE exchanges are moving towards an integrated market there are nevertheless significant differences between them. A good example of these variances is the difference in ownership structure. For example, in Poland, the stock exchange is 98% owned by the State, whereas the Prague stock exchange is 100% owned by its members. In Budapest, on the other hand the exchange is moving towards demutualization and a broader spectrum of ownership. Due to these and other varying characteristics across the Region it was generally agreed that the future capital market growth potential varies from country to country in each of the CEE countries. Early moves towards integration include the creation of working groups and regular committee meetings on such subjects as; derivatives, marketing, regulation and surveillance, in preparation for membership of the European Union. However, many of the issues associated with membership of the European Union and more formal connections with a large Western European stock exchanges still remain to be addressed. On the other hand, alliance activity amongst the Western European stock exchanges has become more and more intense in recent times and is likely to continue to be so as the realities of the economies of scale and other issues press upon the world's more established capital markets. Furthermore, such moves are not limited to stock exchanges alone and also include steps to integrate clearinghouses as part of the quest for greater liquidity and improved revenues.

The issue of voucher privatization, considering its place in post-socialist reform in the CEE and SEE countries, was addressed extensively in the discussion of reform progress, and the lack thereof. As a result of this short cut to privatization, many CEE exchanges have to live with the fact that due to voucher privatization very few companies have actually received new money via the stock exchanges. It was suggested that investor confidence might have suffered as a result of voucher privatization and that despite the political implications; there should be a clear policy on the future of the shares resulting from this process. The possibilities of separating

such shares and the development of new markets should be seriously considered. The vast majority of these shares have not been traded during their time on the exchange, which has created a problem with liquidity. Concern was also voiced that with the development of new markets, small companies would come to the exchanges and that the existing liquidity of the market would not be sufficient for investors. Evidence was provided that a number of blue chip stocks are leaving the CEE markets for the international stock exchanges. However, taking into account the fact that the identity of the investor is all-important, it was suggested that one possible way to prevent this could be to link some of the CEE exchanges regionally, as well as improving marketing efforts. On the other hand, the experience in the London market is that in most of those cases where blue chip shares started by trading off-shore, that they ended up migrating back to the UK.

In conclusion, although a number of the CEE exchanges are oriented mostly towards new markets and new ideals, there remain significant shortcomings in some others. In order to respond to the real issue of economies of scale and cost efficiency in the European Capital Markets, the CEE exchanges must address the challenges of new opportunities as the international exchanges have so far done.

Panel II was composed of senior representatives from the London Stock Exchange, NASDAQ and the OECD, as well as former members of the Chicago Board of Trade and the Canadian Derivatives Clearing Corporation. The panel reviewed developments principally in the American and British capital markets and noted that the stock exchanges were scrambling in order to try to respond to changing regulatory, competitive and even demographic situations.

The stock exchanges of today are not in a position to rely on past success as they used to do but are almost continuously in a state of flux, changing their managerial and regulatory technological approaches in order to stay part of the value chain. All panelists emphasized the fact that their customers had choices and that their success would be dependent on how they provided value to those customers. It was agreed that there was a synergy between the roles of the major exchanges, and that they were attempting to dominate the global capital market as well as the smaller regional exchanges. The argument was presented that the large exchanges would be able to attract the largest volume of blue chip shares as well as the shares of companies that were too large to be able to meet their funding requirements domestically.

In terms of integration, in addition to inter regional EEC agreements, a network of cooperation agreements has already been put in place between London, Estonia, Latvia, Lithuania, Poland, Croatia, Hungary and Romania. It was noted that the whole demography of Europe is changing and that we are starting to evidence a trend of consolidation across the board and even a contracting out of settlement activity. At the same time, the client base of intermediaries is becoming more and more concentrated. In conclusion, it was stated that if stock exchanges do not rise to the challenges all around them, particularly in respect of the growth in electronic commerce, then technology would overtake them.

Panel III consisted of capital market regulators from London, the Czech Republic, Latvia, Poland and the United States addressing the issues of accounting standards in terms of the capital markets. It was agreed that improved implementation and

enforcement of these standards are the main issues. The European Commission mentioned first that it does not seek to impede the progress of technology and secondly that it thought it appropriate to consider talking about the possibility of lighter regulatory regimes for some investors, i.e. Professional investors needing potentially less regulation. The US representative mentioned that this concept has existed in the US for a while in some form and it is an interesting idea worth exploring. The Czech authorities have achieved two important steps in terms of regulation implementation. First, re-licensing seems to have been fairly effective and secondly, the use of a penalty system for poor disclosure by issuers, so far seems to have been a rather effective strategy.

From the enforcement perspective it was generally agreed that it was encouraging to hear of the progress that has been made in the CEE countries. In particular, the alliance between the three Baltic exchanges was reviewed with interest and encouragement by the panel. It was also an interesting difference to the developments in the other CEE exchanges when looked at in conjunction with their efforts to joining NOREX, the Nordic alliance of stock exchanges.

It was agreed that firm adherence to a high level of accounting standards was essential. In Poland, progress has been made in terms of implementing international accounting standards and moving towards IOSCO (International Organization of Securities Commissions) disclosure standards. Nevertheless, this subject is currently a major issue in the CEE countries and there is a need for a professional body to give on-going interpretations of standards and facilitate cross border communication between regulators in the CEE.

It was clear from the discussions that took place, that the changes in the capital markets of the world are posing a challenge for everybody. The US and Western European stock exchanges are actively trying to adapt to these changes and have many tasks in common to address with their CEE and SEE counterparts. Due to the differing degree of advancement and regional characteristics of the exchanges across Europe it is possible that some of those in the CEE and SEE countries may be able to leapfrog important intervening stages.

Grant making activities:

The Bratislava Stock Exchange and Brokers Association:

The Bratislava Stock Exchange proposed a one day workshop in conjunction with the Slovakian Broker Dealers Association to discuss with potential Slovakian medium sized corporations, potential issuers and other interested parties on the issues involved in setting up a specialist smaller companies share market. The date of the conference is still to be determined but is likely to be during April/May 2001. The members of these groups are interested in exchanging views with counterparts from the Czech Republic where a similar approach has been taken in establishing this type of specialized market, as well from Poland that has opted for a different solution. The input of the Hungarians and the Slovenes as well as the Baltic States would also be important. This would involve bringing in CEE and other experts with proven experience of the issues involved in order to share their experiences and provide guidance to the Slovaks on how to set up their own small/medium sized companies share market.

Based on discussions with capital market institutions during the period under review, we expect to receive several concrete proposals for PFS grants during the first quarter of 2001. The proposals discussed include capital markets training programs (seminars on derivatives, bond issues and investor relations); regional harmonization initiatives of the five CEE stock exchanges (Bratislava, Budapest, Ljubljana, Prague and Warsaw) on corporate governance, listing rules and trading systems; and advocacy work on International Accounting Standards (IAS).

PENSION/INSURANCE

Insurance

Following the conference in Budapest in June, representatives from the Macedonian Ministry of Finance requested assistance under a PFS program grant from EWMI to work with representatives in the CEE countries to foster the development of a well supervised, competitive insurance market in Macedonia. In particular, the Hungarian experience was of most interest to them. The project would therefore be to send a Hungarian expert on site first for some preparatory consultations, followed by a more regional experience field trip, offsite.

In order to comply with EU Directives regulating the area of Insurance, the government was planning to draft a new Insurance Law to be completed by September 2000. In preparation for the imminent enactment of the law, the Ministry of Finance sought to learn about the actions involved in regulating the insurance activities from a neighboring country. The Ministry of Finance indicated its commitment to assist in leveraging resources to be used for assistance in developing the insurance industry. It was determined, however, by USAID that such assistance was unnecessary and the potential project was aborted.

Pension Reform

OECD Pension Reform Forum, Prague 4-5 April

Mr. Guilford attended the first meeting of the OECD forum on private pensions, held in Prague during April. The meeting was the first in a series of meetings in this format to be held on the subject, and on this occasion was co-sponsored by the OECD, the Czech ministry of Finance and the Czech Securities Commission. It was co-organized by the Hungarian State Private funds Supervision. Mr. Guilford met with OECD representatives and Ms. Denise Lamaute, USAID pension reform expert, during the forum in order to consider ways in which the PFS program could work with the OECD to develop an international network of pension regulators and supervisors. The object of the network is the implementation of best practices and principles. (See Tab 1, OECD Pension Reform)

OECD Pension Reform Network

In April 2000, the PFS Director met with OECD representatives and Ms. Denise Lamaute in Prague and later in Paris in order to consider ways in which the PFS program could work with the OECD to develop an international network of pension regulators and supervisors.

The objective of the network is the implementation of best practices and principles.

As a result of these discussions, EWMI was able to draft a Memorandum of Understanding (“MOU”) setting out the framework for future cooperation between OECD and EWMI. This MOU was executed by OECD and EWMI on September 4, 2000 and was followed by an operational Addendum setting out the budget and other obligations of both parties.

The cooperation between EWMI and OECD will enable the PFS Program to participate as an equal partner in the creation and implementation of a regional pension reform network. This regional network will be an integral part of the OECD worldwide pension network. It will also play a major role in the exchange of experiences and lessons learned in the region and provide a framework for the development and implementation of best practices and principles.

In some countries, such as Hungary and Poland, reforms have been implemented that create a modern pension system and allow for pension funds to invest in capital markets. The regional Pension Reform Network being implemented by OECD and EWMI under the PFS program will assist this reform process by creating linkages and facilitating pension regulators and fund managers in the pre-accession countries. The Network will also identify gaps in the current structure and help to formulate suggestions for remedial action. However, as EU enlargement approaches, the bottom line for the pre-accession countries will be the same as for the existing Member States. The sustainability of pension systems will determine to a significant extent the EU’s ability to achieve a high level of social protection, which is one of the fundamental articles defined in Article 2 of the Treaty establishing the European Community.² The PFS program will be implementing a coordinated series of action in the Region to assist the pension reform process in this direction as follows:

EWMI and OECD will jointly seek to develop a regional pension reform network for the Baltic States, Central, Eastern, and South Eastern Europe. The network will develop international best practices and guidelines for pension reform in the region, and establish linkages among pension reform regulators and pension markets players, share experiences and accelerate reform as well as provide indicators to measure the success of the reforms. The Regional Network will be part of the International Network of Pensions Regulators and Supervisors being developed by OECD in Paris and will be administered through a Regional Secretariat to be located at EWMI’s offices in Budapest.

Implementation of the project commenced following signature of the Addendum. Additional office space to accommodate the Regional Coordinator has been secured in the EWMI offices in Budapest and a short list of possible candidates was drawn up. The most experienced of these candidates, Mr. Tibor Parniczky, was at that time the advisor to the Hungarian Supervisor. EWMI negotiated with both Mr. Parniczky and OECD to devise an appropriate scope of work for the job. Following completion of

² The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing the common policies or activities referred to in Articles 3 and 3a, to promote throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the social standards of living and quality of life, and economic and social cohesion and solidarity among Member States.

the scope of work, we made an offer to Mr. Parniczky. He has agreed to the terms and commenced work on the project on Jan 8, 2001. Dialog also commenced with the European Bank for Reconstruction and Development (EBRD) to ascertain how we can link the EBRD to the pension reform effort.

CONCLUSION and LOOKING FORWARD

As EWMI looks back over the past year, it is clear that foundations were established in beginning to build the structure of the regional PFS framework, even amidst some structural changes in the program itself.

Over the course of the first year of implementing the regional component of the PFS program, EWMI has established a sound framework to ensure a positive contribution of the PFS program towards the development and strengthening of the region's financial sector. The foundation for this framework has been the creation of an interactive website with a fully integrated database of regional financial sector participants. A progressive program of partnership development trips and outreach activities has supplemented these developments. We have also been successful in reaching out to the other PFS partners, such as FSVC and SEC and hope to link our respective websites.

EWMI consistently works with its in-country counterparts, donors and international organizations to ensure the use of collective expertise and resources to support the region's financial reforms. Through these activities, EWMI intends to create or strengthen linkages among organizations in the region to facilitate transfer of knowledge among the parties regarding common financial sector reform issues.

As noted in its 2001 Workplan,³ EWMI will continue to develop an NGO private volunteer organizations network of partners that can develop financial sector activities under sub-grants, as part of East-East assistance between the two regions and joint programs with OECD and other donors to leverage PFS assistance.

EWMI's immediate goal is to help support, establish, and leave behind organizations that can work together and serve as advocates for change without donor assistance. The OECD-PFS Regional Pension Fund Regulators Network is an example of the initial steps EWMI has taken toward this goal over the past year. EWMI has also made progress in fulfilling its objective to facilitate the exchange of information among organizations in the region.

EWMI is moving forward to create organizational partnerships to address the specific issues of PFS while leveraging resources and facilitating the assistance to be rendered. EWMI is dedicated to leaving behind an organization(s) or an institutionalized approach to analyzing, anticipating, and addressing key financial sector issues that can impede reform and ultimately EU accession. As such, in the coming year, we will continue with our individualized grants program. By facilitating cross-fertilization of

³ The proposed activities described in the 2001 work plan reflect the financial sector issues that PFS team members have encountered in the graduated countries. These regional issues include, globalization of the stock markets, establishment of international accounting standards, reform of pension systems and the accompanying regulatory and implementation issues, consolidation of regulatory supervisory authorities, practical issues in corporate finance, corporate governance regulation issues, bank supervision and training for improved bank management and organization.

experience and knowledge, the activities of PFS will serve to build networks of entities that share similar goals and engender cross-border cooperation.