Proceedings

Partners for Financial Stability Conference: "Celebrating Success and Moving Forward"
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The goal of the Partner for Financial Stability (PFS) Concluding Conference was to provide an opportunity for senior financial sector professionals and policy-makers to celebrate and reflect on the historic accomplishments of the eight Central Europe and Baltic countries in the PFS program[1], from early transition to EU accession, acknowledging the exceptionally rapid transformation. The agenda focused on the remaining financial sector challenges facing these eight countries and what should be the priorities for policymakers in order to narrow the gap with the current EU members.

Opening Session

Ken Lanza, Director, Office of Economic Growth, Bureau for Europe & Eurasia U.S. Agency for International Development (USAID), opened the conference by welcoming the participants and encouraging open and informal discussions throughout the day. Mr. Lanza emphasized that the PFS program has been successful primarily because of the strong partnership and professional working relationship that has existed between the financial sector counterparts within the eight EU accession countries, and the USG and other implementing partners which are represented at this conference today.

During his welcoming remarks, **Mr. Cameron Munter, Deputy Chief of Mission, US Embassy, Poland** discussed the significance of the PFS program. He congratulated the eight countries on the upcoming accession to EU, noting that the US is entering a new phase in its relationship with these eight countries.

He reminded the audience that USAID has often been the first donor to arrive in a country and has stayed until the job was finished. In Poland, USAID provided over $1 billion of assistance, supporting approximately 400 programs, with much of the funding provided in the first 4 years after 1989. USAID has left behind two important institutions, the Polish-American Enterprise Fund, a venture capital firm, and the Polish American Freedom Foundation.

During the life of the PFS program, USAID and its implementing partners provided over $6 million in technical assistance to support over 100 individual and regional programs for the eight countries. The PFS program has significant impact because it focused on specific reforms needed for the final stages of economic transition including areas such as pension, insurance, financial sector supervision and corporate governance. PFS consistently delivered high quality, low cost, demand driven programs throughout the region. This was the key to its success. Specific to Poland, the National Bank of Poland was able to use the PFS assistance to set up the highly successful Training Initiative and Banking Supervision (TIBS) program to benefit the entire region.

Mr. Munter concluded by suggesting that USAID use the lessons learned from participants' experiences with this successful financial sector program to assist other countries outside Central Europe and the Baltics. He thanked all of the participants and implementers for their contribution to PFS.

[1] Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia.

Keynote Presentation

Dr. Kent Hill, Assistant Administrator, Bureau for Europe & Eurasia, USAID began his presentation by expressing his appreciation for the support of Ambassador Hill and Economic Officer Laird Treiber in the implementation of the PFS program. He stated that it was because of their efforts and those of the other Embassies in the region that the program has continued to be so successful.

Dr. Hill then provided a brief overview of the progress of each of the eight Central Europe and Baltic countries to date. In November 2004, it will have been 15 years since the fall of the Berlin wall. In 1989, and again in 1992, the leaders and people of Central Europe and the Baltics, called out to the Western world for help in the transition to market-oriented democracies. The U.S. was at the forefront in responding to that appeal. This was the new frontier for USAID in the early 1990s.

It is no longer the frontier. Far from it. The eight countries whose accomplishments are being celebrated today are firmly entrenched in Europe, they are members of NATO, they are the models for other countries throughout the region and the world in how to transform into market oriented democracies. They are integrated in the world's financial markets. They are becoming global investors themselves. In not much more than ten years, the economic and political landscape has changed beyond recognition.

Dr. Hill congratulated all who have contributed to the economic successes and growing prosperity in these countries. He said that one of the reasons behind the rapid transformation was the establishment of a private, healthy, well regulated, and competitive financial sector. In 1989, essentially no banking system existed in these countries. In simplistic terms, there was a state-owned banking system which existed, but it was insolvent, saddled with huge amounts of non-performing assets, instilled no confidence in the public, did not perform any of its important capital allocation roles, and was staffed with people who were not bankers and did not understand banking. No capital market institutions existed at all. The changes have been revolutionary.

In 1992, the private sector share of the economy was still negligible in all of the PFS countries, with the exception of Hungary and Poland. By 2002, it averaged 76% in Central Europe and the Baltic countries. Almost 50% of workers are now employed in small and medium enterprises, the engine of growth and job creation. Foreign direct investment has also climbed sharply in this region. The growth in lending to the private sector mirrors the privatization of the Central European economies and the banking sector. Private share of capital in the banking sector is just less than 90% on average for all the eight countries.

Reflecting on the broader transformation issues, Dr. Hill shared his observations about this remarkable period of historic change and explained what sets some countries apart from others in the quest for greater democracy and economic prosperity. The definition of capitalism must not only emphasize the importance of free markets and the end of intrusive government actions, but laws and regulations which insist on a level playing field, an independent and fair judiciary, and an end to endemic corruption at all levels of society. Secondly, successful capitalism cannot be achieved by simply moving to private ownership, free markets and the legal mechanisms that guarantee both. These institutions will only be successful if private virtues which enhance trust and make commerce possible are cultivated. Only in such a context will honesty, hard work and innovation lead to success.

The PFS program has taken a broad view of financial sector development and has worked hard to help strengthen not only the laws and their enforcement, but also the judicial system. In addition, PFS activities have focused on improving accounting standards and building a trustworthy accountancy profession, as well as focusing on corporate governance in the financial markets. PFS recognized that institutions and the culture they instill matters. In sum, behind PFS' successful partnership was a philosophy of shared values and commitment to financial sector integrity.

Dr. Hill celebrated the successful partnership that PFS represents and its role in this transformation. The PFS program recognized that although the basic building blocks of the financial sector were in place by the end of the 1990's, there were still large gaps in building a sound, vibrant, financial sector which would fulfill its key role in a market economy. The beauty of the PFS program was that USAID could continue to help strengthen laws, institutions, courts, and transfer skills in a new cost effective and cost sharing way. PFS was a demand driven program in which country beneficiaries stated their priorities in the financial sector and were required to contribute cash or in-kind services, to be assured that assistance was focused on needs that had the highest priorities. Local partners, the financial institutions and senior professional staff played the most critical role. They helped to set priorities and convince their bosses that the financial and other contributions that PFS required would bring greater benefits than the costs.

Dr. Hill assured participants that the US and USAID will remain a great friend, ally and economic partner. While this phase of the PFS project has ended, USAID is exploring the possibility of expanding this program to Southeast Europe and Eurasia. He challenged participants to help in this endeavor and teach others in the region, not just the technical skills and the legal provisions, but the underlying secrets of the economic success of the eight countries represented.

PFS: Review of Program and Accomplishments

Ken Lanza, Director, Office of Economic Growth, Bureau for Europe & Eurasia, USAID provided a review of the PFS program and highlighted some of the major accomplishments achieved during the course of its implementation. In the design of the PFS program, USAID decided to focus on the financial sector for three reasons: (1) the financial sector is central to the functioning of any economic/political system and its success is critical to continued progress and development within any country; (2) in each of the PFS countries, there were first rate counterpart institutions and experts committed to reform; and (3) the US has a comparative advantage in understanding the financial sector. The overall goal of the PFS program was to promote a more competitive and responsive financial sector by focusing on filling the remaining gaps from the initial support provided by USAID throughout the 1990's as well as to strengthen US linkages within the region. The unique part about the PFS program is that the technical assistance provided was targeted and demand driven. PFS brought together all the important institutions and practitioners that make a financial sector function well.

Under the PFS program, 150 projects were implemented, including regional seminars and workshops, country specific advisory programs, and grants to a variety of financial sector NGOs and universities. The primary areas of assistance covered by PFS were: banking reform, capital markets development, corporate governance, financial crimes and anti-money laundering, international accounting and audit standards, pension and insurance reform

Another important aspect of PFS was that it initiated a cross border exchange of information between the financial sector practitioners across the region to promote stronger integration. It organized 21 study tours for financial sector practitioners to attend training courses in the US and Europe and get hands on experience with US financial institutions and regulators. PFS technical and legal training was delivered to approximately 3,000 financial sector professionals in Central Europe/Baltics. A website for the program was developed – www.ewmi.hu.

Mr. Lanza then provided a brief overview of the types and numbers of projects implemented in each country. The highest demand for assistance under PFS was focused on banking as well as pension reform, which represented approximately 25% each of all PFS assistance programs. Since the events of September 11, 2001, requests for assistance in anti-money-laundering and compliance with the Patriot Act have been high, and there has also been strong demand for training in IAS in the last years. Specific mention was given to the Training Initiative for Bank Supervision (TIBS) project at the National Bank of Poland which has delivered 5 week-long seminars to 120 regulators from over 20 countries in the region, and to the International Network of Pension Regulators and Supervisors (INPRS), which provides a forum for pension regulators to communicate and continue to improve the operations and standards of pension regulatory agencies.

Beyond all the seminars and on the job training, Mr. Lanza characterized the real impact of PFS as: greater credibility and accountability of key government financial sector institutions; increased access of enterprises and households to a growing variety of competitively priced financial services and products; security of savings in banks; provision of more transparent, reliable information by companies; less vulnerability of banking systems to money laundering; well-run pension funds supporting aging populations; and more competent judiciaries that can support a market economy. The end result is a deeper, more competitive financial sector that promotes faster economic growth.

Panel #1: Financial Sector Regulation

The focus of this panel was on (1) the importance of cross-border cooperation between supervisors, especially with regard to multinational groups with a strong presence in Central Europe and the Baltics; and (2) the convergence of regulatory and supervisory practices in the context of the new Basle Capital Accords. (Basle II).

The moderator, **Piotr Bednarski, Deputy Director, General Inspectorate of Banking Supervision, National Bank of Poland,** focused on how to continue the development of an effective and efficient regulatory infrastructure within the region in the context of EU membership and implementation of the expected new Basle II Accord. Cross border cooperation between home and host bank supervisors in Central and Eastern Europe and the Baltics is essential to the success of the banking industry given that over the last ten years, the major European and US banks have acquired the dominant share of the banking sector in the region. In addition, the combination of Basle II with cost cutting efforts, tends to promote centralization of decision-making at international banks. It is understandable that, for example, the Federal Reserve and the OCC want to minimize the regulatory burden for the biggest banks like Citibank with over 100 worldwide subsidiaries. Nonetheless, it is important that the concerns of the host country regulators are not ignored. While the overall responsibility for the consolidated supervision does remain with the supervisors of the parent company, the full responsibility for supervision of the subsidiary banks still resides within the host country regulator in the region. If too much authority migrates, local markets will face several problems.

Mr. Bednarski concluded by stressing the importance of developing a more symmetrical relationship and mutual understanding between the home and host country supervisors. This means that some decision-making functions remain in subsidiary banks, with the added benefit that investors will remain interested in Poland, Latvia and other countries in the region. There should be more programs to intensify the exchange of technical expertise between home and host country supervisors and greater cooperation and coordination between supervisors, the banking industry and the public.

Uldis Cerps, Chairman, Financial & Capital Market Commission, Latvia represents one of the few consolidated financial regulators in the region. He too focused on the importance of clarifying the roles between home and host country control given EU inconsistencies in financial markets structure and regulation.

Although the EU is currently operating within a common financial market, the banks are still regulated by the home country regulator, there is no EU bank regulator. Banks that provide cross border services can set up their operations in one of three ways: (1) as a subsidiary regulated by the host country; (2) as a branch, regulated by the home supervisor with some functions delegated to the host countries; or (3) as a cross-border bank with no physical presence, regulated primarily by the home country. He noted that it is very interesting that only the Accession countries have banking systems dominated by EU banking groups, (i.e., the banking systems in the current EU members remain dominated by domestic banks.)

Although the banks in the Accession countries currently operate for the most part as subsidiaries, this could change and the subsidiaries could become branches. This would bring into question the supervisory response necessary if one of these banks should fail. There is an asymmetric market share between the home and the host countries. Whereas a bank may only have 5% of the domestic market in their home country, they may have 25% in one of the accession countries. To what extent would the home country regulators and finance ministries find it advisable to step in to alleviate the effects of a failure in the host country? This means that the health of the current EU banking system is critical to the health of the EU-Accession banking systems. But to whom do the host country authorities and policymakers turn to, to understand the risks in their banking system if the primary regulator of the bank is not the domestic bank regulator.

In Cerp's view, a consolidated regulator for the EU is not the answer. Local conditions must be understood and incorporated into the enforcement of regulations in order for them to be implemented effectively and efficiently. Regulations only work if they are accepted and understood.

The solution to the issues is to implement the EU directives more consistently across countries. Committees should be established to develop the rules and then supervisory committees could be established to oversee the implementation of the rules and directives. Bottom line is that there needs to be much greater cooperation between regulators.

Andrzej Kulik, Regional Director, PRIMA, Poland discussed the importance of better education in improving risk management in the financial markets of the region. In his view, risk management is local and cannot be centralized. Banks and organizations must manage risk locally in order to account for local market conditions. However, local regulations should be consistent with world standards. This should be seen as a logical step in the development of local financial markets. Local risk managers need to possess similar skills to their counterparts in large financial hubs. Otherwise, the trend to centralize all risk management functions will continue.

As emerging markets are capital demanders, they must take steps to provide better, more transparent information in their risk management capabilities. In order to do this, it is fundamental to have a sufficient number of well-trained people in regulatory bodies, the banking/finance industry, and in academia.

Panel #2: The Future of the Domestic Financial Sector

This panel focused on how to deepen the local financial markets, the possibility of developing new asset classes, such as mortgage backed securities and the outlook for national stock exchanges in the region.

The moderator, **Wojciech Lipka, Managing Director, FitchRatings, Poland** opened the session with this question. On the eve of EU accession, is there a future for domestic capital markets? This is not just an academic issue and the answer has implications for the capital markets industry and professionals and to some extent, the economy overall.

Maria Hurajova, Director General, Bratislava Stock Exchange, Slovakia provided a brief overview of the Bratislava Stock Exchange (BSE). A significant amount of work has been done in the development of the market and the stock exchange is benefiting. Foreign direct investment is coming to Slovakia, but not through the exchange. While this is good for the economy, it has had little impact on the capital market development in Slovakia.

The capital markets' picture in Slovakia is mixed. The Slovak stock index experienced one of its most successful years. For the future, the BSE needs to work on the development of corporate bonds and is trying to convince investors to list bonds as a step towards utilizing the capital markets. However, because the banking sector is over liquid there is little incentive for banks and companies to issue bonds. As a result, the BSE is focusing on capturing gains from privatization and pension reform. Fifty percent of pension investments must be held in domestic instruments; this requirement has helped to maintain funds in the market. In addition, to improve the quality of the stock exchange, the BSE has been focusing on improving corporate governance to make the market more transparent and more reliable for potential investors.

Zbigniew Krysiak, Chairman, Committee for Real Estate Finance, Polish Bankers Association, Poland discussed the development of the mortgage market in Poland, which has grown between 25-40 percent annually since 2001. Currently, 30 banks are providing mortgage loans and outstanding mortgages total approximately USD 8 billion. Nonetheless, this still represents only 4 percent of GDP in Poland, a very low share compared to the current EU countries. So mortgages markets can continue to grow at a rapid pace as long as there is adequate funding. This is why the development of secondary mortgage markets, particularly instruments such as mortgage backed securities, is so important. Without new sources of funding, in a few years, the development of the market will be slowed because of the risks and capital requirements for the banks. EU membership will be positive for the local mortgage markets.

The key issues that need to be addressed by governments and the industry are the development of more aggressive financing for construction companies, development of more mature insurance and guarantee systems, creation of incentives for the development of secondary market institutions for securitization, and development of financial systems for rental housing. The Polish Bankers' Association intends to play an important role in creating secondary mortgage market instruments and the necessary legal framework. The Committee for Real Estate Financing has focused on risk management and education. In conclusion, capital markets development is going in the right direction. Well established institutional investors exist with growing demand for new debt instruments. A well developed primary mortgage market in Poland will help in the secondary mortgage market activities. The recent EU initiative to create the European Mortgage Finance Agency looks promising for the region.

Janusz Czarzasty, President of the Management Board, Centralna Tabela Oferta (CeTO), S.A., Poland described CeTO as a company licensed to organize and manage the regulated off-exchange market in Poland, and simultaneously, to create electronic platforms for trading in securities and other financial instruments on the non-regulated market. He listed several problems with the public market which need to be addressed, including: the lack of appropriate regulatory solutions for debt market instruments; the role of brokerage houses as intermediaries on the market; and, a lack of regulation allowing banks to serve as intermediaries on CeTO. He characterized the most likely future scenario for the evolution of the financial sector in Poland as consolidation of the banking sector and a strengthening role of the non-banking sector, especially institutional investors. CeTO is playing a significant role in developing the capital markets in Poland.

Currently, steps are being taken to allow access to the electronic platform of non-bank market participants. CeTO is lobbying for banks' participation in the CeTo public market as intermediaries. Their goal is to expand the membership and participation access and promote debt instruments as an attractive alternative to other sources of financing.

In response to questions about whether there are efforts being made by stock exchanges in the region to cooperate in order to survive in some form over the next few years, **Ms. Hurajova** said that the big problem until recently was that the stock exchanges have not been able to find a way to cooperate that would be beneficial for all countries. It is not easy. We are for profit companies operating with very different operating principles. What we see now is that we need to adjust our legislation to fit the EU requirements. It is within the context of the EU that the CEE stock exchanges are finally discovering that as neighbors we can find a common platform to work together. **Ms. Sarmienta Salazdiene, of the National Stock Exchange of Lithuania,** added that being a small market, the NSEL has always tried to cooperate with other markets, primarily in joint marketing and exchange of information. USAID programs and PFS have helped a lot in this regard. As we speak, the Lithuanian stock market is going through privatization. The two bidders are both European. Privatization is viewed very positively as a means to join other European platforms and make it easier for investors to gain access to local markets as well as allow Lithuanian companies greater access to international capital.

Ken Lanza, as conference moderator, summarized the themes from the morning sessions. Debt markets are very active but are being crowded out by large numbers of government issuances. The need to focus on corporate debt is clearly there. Mortgage demand is increasing. The need for increased liquidity can be satisfied to some extent from pension funds. Pension funds are being restricted by legislation that needs to be changed and thought about. Secondary markets are underdeveloped and are an important next wave in terms of where financial sectors need to move. Capital markets are clearly dominated by debt. Capital market platforms and probably integration will come from market forces. Privatization is one way to begin integration of clearing and settlement systems.

Panel #3: Financial Sector: Challenges for Development and Regulation of Regional Pension and Insurance Markets

Tibor Parniczky, Regional Coordinator, International Network of Pensions Regulators and Supervisors, France provided a broad overview of pension reform in the region. After a decade of reforms, Hungary, Poland, Bulgaria, Croatia, Latvia, Estonia, Lithuania, Slovakia, and Romania all have adopted a three pillar system. Only the Czech Republic and Slovenia of the PFS countries have only voluntary private pension funds. (See power point presentation for more details on each country.) Pension reform is still young in all these countries and pension fund management and supervision are still in the beginning stages. It will be important to continue to assess these markets to determine if they meet international standards. Supervisory staff and pension fund managers need more training to be more effective in their jobs.

Csaba Nagy, Managing Director, OTP Private Pension Fund, Hungary summarized the achievements and future challenges of the pension funds in Hungary. Hungary was one of the first markets in the region to set up pension funds with voluntary mutual pension funds established in 1993 and mandatory private funds in 1998-99. The key features of these two types of funds are that they: are made up of non-profit organizations; are fully funded schemes; grant tax incentives in order to stimulate savings; determine benefits based on the contributions paid on behalf of the member and the investment returns earned; and usually have mutual (member) ownership. Mr. Nagy emphasized that the funds were the most efficient savings vehicle to provide pension supplement after retirement

One issue for Hungary, is that despite initial strict licensing criteria, there are too many pension funds. Some consolidation has taken place. It was market driven as several funds could not afford the IT improvements necessary. This problem is only going to get worse; in 10 years, pensioners can withdraw their money from the third pillar pension funds which will put pressure on many funds.

Kadi Oorn, Chief Specialist, Insurance Division, Financial Policy Dept, Ministry of Finance, Estonia discussed the developments in the Estonian Pension system focusing on second pillar coverage. Estonia's system is similar to the Hungarian one. In Estonia, it is compulsory for new entrants to the labor market to be a part of the second pillar coverage There are six pension fund managers in Estonia. Estonia is a small country with a population of only 1.4 million and the funds invest primarily in foreign bonds held outside the Baltic states. There are no restrictions on foreign investment though there is a currency matching rule. Only 30 percent can be invested in other currencies. The rationale is to ensure the highest returns to the pensioners. Twenty eight percent of pension investments are in the Baltics and only 10 percent in Estonia.

A current issue for pension funds is investment in real estate. Direct investment in real estate is currently allowed, though funds have not done so to date. Estonia is planning to introduce mortgage funds.

Tibor Parniczky summed up the panel discussion by noting that consolidation of pension funds will be a challenge for the future. Competition in the market is a good thing. Regulators should view their role as stimulating competition in the marketplace. He said that in 2001, there were technical rules that were established for the mergers of pension funds. This is an important area that needs attention. There may need to be a reduction in the number of pension funds and regulators need to be prepared.

Panel #4: Corporate Governance and International Accounting Standards/International Financial Reporting Standards

Ewa Piwowar, Executive Director, Management Board Dept., Bank BPH PBK S.A, Poland said that one of the key challenges facing the PFS countries is convergence with the EU financial services action plan that is expected to be completed by the end of 2005. The goal is to create a pan European financial market that can compete with the US. In the current stage, there is not much that can be done by the PFS countries, but in May, we should have a say in the implementation plan. The CEE/Baltic markets are relatively young and underdeveloped compared to the other European markets. The positive side of this is that it has enabled us to follow world proven schemes and best practices, thus avoiding mistakes and bad habits of many of the mature markets.

While CEE/Baltic markets lag in some financial sector areas, best practices are embedded into the system. This is one of the positive outcomes of the PFS program. In Poland, awareness of corporate governance issues is due in part to the PFS program. The CEE/Baltic countries are in line or exceed the standards of the EU in corporate governance and it is only now that Western Europe is really starting to address this. Recent developments in corporate governance have been really promising in most areas, but there is still plenty to be done in our countries. Foreign strategic investors dominate the ownership structures of the CEE publicly listed companies. Their impact within subsidiaries can not be underestimated. The most neglected corporate governance issues are: top management remuneration, directors' accountability for decisions made, and lack of Supervisory Board committees.

Miroslaw Kosmider, President of the Management Board, Pro Audit, Poland focused on accounting and auditing standards within the PFS countries, specifically in Poland. Accounting is the common language of business and therefore, it is important that it is standardized. Every EU and EU accession country is in a different stage in the implementation of IAS. 2005 will see the biggest accounting changes ever in Europe, when the EU will require that all publicly traded companies report using IAS. Other companies can continue to report using national accounting standards, so it is important to make Polish standards more similar to IAS. However, the transition to IAS in Poland has been slow for numerous reasons -- history, tradition, the legal culture and the mentality of the managers, auditors, and accountants.

In addition, over 75 percent of Polish companies are not legally required to have an audit. This is a very big risk for investors, banks, and the safety of the economy. There are also concerns in Poland about the independence of auditors, since they can provide advisory services to those companies they audit, though not bookkeeping services. Rules governing who has the authority within a company to appoint an auditor also need clarifying. While it should be the board of directors, this authority can be delegated to another person in the organization. Last year, in order to address some of these issues, there was a special committee established to oversee the quality of audits in Poland.

In response to a question about accounting requirements for small and medium enterprises and whether IAS can be too burdensome; Mr. Kosmider said that perhaps SMEs may need to have different rules and not be required to use full IAS.

The OECD Principles of Corporate Governance issued in May 1999 are the most significant multilateral statement on corporate governance issues and are particularly important in the EU countries given the lack of a uniform company law. The Principles have been recognized as one of 12 key standards for sound financial systems by the Financial Stability Forum. **Bob Strahota, Assistant Director, International Affairs, US Securities and Exchange Commission,** also provided an overview of the recent developments in Corporate Governance principles that were agreed to at the OECD Steering Group meeting in February 2004. The changes attempt to broaden the concept of corporate governance to look at the bigger picture. For example, the principles have been extended from protecting rights of shareholders to the identification of additional rights in order to facilitate their exercise. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress. The principle that stakeholders should have access to relevant information has been strengthened to clarify that such information should be sufficient and reliable and that it should be provided on a timely and regular basis. Disclosure and transparency issues have been strengthened to require additional material information to be disclosed. Finally, the responsibilities of boards have been further clarified to establish that they should apply high ethical standards. The OECD Principles recognize the primacy of the board of directors as essential to sound corporate governance.

Egle Surpliene, Vice-chairperson, Securities Commission, Lithuania thanked USAID and EWMI for all of the assistance provided through the PFS program. She stated that USAID was one of the first organizations to help establish regulatory institutions in the eight PFS countries. Regarding the impact of EU accession, Ms. Surpliene asked "Are we potential losers or winners?" She identified three market players: issuers, investors, and financial intermediaries, and evaluated whether they have been winners or losers in the process of financial sector development. Issuers are potential winners in the unified EU market. Because of the strict regulation and disclosure requirements, companies will find it easier to raise capital in the wider market and will be more attractive for the international investors. Investors are also winners, because they will be able to understand better the situation of specific countries and companies. As for the financial intermediaries, they will face the strongest competition. However, most of the main players in the Central European markets are already owned by foreigners so they should be experienced in dealing with international competition. In sum, whether EU accession is good or bad depends on the partners that the countries will have. Therefore, it is best to be optimistic that we will all be winners.

Panel #5: Prevention of Money Laundering: Compliance and Enforcement

Richard N. Seaman, Regional Advisor, Financial Crimes Law Enforcement, US Department of the Treasury, Hungary presented the three necessities for an effective anti-money laundering system – an adequate legal and regulatory framework, strong implementation by public and private institutions, and effective application of enforcement mechanisms to ensure compliance and punishment of wrongdoers. The PFS countries have made significant progress in the first two areas, however, they are struggling with the application of enforcement mechanisms. Until this improves, anti-money laundering efforts will continue to suffer. He then discussed the common problem areas in combating money laundering and terrorist financing including: low priority of money laundering enforcement, until recently; an insufficient legal framework; lack of access for financial intelligence units to police and tax authority databases, insufficient funds to carry out many of the tasks assigned to them; and finally, a lack of awareness of terrorist financing methodologies. These issues are common problems throughout the region as well as in the countries currently members of the EU, as evident by the findings of a study on the Financial Intelligence Unit of the UK in a recent European Policy Forum report.

In response to a question about the international aspects of money laundering and the cooperation to share information between countries, Mr. Seaman said that this highlights the number one problem in tracking money laundering. It is complex and transnational. Once money goes to another country, it puts it out of reach of law enforcement, because these countries are not necessarily interested in cooperating. Once we get companies in line to cooperate, the money launderer has moved money to some place else. Many task forces have begun to focus more and more on the exchange of information between countries. There is movement in this area, but not as much as there should be. Don't neglect the informal network of communication.

Michael Adlem, Partner, Forensic Services, Deloitte & Touche Central Europe, Poland discussed several of his experiences in working on anti money laundering issues in Western Europe and the UK. Specifically, he stated that, although the laws were in place, it wasn't until 2001 that the regulators actually started to regulate. Surprisingly, banks actually knew about the corruption and money laundering activities that were occurring in their banks and knew where the funds were coming from. He then continued to tell anecdotes of some of his experiences in working with banks throughout Europe to demonstrate some of the inefficient anti-money laundering processes and policies in place at banks. He also discussed several positive developments that have occurred in the prevention of money laundering. At one bank in the region, they are doing a complete review of everyone in the bank and closing down inactive and questionable accounts. He ended by stating that regulators do need to regulate and enforce the laws in order for any anti money laundering system to be truly effective.

Cezary Michalczuk, Public Prosecutor, Ministry of Justice, Poland presented the changes in the Polish legal system from the point of view of the prosecutors. When he started his career, he was not aware of the term 'money laundering' because it was not introduced until 1997. When it was introduced, people were not sufficiently trained and therefore, did not realize the complexity of the problems. There have been several changes in the Polish legal framework since 1997. For the most part, Polish anti money laundering standards are in line with international standards. The law is fine, but the practice does not necessarily follow. More training and support is needed for the effective implementation of the legal statutes to prevent money laundering. So far, Poland has adopted several international aspects of money laundering to be in compliance with the EU.

PFS Implementing Partners

Geoff Mazullo, Director, Partners for Financial Stability, East West Management Institute described EWMI's implementation of the PFS program. He stressed that as a public private partnership, PFS required financial contributions from EWMI and the counterparts in the eight countries. EWMI has implemented 69 activities that reached over 3,000 participants in all eight countries and across all technical areas described earlier. One of the important legacies, according to Mr. Mazullo is the extensive PFS network of financial sector professionals, the involvement of numerous counterpart organizations and the contact database that was established. He also highlighted the enormous progress that was achieved during the PFS program in all the technical areas giving special recognition to the significant improvements in the disclosure and transparency of the capital markets in the region. Mr. Mazullo ended by noting that it has been a pleasure and an honor to work with all the PFS participants and thanking everyone for their dedication.

Sal Pappalardo, Director, FSVC presented FSVC's involvement in the PFS program. He gave an overview of the types of activities completed and highlighted select program achievements. Mr. Pappalardo commended the cross-country assistance to leverage the regional expertise in the region that has occurred under the program. He closed with a brief summary of some of the remaining challenges and opportunities in the region, which include the importance of sustaining US institutional linkages and the need for continued assistance to support further reforms in internal audit and insurance market development.

Closing Comments

In summing up the discussions, **Jean Lange, Senior Financial Sector Advisor, Office of Economic Growth, Bureau for Europe & Eurasia, USAID** thanked all the participants for the high quality and very thoughtful presentations and discussion. This reflects the success in developing a professional financial community across the region. The financial sectors in Central and Eastern Europe and the Baltics remain very bank centric similar to continental European financial sectors. This means that capital markets have been slower to develop. Pension reform and the demand for non-government securities should help drive and catalyze the introduction of new products, such as mortgage and corporate bonds and mortgage-backed securities. Given entry into the EU, the impact of pension and insurance reform may be diminished since institutional investors will now have easier access to the European markets as financial borders come down. EU accession will continue to change the dynamics of the financial markets in the eight PFS countries. Competition and consolidation will give the regulators a lot of work to do and strong regulatory oversight will be needed. The financial sector professionals in the PFS countries have much to offer to their current EU counterparts.

Ms. Lange said that in 1998 when USAID designed this program, they could not have envisioned a meeting like this concluding conference nor imagine the kind of impact that the program has had. She congratulated everyone in attendance, including all of the counterparts and the implementers for their contributions to and enthusiasm for the PFS program She restated the points made at the beginning of the day, that there are still vital US economic and commercial interests in all of these countries. The US is not ending its relationship with the financial sector counterparts in these eight countries, but beginning a new partnership. She stated that USAID is looking forward to working with all of the participants as it implements programs through the rest of Europe and Eurasia since everyone at the conference has so much to offer.

Ken Lanza, Director, Office of Economic Growth, Bureau for Europe & Eurasia, USAID closed the conference by thanking the counterparts, implementers, panelists, speakers and conference organizers.