PARTNERS FOR FINANCIAL STABILITY: AN ASSESSMENT

A REPORT SUMBITTED TO THE UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPEMNT

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By

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EXECUTIVE SUMMARY

When USAID launched the Partners for Financial Stability (PFS) program in July 1999 as a post-presence activity in eight CEE countries, it was decided that the financial sector in all of them could benefit from additional technical assistance in the fields of accountancy, banking regulation, capital markets, corporate governance, and pension reform. PFS was designed to support specific, short-term consultancy assignments or participation at regional conferences where such issues would be addressed. From the outset, cost-sharing was an important condition of PFS funding.

This report addresses the activities of USAID and four Implementers – Financial Services Volunteer Corps (FSVC), East-West Management Institute (EWMI), U.S. Treasury Department (Treasury), and U.S. Securities and Exchange Commission (SEC) – in managing the delivery of that assistance to the post-presence countries. The report was prepared through an extensive interview process, both in the U.S. and three of the CEE countries. Cooperation was received from all parties. The most important recommendations are those needed to tighten senior level management control by USAID, and are as follows:

1. Improvement of communication at all levels: everything from a clear Mission Statement – through individual country strategies – through to the individual projects. PFS activities should be known to all relevant Embassies as well as the status of applications from their countries. Expanded and active use of the Technical Review Committee (TRC), is critical to give the PFS focus, direction, and the sense that informed decisions are being made when required.

2. Development and implementation of a carefully coordinated and monitored marketing program, to include a PFS information package, for use by USAID and Implementers. Among other things, the program should eliminate any confusion attached to the concept of marketing PFS, either by USAID or an Implementer. The program will continue to be demand driven.

3. Renegotiation of the Cooperative Agreements with EWMI and FSVC to clarify the roles and responsibilities of each. Terms and conditions of the Agreements must be consistent wherever possible, and structured to encourage cooperation and coordination with one another, and with the three USG Implementers. Importantly, the Agreements must be adhered to by all.

4. Restructuring of the application format and process so it is clearly understood and more responsive. Applicants might be promised a response within, say, 60-90 days or an indication of why further delay had become necessary. This process should involve less reliance on U.S. Embassies and more involvement by USAID.

5. Establishment of management controls within USAID to track essential aspects of the program such as: (1) marketing activities, (2) TRC decisions requiring follow-up, and (3) application status.

Although this report concentrates on PFS management, certain substantive issues have emerged that are difficult to disassociate from the management process. They are:

1. Since the beginning of the PFS program, and until quite recently, assistance has been delivered through short-term assignments of less than a month or conferences lasting no more than a few days. Given the complexity of financial sectors in the post-presence countries, some thought should be given to considering longer-term projects eligible for PFS support, understanding that a long-term approach may be necessary on an exceptional basis.

2. The concept of "partnering" with Implementers and Counterparts, should be reconsidered in the context of its use under PFS.

On the positive side, it was important to emphasize the financial sector in designing a post-presence USAID program for the CEE countries. Furthermore, the interviews have made clear that the quality of PFS assistance has been high. With minor exceptions, the projects and conferences have proven beneficial and there is a steady demand for additional support. This attests to the professionalism of the individuals performing PFS tasks.

The key recommendations present in this report, and the ones that should be promptly implemented, concern the elements comprising greater management control over PFS. See Conclusions and Recommendations for more detail. With a greater degree of high-level management attention, a program that is already delivering useful technical assistance to an essential sector could become even better.

GLOSSARY OF ACRONYMS

AEEB – Assistance for Eastern Europe and the Baltic States
CDIE – Center for Development Information and Evaluation
CEE – Central and Eastern Europe
E&E – Europe & Eurasia
EBRD – European Bank for Reconstruction and Development
EWMI – East-West Management Institute
EU – European Union
FAA – Foreign Assistance Act
FDIC – U.S. Federal Deposit Insurance Corporation
FSVC – Financial Services Volunteer Corporation
GBTI – General Business, Trade, and Investment
IAS – International Accounting Standards
IMF – International Monetary Fund
IQC – Indefinite Quantity Contract
KOB – Konsolidnaci Banka
MIS – Management Information System
NGO – Non-Governmental Organization
NIS – Newly Independent States
PFS – Partners for Financial Stability
PVO – Private Volunteer Organization
RFA – Request For Assistance
RFQ – Request For Quotation
SEC – U.S. Securities and Exchange Commission
SEE – South Eastern Europe
SEED – Support for Eastern European Democracy (to be supplanted by AEEB)
SEGIR – Support for Economic Growth and Institutional Reform
SKA – Slovak Konsolidnaci Agency
TRC – Technical Review Committee
USAID – U.S. Agency for International Development
USG – United States Government

CHAPTER I

Introduction and Report Methodology

<u>Introduction</u>

In 1997-98, as USAID began to terminate its bilateral assistance programs in central Europe, the Agency became convinced that a degree of support was still justified with respect to the financial sector. By early 2001, bilateral program closure was in effect with respect to the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia. They have been “graduated” from most USAID programs, and are referred to as “post-presence” countries. Concurrent with the end of bilateral assistance programs, most USAID Missions in these countries have been closed or are being reoriented to focus on countries in the SEE region.

Financial sector reform was selected as an area which would continue to receive a modest assistance effort due to the problems encountered in acceptance of Western standards of market-oriented transparency, coupled with the adverse effect this could have on the development of national economies were continuation the reform effort abandoned. Furthermore, it was an area where USAID bilateral assistance programs had been reasonably effective and where many of the post-presence countries indicated that additional assistance was needed.

The program designed during the first half of 1999 to address this need was termed Partners For Financial Stability (PFS). It was launched in July 1999 and became effective in the beginning of FY 2000. The financial sector in the post-presence countries is considered to include: banking, capital markets, insurance, and pensions. In many of these countries USAID provided bilateral assistance for the financial sector prior to mid-1999, and the advent of PFS meant continuation of support, but under a modified format, rather than termination, as was the case with other programs. Agreements were entered into by USAID with two USG agencies, a U.S. NGO, and a U.S. PVO that were tasked with delivering specific types of technical assistance to recipients (Counterparts) in the post-presence countries. Although not a legislative requirement, it was expected by USAID that PFS would have a “sunset” provision after five years, i.e. around mid-2004 <u>all</u> programs in post-presence countries would cease.

<u>Report Methodology</u>

In order to conduct an assessment of PFS, USAID’s Europe and Eurasia (E&E) Bureau signed a contract with Nathan Associates, Inc. in early October 2000 under SEGIR GBTI. In Task Order No. GBTI-010, dated October 24, 2000, Nathan subcontracted the work to First Washington Associates (FWA), Arlington, VA. Activity under the FWA subcontract commenced in January 2001. Edward A. Greene, Vice President, and John W. Lentz, Senior Associate, were assigned by FWA to perform its work under the FWA subcontract. The work comprises an assessment of the PFS program concentrating on operations of East-West Management Institute (EWMI), Financial Services Volunteer

Corps (FSVC), U.S. Department of the Treasury (Treasury), and the U.S. Securities and Exchange Commission (SEC). These four entities are collectively referred to as Implementers.

Primary objectives of FWA were to determine which mechanisms were used by the different Implementers, to measure the impact of each approach, to gauge the performance of Implementers and Counterparts, assess the extent to which PFS activities are helping to develop sustainable partnerships, consider new ways to develop and support partnerships, identify problems encountered and lessons learned, and finally to offer recommendations on further steps to be taken.

These objectives were not intended to involve analysis of the substance of the technical assistance delivered under PFS, but rather the management and process of that delivery. While substance has, at times, been addressed, it is within the context of illustrating an aspect of management or process.

The work was divided into the following segments:

1. Preparation of questionnaires for PFS Implementers (Appendix A) and Counterparts (Appendix B). These were used as interview guides and were not given to the party interviewed; however, they indicate the initial emphasis placed on partnering. Both Appendix A and B were cleared in draft with USAID.

2. FWA attended the Annual Implementing Partners Conference, sponsored by USAID's E&E Bureau at the Hotel Washington, Washington, D.C., on January 30-31, 2001.

3. Each of the four original Implementers was interviewed in the U.S. with a member of USAID's staff present. In addition, there were a series of early discussions with USAID itself. These took place between February 6-15, 2001. The initial U.S. interview notes are in Appendix C.

4. Between February 19 and March 3, 2001, a trip was made to three post-presence countries where the PFS program was active: Hungary, Slovakia, and the Czech Republic (Target Countries). The FWA team was accompanied by a member of USAID's staff. Interviews with two of the Implementers, numerous Counterparts, and the U.S. Embassies were carried out. See Appendix D for the interview notes.

5. On March 7, and again on March 14, 2001, FWA gave debriefings to E&E Bureau staff on preliminary findings of the trip to the three post-presence countries.

6. During the remainder of March 2001, a final series of interviews was conducted by the FWA team with each of the original Implementers. These

interviews were conducted by the FWA staff alone. Interview notes are in Appendix E.

7. On May 10, 2001, FWA gave a briefing to the PFS Technical Review Committee that summarized the conclusions and recommendations of this report.

8. On May 15, 2001, the subject report was submitted to USAID in draft.

FWA is prepared to disseminate copies of the final report to all parties requested by USAID.

CHAPTER II

Existing PFS Program

Background

Since its inception in July 1999, the PFS has focused on financing technical assistance to address problems in the financial sectors in the eight post-presence countries of central and eastern Europe (CEE). That problems still persisted after 8-9 years of USAID bilateral support is not surprising as the financial sector was proving less than tractable in its conversion to the market-oriented, transparent systems that characterize Western practice. Many laws, accounting standards, disclosure requirements, financial sector regulation practices, and corporate governance procedures were still based on socialist or "command" principles. Alternatively, some principles, were not even recognized. A related and wide-ranging issue concerned bank lending criteria. They were often based, not on measures of borrower viability, but on political connections that included an unwillingness to deal forthrightly with non-performing loans. Every step forward in these areas, and there were some, took on an intrenched constituency, delaying the reform process.

Yet, because of the importance of the financial sector to the economies of CEE countries, as well as the dire need of many post-presence countries to attract Western capital for rebuilding inefficient industrial enterprises, the sector laid legitimate claim to a continuance of USAID assistance. A corollary objective was to protect U.S. direct and portfolio investors.

As might be expected, the post-presence countries varied in their degree of willingness to accept Western financial practices. In the three Target Countries visited, Hungary has the most Western-oriented financial sector and Slovakia the least, with the Czech Republic showing good progress in some areas and spotty performance in others. The fairly sharp division among these three post-presence countries appears representative of the eight in this category. In other words, when holding their financial sector practices up to Western standards, some of these countries were clearly unprepared for any sort of graduation. Much work remained; however, the pressures on USAID to curtail its bilateral programs could not be resisted. For Slovakia and the Czech Republic, as well as other post-presence countries in specific disciplines, further financial sector technical assistance continues as a high developmental priority. This view was shared by other donors such as the European Union (EU), European Bank for Reconstruction and Development (EBRD), and World Bank that are active in the region.

Examples of ongoing, possibly long-term needs include:

- The Slovak Konsolidation Agency (SKA), is a new financial institution, established in part with pre-PFS bilateral support, to take non-performing loans from commercial bank balance sheets and package them for sale to foreign investors. SKA has been created, but, according to the contractor carrying out the work for USAID, the staff require some six months of additional training. To back away from the project at this stage could cause the bad debts to be left in limbo on the original lending institution's balance sheets, thus delaying bank privatization and creation of fully objective bank lending criteria. It was encouraging to have this problem discussed at the TRC meeting of May 10, 2001.

- The National Bank of Slovakia, the Central Bank, had previously received long-term technical assistance from an advisor supported under a bilateral USAID program that pre-dated PFS. During a visit to this bank on February 23, 2001, USAID was informed that an additional request was being prepared. It may be important to coordinate this with the World Bank and that USAID keep an open mind about the desirability of supporting assistance over a longer period than is customary under PFS.

In moving from bilateral support to the PFS program as a delivery vehicle for this assistance, USAID developed the concept of Implementer and created a novel relationship with two of them, EWMI and FSVC, through Cooperative Agreements. An Implementer is essentially an arranger that either delivers the assistance directly or causes it to be delivered. A further discussion of Implementers is in the next section; however, the new relationships with two of them, EWMI and FSVC, involved USAID theoretically placing a high degree of trust in their activities and operations. The new relationships appeared necessary since USAID Missions in the post-presence countries have closed and the Agency believed it had to be represented on the ground for PFS to succeed. That the present Cooperative Agreements lack consistency, appear to have contributed to some USAID loss of control over the PFS program, and created some friction with the two Implementers, will be a central theme of the subject report.

USAID also considered that establishing a "partnership" with Implementers and Counterparts as one of the new and desirable aspects of PFS; however, FWA can find almost no elements of PFS activity that would fall under a common definition of partnership. See Chapter III, Section 2, for a further discussion of this point.

As was common with many USAID programs in the recent past, the Agency required its grant support to be leveraged. Such co-financing is desirable in that it: (1) spreads scarce USAID resources over more projects, and (2) causes the ultimate grantee, or Counterpart, to carefully review its assistance request since some of its own resources must be committed. Co-financing may be in cash or an "in kind" contribution of services, reflecting the cash-poor nature of many of these institutions.

In many cases, financial sector technical assistance can be effectively delivered from the U.S., particularly in such disciplines as accounting standards and banking reform. In some others, such as corporate governance and financial sector regulation, practices between the U.S. and Europe differ. USAID should be aware that the PFS assistance it supports does not necessarily need to stress adoption of U.S. techniques. Alternatively, it could concentrate on areas where there are no differences in practice; however, this is not recommended. Contrasts between the size of the U.S. financial sector, the world's largest, and, say, that of Slovakia are enormous in terms of near-term developmental needs and the resources available to accommodate them. Furthermore, most of the post-presence countries are consciously designing their financial sectors with the objective of EU integration – at a date uncertain, but possibly 4 to 5 years off. When EU standards for a particular financial sector activity differ markedly from U.S. practice, USAID might consider encouraging one of the numerous European financial institutions to provide the appropriate assistance.

This is only to repeat the basic developmental mantra that effective assistance must work within the country context. Some of the most successful PFS training appears to have been through "East-East" exchanges where one country in the region offers its experience to another. For this training to be most useful, it would be desirable if USAID does not become overly restrictive with respect to the content delivered. Its early policy of permitting some PFS-supported conferences to include representatives from less developed countries in SEE should be continued.

It had always been expected that PFS would be "demand driven", by which it was intended by USAID that Implementers not engage Counterparts with aggressive selling tactics for delivery of specific services that they happened to have available. This is a desirable restriction on marketing for USAID, but should not be misinterpreted as a requirement that Implementers act in a completely passive manner. See Chapter II, Section 4, for further discussion.

The intention under PFS was to provide short-term assistance for discrete projects by U.S. experts with specific financial sector skills, or to partially sponsor conferences/seminars of short duration in the U.S. or in the region at which financial sector topics would be addressed. While FWA believes this approach makes sense, USAID must recognize that on occasion instances will arise where flexibility is required and long-term support may be called for. An example is the SKA situation cited above.

<u>Implementers and Counterparts</u>

For delivery of PFS technical assistance USAID continued to utilize the services of the four entities that had performed similar roles under previous bilateral programs. There are: East-West Management Institute (EWMI), Financial Services Volunteer Corps (FSVC), U.S. Treasury Department (Treasury), and U.S. Securities and Exchange Commission (SEC) – collectively known as Implementers. Following is a brief description of each Implementer, together with its intended role under PFS:

<u>EWMI</u> – This is a non-profit NGO founded in 1988 by George Soros, a financier and philanthropist, to assist with legal and economic reform in central and eastern European countries as well as the former Soviet Union/Russia. EWMI has been active in most of the post-presence countries over the past 13 years by providing technical assistance in legal and regulatory reform, privatization, enterprise restructuring, and capital markets development. This has taken the form of assigning individual consultants on a short-term

basis or arranging conferences. Since EWMI has an independent source of funds, it is able to comply with USAID's cost-sharing requirement on all PFS projects.

In 1995 EWMI signed a multi-year contract with USAID to provide technical assistance in the CEE and NIS countries. With respect to the post-presence countries, this contract was replaced with a Cooperative Agreement with USAID dated 12/6/99. EWMI was assigned to carry out regional PFS responsibilities, although it has the ability to handle bilateral assignments as well. EWMI maintains U.S. offices in New York and Washington, as well as a regional office for the CEE and SEE countries in Budapest. Under this contract USAID has the right to: (1) approve key personnel hired by EWMI, (2) review the annual work plan, and (3) approve all projects where USAID's share would exceed U.S.$10,000. It is interesting to note that EWMI has never attempted to use the USAID approval process for larger projects as all of theirs have had a USAID component of less than $10,000. Communication with other Implementers is informal and irregular, although recent conversations with the SEC have been initiated.

FSVC - Organized in 1990 as a PVO, FSVC has promoted the development of market-oriented financial systems in over 25 countries worldwide. One area of concentration has been the CEE countries; however, FSVC has also been active in Russia, Ukraine, Poland, Indonesia, Mongolia, and China. In addition to USAID that provided some 35% of its 1999 revenues, FSVC receives funding from the World Bank, U.S. Treasury, as well as various foundations and individuals. Its style of delivering technical assistance has been, in most cases, to recruit U.S. citizens from their current employers or, in a few instances, those in retirement. These volunteers undertake short-term (typical length of 1-2 weeks) assignments abroad following receipt of a specific request from the host country. The individual's time is donated; however, salaries may continue to be paid by an employer. FSVC has also financed participation of key host country institution staff members at conferences in their fields. FSVC only pays for a portion of travel and per diem expense; consequently, its support is delivered on a cost-effective basis.

Based on its experience, FSVC believes it is qualified to handle both bilateral and regional responsibilities under PFS. On 2/17/98 FSVC signed a Cooperative Agreement with USAID under which it was subsequently given responsibility under PFS to provide bilateral financial sector technical assistance in the post-presence countries. Under the Cooperative Agreement, USAID has the right to approve key FSVC personnel and all individual projects. Unlike FSVC, there is no requirement for submission of an annual work plan as all projects must be approved in advance by the TRC. Since this Agreement pre-dates PFS, it has been amended numerous times. FSVC's headquarters is in New York; however, its office in Warsaw, Poland, has primary PFS responsibility. Representation and marketing in the region is largely maintained through periodic visits by New York-based personnel. With respect to projects in the Target Countries, communication with the SEC has been fairly regular, while communication with other Implementers is based on the specifics of the assignment.

Treasury – Treasury's Office of Technical Assistance was organized in 1990. It has a worldwide annual budget of about $30 million, of which $13.5 million is applicable to the region that includes the CEE and SEE countries. Technical assistance is offered in financial institution management, budget and fiscal issues, debt management, tax policy, and enforcement. Assistance is delivered on a demand driven basis, on the basis of short and long-term assignments. A regional office is maintained in Budapest with six advisors that can be assigned within the CEE and SEE regions, to the FSU, and more recently to other areas outside these regions. Nonetheless, Treasury's has only one PFS activity at present – in the Czech Republic. Treasury has an Interagency Agreement with the State Department under Section 632(a) of the Foreign Assistance Act of 1961, as amended, (FAA). This Agreement provides for an annual budget transfer of about $0.5 million in funding under the Support for Eastern European Democracy (SEED) Act to partially support Treasury's technical assistance activities. Since this is simply a budget transfer, Treasury is not obligated to provide USAID with any reporting, monitoring, or work plan requirements. Treasury has utilized this funding for its activities in the SEE and CEE countries. Treasury does not receive PFS funding that entail any of the conditionality of the other Implementers. While Treasury occasionally cooperates with other Implementers, the bulk of its technical assistance is delivered independently. Communication with other Implementers is informal and infrequent.

<u>SEC</u> – The SEC's assistance has been spearheaded by an individual, the Assistant Director, Office of International Affairs, who took an interest in the PFS program and has most of the required technical skills. The overall program commenced in 1992, predating the PFS. Assistance has been through a variety of bilateral assignments or attendance by post-presence country officials at annual SEC conferences in the U.S. for senior and intermediate level regulators. It is expected that one of these conferences will be held in Prague in the near future. The bilateral assignments have been short-term in nature to advise on securities-related laws, establishment of capital markets regulatory commissions, etc. On 9/29/00 the SEC signed an Interagency Agreement with USAID under Section 632(b) of the FAA for which $200,000 was allocated in FY 2001 for PFS activities. The SEC uses its PFS funding to pay for travel and per diem expense under the program. The agency's own budget for PFS was not revealed to FWA. The SEC has cooperated with other Implementers, either in performing a specific assignment or by participating in a conference. The SEC appears to maintain regular but informal communication links with the other Implementers.

It is noted that another USG agency, the Federal Deposit Insurance Corporation, has begun to participate in the PFS program by delivering technical assistance to financial sector Counterparts in the post-presence countries. Although its activities are too recent to be treated in this report, the presence of an additional USG agency, renders overall management by USAID all the more important.

Counterpart is the term utilized for host country PFS assistance recipients. These vary widely, but include such entities as government agencies, universities, financial industry trade associations, and NGOs. In some cases, the ultimate beneficiary is a private business or even an individual. During the Target Country survey of February 19-March 3, 2001, the general quality and professionalism of PFS assistance was praised. The only instance where assistance came into question was a U.S. training program on derivatives and commodity futures trading for the Slovak Association of Securities Dealers, the assertion being that the Association was at a far more basic level in actual operations than such a level of training would imply.

Most PFS assistance is delivered through short-term, highly specific assignments. Partial exceptions might be the long-term relations developed with an entity such as Charles University in Prague; however, this university is more of the nature of an Implementer since it serves as a venue for training. Instances where long-term assistance appears to be required are with respect to any continuing support for SKA in Bratislava, the National Bank of Slovakia, as well as KOB in Prague. While it is reasonable that the great majority of future PFS will continue to be of a short-term, 1-4 week nature, USAID should be prepared to consider exceptions in cases where a relationship of some months might be called for. The recent willingness of USAID to consider longer-term support for continuance of assistance to SKA is encouraging. The important point is to deliver effective technical assistance, not the precise timeframe over which it takes place.

Budgets

For both EWMI and FSVC, PFS funding is a major source of revenue. Each have signed multi-year Cooperative Agreements with USAID for $1.8 and $2.0 million, respectively, and 25-30% of the funding thereunder sustains administrative support functions. In the case of EWMI, program administration emanates from Washington and Budapest, while for FSVC administration is out of its New York headquarters. The situation is different for the two USG Implementers, Treasury and the SEC. With respect to Treasury, its technical assistance funding from the SEED (recently renamed AEEB) Act comes as a direct transfer without reporting requirements or other conditionality. The SEC utilizes SEED Act funding to supplement its own budget for the purposes of covering travel and per diem expenses; however, the Agency indicated the amounts are not essential to its program. If allocations under PFS were reduced or eliminated, the SEC stated it would be able to continue providing technical assistance to the CEE countries, but would have to be more selective.

Consequently, not only are four different types of contracts in place with the four Implementers, but the funding under each contract is provided with differing conditionality. This situation represents almost the maximum amount of separate combinations. It could be clarified and PFS program management strengthened if greater contracting consistency were established, particularly with EWMI and FSVC.

Some of these differing parameters are indicated in the following matrix:

	EWMI	FSVC	Treasury	SEC
Type of Agreement	Cooperative	Cooperative	Interagency under 632(a)	Interagency under 632(b)
Date of				

Agreement	12/6/99	2/17/98	N/A	9/29/00
Scope of Activity	Regional	Bilateral	No limits	No limits
Special Conditions	Work plan Key personnel TRC approval Progress reports	Key personnel Progress reports	N/A	Work plan TRC approval
Annual or Multi-Year Funding	Multi-year agreement; annual funding	Annual, but numerous extensions	Annual from SEED Act	Annual
Current PFS Budget	$600,000	$350,000	$500,000	$200,000
USAID Approval Required	If USAID portion exceeds $10,000	All Projects	No	No
Post-Presence Countries in Which Active Since 12/31/99	5	3	2	1
Degree of Co-Financing Provided	Approx. 60% by EWMI	65% by FSVC or Recipient	Varies	Varies - covers travel & per diem

<u>PFS Country Activity</u>

Technical assistance delivered under PFS might be divided into: (1) training of counterparts in conferences or seminars held in either the U.S. or regional European centers, and (2) specific technical assistance assignments, usually carried out in the host country, but sometimes in the U.S. relating to review of draft laws or regulations. Of the four Implementers above, the SEC has been most active in training through Counterpart participation in its annual conferences. EWMI has also given emphasis to training by arranging various regional meetings on such issues as corporate governance and securities market regulation. The other two implementers, FSVC and Treasury, have tended to concentrate on specific, on-site assignments, although representatives from either may participate in certain conferences.

With respect to the eight post-presence countries in which discrete assignments have taken place under PFS, the record is as follows: EWMI – Czech Republic, Hungary, Slovakia, and Slovenia; FSVC – Czech Republic, Hungary, and Slovakia; Treasury – Czech Republic and Slovakia; and SEC – Czech Republic. This represents a heavy concentration since half of the post-presence countries – Estonia, Latvia, Lithuania, and Poland – were not represented as of early 2001. Further, the Czech Republic has received specific assistance from each of the four Implementers. USAID is aware of this concentration and, since the FWA visit to the Target Countries, has begun to consider implementation of a few PFS projects in the Baltic countries and Poland.

USAID should make an effort to determine why this concentration has taken place. Possible reasons could be disinterest in the financial sector advice offered by U.S. experts or failure of the Implementers or U.S. Embassies to effectively market the program.

Chapter III

PFS Issues Related to Assumptions and Definitions

The PFS program might attain more clarity and present a more simplified management challenge if certain assumptions, definitions, and practices were re-examined. In some cases, little can be done at this stage; however, in others change is possible. This latter category comprises:

Graduated Countries and EU Accession

Even had it desired, it is doubtful whether USAID could have resisted closing its bilateral programs in 1998-2000 in the eight countries now designated as “post-presence”. They are: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia. The shrinking aggregate U.S. assistance budget, deserving appeals from developing countries (some of which were in the general region), and an impetus to demonstrate USAID success through graduation - all were factors influencing the trend.

Nonetheless, the concept of a country that had been subject to decades of socialist, anti-market economic policies suddenly “graduating” to full-fledged developed country status was always problematic. Clearly, the EU does not consider these countries sufficiently developed for near-term admittance, and both the World Bank and EBRD continue to offer financing. Final dates for their accession to the EU have not been set, but are probably at least 3-4 years away. In each country a vibrant financial sector is vital to economic progress because of its ability to effectively allocate the small pool of investment and savings. However, much financial sector developmental activity in these countries is yet to be completed. Financial fraud in many of the eight countries during the 1990s left early investors with heavy losses and a distrust of market-oriented systems, rather than hoped-for profit. The common refrain was, “If this is capitalism, we don’t want it.”

Of course, it wasn’t capitalism, but economic systems heavily influenced by corrupt practices coupled with an inability to obtain satisfactory legal redress – what one commentator termed “market bolshevism”. A valid conclusion might be that if the situation could not be reversed and true market-oriented, transparency implanted in the financial sector, much economic progress might be jeopardized. USAID’s proposal to continue in these countries with a single, modestly funded program of financial sector reform was, therefore, well placed. If effectively implemented, the economic ripple effects could be substantial.

Other donors were also prepared to back the financial sector so that a significant pool of additional technical assistance funding has become available to include the World Bank, IMF, EBRD, EU, and various European governmental bilateral programs. A common EU practice is “twinning” whereby a ministry or agency in a EU country is paired with an eastern European counterpart, and individuals are assigned from the former on long-term consultancies. Most of this assistance points the recipient country toward conforming its financial sector with those in the EU in order to speed accession. However, some EU practices differ from those in the U.S. Examples include: (1) those emphasizing a consolidated financial sector regulatory authority, rather than a variety of such bodies; and (2) advocacy of somewhat less transparency in the EU corporate governance model. Post-presence countries naturally tend toward the EU practice to ease accession, instead of adopting a U.S. practice and risking delays in membership approval if the area had to be revisited. In some cases, U.S. practices are attractive since they represent those in the world's most developed financial market.

To the extent CEE countries are drawn toward EU practices, FWA believes this ought to be viewed as a natural development, and one where any EU-related outcome was a decided improvement over practices of the recent past. With respect to PFS, USAID should be considering support for U.S. technical assistance where financial sector methods are similar, such as IAS and bad debt consolidation, rather than attempting to steer countries away from EU practices when they are desired. Alternatively, EU practices could be supported under PFS if the difference with those in the U.S. was not pronounced. To the extent influence to "go U.S." is exerted, the assistance could be ineffective as the Counterpart may not act on the message. Furthermore, many EU-related institutions are prepared to offer technical assistance in financial sectors that <u>must</u> be "harmonized" before the recipient country is granted accession.

Another complexity is that eight countries have been graduated. At one end of the developmental spectrum is a country like Hungary where most aspects of financial sector reform have taken hold (excepting pensions). At the other stands neighboring Slovakia, in which the overall reform effort is in a nascent state and backsliding could easily occur. Within the eight countries, PFS program needs vary. USAID is aware of this situation, and makes use of financial analysts in the E&E Bureau, as well as Embassy advice, when considering applications for PFS support. Nonetheless, PFS effectiveness could be enhanced if individual strategies were developed which identified how and where PFS assistance was to be directed in each of the eight post-presence countries. Country strategies should be prepared with assistance from Implementers and the particular Embassy, and could be subject to annual or semiannual review by the TRC. If a PFS project was to be considered outside an approved country strategy, it should be considered by the TRC.

<u>Partnering and Agreements with Partners</u>

<u>Partnering.</u> The word "partners" and its derivatives are used in the program's title and throughout PFS. Many aspects of partnering were described in the USAID paper, <u>Partnerships for Sustainable Enterprise Growth</u>, published in July 1999 – the same month as PFS was launched. FWA's scope of work for the subject PFS assessment requires: (1) an examination of the ways in which PFS activities are helping to develop sustainable partnerships, and (2) consideration of new ways to develop and support partnerships.

The above paper defined partner as "the broad array of organizations and individuals that interact with USAID funded activities". This all-inclusive definition is less than helpful in that it seeks to bring under the partnering tent a wide variety of entities - USG agencies; U.S. NGOs; personal services contractors/volunteers; as well as host country Government agencies, NGOs, and individuals. If the concept is to be of any use, it should be able to be defined in a helpful way that is relevant to delivery of technical assistance to the financial sector in CEE.

In the study, Durable Partnerships, submitted to USAID in March 2000 by the Academy for Educational Development, a partnership was defined as including the following key characteristics (italics follow contrasting actual PFS activity):

1. Goal of mutual benefit: Entities participating in a partnership should perceive mutual benefit. *Relations between a USG agency delivering technical assistance or an NGO managing a sub-grant program and their Counterparts do not constitute examples of mutual benefit. Establishment of roughly equivalent peer relations is an essential quality in a partnership, rather than that of dependency as between an aid giver and receiver.*

2. Long-term relationship: In the sense that USAID uses the partnering concept, long-term, sustainable relationships are implied that will endure after PFS terminates. *Although USAID's relationships with the Implementers have been in place over a long term, actual PFS assistance is delivered by a variety of individuals through assignments of about 1-4 weeks duration or conferences of no more than a few days. This is not what is normally implied by a long-term, sustainable relationship. Furthermore, the sustainability of financial sector technical assistance after the PFS program appears dependent on multilateral and European bilateral support.*

3. Written agreement that is administered with flexibility by both partners: Written agreements are present with all Implementers and in many cases between Implementers and their Counterparts. *Both NGO Implementers are concerned their Cooperative Agreements are not administered by USAID in the spirit of partnering, but more as standard procurement contracting. USG Implementers show little concern as PFS appears marginal to their overall technical assistance programs. Resource transfers under all Agreements are one directional.*

The above contrasts between some standard partnership criteria and PFS activity "on the ground" include sufficiently important differences to make one question whether PFS is a partnership or a form of short-term contracting that, indeed, may be well-suited to delivery of the services. Interestingly, in neither FSVC's annual report for 2000 (EWMI does not publish one) nor in the interview process was there any reference to partnering. FWA's conclusion is that PFS has little to do with developing "sustainable partnerships", as they might normally be defined, nor should there be new ways to "develop and support partnerships". Rather, it would seem incumbent on USAID to first define PFS partnering in a more helpful, relevant manner than in its July 1999 study, and act on the basis of that definition, or introduce a different terms, e.g. "alliances" or "linkages", that would more accurately describe the activities taking place. Language is important, and at the very least, it should not confuse participants in the PFS program.

<u>Agreements with Partners.</u> With respect to the Agreements between PFS entities, some obvious characteristics are that: (1) each of the four Implementers approaches PFS with a different style, and (2) four different types of Agreements are in place. According to their Agreements, either FSVC and EWMI have an apparent ability to take on <u>all</u> of the "arranger" functions for PFS assistance, yet sometimes similar work has been divided into bilateral (FSVC) and regional (EWMI) categories. Concern has developed when USAID assigns a project to one that the other sought. Furthermore, having a different contracting arrangement for each Implementer invites misunderstanding on all sides. USAID should consider having one style of reasonably consistent PFS contract, the Cooperative Agreement, for both EWMI and FSVC and a standard Interagency Agreement under Section 632(b) with the SEC and any USG agency participating in the future. A 632(b) Agreement would give USAID a degree of control over other the other agencies – which is warranted to justify the funding. In order to avoid disruption of the program, it is not recommended that Treasury's Agreement under Section 632(a) be modified.

In terms of PFS management skills required by USAID, the two USG agencies appear to be at one end of the spectrum and EWMI/FSVC at the other. Both Treasury and the SEC have independent, well-defined programs of technical assistance focused on their areas of expertise. Each tends to use PFS funding as a modest supplement to an existing program. If PFS were not present, FWA believes both programs would continue, but at slightly reduced levels. Being USG agencies, both seem willing to cooperate with USAID in attaining overall PFS coordination.

On the other hand, the NGO/PVO Implementers, EWMI and FSVC, call for more management attention by USAID. This is in spite of an initial attempt to establish sectors of activity for each by designating EWMI to address regional PFS activities and FSVC the bilateral. In practice, EWMI has come to be the conference arranging specialist and FSVC the entity delivering one-on-one technical assistance. Gaps to be filled relate to possible conferences that are not regional and regional conferences to which both SEE and CEE countries might benefit.

An important issue for both EWMI and FSVC is the implicit trust apparently placed in them by USAID under their Cooperative Agreements. However, they are different Cooperative Agreements. That with EWMI calls for submission of: (1) an annual work plan, following approval of which EWMI is at liberty to carry it out with broad latitude, (2) USAID approval of key personnel, (3) TRC approval of all projects involving a USAID contribution exceeding $10,000, and (4) progress reports. The contract with FSVC pre-dates PFS. It does not require TRC approval or USAID review of a work plan since all FSVC projects must first be approved by USAID. Both of these Implementers desire to renegotiate their contracts to clarify responsibilities and avoid situations where the contracts are being amended orally by USAID.

For both EWMI and FSVC, USAID funding through PFS appears more important to their overall budgets than does that provided the USG agencies. Unless the Cooperative Agreements for EWMI and FSVC are accorded careful and sympathetic attention by USAID, natural competitive forces could arise to the detriment of the program.

Separation of Regional and Bilateral Focus

The issue of regional and bilateral focus among the post-presence countries arises because of the division of responsibilities between EWMI and FSVC. This concern does not arise with Treasury and the SEC that are functionally organized and have delivered technical assistance in their areas of expertise on either a regional or bilateral basis. Since neither EWMI nor FSVC have a technical base, the division of labor between them has necessarily been demarcated by geography. The issue would resolve itself if there were a single NGO Implementer; however, the decision was taken to have two and FWA does not recommended that the status quo in this regard be altered.

Problems arise because PFS activities sometimes do not fall into precise regional (EWMI) or bilateral (FSVC) categories. In general, EWMI has devolved into the conference arranging specialist on the assumption that conferences are inherently regional, while FSVC has become the one-on-one bilateral assistance provider. Some issues that have led to concern were: (1) an FSVC proposal to hold a conference within a country where the topic was apparently only of local interest, but were told that FSVC "does not hold conferences", and (2) a program of apparently bilateral assistance that FSVC was about to begin when USAID considered the subject "regional" and the Implementer changed.

A further issue relates to the definition of "regional" as to whether it includes countries beyond the CEE nations. In many cases, a truly regional financial sector conference topic is applicable well beyond the eight post-presence countries where PFS is formally present. USAID appears to have successfully resolved this point by permitting neighboring countries outside the defined PFS area to attend such conferences, provided that the issue had arisen within the PFS region and PFS country representatives were invited. This approach should be encouraged since it is often through East-East exchanges at a conference that effective technical assistance is delivered. It would be very arbitrary to restrict this East-East approach to the eight post-presence countries.

It has previously been recommended that the Cooperative Agreements for both EWMI and FSVC be renegotiated. With respect to the regional and bilateral focus of each, a renegotiation will provide the opportunity to refine their scope of work to minimize friction on this issue in the future.

Another element that should be addressed is the role of the U.S. Embassy, and in particular the Economic Officer, in each PFS application. While USAID commonly administers its programs through Missions attached to U.S. Embassies, in post-presence countries this appears to have led to giving Embassies not only the initial review of PFS applications, but also the ability to veto them. Most other USG financing assistance agencies, when administering programs from Washington, accept applications directly from a foreign entity and only request Embassy comments thereon, with emphasis on political analysis. Assuming a PFS country strategy is first coordinated with an Embassy, it is recommended that USAID advise all parties it is prepared to accept PFS applications directly from Counterparts and that Embassies should promptly pass on applications to USAID Washington. Embassy comments would then be requested by USAID; however, responsibility for the application would be with USAID Washington at all times. This would relieve sometimes overworked Economic Officers, establish a clear line of responsibility, and resolve the problem of lack of Embassy interest in an application related to regional activity.

Marketing

When introducing PFS as a new program in mid-1999, USAID might have developed a concerted marketing program, including such aspects as: (1) preparation of a Mission Statement and program literature, (2) detailed staff briefings on program parameters, (3) program launch briefings in host country centers, and (4) follow-up marketing reviews with each Implementer. The purpose would have been to deliver a consistent, widespread message on PFS and monitor how successfully it was being received.

USAID did not adopt this approach, instead taking the view that "marketing" was to be discouraged so that unwanted technical assistance would not be pressed on a proposed Counterpart. This rather passive outlook toward marketing is not shared by EWMI, FSVC, or the Treasury – all of which believe it is important to deliver program information to possible users and make sure it is understood. The advantages of this approach, including improved applications and objective criteria on which to base amendments or denials, are generally considered to outweigh the possibility that some individuals may give a "hard sell" to an unwanted product. This problem is always present, but can be cautioned against by senior management at the outset and subsequently monitored.

With respect to marketing, it is never too late to adopt a new approach. Accordingly, it is recommended that USAID consider implementation of a PFS marketing program involving the following parameters:

1. Create a PFS "Mission Statement" to define the overall goals of the program.

2. Prepare program literature, possibly divided into brochures for private and government entities. English language material should suffice since it is the international communications medium of the financial sector.

3. Develop a set of common standards by which the Economic Officers in the Embassies can understand and interpret the program, then convene a short meeting in a CEE center at which USAID personnel would explain those standards. Clarify typical reasons for amendment or denial of an application.

4. Develop a country strategy for each of the eight PFS countries. The Implementers and relevant Embassy ought to contribute, and the final strategy should be approved by the TRC. Country strategy could be reviewed by USAID on an annual or semiannual basis.

5. Encourage Implementers to host their own PFS meetings to explain the program.

6. Develop forms and procedures for PFS feedback from Counterparts that would be submitted through the Implementers to USAID immediately after conclusion of a particular project.

Moving forward with a PFS marketing/evaluation program as outlined above should not involve selling technical assistance that was not desired, but would go far toward establishing greater uniformity of response by USAID and understanding in the field. The latter is particularly important since USAID has no direct representatives in post-presence country Embassies where PFS is one of many programs under the State Department Economic Officer.

CHAPTER IV

PFS Issues Related to Structural Constraints

Communications

Communications issues cut across a wide array of PFS program activities, and have a significant impact on its operations. For PFS to be successful, effective communications are essential, and are required at three distinct levels: the overall program level, the country/regional level, and the specific task order/project level. The following section focuses on a number of communications issues and their effect on PFS during its first 18 months of operation.

Program Level

In the broadest sense, a simple and well-understood message, that clearly articulates objectives and the means of accomplishing them, does not appear to have been developed for PFS. As a consequence, no organized plan or concerted effort was implemented at the outset which was aimed at describing the purpose and objectives of PFS, the methods employed to achieve these objectives, and the means to be used in disseminating this information to key players. Extensive conversations held with the four Implementers; USAID personnel in Washington and overseas; as well as U.S. Embassies, potential foreign government beneficiaries/recipients, and other donors in the three countries visited reveal a fundamental lack of a clear and consistent understanding of PFS and its intended objectives. Instead, what emerged from these conversations was a disparate view of PFS, which to a large extent was determined by the perceptions, biases, and specific interests of each entity. In short, at the program level, it does not appear that USAID developed and circulated a Mission Statement describing PFS and its objectives that provides a comprehensive overview of the PFS program.

Country Level/Regional Level

For each of the three countries visited (i.e. Hungary, Slovak Republic and the Czech Republic), there was no individual country plan or agreed strategy in place which outlined how, what, and where technical assistance under PFS should be directed and who should provide it. Nor does there appear to be a working mechanism or process that would allow for periodic country reviews and/or updates of developments affecting program substance and delivery. Conversations with USAID personnel, Embassy officers, and Implementers revealed significant differences of opinion regarding how and to whom PFS should be marketed and what should be said. Moreover, USAID representatives and Embassy officers expressed markedly different views of what form PFS marketing should take and how and who should be involved in it, from the views on marketing expressed by FSVC and EWMI. State and USAID expressed the concern that there was a danger FSVC and EWMI were primarily engaged in “selling”products for which there was little, if any, demand. Accordingly, it was necessary to monitor and closely control their activities. On the other hand, FSVC and EWMI believe strongly that the only way to learn what type of assistance is appropriate is to meet regularly with local entities, both public and private sector, to get a sense of what is wanted and needed, and how it can be best delivered.

Lack of an agreed and clearly annunciated PFS country strategy is further complicated by the fact that under PFS, the mandate of one of the Implementers, EWMI, is directed toward providing technical assistance in support of regionally based activities. Under PFS, Embassy economic officers are expected to play a key role in supporting the PFS process. However, their professional responsibilities call for them to focus primarily on bilateral economic issues, that is, economic issues involving the host country and the U.S., and as a consequence they cannot and do not become engaged in matters relating to issues where technical assistance involving regional approaches and solutions is being requested or proposed. Thus, the role of the PFS Implementer tasked with responsibility for providing regionally based technical assistance may not be fully appreciated by, nor seen as being relevant to the duties and role of another key PFS participant, the Embassy economics officer. Yet under the current PFS approach, EWMI and Embassy economics officers are expected to coordinate their activities and work closely together in advancing the goals of the PFS program.

Task Order/Project Level

Identification and implementation of task orders/projects under PFS is affected by a number of factors. Important among these is the type and format of the agreement USAID has executed with a particular Implementer. Each of the four Implementers currently operates under separate and distinct agreements, none of which contains the same terms and conditions. With Treasury, USAID operates under Section 632(a) of the FAA, and acts solely as a pass-through for funds Treasury receives under the SEED Act. USAID has no authority over how these funds are used by Treasury to support technical assistance in PFS countries. Exchanges of information between Treasury and other PFS participants, including USAID, is informal and limited. Coordination of Treasury's SEED-funded activities with other PFS participants is minimal.

With SEC, USAID has entered into an Interagency Agreement under Section 632(b) of the FAA. Under the Agreement, SEC, among other things, is obligated to adhere to a number of conditions governing the manner in which it uses funds to extend technical assistance in the PFS countries. Among these is the requirement that SEC'c role under PFS be coordinated through the TRC. However, the TRC has met infrequently over the last 18 months (no more than 2-3 times), and accordingly has not served as an effective platform for coordinating SEC activities nor for exchanging relevant information to other participants. Nonetheless, through its PFS related activities, SEC has managed to develop informal links and good working relationships with USAID and other PFS participants. These relationships have resulted principally from joint participation on specific PFS projects.

Like the SEC Agreement, EWMI's Cooperative Agreement with USAID also calls for it to coordinate its PFS related activities through the TRC to obtain prior approval, but only for those activities where USAID funding exceeds $10,000. For activities less this amount, EWMI has discretionary authority to proceed without prior approval. To date, no EWMI PFS activity has reached this level, and as a result, formal prior TRC review of EWMI supported technical assistance has not occurred since the introduction of PFS 18 months ago. During this time, EWMI has supported approximately 14 activities.

Other than conditions relating to cost sharing requirements, FSVC's Cooperative Agreement is broader than those of SEC and EWMI. FSVC has no conditions governing the specific use of PFS funds, and contains no provision requiring that its role be coordinated through the TRC. And unlike the SEC and EWMI agreements, FSVC is not required to submit an annual work plan. Nonetheless, FSVC views itself as being "on call", responding to periodic requests made by USAID. Accordingly, FSVC maintains regular and direct contact with USAID. Its exchanges of information and efforts aimed at coordination with other PFS participants is informal, carried out on an ad hoc basis and is determined in large measure by circumstances related to a specific project or set of issues.

USAID had attempted to facilitate communication between itself, Implementers, and U.S. Embassies by introducing a restricted web-based system known as the Extranet. This initial attempt has been abandoned as: (1) it was not compatible with Embassy computers, and (2) USAID in-house development and site design was not satisfactory. If the idea is revived, it maybe necessary to consider outside contracting for the program. Given the number of Implementers and the fact that PFS has the potential to be active in eight post-presence countries, accurate and prompt communication is essential. Consequently, FWA believes the former Extranet should be redesigned to be fully effective as the benefits appear to outweigh probable costs.

Management Control

The means for providing technical assistance in the E&E Bureau (Washington, D.C.-based personal service contractors and regional IQCs) and under PFS (non-presence countries) differs significantly from the approach followed by other geographic bureaus (global IQCs) and bilateral Missions (local staff). Under its traditional approach, USAID relies heavily, if not exclusively, upon field Missions to oversee most aspects of providing technical assistance. This includes preparation of country strategies and budgets (R 4), project identification and initiation, preparation of RFPs/RFAs, evaluating and selecting contractors' bids, and monitoring and ensuring the ultimate delivery of effective assistance. For conventional bilateral programs, Missions play a crucial management role in contributing to USAID's overall development success.

By definition, there are no field Missions in the non-presence (graduated) countries to perform these critical management functions for PFS-sponsored assistance, and accordingly, alternative management approaches need to be clearly defined and properly implemented in Washington, D.C. Unfortunately, the *ad hoc* cobbling together of existing bilateral activities and the rapid development of a new regional activity has caused PFS to be structured and managed inconsistently.

There are a number of reasons for this development, some of which are:

1. A collective Mission Statement for all PFS Implementers has not been developed.

2. The eight graduated countries bilateral R 2's did not articulate any common post-presence strategy to provide guidance to Implementers when seeking to implement PFS assistance. A strategy for PFS should be developed.

3. PFS does not have commonly accepted and followed procedures to identify, review, and approve requests for PFS sponsored assistance, and once approved, to monitor/evaluate its effectiveness.

4. The Agreements with the four (now five) Implementers differ in fundamental respects, are not consistent, and in some instances have been "informally amended".

5. There have been rare instances of overlap between FSVC and EWMI. This is due, in part, to the lack of clear implementation guidelines. A mechanism to assist the Implementers in developing relationships, between and among each other, as well as with USAID and PFS Embassies to encourage and facilitate the exchange of relevant information, would be appositive improvement.

6. The overseas marketing activities of FSVC and EWMI are not well understood, and, as a consequence, have led to confusion particularly with Embassy economics officers and some USAID personnel.

7. In general, USAID's management and staff appear to have been unable to provide a concerted and consistent direction to PFS programming.

For USIAD to effectively manage PFS from Washington, D.C., various MIS programs (e.g. Lotus Notes – Domino) and communications networks are recommended for introduction. These should include computer-based programs to: (1) monitor all Implementers in their PFS marketing, travel, and actual program activity; (2) track PFS applications from their receipt by USAID in Washington, D.C., through assignment to a processing-technical officer, to the various stages of analysis, including requesting Embassy comments, to final approval or denial, and receipt of Counterpart comments at the conclusion of the activity; (3) determine that actual follow-up took place on all TRC decisions; (4) archiving of completed assignments within CDIE; and (5) periodic assessments and evaluations of technical assistance to determine its impact. A variety of such programs are available, the important aspect of them being integration with existing software or suites. For example, "Microsoft Project" would share formats with other Microsoft programs such as Word, Excel, and Powerpoint. Selecting the program should also involve a more detailed formulation of USAID's requirements (FWA would be prepared to assist with program selection).

Role of the U.S. Embassy

In the absence of USAID Missions located in PFS countries, planning for the program during the first half of 1999 assumed that Embassy economics officers would be enlisted to undertake a number of PFS-related field tasks. These included: (1) maintaining contact with key government officials and private sector representatives in the local banking and financial communities to keep abreast of important developments; (2) acting as coordinator, sounding board, and source of information for implementers and USAID representatives engaged in in-country marketing activities; and (3) serving as "gatekeepers and recommenders" in reviewing and evaluating requests for PFS assistance submitted by locally based entities. In some instances, the economics officer was well placed to carry out these tasks, but in others, factors arose which limited effectiveness and led to delays and/or confusion in program implementation.

Some of the negative factors adversely affecting economics officers' involvement in PFS support activities included: (1) excessive workload requiring substantial amounts of time and attention being directed to other non-PFS Embassy responsibilities; (2) lack of understanding of the duties, responsibilities, and roles of FSVC and EWMI; (3) in the case of EWMI, possible incompatibility of roles, that is EWMI's mandate is directed toward providing technical assistance of a regional nature whereas Embassy economics officers are primarily interested in bi-lateral economic issues; and (4) the continual turnover of Embassy personnel (e.g. two depart Prague and one departs Bratislava this summer).

A modification of the PFS application process is being recommended to address improve the role of the U.S. Embassy under the program.

Application Processing

Requests for technical assistance under PFS can be initiated by a variety of sources (trade associations, regulators, central banks, government ministries, stock exchanges et. al.), are presented in varying formats, and can be submitted for review to different PFS representatives (the Embassy economics officer, directly to USAID, and/or to one of the Implementers). Receiving and evaluating requests for assistance under such circumstances, especially when there is no country "road map" to provide overall guidance can lead to processing delays and confusion, as well as result in ad hoc, inconsistent and poorly informed decision-making. In turn, these factors can and will combine to undermine PFS's effectiveness and ultimately its credibility. Examples of such delays and confusion in the processing of PFS applications emerged during FWA's visit to the three countries.

Role of the Technical Review Committee (TRC)

Membership of the TRC is comprised of USAID, State, Treasury, SEC, EWMI, FSVC, and FDIC (FDIC recently became a member). It is chaired by USAID. The intended role of TRC was to serve as the senior level forum for PFS by: (1) reviewing and approving requests for technical assistance; (2) coordinating the activities of Implementers, USAID, and economics officers; (3) facilitating the exchange of ideas among participants; and (4) managing program implementation to ensure achievement of PFS goals and objectives. To carry out these tasks, it was envisaged that TRC would meet regularly, between four and six times annually.

For any number of reasons, during the first 18 months of PFS activity, TRS convened on only two or three occasions. As a result, its intended role of serving as the guiding force for PFS was never realized. Even more important, because of the diminished role of the TRC, USAID was never able to assume the early leadership needed to ensure PFS's initial success. Without this leadership, the early phases of the PFS program has suffered.

Chapter V

Conclusions and Recommendations

Conclusions

1. PFS implementation has been undermined by lack of effective communications. This situation is the result of the following factors:

> There is no clear Mission Statement;
> There are no articulated and agreed strategies for the eight PFS countries;
> There is no agreed and coordinated marketing plan; and
> There have only been marginal efforts made to coordinate activities and facilitate exchanges of information among participants.

2. There are no accepted procedures in place to identify, control, and approve requests for PFS sponsored assistance; and, once approved, to monitor effectiveness.

3. The Cooperative Agreements with the Implementers differ in fundamental respects from one another.

4. The effectiveness of Embassy economics officers in serving as “gatekeepers and recommenders” is at times limited.

5. Direct senior level USAID management involvement has been limited. The TRC has met only twice in 18 months.

Recommendations

1. USAID should convene the TRC on a regularly scheduled basis, and take a strong leadership role in its deliberations.

2. Develop a PFS Mission Statement in coordination with key participants, and circulate to interested parties.

3. Prepare individual country strategies in close cooperation with key participants, emphasizing areas where PFS assistance can be most effective. Country strategies would be approved by the TRC and would be reviewed on an annual or semi-annual basis.

4. Closely coordinate efforts of Implementers in the development of their marketing plans, to ensure consistency and to avoid overlap and confusion of activities.

5. Work with Implementers to design and prepare PFS program literature to include the Mission Statement, a description of the application process, and a standardized application form.

6. Request EWMI and FSVC to develop and submit quarterly PFS calling schedules of upcoming activities, and quarterly reports summarizing past calls and the results. SEC, FDIC, and Treasury should also be requested to submit similar quarterly reports. Eventually, a database should be developed which would contain this information and be able to be accessed by key participants.

7. Invite EWMI and FSVC to renegotiate their Cooperative Agreements to clarify the roles and responsibilities of each, and to make their Agreements more consistent with those of the USG Implementers.

8. Restructure the entire application process, including the standardization, wherever possible, of forms and procedures. The process should not require prior Embassy approval before submission to USAID Washington. Embassy comments should be requested by USAID Washington following receipt of an application. It is essential that USAID Washington maintain control of the application, and be responsible for it, at all times.

9. Establish MIS controls to track and manage: all marketing activities, TRC or other committee decisions requiring follow-up, and the status of all applications.

10. Consider making longer-term projects eligible for PFS support on the understanding that a long-term approach may be necessary on an exceptional basis.

11. Reconsider the concept of partnering and its applicability to the PFS program. The definition of partnering must be clear, concise, and accepted by all major participants if it is to be meaningful.

APPENDIX A

USAID - PARTNERS FOR FINANCIAL STABILITY (PFS)

QUESTIONS FOR PFS IMPLEMENTERS

The questions below cover four relationships that the Europe and Eurasia (E & E) Bureau of USAID has concluded relating to provision of technical assistance for financial services under the PFS program. The entities involved are: East-West Management Institute, Financial Services Volunteer Corps, The Department of the Treasury, and the U.S. Securities and Exchange Commission (referred to collectively as Implementers). In addition, there is a pending relationship with the Federal Deposit Insurance Corporation. The questions relate to contract activity by Implementers in the Czech Republic, Hungary, and Slovakia (Target Countries). Their purpose is to assess the degree of "partnering" for provision of the services that has been or may be carried out by the Implementers with other Implementers and/or local partners (Counterparts). The questions are designed as a guide for interviews.

A. Background

1. How many individual requests for technical assistance have been or are being implemented through USAID's PFS program?

2. Briefly identify each PFS consultation, when it became operative, and its current status. Describe any particular style you have developed for delivery of your services.

3. Does your relationship with USAID emphasize USAID's interest in the partnering concept?

4. Does your Cooperative Agreement, Interagency Agreement, or contract define partnering?

5. Has USAID held discussions with you to review the E & E Bureau's "Vision 2000" Sustainable Partnerships? If so, please briefly identify and summarize results.

6. Does the type of service you are providing lend itself to partnering, or do you believe you have the expertise to offer the service in the particular Target Country without assistance from a partner?

7. Did the Counterparts for which you provided the services request or discuss partnering? If so, did they suggest particular entities with which to partner?

8. Do you actively market your services as a PFS Implementer?

9. Can you identify the primary contract, logistic, or cultural problems that have arisen when you partnered under the PFS? What could USAID or others do to be of assistance in resolving such problems?

B. Identification of Each Partnering Activity

1. Please list the individual instances where you have partnered under the PFS in the Target Countries, including the partner's name, address (including e-mail), and any other contact data.

2. Have you partnered with another Implementer? If so, contrast the experience compared to entities, such as a PVO, NGO, or governmental agency, either in the U.S. or the host country. How do you coordinate activities with another Implementer?

3. In each case, where did the idea to partner originate?

4. Did you conclude a written agreement with each partner? If not, did another entity conclude an agreement with your partner?

5. Briefly describe the agreement. Was the work plan for you and your partner clear, and reasonably flexible, at the outset? What resource transfers took place? Did the agreement have a monitoring/assessment system? Was there a method for dispute resolution?

6. Did your partner adequately account for any funds you advanced?

7. Have your partner's operations been conducted in a transparent manner?

8. What was the purpose of the partnership, and is it still in existence?

C. Assessment Of Each Partnering Activity

1. Values and Capacity.

   a. Did you and your partner have a set of shared goals/objectives at the outset of the partnership?

   b. Did you/they have the capacity to carry out each parties' responsibilities?

   c. What elements held the partnership together and what tended to disrupt it?

d. What type of relationship do you have with your partner? Would you partner with this entity again?

e. Did the partnership provide for wrap-up provision of services after the primary tasks were completed?

2. Process.

a. Did your partner perform according to the agreement? If not, please describe any discussions held to improve performance.

b. Have the quality and timeliness of services provided by your partner been satisfactory? What “value added” did your partner provide?

c. Did partnering delay your ability to provide your share of the services?

d. Have Implementer’s websites, the PFS database, and the Extranet been useful in your partnering? Are the other forms of communication satisfactory?

e. Was there adequate time for the partnership to function?

f. Has your partner ever provided comments on its satisfaction with the arrangement? If so, please summarize.

g. Were relationships between you and your partner’s funding organization satisfactory?

3. Impact.

a. Briefly describe what characteristics made the activity a successful or unsuccessful partnership.

b. How did any factors beyond your control adversely influence the partnership?

c. How did the partnership accomplish the goals/objectives you had set for it?

d. How did partnering contribute toward acceptance and sustainability of changes resulting from the services you and your partner provided? Did it contribute toward disseminating information on the changes?

e. What has been the trend of USAID funding for your partnership?

f. Will you and your partner continue with any follow-on activity after your partnering agreement concludes?

g. How did partnering benefit you as an Implementer?

D. Future Partnering

1. Do you agree with USAID's interest in the partnering concept for provision of technical assistance in the Target Countries?

2. What lessons have you learned from your past partnering activity that might be applicable to the future of the PFS program?

3. Has your partnering experience led you to consider partnering with other entities outside of USAID's PFS program?

APPENDIX B

USAID - PARTNERS FOR FINANCIAL STABILITY (PFS)

QUESTIONS FOR PFS COUNTERPARTS

The questions below cover various written agreements that East-West Management Institute, Financial Services Volunteer Corps, The Department of the Treasury, and the U.S. Securities and Exchange Commission (Implementers) may have concluded with PVOs, NGOs, or Governmental agencies (Counterparts) with respect to provision of technical assistance for financial services through the PFS program. The questions relate to activities in the Czech Republic, Hungary, and Slovakia (Target Countries); however, the Counterparts could be located either within or outside of these countries. The purpose is to assess the interaction between the Implementers and their Counterparts, as well as to discern the characteristics of successful partnering. The questions are designed as a guide for interviews with various Counterparts.

A. Background

1. In how many instances relating to provision of technical assistance in the Target Countries under the PFS have you partnered with an Implementer or another Counterpart?

2. Briefly identify each relevant partnering activity, when it became operative, and its current status. Describe any particular style you have developed for delivery of your services.

3. Do your written partnering agreements emphasize USAID's interest in the partnering concept?

4. How would you define partnering?

5. Has USAID held any discussions with you to review partnering? If so, please briefly identify and summarize results.

6. Could your services have been provided by your partnering entity (either an Implementer or another Counterpart) on a cost effective or timely basis?

7. Do you actively market your services to PFS Implementers or potential Counterparts?

8. Can you identify the primary contract, cultural, or logistical problems that have arisen when you partnered? What can USAID or others do to be of assistance in resolving such problems?

B. Identification of Each Partnering Activity

e. Please list the individual instances where you have partnered under the PFS in the Target Countries. Include the partner's name, address (including e-mail), and contact data.

2. In each case, where did the idea to partner originate?

3. Did you conclude a written agreement with your partner? If not, did another entity conclude an agreement with your partner?

4. Briefly describe the agreement. Was the work plan for you and your partner clear, and reasonably flexible, at the outset? What resource transfers took place? Did the agreement have a monitoring/assessment system? Was there a method for dispute resolution?

5. What was the purpose of the partnership, and it still in existence?

C. Assessment Of Each Partnering Activity

f. Values and Capacity.

a. Did you and your partner have a set of shared goals/objectives at the outset of the partnership?

g. Do you have a strategic plan with respect to the partnership?

h. Did you have the capacity to carry out your responsibilities?

i. What elements held the partnership together and what tended to disrupt it?

j. What type of relationship do you have with your partner? Are you on a relatively equal footing?

k. Did the partnership provide for wrap-up provision of services after the primary tasks were completed?

l. Would you partner with this entity again?

2. Process.

a. What did you contribute to the partnership?

b. Have Implementer's websites, the PFS database, and the Extranet been useful in your partnering? Are other forms of communication satisfactory?

c. Was there adequate time for the partnership to function?

d. Has your partner ever provided comments on its satisfaction with the arrangement? If so, please summarize.

e. What were your funding organizations? Did you have satisfactory relationships with them? If they were different from your partner, was this a concern?

m. Did USAID's participation help or hinder you to attract additional funding?

3. Impact.

a. Briefly describe what characteristics made this a successful or unsuccessful partnership.

b. Did any factors beyond your control adversely influence the partnership?

c. Did the partnership accomplish the goals/objectives you had set for it?

d. Did you and your partner identify any indicators to measure success? If so, please identify.

e. Did the partnership benefit you through improved financial sustainability, enhanced knowledge base, broader contacts, etc.?

f. Did partnering contribute toward acceptance and sustainability of changes resulting from the services you and your partner provided? Did it contribute toward disseminating information on the changes?

g. Will you and your partner continue with any follow-on activity after your partnering agreement concludes? Is there funding for any such activity?

D. Future Partnering

1. Do you agree with USAID's interest in the partnering concept with respect to provision of technical assistance in the Target Countries?

2. What lessons have you learned from your past partnering activity that might be applicable to the future of the PFS program?

3. Are you prepared to consider partnering with other entities under future USAID activities?

APPENDIX C

USAID - PARTNERS FOR FINANCIAL STABILITY (PFS)

INITIAL INTERVIEWS IN THE U.S.

All interviews were conducted by Edward A. Greene, Vice President, FWA; John W. Lentz, Senior Associate, FWA; and Georgia A. Sambunaris, Senior Financial Markets Advisor, E&E/MT/FSP, USAID.

1. Securities and Exchange Commission, Robert D. Strahota, Assistant Director, Office of International Affairs – 2/6/01.

The SEC conducts an annual two-week program for senior regulatory and stock exchange officials as well as one-week training programs in corporate finance and related issues for intermediate-level officials. These have been held in the U.S.; however, the SEC is considering whether to offer some of the latter training in Europe at a central location such as Charles University in Prague. Representatives from the target countries have attended these programs with their travel expense and per diem paid by USAID. The World Bank is seeking to participate in giving this training or supplementing it with an "add-on" program.

With respect to its technical assistance under the PFS, and even prior to establishment of the PFS as a USAID post-presence program, the SEC has been reactive in that it responds to requests generated within the host country and referred to it by USAID or the FSVC. When its participation has been approved by the PFS Technical Review Committee (TRC), either USAID or FSVC funds the travel expense and per diem costs, while the actual staff expense is borne by the SEC itself. In most cases, the staff member in charge of the given project has been Mr. Strahota, although on some occasions another SEC officer or an outside counsel may accompany him.

Following is a summary of the SEC's activity in the target countries:

Hungary – Hungarian stock exchange and regulatory officials have participated in the above SEC training programs in the U.S.; however, the SEC has yet to undertake any consulting activity in the country. Hungary has received most of its advice in this area from sources other than the SEC.

Slovakia – Prior to the PFS program, the Mr. Strahota had visited the State Capital Market Supervision Agency, an entity under the MOF, to assist in designing the legal and operational framework to reconstitute the Agency as an independent securities commission that would be self-regulated. The proposal for this work was written by FSVC, and FSVC assisted with logistics while Mr. Strahota was in Slovakia. Following his visit, a change in government rendered his recommendations moot since a policy decision was taken by the Slovak Government not to create an independent securities regulatory body but to integrate it into a consolidated financial sector regulatory commission.

Czech Republic – The SEC, comprising Mr. Strahota together with an outside counsel, has worked with the Czech Securities Commission to review their securities laws. This work is continuing at the present time. The PFS has funded the SEC's travel/per diem expense. The SEC has used FSVC both for logistic and substantive assistance, and an ad hoc agreement is signed with FSVC for each consulting activity.

In general, Mr. Strahota believed the SEC's most successful work under the PFS had been in the Czech Republic, while Slovakia had been least successful due to the political change that decreed the establishment of a consolidated regulatory commission which will include securities supervision/regulation. With respect to Hungary, the SEC had included Hungarian participants in its U.S. programs/seminars, but had not worked in the country. Some benefit had come to the SEC, however, through information sharing by Hungary.

Partnering - The SEC appears to have established strong informal ties with FSVC through shared project proposal information and actual work on projects. Ties with EWMI are in the embryonic stages as a meeting to discuss them is scheduled in the near future. Informal communication is maintained with Treasury through periodic phone conversations. Our impression was that the SEC's consulting activity in the target countries had not operated under any formal partnering concept, but had been carried out either on a strictly bilateral basis or through enlisting assistance from the FSVC for a specific activity on a case-by-case basis. Whenever the SEC considers an overseas activity, USAID's approval in sought through the TRC.

In conclusion, there was a brief discussion of whether the TRC might be modified to meet more frequently and involve the U.S. Embassies only on a "no objection" basis.

2. Department of the Treasury, G. Edwin Smith III, Director, Office of Technical Assistance; Van B. Jorstad, Associate Director, Office of Technical Assistance – 2/9/01.

Treasury has six advisors in Budapest to conduct technical assistance in the CEE and FSU countries. Excluding a special enforcement area, they offer assistance in financial institution management, budget and fiscal issues, debt management, and tax policy. Depending on the nature of a technical assistance assignment and availability of personnel, Treasury might assign one of the above advisors or obtain the services of an outside personal services contractor.

The Office of Technical Assistance has an annual budget of about $30 million, of which about $9 million was applicable to the central European countries. Funding comes from the host country or institution, World Bank, Treasury's own resources, and USAID. The most recent allocation under the PFS program of USAID was only $0.5 million that was considered extremely modest and able to be committed "in a heartbeat". USAID funds are largely committed under Section 632A of the Foreign Assistance Act where they represent a simple budget transfer or pass-through with no reporting involved; however, some funding is under Section 632B, that involves monitoring by and reporting to USAID. Treasury's PFS funds are not co-mingled with other Treasury technical assistance, but are earmarked for short-term, specific projects. There appears to be no mechanism in place that would allow Treasury to fund an on-going relationship for the recipient of a PFS supported project. Thus, Treasury's ability to ensure sustainability of its PFS projects through appropriate follow-up is significantly constrained. In addition, there appears to be no mechanism that would allow Treasury to share information regarding the success/failure of its technical assistance projects with other donors. Treasury generally adheres to the principal that PFS projects should be demand-driven; however, it appeared to be more pro active than the SEC, partially because it had representatives in the field to assist in initiating projects.

Treasury's activities in the Target Countries are as follows:

Czech Republic – Mr. Larry Connell, working out of the Budapest office, has advised Konsolidanci Bank Praha (KOB) since 1999 in formulating policies on work-out loans that KOB has assumed from the rest of the Czech banking sector. More recently, the advice has shifted to that involved in designing policies to selling a specific package of restructured loans. This advisory work is apparently considered by both parties to be a success story largely due to the good rapport established by all concerned; however, Mr. Connell's time on the activity will soon be replaced to a degree by a personal services contractor.

Slovakia – Mr. Bill Sudmann has been advising on bank privatization since 1999 and also with respect to budgetary issues. The experience had not been as successful as that in the Czech Republic due to the Slovak Government's lack of responsiveness and apparent disinterest in suggesting additional projects.

Hungary – The last Treasury project terminated in September 2000.

Mr. Jorstad offered some suggestions for improvement of Treasury's technical assistance in the region, as follows: (1) Improve coordination in the U.S. with State, USAID, and other donors in an effort to reduce program overlap, (2) Take advantage of the skills of different implementers, (3) Increase PFS funding to Treasury beyond the modest $0.5 million in the most recent FY, (4) Fund across FYs, and (5) Design a funding and assistance delivery system so that small scale but important follow-on advice could be implemented without delay. There had been problems when countries had been "graduated" too early from USAID programs (Slovakia).

Partnering – We were told of a large-scale partnering activity involving the World Bank, IMF, USAID, and Treasury to rescue Yugoslavia; however, this type of donor coordination is not within the definition of partnering under the subject report. With respect to partnering between Treasury and host country institutions, no examples were brought forward whether under PFS or otherwise. In fact, the long-term relationship implied in most definitions of a partnership appears to run counter to the fact that assistance under PFS is typically delivered under specific, short-term contracts. Also, USAID's moderate funding ability, lack of a presence in the Target Countries, and constraints on multi-year commitments argue against formation of true partnerships.

We discussed possible improvement of the TRC including a more active meeting schedule that would render its decisions in a timely manner. A revived TRC could also improve assistance coordination.

3. USAID, Europe and Eurasia Bureau, Lawrence Camp, Privatization Specialist, and Victoria Wohlsen, Capital Markets and Banking Advisor – 2/12/01.

PFS was launched in July1999 and the first projects funded in FY 2000. Since that time, the program had been subject to three policy revisions with possibly more to come. There is no agreed definition of partnering despite the fact the word "partner" is in the program's title. It is important to distinguish between financial sector projects funded under PFS from similar projects in the Target Countries that are funded through other sources. The World Bank was supportive of PFS, and might be considered as a "silent partner".

Mr. Camp mentioned the PFS assistance in Slovakia to establish an improved broker/dealer system for the securities market. There was also a debt revaluation project, not funded under PFS, where the USAID contractor (Barents) had established laws and procedures for an RTC-type debt consolidation agency, and was now turning to bundling specific loans for sale to the market. USAID was interested in organizing a regional conference on debt consolidation, again with the assistance of a contractor, that would probably be funded under PFS where most presentations would be from countries, such as Hungary and Poland, that had addressed the problem. The conference would be on an East-East theme, rather than having Western speakers dictating our systems/values. Mr. Camp thought the U.S. Treasury might be invited to the conference, but that presentations would be from regional players.

Generally, Mr. Camp viewed the PFS as funding short-term "interventions" in post-presence or "graduated" countries where there was a specific task to work out a problem identified by the country itself. It concerned him that there was no mechanism to fund reasonable follow-on work after the task had formally concluded. He believed some countries in the region had been graduated despite the presence of systemic financial problems. It was expected that long-term assistance would be funded through programs other than PFS.

4. East-West Management Institute (EWMI), Sarah B. Colley, Program Manager – 2/13/01.

Although the PFS had only been operational for about 18 months, Ms. Colley thought it a good idea to assess the program early so problems could be fixed early. In mid-1999, when the PFS was being designed, an informal (non-legislative) timeframe of five years was envisaged in the post-presence countries, after which it was assumed financial sector assistance by USAID would not be required. Currently, this timing for final USAID pull-out is considered by many to be too optimistic since the premise of large-scale sustainability has not come to pass. In the most progressive countries it might be possible; however, for the large majority reorienting the financial sector to market-responsive practices is taking much longer than originally expected. In fact, it is difficult to predict a time when the complete transformation might take place.

EWMI markets itself in the Target Countries as a tool for them to use in solving locally-identified financial sector problems. In this it is unlike the SEC which is passive/reactionary. Local ideas for assistance are vetted through EWMI's Budapest regional office and subsequently its U.S. offices in New York and Washington. Coordination is also maintained with U.S. Embassies and USAID Washington. Some of its PFS projects are of the one-off interventionist nature, such as capital markets seminars, while one, a regional pension reform network operated from Budapest where country experiences are shared, is decidedly longer term. Various PFS-supported projects in the Target Countries were noted (a regional seminar to announce the PFS, and capital markets seminars in the Czech Republic and Slovakia); however, Ms. Colley said she would provide a complete list. EWMI should soon be cooperating with the SEC on a regional securities conference to be held in a central European venue. In long-term projects it is important to educate the public and create the synergy to sustain activity.

EWMI's cooperative Agreement with USAID covers $4.0 million of activity over three years in eight post-presence eastern European countries. With respect to this total activity, about 55% of funding for individual projects ($2.1 million) is from EWMI and 45% ($1.9 million) from USAID. USAID's share of the budget averages only about $79,000 per country per year. EWMI must, therefore, leverage this modest support with a requirement the counterpart NGO to which it is extending a grant contribute about half of the EWMI share, usually in the form of services rendered. This degree of self-funding is important since it builds local support for the project. These limited resources are matched against USAID's wide-ranging goals and the apparently extensive needs of countries in the region.

Apart from the resource constraint, there are potential definitional issues in that key terms (such as “partner”, “regional”, and the role of U.S. Embassies) have not been defined. EWMI has developed some of its own definitions, which Ms Colley offered to share with us. She believes all parties should strive for agreed terms; otherwise, the assistance delivery process under PFS could become chaotic. If that became a reality, the possibility of adverse Congressional reaction could alter the program drastically. A challenge would be to create definitions, including a mission statement, that would allow for needed flexibility as the financial sectors in these various countries changed over time. In addition, there was an issue about the lack of information sharing between implementers and within the region on specific issues. A “secure” website might be one answer; however, the current situation called for much greater sharing under whatever format.

Some of these problems are understandable, given that the PFS program is the first of its kind and was just recently launched, but they should be addressed without delay – particularly if the activity may well extend beyond its initial five-year timeframe.

5. <u>Financial Services Volunteer Corps (FSVC)</u>, Salvatore J. Pappalardo, Managing Director – 2/15/01.

FSVC began working in central European countries in 1991 when USAID had Missions in most capitals. As some countries were graduated and the “post-presence” concept for USAID assistance was introduced, FSVC continued with its basic role of acting as a catalyst to provide U.S. volunteer consultants on a short-term basis to render specific financial services. Since the consultants utilized are either retired or on assignment from their current jobs, Mr. Pappalardo believed the assistance had been rendered on a cost-effective manner with only transportation and per diem being out-of-pocket to FSVC. Assistance is primarily given on a bilateral basis with projects being initially suggested by the host country recipient (regional projects are supposedly under the aegis of EWMI). Approximately 90% of FSVC’s cash budget is furnished by grants from USAID.

When the PFS was introduced in mid-1999, FSVC’s activities did not change. FSVC is aware of the PFS five-year time horizon (to about mid-2004), but it is too early for that feature to have affected policy, and the host country recipients have not begun to address the “sunset” nature of the program. This may not be critical since many European institutions appear prepared to continue support for financial sector projects over the long term. Mr. Pappalardo believed there was an issue of definition with respect to USAID’s emphasis on the partnering concept that contrasted with the stream of short-term projects on which FSVC actually worked. With respect to other Implementers, FSVC had worked with the SEC and is attempting to coordinate more with EWMI. FSVC tended to be pro active and market its services; however, Mr. Pappalardo thought that USAID policy for Implementers on being pro active or passive should be clarified.

The ideal way projects were supposed to move (through local definition, vetting by the Embassy, and final review by USAID Washington through the TRC where award to, say, FSVC would be made) was more complex in practice. Local project definition/preparation was imprecise so that FSVC had to intervene early to clarify the counterpart's goals and advise how they might be satisfied. Only in this way could a well-packaged proposal be submitted to the Embassy and, in turn, to USAID in Washington. Despite FSVC's efforts, Mr. Pappalardo believed unnecessary disagreements had arisen with certain post-presence country Embassies on the importance of some projects. [This raises the question of whether Embassies should be considering PFS projects on a "no objection" basis or continuing to have this early veto ability.] In one case, the approval process had taken over a year, including discussions between the U.S. Embassy and USAID, and the Counterpart became concerned. Generally speaking, PFS assistance had been well received in the field since it concentrated on practical implementation rather than abstract theory.

Mr. Pappalardo believed more effective dialogue and information sharing was essential, possibly with fewer people involved. Other issues he summarized were: (1) the Extranet was not completely "up" yet and depended on the willingness of participants to share data; (2) often USAID receives information, but it is difficult to retrieve, (3) the roles of the State Department and USAID are unclear, and (4) views on policy are unable to find a forum for discussion/resolution. Possibly a modified TRC could be the vehicle if it met more often and had an expanded mandate. Part of the difficulty is that there are no clear PFS priorities by which Embassies appear to judge projects. This also relates to a lack of definitions. An important one of these would be whether USAID wants to manage these projects or stay in the background, trust its Implementers, and observe them develop - presumably with a few basic controls.

APPENDIX D

USAID - PARTNERS FOR FINANCIAL STABILITY (PFS)

INTERVIEWS IN TARGET COUNTRIES

All interviews were conducted by the same three-member team that did those in Appendix C between 2/6/01 and 2/15/01 (Greene, Lentz, and Sambunaris).

Hungary

1. Department of the Treasury, William Sudmann, Regional Advisor, Financial Institutions Technical Assistance - 2/20/01.

Treasury maintains three advisors in Budapest that serve the central and southern European region, but rarely carry out assignments in Hungary itself since there is little requirement. They consider the IMF and World Bank as "partners" on the policy side, but without budget. Technical assistance is considered in the same sectors as mentioned during our meeting on 2/9 in Washington.

Projects are originated by national MOFs that contact Washington, then the project is often referred to Treasury's Budapest regional office to determine if it is feasible. Close coordination is maintained with State and the relevant Embassy; however, this is handled by Washington. Donor coordination is difficult with “rules”, if there are any, being determined on an ad hoc basis. In Slovakia there was some early work done for restructuring of IRB Bank, but Treasury later backed off when it became clear the Slovaks were unprepared to go through with it. Later much of this activity was taken over by the EU in cooperation with the Slovak MOF. In fact other than its current work with KOB in the Czech Republic, Treasury activity in the PFS countries appears to be on the decline. For example, Sudmann noted that he is currently looking at/involved in activities in Albania, Bosnia, Romania, and Yugoslavia (Belgrade).

After “graduation” (often premature) of these post-presence countries there had been little coordination; there is no “core” to the program. Treasury stays involved through Mr. Sudmann’s extensive personal contacts. Treasury has had no contact with EWMI, but can go to FSVC, although Mr. Sudmann said this seems to have rarely happened. [FSVC indicated there have been frequent contacts with Mr. Larry Connell of Treasury’s Budapest office.] Basically, Treasury is running its own program of financial sector technical assistance and Mr. Sudmann had had no experience with the PFS program to date. Trip or project reports are completed; however, frequently they are sanitized as Treasury takes very seriously its confidentiality agreement with each counterpart. It is best to engage Treasury via Washington.

International accounting firms are now doing "soup to nuts" privatization work, rather than just auditing work. All of this financial assistance was separate from the lack of a social safety net in many countries to provide an adjustment mechanism on the resulting unemployment - often made worse by the immobility of labor.

2. USAID, Marc Ellingstad, Project Officer 2/20/01.

Mr. Ellingstad saw us since Ms. Pat Lerner, with whom the appointment was made, was unavailable. Ellingstad had recently returned from vacation and didn't appear to have a clear understanding of the purpose of our visit.

The USAID Mission in Budapest is a contracting and financial control office for the region with little or no programmatic activity. One long-term project had been pension reform in Hungary where two personal services consultants that were well-respected in the field had been working since late in 1998. Funding was from USAID under a non-PFS program through the E & E Bureau. He believed this project had basically managed itself; however, there was satisfactory coordination with his office.

Relations with EWMI's Budapest Office were "polite" but there was no substantive relationship. Although both have offices in Budapest, USAID Washington handles program details. He noted that marketing by EWMI is discouraged. There is no contact with FSVC. With the USAID financial spigots closing or closed, it is not surprising that Embassies lack project information. It would be helpful if the Extranet were fully functional (promised for June 2001). Often advice from the EU, for example on corporate governance, is different from what a US entity would recommend, but countries that seek accession can be prone to lean in the European direction. The EC tends to work directly with Ministries and its advice is long-term in nature.

Ellingstad stated he was unaware of the existence of any mechanism for vetting requests for assistance under PFS. After a project need was assured, it would be helpful to have a formal evaluation through something like an expanded TRC.

3. International Center for Economic Growth (ICEG). Pal Gaspar, Director, Central Europe Program - 2/20/01.

ICEG, established in 1984, is based in San Francisco. It is a not for profit organization whose mission is to enhance the capacity of policy research institutes located in developing and transitional countries so they, in turn, can foster the policies and institutions of a market economy in those countries. It seeks to accomplish this objective by working through a network of roughly four regional operations based in the Philippines, Hungary, Egypt and Costa Rica and 95 indigenous institutes globally. In addition to USAID, ICEG receives funding from various international foundations including Ford and Volkswagen as well as other governments,(e.g. Germany) and the

World Bank. ICEG's Hungary operation has a current budget of approximately US$ 1 million, part of which it receives from San Francisco and part of which it is expected to raise itself.

Currently, ICEG's activities are for the most part driven by the projects it undertakes at the request of those entities that provide its funding. For example, Bulgaria recently requested the EWMI to analyze and evaluate the successes/failures of bank privatization efforts carried out in Poland, the Czech Republic and Hungary, compare the three countries' results and pass them onto Bulgarian authorities to be used a guide to assist in its bank restructuring program. In turn, EWMI, under PFS asked ICEG Hungary to undertake the relevant analysis in Hungary (two other indigenous entities were asked to complete the analysis in the other countries) and to coordinate and complete the comparison effort. ICEG Hungary was given US $27,000 by EWMI for this work, and in addition was asked to provide some of its own resources to support the project. At the project's conclusion, ICEG will sponsor a conference/workshop to present its findings. It is expected the project will last approximately six months. Other than being given a broad outline by EWMI of the work to be done, ICEG Hungary is carrying out its work for the project independent of EWMI control/guidance.

At present, ICEG Hungary does not initiate its own projects nor set its research agenda, but rather responds to the requests of others who have the resources to fund the projects they believe to be suitable to deal with the economic/financial problems confronting a particular country or region. However, ICEG's medium term goal is to achieve greater financial independence so it can then become more proactive and less reactive in determining the types of work it undertakes. Its apparent strength is its detailed knowledge of the Hungarian economic and financial scene. When questioned, Gaspar stated that ICEG was objective in its work but acknowledged that funders could seek to influence the outcome of its efforts.

4. American Embassy, Budapest. Gregory S. Groth Second Secretary, Economic Section - 2/20/01

Groth kindly agreed to see us on short notice as both Curt Donnelly, First Secretary, and Jean Bonilla, Economic Counselor were out of town. Groth, a former Peace Corps volunteer in Zaire, has been in Hungary in his present position for about 18 months. There are four foreign service officers in the Embassy's economics section: Bonilla who heads it up, Donnelly who has been in Hungary for six months, responsible for macro issues, Groth responsible for certain functional areas such as intellectual property rights, civil aviation, and certain trade related issues, and an environment, science and technology officer.

Groth seemed to have little if any knowledge of the PFS, the activities of USAID Budapest (other than to note that its primary responsibilities were logistic in nature, i.e. contracts, financial administration etc.), EWMI operations in Hungary or Treasury, although he did indicate that he and his colleagues had some contact with the Treasury people. He noted that whatever Embassy involvement/contact that did exist with these entities, it was handled by Donnelly. However because of the significant workload carried by the economics section, Groth suggested that Donnelly's involvement with USAID/ technical assistance activity in Hungary was most probably limited to receiving information generated by others. While he acknowledged that Hungary had considerable influence over economic matters among countries in the region, primarily because of their speed in adopting western style economic policies and procedures, the Embassy's economic focus was almost exclusively bi-lateral with very little attention given to regional economic issues.

When asked, Groth stated he was unaware of the existence of any Hungary country economic strategy prepared by the embassy or anyone else that listed in order of importance the types and/or areas of technical assistance that should be directed to Hungary under PFS. Nor did he believe that there was any agreed upon process in which the embassy participated in reviewing requests for technical assistance submitted by Hungarian authorities.

Given the apparent heavy workload carried by the economics section and the fact that Hungary is a post presence country, the Embassy's involvement in technical assistance at both the bi-lateral and regional levels appears marginal at best.

5. East-West Management Institute(EWMI), Geoffrey Mazullo, Acting Director 2/21/01.

The requested list of projects would be delivered in our afternoon meeting, for the notes on which see below. EWMI's contract covers regional PFS activities. If they involve a USAID contribution of more than $10,000 prior USAID approval must be sought; however, for projects less than this amount EWMI has discretion under its Cooperative Agreement to proceed. Under PFS, EWMI focuses only on regional issues, while Embassies of the region almost exclusively focus on bilateral activity, and it is doubtful this approach will change.

EWMI is planning a regional securities enforcement conference in Budapest this June with the SEC and one in Poland in the fall concerning disclosure. These were formerly U.S. based programs, but are being moved to the region to attract greater participation. In such situations the PFS could be partially funding both the EWMI and SEC shares. The World Bank usually picked up reception costs. Although some regional securities agencies had claimed they had no travel budget, some funding, say for a plane ticket, would have to be forthcoming in order for a representative from the agency to attend the conference.

Much local hand-holding was necessary to get requests for regional assistance in a condition where they could be seriously reviewed for funding. The theory on project progression was that the local entity would devise the project on the understanding it was a demand driven program, present it to EWMI who would then refer it to the Embassy and USAID (Washington), from where a decision on the larger cases would emanate, probably from the TRC. The TRC would also decide who the Implementer should be. However, the reality was that most local institutions will not contact strangers and desire early discussion with someone like EWMI. If this involves making a trip, EWMI contacts the local Embassy Economic Officer to provide a travel agenda and a follow-up trip report with a copy to USAID (Washington). EWMI sent a letter in January to all Embassies on the PFS to enhance awareness of the PFS program as it was low in many instances.

There is a definitional problem about "marketing" since EWMI considers it broadly and believes this awareness knowledge must be disseminated with the program specifics still able to be demand driven. EWMI's brief is only to deal with regional projects where cost sharing with the counterpart is possible - all others are rejected.

6. The World Bank, Laurens Hoppenbrouwer, Chief of Mission, and Mihaly Kopanyi, Senior Financial Economist - 2/21/01.

The World Bank believed it had played a catalytic role in the region with respect to financial institution and enterprise restructuring. Its Enterprise and Financial Sector Adjustment Loans (EFSAL) to various countries had introduced the necessary conditionality. In the Target Countries, an EFSAL was under review for Slovakia, but others had already been disbursed. In meeting EFSAL conditionality requirements, usually recipient countries adopt EU based approaches if they differ from those in the U.S., as the former would be required when EU membership was to be formally considered. Frequently, EU technical assistance was utilized under these loans for the above reason. They thought this assistance was actually ramping up, rather than in any "sunset" mode, as possible EU membership drew closer. The above loan for Slovakia was the only World Bank financing under consideration since the other two countries we were visiting (Hungary and the Czech Republic) could obtain funds from the international capital markets.

The issue of privatization in Hungary was briefly discussed. Approximately 80% of Hungarian banks have now been privatized, while 90% of Hungarian insurance companies are privately owned. Of the privately owned banks, 60% are held by foreign interests, while for insurance companies, the comparable figure is 90%.

7. USAID Budapest Regional Service Center. Patricia J. Lerner, Regional Director (Mark Ellingstad who we met earlier was also present) 2/21/01.

Following up on our meeting yesterday with Mark Ellingstad, we met today with Pat Lerner to give her a debriefing of our Hungarian calls and to learn of her current thinking regarding PFS. G.S. provided a brief rundown of our four meetings, i.e. with Bill Sudmann, Treasury, Mark Ellingstad, USAID Budapest, Pal Gaspar (an EWMI project director) and Greg Groth, U.S Embassy. Lerner was straight-forward in her remarks. Other than pension reform, she stated that Hungary does not need technical assistance in the financial sector. When we noted that Budapest increasingly appeared to becoming a regional center, she noted it should always be kept in mind that U.S. Embassy economic officers focus on bi-lateral issues and very rarely get involved in regional matters, and that was certainly the case in Hungary.

As for PFS, she expressed general concern about the effectiveness of programs run from Washington, noting that she had urged extreme caution several years earlier to a visiting USAID team who were then designing PFS. She went on to state that from what she had seen and heard since, there had been problems with PFS resulting in it being increasingly micro managed by USAID Washington. That by its very nature, a Cooperative Agreement under PFS was meant to grant the recipient partner signing the agreement broad authority and responsibility to manage its activities without significant AID involvement, something that she believed was not now being done. She also expressed concern over what appeared to her to be a PFS that was increasingly being supply and not demand driven. She emphasized that TA delivered to counterparts should be determined by the counterpart's needs and not by what the PFS partner is capable of providing. In this context, she said it was critical to improve the standards and criteria currently used in determining how to use PFS's limited resources most effectively.

Finally, she stated in categorical terms that PFS should not be used in the Southern tier countries where existing bi-lateral programs were quite substantial, but rather it should be directed only to those activities in graduated countries where relatively small amounts of support can be significantly leveraged to increase the activity's overall effectiveness. As an example, she cited a third country program initiated and developed by Mark Ellingstad, called Hungarian American Partnership Initiative (HAPI) with a budget of US$ 150,000 and a life of 2 years. It aims to promote the transfer of experiences and lessons learned in Hungary during the last ten years of the social and economic transition to a market driven economy to other countries still struggling with similar issues. According to Lerner and Ellingstad, HAPI has been quite successful. We were provided with a brochure.

As for her wishes regarding her involvement/interest in PFS, she stated that other than keeping her advised, as a matter of courtesy, of PFS related matters which affect Hungary, it was not necessary to do anything more.

8. <u>East West Management Institute</u>, Geoffrey Mazullo, Deputy Director and Sarah Colley, Program Director, (during most of this meeting G.S. was not present). 2/21/01 4:30 pm .

This meeting, in which we were joined by Ms. Colley, who was visiting from Washington was a continuation of our meeting started earlier in the day with Mazullo. It focused primarily on issues that EWMI felt needed to be addressed and resolved if EWMI PFS activity under its Cooperative Agreement with USAID was to achieve its full potential over the next several years. A major concern expressed by EWMI is lack of effective communication between EWMI and USAID. EWMI is comfortable with the team concept of PFS and happy to participate as a team member with USAID and other PFS participants, but noted that direction and policy is not always clear given that USAID often speaks with several voices, thereby making effective program management and implementation difficult at times.

It was noted that in meetings which EWMI staff had participated with USAID staff, a number of differing views had been expressed by various USAID staff on a particular issue, where at the meeting's conclusion there was no stated USAID policy or unified approach to deal with the problem being discussed. This uncertainty led to lack of direction and focus and often caused confusion. EWMI recognizes that a variety of USAID staff have legitimate reasons to be involved in a particular PFS activity, but noted that USAID had to exercise the necessary internal control and leadership to make certain that its policies and preferred approaches were clearly articulated and understood by EWMI and other PFS participants.

EWMI believes that its role under PFS is to provide technical assistance of a regional nature to recipients in PFS designated countries. To do so, EWMI needs to make visits to the PFS designated countries and call upon various entities to learn of possible areas where technical assistance organized by EWMI could be offered, with the timing and destination of this calling effort to be determined by EWMI. In carrying out this activity, EWMI has been confused and dismayed in some instances by USAID's reaction. In particular, they were surprised to be asked by USAID why they were visiting a particular country or calling upon a certain entity. It was not their understanding that under their Cooperative Agreement they were required to get country clearance or to receive prior approval from USAID for their trips. As a consequence, it was their belief that in these circumstances EWMI was being unnecessarily micro managed. Nonetheless, to avoid further misunderstandings, Mazzulo indicated he is now providing USAID Washington and economic officers at relevant Embassies copies of his itinerary before departing on a trip as well as trip reports upon completion of his trips.

Related to and perhaps part of the issue of communications, was the lack of clarity over the respective roles to be played by EWMI and USAID under their Cooperative Agreement. It is the view of EWMI that under its Agreement with USAID, USAID has three principal roles: to approve the appointment of EWMI's Director selected from nominees submitted by EWMI; to review and comment upon EWMI's annual work plan making amendments where necessary; and to approve proposed PFS activities/projects submitted by EWMI on a case-case basis, where USAID's financial contribution will be US$ 10,000 or more. Beyond these three areas, EWMI believes USAID's involvement in EWMI's day-to-day activities under PFS should be limited. However, EWMI is of the opinion that USAID has become far more engaged in EWMI's work than is called for in the Agreement, which in EWMI'S view has resulted in unnecessary misunderstandings between them.

EWMI also expressed concern regarding how their visits to potential recipients were being viewed by some Embassy and USAID personnel. It is EWMI'S firm belief that to determine whether technical assistance is needed and whether the type of assistance being sought is appropriate, it is necessary for them to meet directly with prospective TA recipients/beneficiaries. Without these visits, it would be difficult if not impossible for EWMI to assess technical assistance needs effectively and to structure appropriate responses to requests for assistance. Moreover, given the fact that EWMI has established a presence in the region, it is only seems logical to use this base to call on potential TA recipients/beneficiaries throughout the region. However according to EWMI, at times their visits have been characterized by USAID/Embassy personnel as marketing efforts or attempts to sell services/products/assistance that are not necessarily needed, a description which EWMI feels is inaccurate and unfair, and one which ignores the need to meet with prospective recipients to identify and meet legitimate demands for T.A.

A final EMWI concern deals with the fact that after entering into its Cooperative Agreement with USAID, which covers the offering of technical assistance to SEE countries in addition to the post presence countries, USAID, decided not to use PFS funds to support assistance to SEE countries. EMWI was extremely disappointed that USAID took this action which appeared to them to be unilateral in nature and taken after the Cooperative Agreement had already been agreed to and entered into by both parties. Moreover, it raised an element of uncertainty for those situations where participation in a regional conference could benefit both PFS and SEE countries.

We then discussed how the communication problems outlined above might be resolved. EWMI indicated it would be willing to participate in regularly scheduled (monthly or quarterly) discussions (telephone or face to face) with USAID and other PFS participants, if such discussions were structured in a manner that would: articulate USAID policies and strategy; ensure the exchange of relevant information among participants; reach clear cut decisions on matters of mutual concern; and coordinate activities so as maximize effective use of resources and avoid program overlap/duplication among participants. They went on to state that for these discussions to be successful they would need to be held at regularly scheduled intervals, they would need to involve senior representatives with decision-making authority, and importantly, USAID would need to take an active leadership role in providing direction and guidance to the discussions/participants.

Slovakia

9. Association of Securities Dealers, Igor Hornak, Chairman of the Executive Committee Robert Kopal, Director - 2/22/01.

The Association was established in 1995 and currently has 44 members. Its role was originally to develop the Slovak securities market by previously assisting with distribution of State assets to the market and, more recently, attempting to bring new issues to market and interest the public in investing in the market as opposed to bank deposit accounts. It had been hindered, however, by an inappropriate legal structure and securities regulation that was centered in the Ministry of Finance. Other problems that needed to be addressed were the rights of minority shareholders and corporate governance. The primary model they looked to was that of the EU in order to prepare for the all-important accession of Slovakia to the EU.

FSVC has sent advisors to the MOF in 1994 and 1997 to comment on establishment of an independent regulatory body and a program of self-regulation. Financing had been under USAID bilateral programs that preceded PFS. In the summer of 2000 some of their representatives attended the SEC summer program in Washington as well as a CFTC conference in Chicago. The Association sought additional assistance, had written to FSVC, and was impressed with the reply received. A new Financial Services Authority had recently been established with 3 out of 5 of its Board being allies of the Association. An Association representative had attended a December 2000 securities conference in Germany with some financing support from FSVC. They look forward to a regional securities conference in May sponsored by EWMI, but probably having an FSVC sponsored speaker. It will focus on IPOs.

They spoke highly of FSVC and the practical nature of its assistance, but were just beginning a relationship with EWMI. There had been little contact with the U.S. Embassy. They indicated technical assistance would be helpful on the legal side, capital markets formation, and data sharing. That offered by the EU was to Ministries and had more of a regional and central government approach, rather than being directed to market participants, despite their interest in adopting EU systems. The message was that the securities market in Slovakia was still in need of basic technical assistance.

10. U.S. Embassy   Mark Bocchetti, Economics Officer, 2/22/01 3:30 PM

Bochetti has been in Bratislava for 2 years. He is assisted in his work by one local hire who is responsible for covering capital market development. He has a good working relationship with the three USAID employees (also local hires) who appear to provide him with informal support from time to time but whose primary responsibility is to provide administrative/logistical support for a number of USAID projects which are winding down and scheduled for completion later this year. Bochetti seems to have a heavy workload.

He opened the meeting by noting that given Slovakia's graduated status, the Embassy is not looking for "new business" i.e. no new AID work, but rather is winding down. There is therefore little if any reason to get involved in major new projects at this time. Through PFS, USAID can "throw a band aid here or there" to help fill the gaps, but even under PFS Bochetti claims to have seen few if any legitimate requests for technical assistance.

He then expressed frustration at not really knowing what was going on under PFS, what is was all about, who was running it and the fact that over the last few months there had been three PFS related visits to Slovakia, one by Vicki Wohlsen, one by FSVC (SB) and now the three of us (interestingly, Bochetti was apparently unaware that in fact there had been four visits - EWMI has also recently been to Slovakia). Why all the visits when there doesn't appear to be any significant legitimate demand?

G.S. explained the purpose of our visit, that is we were in Slovakia to gather information to be used for a mid term assessment of PFS. She also described in some detail the PFS, its partners and the various operating agreements governing the relationship between USAID and the five participating partners. She then described how, under PFS, USAID viewed the Econ Officer's role as that of providing the initial screening of submitted requests before they were passed onto USAID Washington, accompanied with the Econ Officer's recommendations. He seemed to agree and accept her description of the Econ Officer's role in this process.

We discussed our earlier call of the day on the Broker-Dealers Association and the fact that they had suggested we meet with the Financial Services Authority, the recently established consolidated regulatory body, to see whether TA under PFS would be possible. G.S. asked Bocchetti whether he would agree to our meeting with them, to which he declined, stating they had previously been asked twice to submit requests for TA and have yet to respond. Given their lack of response to these previous requests, he felt it was inappropriate for us to ask yet again. We then asked if there were other meetings we should set up while here. Initially, he was unenthusiastic for us meeting with anyone, but as our talks progressed, he became more positively disposed to the idea and agreed that we should call on the National Bank, the British Know-How Fund and the Association of Asset Management Companies, from whom Bochetti/USAID had recently received a well written request for assistance. We quickly reviewed the request and Bochetti provided G.S. with some substantive input that she agreed to pass onto to Vickey Wohlsen upon our return.

During the course of our discussions, Bochetti seriously questioned the wisdom of using USAID support to fund trips by members of the Broker Dealer Association to attend CFTC seminars in Chicago covering derivatives. He felt that given the state of development of capital markets in Slovakia, the subject of derivatives was far too advanced to be discussed at this time.

Bocchetti then asked us to speak with Barents who were completing the first phase of a program to set up a Slovakian entity (Slovakia Consolidation Authority - SKA) to package and sell non-performing assets purchased from Slovakian banks in the run up to their privatization. Bocchetti thought it might be useful to see whether PFS supported TA could be effectively utilized in this project. We spoke with Barents which is the subject of a separate call memo.

11. <u>Association of Asset Management Companies</u>, Roman Scherhaufer, Managing Director, with J&T Asset Management Inc., Boris Procik, Chairman of the Board, and Tatra Asset Management, Roman Vlcek, General Manager - 2/23/01.

This Association has 6 regular members and 5 firms that are associated. They are interested in creating greater public awareness and acceptance of the legitimate local investment industry to the exclusion of those firms pushing “pyramid schemes” which are legal in the country. The ineffective legal framework and lack of an independent SEC-type regulator were basic problems. Although neither EWMI or FSVC had visited them, they had met with Ms. Wohlsen of USAID and on this basis had prepared a letter requesting PFS support for 6 projects.

The above letter, dated February 6, 2001, was discussed in some detail by USAID. The most promising projects (a legal advisor to comment on revised legislation and support for a CFA program) were identified by USAID, some were discouraged as not being within current USAID policy, and on others suggestions were made for revision of the request.

This appeared to be a situation where some very helpful “marketing” was carried out by USAID on a request the agency had solicited. It is interesting to note that concern was expressed over the lack of an FSVC visit to the Association, presumably to engage in a similar discussion of what could be done to provide them with technical assistance under the PFS program. The importance of cost sharing was stressed.

12. National Bank of Slovakia. Jan Tencer - Off Site Director, Stefan Galbac - On Site Director, Vladimir Hromy - Director Licensing Department, Milos Svanter - Banking Supervision, 02/23/01.

All the gentlemen present had visited the U.S. supported by USAID funding. Two had spent three months, and the other two, three weeks. In addition, USAID had supported a long-term adviser (former OCC examiner) to the National Bank over a four year period in the area of on site supervision. However, National Bank is still in need of additional bank supervision training, and to this end is beginning the process of formulating its request that it intends to submit to USAID as soon as possible. It is our understanding that Mr. Svanter has been assigned the task of preparing the request for this assistance.

At this moment, the question of where Slovakia bank supervision will housed, and who will have responsibility for its management is very much up in the air. Currently, bank supervisory responsibility is housed with the National Bank. However, with the establishment of the Financial Services Authority, a newly formed consolidated financial regulatory body, it is not clear whether bank supervision will remain with the National Bank, or be shifted to the new Authority. Where the function is eventually placed could affect the type and amount of training delivered. Nonetheless, there is a general consensus that regardless of who and how bank supervision is handled, upwards of two to three years will be needed for the transition to occur should the decision be taken to transfer authority to the new Authority. In the meantime, technical assistance for supervisory personnel will still be required. It is in this context that the Supervision Department within the National Bank is preparing its request for assistance. It is not clear at this point whether the requested assistance will be eligible for PFS support, but it also has to be kept in mind that the type of assistance provided under PFS is usually short term in nature and is intended to address specific issues.

In the past, the National Bank has worked with Bill Sudmann, U.S. Treasury, and recently has been visited by FSVC. It is possible that some PFS assistance could be offered to the National Bank through either or both of these PFS partners. Once USAID receives a well-structured request for assistance from the National Bank, it will then be in the position to determine whether assistance under PFS will be forthcoming, and if so, which of the partners should be given responsibility for delivering it. Given the likelihood that the request for required assistance may be complex, it may be appropriate to work closely with the World Bank before any decision is reached. The World Bank has been in close contact with senior MOF and National Bank officials regarding the issue of where the bank supervision function should be located. The discussion with the National Bank suggests its requirements may well call for longer term assistance to address and resolve a wide range of supervision issues.

13. British Know - How Fund. Ms. Viera Gazikova 02/23/01

Prior to joining the Know-How Fund, Ms.Gazikova worked at USAID in Bratislava so she was generally familiar with PFS. The meeting was useful because we were able to learn what technical assistance the British Government was providing to the Slovak financial sector. Following introductory remarks by G.S. we discussed the following.

According to Gazikova, the British recently agreed to provide the Financial Services Authority with UK L 660,000 to support assistance in a number of areas including: amendment of existing legislation, institutional strengthening, re-licensing of capital market participants and staff training. It is also possible that support could be directed to non profit associations engaged in self regulation (e.g. SROs such as the Association of Asset Management Companies with whom we had met earlier in the day and from whom we had received a request for assistance), but support cannot be given to private sector entities. It was interesting to learn that the Know-How Fund had also received the same request for assistance from this Association as the Embassy/USAID received. G.S. and Gazikova briefly exchanged views on this request.

We also learned that the British were providing up to U.S. $2.1 million to support a foreign investment adviser to the Slovakia Consolidation Agency (SKA). This adviser will be assisting in structuring the loan packages to be sold to investors a part of the asset sales phase of technical assistance. The asset sales phase follows the initial work undertaken by Barents that is funded by USAID and is scheduled for completion in June of this year.

There does not appear to be any recognized mechanism amongst donors for channeling technical assistance in Slovakia. However, based on Gazikova's comments, there does not seem to be overlap between USAID and the Know How Fund in the assistance they both are (will be) providing to SKA.

14. Barents. Jack Biggs, Chief of Party, Slovakia Consolidation Authority (SKA) Project - 02/23/01 4:15 p.m.

At the suggestion of Mark Bochetti, we telephoned Jack Biggs, who at the time was on home leave in Dallas but expected back in country next Tuesday. Biggs has been on the job since last August and is providing assistance in helping with the actual operational set up of SKA, the entity tasked with the responsibility of repackaging and selling the bad loans of certain Slovak banks to international purchasers/investors. This establishment and operational phase of the work, which continues through June of this year is being funded by USAID with the work being carried out by Barents. The project commenced in November of 1999 and SKA was formally established in August of last year. The British Know How Fund will be sponsoring the next phase of work expected to be initiated this coming June which will involve the structuring and selling of SKA's repackaged loans. The purpose of our call was to get an update on the work to date, and to see whether Biggs felt there were areas not covered by Barents' original TOR or that may not be completed before June that could possibly benefit from assistance funded by PFS at this time.

Biggs noted that the Slovaks were slow in the early days of the project resulting in more time being spent in setting up SKA than had been originally planned. As a consequence, there were still a number of operational areas (as many as 8) that needed technical support if SKA was to carry out its function of successfully structuring and selling bad loan portfolios to international investors. Biggs estimated that as much as an additional 48 person months was needed to place SKA in a fully operational position. Although the original plan called for SKA to complete all of its work in three years, Biggs was convinced that if it performed its role effectively, there would be demand from other sectors to assist with the disposition of bad debts, which in turn would mean an operational life of considerably more than three years. In Biggs' view, it therefore made sense to provide this additional TA now to ensure the establishment of a technically competent SKA that was professionally managed and capable of effectively disposing of distressed assets from broader spectrum of industries and over a longer period of time.

G.S. described PFS, noting that it was not intended to be used to support longer-term projects, but rather to be employed to provide shorter-term assistance (1-4 weeks) addressing specific issues. Moreover, in considering the granting of PFS support, preference is to be given to those situations were USAID support can be matched in some manner by local contributions. Given these considerations, it wasn't clear that PFS would be an appropriate funding vehicle for the type of work described by Biggs. Upon her return, G.S. agreed to discuss this issue in greater detail with Lawrence Camp and other USAID colleagues.

Czech Republic

15. PriceWaterhouseCoopers, Michael Hackworth, Managing Partner, and David Parish,

Partner - 2/26/01.

An industrial “revitalization” program announced by the leftist Minister of Industry was still just an announcement as no funding was behind it and the idea to somehow rescue many ailing “rust belt” businesses was of dubious merit. Price Waterhouse was the largest of the Big Five accounting companies in the country with the Central Bank and about 70% of the market as their clients. The firm had just completed an “opacity” study to analyze the costs of national corruption, ineffective legal protection for investors, confused economic policies, problems with accounting and corporate governance, and an uncertain regulatory environment. The Czech Republic scored a high 71, compared to 36 for the U.S., the Czech score translating into foreign direct investment being some 220% lower than it might have been in the best environment. We were promised a copy of the full study; however, the country scores were provided.

Some 10 SROs were attempting to bring business ethics to the market; however, corruption was still widespread. Lack of transparency in the small securities market was an issue in holding back possible growth as well as in qualifying the country for accession to the EU. Focusing on supposedly hot topics, such as e-commerce, was premature since the basic legal and regulatory framework still needed to be addressed. Large companies that were western in their approach did not associate themselves with the local stock market (that had only 5 actively traded stocks), but migrated to more developed European exchanges. They believed the only viable regional exchange was in Poland. It was their opinion that the process of EU accession will encourage increased activity of stock exchanges in larger centers, but not in cities such as Prague. The only way to invest on a large scale was to buy a controlling interest since the rights of minority shareholders were still disregarded by insiders. In such a small market clearing costs for a cross border transaction were 10-20 times those in the U.S. They believed the most promising area for PFS support was enforcement.

Local accounting rules were minimally acceptable and most large firms also kept an IAS set of books. The Big Five use international standards for their audits. USAID’s investment in prior accountancy standard projects had provided a good return. Bank restructuring and subsequent sale to foreign investors was in process with an initial sale of distressed credits having been completed at 8 cents on the dollar (one purchaser was Goldman Sacks). The cleansed banks, mostly in foreign hands, would presumably make loans to viable projects. For a thoroughgoing restructuring greater political will was required. Of Czech banks privatized, there is a higher percentage of foreign ownership than there is in Hungary.

16. <u>KPMG</u>, Charles Randolph, Managing Partner and current President of the American Chamber of Commerce - 2/26/01.

When we described the PFS program he was unfamiliar with FSVC and just slightly so with EWMI. EU accession issues were between the Government and the EU; KPMG’s advice had not been sought. Constant amendment of the bankruptcy law had still left a situation where lender's rights were ineffective, often due to the weak judiciary. The local market had never generated an IPO and he thought none probable. Asset stripping or "tunneling" was common, while a "Clean Hands" enforcement attempt had failed. Thus, the local capital market was insignificant, and likely to stay that way.

Foreign direct investment had increased, but could have been far better is the above problems had been successfully addressed. The country undershot its potential. Banks had no problem retaining an auditor, but often there was a lack of will to implement all recommendations. Development of counterpart or minority rights was essential to a functioning securities market. The burden of social taxes was about 35% of revenues, and many of the old-line firms found it impossible to pay, in many cases finding a lenient tax authority. This attitude as well as heavy State interest in some of these companies was still postponing a full-scale restructuring. The beneficial side of this foot-dragging was that he adverse social consequences was also spread out rather than impacting society all at once with possible adverse consequences for politicians.

17. Arthur Andersen. Magdalena Soucek, Head of Audit - 02/26/01 4:00 p.m.

Soucek, who opened Andersen's Prague office in 1989, was born in the Czech Republic, lived in the U.S. for ten years before returning. She holds a CPA in addition to being qualified as a Czech Auditor. She stated she wasn't all that familiar with the Czech financial sector as most of her work is involved with the larger industrial companies. Nonetheless, as a general observation she stated she was very optimistic about prospects for the Czech banking sector, noting that with the upcoming privatization of KB bank, the last of the major state owned banks will have been sold to private owners. This development was a positive one because according to Soucek the new owners/mangers would employ effective credit standards when assessing requests for loans that, in turn, should lead to improved loan portfolios and eventually a stronger banking system.

G.S. outlined the PFS program, and stated that one reason for our visit was to determine whether it made sense for USAID to use local accounting firms such as AA to assist in carrying out some of the accounting related technical assistance that might be offered to Czech entities under the PFS. We also wanted to hear from Soucek of those areas in the Czech financial sector that could benefit from the type of assistance available under PFS. Soucek stated that the Czech SEC and MOF could use assistance in helping to improve the existing commercial law governing capital markets activity. She acknowledged that while some positive changes to the law had recently been approved in June and August of last year, it wasn't all that clear how effectively the courts would enforce the rights of creditors under this amended legislation. Nonetheless it was important for the Czechs to address effectively such practices as tunneling and questionable corporate governance procedures that have ignored the rights of minority shareholders.

18. European Union, Roman Gardea, Business and Finance, and Stephane Ouaki, Economic Advisor (accompanied by Douglass Benning, U.S. Embassy) - 2/27/01.

A program of technical assistance to Consolidation Bank had ended last June. In another case, the EU financed an advisor to the stock exchange on a one-year contract in 1998; however, the individual had left after 6 months feeling that the advice given was unwelcome. The remainder of the contract was converted to ad hoc stock exchange activity. The new Czech Securities Commission was originally intended to receive EU and EBRD technical assistance to establish itself; however, by the time the project was operative the Commission was already operating so the assistance was converted to a review of its legislation. Their conclusion from this project was that the Czech Government had no political will to establish an independent securities commission. Another project in cooperation with the British Know-How Fund had been to license accountants - which effectively meant dropping about 80% of so-called accountants from certification under the process.

PHARE's procedures call for the Government of a host country to request assistance, although this is often done at their "suggestion". The contracts are then offered to EU member countries to bid on. If no bids are received after two offerings, the contract is then put out to the private sector in EU or candidate countries. Another form of assistance is "twinning" where an EU member sends one or more civil servant to create an institutional link with the host country agency leading toward preparing the latter for EU accession. This is government-to-government assistance with no private sector involvement. Assistance on both sides is approved at a high level (Deputy Minister) in an attempt to make the links more permanent.

The Securities Commission continues to need assistance, primarily to train medium-level cadres, yet it continues to be clear the MOF does not want an independent commission. This emphasis on consolidated regulation is not required by the EU, but is up to each host country. Coordination between the EU PHARE program and bilateral technical assistance programs is informal with each Embassy expected to keep the PHARE program advised of its bilateral activities. They questioned whether Charles University in Prague would be the best venue for securities regulation seminars since the Czech Republic hardly had the best practices in the region compared to Hungary or Poland.

The EU has no "sunset" provision with respect to this assistance; rather, the goal is long-term accession of the country to the EU (unclear for the next group of possible entrants, but possibly around 2004). Since the goal is long-term, assistance is similarly tailored. This results in almost the opposite framework from the PFS' long-term projects as opposed to short-term projects. In some cases, short-term advisors might be utilized within a long-term project.

19. Ministry of Finance. - Frantisek Cvengros, Head of Economic Forecasts Division and Ales Krejdl, Head of Fiscal Forecasts and Analysis (accompanied by Andela Kunstova - U.S. Embassy) - 02/27/01 2:00 p.m.

We were scheduled to call on Ms. Drahomira Vaskova, but she was unable to meet with us so Cvengros and Krejdl substituted for her. G.S. outlined the PFS and the reason for our visit. It quickly became apparent that these two gentlemen thought the purpose of the meeting was to discuss recent macro economic developments in the Czech Republic but not the PFS. Following brief remarks from both sides, it was agreed that we should adjourn the meeting and attempt to reschedule it with personnel who were familiar with the PFS and in a position to suggest how it could be used to direct TA to the MOF.

20. U. S. Embassy, Judith Garber, First Secretary - 2/28/01.

Ms. Garber is the sole member of the Economics Section as this Embassy is resource poor after having to cede some of its personnel to Bratislava when the Embassy in Slovakia was established. She did not want to interfere with PFS Implementers, such as EWMI and FSVC, since they had contacts in the country going back over the past 10 years. It was important, however, that she receive in advance a schedule for proposed visits, a debriefing at completion of the visit and a trip report to avoid being “blind sided” later. Most Counterparts here did not distinguish between an Implementer and the USG itself.

She considered the PFS to be an unusual AID program. When it was established the Embassy was involved and staked out the debt overhang and capital markets transparency as priorities for its program in the Czech Republic. If the exercise were to be repeated, she might include pension and fiscal issues. Judicial reform has been handled by a number of other programs as training has been provided for a large number of judges. When the PFS got rolling she received program literature and also a copy of a successful application, both of which had been useful. [Copies of both were promised and that related to “program literature” received. It comprised a one-page memo dated July 14, 1999, that related to the format for PFS Assistance Requests.] The Embassy does not have time for application hand-holding, but takes it as a measure of a Counterparts interest in the program as to whether there is real follow-up to apply. She gives an Embassy opinion on those applications she receives and forwards to USAID Washington. Phone call coordination with AID/Washington had proven useful. On the other hand, the Extranet had been useless since it could not be fully accessed on State Dept. computers. Coordination with Treasury had also been good with one exception.

The Embassy’s focus, and that of all other Embassies, was on bilateral assistance with State input on regional assistance being handled out of various regional bureaus in Washington. For example, the North Central Europe Bureau (Office) might be a useful contact point for regionally supported PFS activities.

It was clear that EU assistance had a longer time frame and was geared to the country’s accession; however, the short-term nature of PFS advisors was often helpful to as a complimentary activity, e.g. review of a particular law. That of John Gruner (through FSVC) for the Czech Securities Commission in November 1999 was very helpful.

The current Government is a coalition and not reformist in outlook, although exceptions have been the privatization of the banking sector and modest steps taken by the Securities

Commission. Bold strokes on reform should not be expected. It is uncertain whether the Securities Commission reforms will "take" as new leadership there is moving slowly.

21. Czech National Bank (the Central Bank). Vera Masindova, Executive Director, Banking Supervision Policy, and Pavel Vacek, Director, General Policy and Regulations, Banking Supervision Policy - 2/28/01.

They had just completed a self-assessment with respect to banking supervision including the efficiency of their banking regulation policy. The IMF and World Bank had offered some very helpful and comprehensive training; however, there was one area where they had requested assistance from the U.S. and not received a reply. This was with respect to a 2-3 week training period devoted to regulation of bank holding companies. They believed the U.S. offered the best assistance in this area, possibly through the FDIC. The original request had been submitted about 2 years ago and various clarifications had been sought since that time by the U.S. Embassy. We agreed that 2 years was a long time to wait for a definitive reply, and promised to look into the situation with the Embassy and USAID in Washington. [The Embassy indicated this was a situation where the Governor of the Czech National Bank first stated assistance was not required, then reversed himself. Additional time was taken clarifying the request, and in finding time to work on it since the application had at one point been on the First Secretary's desk for three months without action.] Copies of correspondence with the Embassy were provided. This request was mentioned to FSVC during a visit about 6 months ago, but there still has been no response.

Their definition of consolidated regulation differs from that of USAID in that they focus on regulating a group of consolidated financial entities, e.g. a bank holding company, rather than combining the regulation of various financial sector players under a single agency. They are emphasizing more "on site" regulation as per advice from the World Bank. Work with private bank auditors is going well. They were involved in a "twinning" project with regulators from the Greek and German central banks with financing through the EU's PHARE program. A total of 18 banking groups that are engaged in non-banking activities are under the supervision of the National Bank with almost all of them being foreign controlled.

Mr. Vacek indicated his SEC-arranged visit to the U.S. last year was most productive.

22. Consolidation Bank (KOB). M. Zamecnik, Head of International Relations (Accompanied by Judith Garber, First Secretary U.S. Embassy) - 02/28/01 4:00 pm.

In addition to Mr. Zamecnik, we were also scheduled to call on Mr. Ladislav Reznicek, Director General, but he was unable to meet with us.

Legislation which would transform Consolidated Bank's legal structure from a bank to a restructuring and asset disposal agency has been drafted and introduced to Parliament where it will have its first reading tomorrow. Given its modified legal structure and the fact that it will no longer be subject to National Bank supervision, some opposition members have voiced concern over the lack of adequate mechanisms to oversee and control the new agency's activities. To an extent, Zamecnik indicated he shared this view but stated that with a strong Advisory Board, proper oversight could be achieved. Accordingly, he felt that parliament would enact the legislation. It is expected that Consolidated Bank will cease to exist by August of this year.

Following a description of PFS by G.S., Zamecnik who was familiar with USAID, having had extensive contact with Treasury, and FDIC advisors expressed his appreciation for past USAID support and stated that he hoped it would continue. He indicated that it would probably take two more years for Treasury to complete its work at Consolidated Bank and its successor agency. He noted that T.A. provided by FSVC to the Czech Securities Commission (KCP) had also been welcomed and was very valuable, but because of political considerations, it had not yet been fully digested.

Zamecnik then described at some length a Consolidated Bank activity which had involved both Treasury and FDIC participation, which he felt was and continues to be quite successful. It involves the establishment of Special Purpose Vehicles (SPVs) set up to take over financially troubled Czech entities which have the potential for becoming commercially viable but which require substantial restructuring, significant downsizing (i.e. loss of jobs) and disposal of under performing assets. So far, two SPVs are up and running with a third expected to be established soon. The goal of the SPV approach is to rescue entities that exhibit the potential to be commercially viable, restructure them to have employment levels that will allow for profitable operations, and eventually sell to them to private shareholders as soon as they become self sustaining and financially independent. Lazards, the international investment bank along with a small U.S. investment bank, Latona Associates have been retained by Consolidated Bank to manage these SPVs. Treasury and FDIC play an important role in the process by serving as advisors along with the EBRD, an international law firm, Transparency International and the E.U. Their roles require them to attend meetings in Prague on a monthly basis. The involvement by Treasury and FDIC had given the process legitimacy and transparency that helped to minimize political "second guessing" and interference. From the description given by Zamecnik, the SPV approach appears to involve the use of fairly sophisticated financing techniques. It is not clear at this point, whether PFS supported TA would be appropriate for SPV activity. It is possible however, that PFS funding could be used to support conferences/seminars that examine the applicability of the SPV approach as an appropriate means for enterprise restructuring in other PFS countries.

23. <u>White & Case. Feddersen</u>, Michal Dlouhy - 3/1/01.

The general quality of law in the Czech Republic was satisfactory, but its enforcement by the courts was completely inadequate. On one hand were Communist-era judges who had experience but did not grasp the issues, while on the other were young judges that lacked experience. Judges were considered bureaucrats, and their primary goal was often to move paper rather than make a fair decision. If you were a creditor, it was difficult to make your case stick; this was a defendant's "haven". Another problem was that there was no commercial-administrative register in which to record relatively minor corporate decisions/amendments. All had to be verified through a judge, and this clogged the courts as well as creating a commercial problem. This register should be privatized and made automatic.

Some judicial corruption was present on a low level, though this might be looked on as a simple payment to get things moving - greasing the wheels of commerce. The modern commercial system started about 10 years ago without making an effective, workable set of laws.

One IPO had been done on the Prague stock exchange; it was basically a bureaucracy. For new capital most companies went to their traditional sources - commercial banks. Debt workouts are not creditor led since this group can be easily frustrated; however, if the borrower cooperates it is possible. Reorganization is difficult, with the exception of a few KOB cases, and bankruptcy is the primary route. If the lender has a security interest in real property this is possible to enforce, but for leases related to movable property one had better have a strong lessee and not rely on the asset.

They were one of 30 members comprising the Association For Capital Markets, an SRO including accountants, lawyers, and investment brokers/dealers. The Association had advised on disclosure, use of IAS (vs. Czech accounting that is tax driven), and related laws. The MOF held the key to further reform and it was opposed at this time, viewing the capital markets as able to exist without regulation - a serious error. The political situation was uncertain, there was an election in about a year, so there would be little movement in the near future.

24. GE Capital Europe. Ladislav Nussebauer, Country Director, Business Development for Czech Republic, Slovakia & Hungary - 3/1/01.

They bought Agrobank, reduced the branches from 300 to 200, purged the balance sheet of non-performing loans, and are now heavily committed to retail banking. This was supplemented by investments in GE Capital Leasing, the third largest car lessor, and a telecom company that is not controlled.

GE Capital had experience with purchasing distressed loan portfolios in Thailand, Korea, and Mexico, considering it one of their core businesses. It was important to acquire a large corpus of loans - generally $500 million in face value and up. Their strategy was to bring in a specialized evaluation and servicing team from headquarters. If successful in the bid, GE Capital would then quickly seek to sell the loan back to the borrower for cash or payment in a short period at a discount, but still with sufficient profit to meet its overall NPV goals. Another strategy was to sell the collateral separately from the loan. The evaluation process was time-consuming as each transaction had to be examined. He found the borrowers willing to settle to avoid a court fight.

In the case of the KOB package of 500 loans with a face value of US $300 million sold about a month ago, the three "usual suspects" were bidders: Goldman Sachs, GE Capital, and Lone Star. Goldman won and GE was the under bidder. A second offering is expected before the end of 2000. In general, he believed the sale went well which was important as this was the first such sale in Central Europe.

It was important to have foreign advisors and bidders with respect to these tenders as the combination gave transparency to the sale. In other words, the local seller i.e. KOB got political cover and was less likely to be accused to giving assets to friends. The procedure should be replicated in other countries so that the State can move these loans out to the private sector. State agencies such as KOB did not have a staff with sufficient expertise to make these evaluations, frequently with less than ideal financial information, and conduct the negotiations for the volume of debt involved. When the legal framework for creditors is improved so do the prices paid for such debt increase: for Korea it was 12 cents on the dollar before legal reform and 40 cents after. Such examples should provide incentive to modify this area of the law.

25. <u>Czech Securities Commission (KCP).</u> Tomas Jezek, Member of the Presidium and Katerina Palkova, Department of External Relations - 03/01/01 2:00 pm (accompanied by Judy Garber, Economics Officer- U.S. Embassy).

The purpose of our visit to KCP was to get an update on its most recent activities and to learn whether the recommendations contained in the Nov.1999 PFS sponsored FSVC study carried out by accounting expert, John Gruner had been implemented. The KCP was established in April 1998 with responsibility for regulating the Czech capital markets. KCP's role is directed at overseeing only those companies issuing registered shares in the Czech Republic, which currently number about 100, as compared to the 1000 companies that had been privatized in the early 1990s. Prior to KCP's establishment, capital markets regulation fell under the purview of the MOF. While the KCP is financed directly from the state budget, and is now separate from the MOF, the Finance Minister and the MOF continue to exercise a certain degree of influence and control over KCP's activities, the most significant of which is MOF's authority to oversee and manage the submission to Parliament of new capital markets legislation or amendments to existing legislation, and to the issuance of regulations governing the capital markets.

Jezek openly acknowledged that differences existed between MOF and KCP, and stated it was up to the two agencies to resolve them effectively. He went on to note that at this time, a key objective of KCP was to acquire the right to issue its own regulations without first getting the backing of the MOF and/or Parliament. In this regard, he expressed confidence that MOF and parliament would be amenable to such an approach, and noted that both the IMF and World Bank will support the expansion of KCP's authority in this regard.

Jezek noted that although the most recent attempt at amending the existing accounting legislation had been unsuccessful, a second effort would be undertaken in the spring that he thought would be received more favorably and eventually enacted. Among other things the proposed amendments would include the requirement that companies listed on the Stock Exchange would, as of their 2001 annual reports, submit their accounts based on standards that comply with IAS. Passage of this amendment would be a direct result of one of two major recommendations contained in the Gruner report.

The second Gruner recommendation proposed that KCP should engage a chief accountant to oversee the upgrading of its accountancy practices and procedures. When queried on the status of this recommendation, Jezek stated that at this point in its development, KCP needed staff with the ability to effectively evaluate annual reports, and to foster and help listed companies develop a culture that encourages transparency and is open to disclosure. Companies need to be encouraged to improve the quality of the information they distribute to the public. “Accountancy professors” were not needed at this time at KCP.

When asked about corporate governance, Jezek noted that KCP had recently published a code patterned on the OECD model. At this time, the code is voluntary, but Jezek noted that about 60%-70% is enforceable under existing laws. Moreover, all listed companies will be obliged to adhere to the Code’s provisions by 2003.

Discussion then focused briefly on IPOs and why only one had been issued so far on the Prague Stock Exchange. Jezek noted that in response to a request from Parliament, KCP, in cooperation with the Stock Exchange and some associations had recently submitted a report addressing this issue. Jezek noted that although there are administrative/legal problems particularly with the commercial registration process, which discourage the issuance of IPOs, the problems inhibiting IPO issuance are for the most part psychological in nature and can be divided into two classes, perceptions of the prospective issuer and perceptions of the prospective investor.

On the demand side, potential Czech issuers are reluctant to raise capital through the issuance of IPOs because they are concerned it will dilute their ownership and lead to their losing control of their businesses through hostile takeovers. Moreover, access to readily available funding through banks has until recently always been a fairly straight forward process, thus obviating the need to obtain funding through alternative sources such as the capital markets. On the supply side, Czech investors have been especially reluctant to purchase share issues following the scandals of the early and mid nineties where many lost considerable amounts as a result of tunneling schemes and other similar fraudulent practices which were employed by majority shareholders and/or management. Moreover, over the years Czech investors have been influenced by well-entrenched German and Austrian practices that have traditionally directed savings to banks rather than to the securities markets. Investing in the Czech securities markets will therefore require that strong cultural traditions be overcome.

Interestingly, at the end of the meeting, Palkova told us that it seemed likely that KCP's authority would soon be expanded to include pension fund regulation, a development that KCP apparently would welcome. However, she was quite emphatic in stating that KCP would not want to take responsibility for regulating the insurance sector, it had "too many problems".

25. U.S. Embassy, Prague. Mr. John Boris, Counselor for Political and Economic Affairs - 03/01/01 3:30 pm (accompanied by Judy Garber, Economics Officer - U.S. Embassy).

This meeting, which lasted 20-25 minutes was primarily a courtesy call in which we briefed Mr. Boris (who was acting DCM) on the purpose of our visit to the Czech Republic (PFS assessment), and the outcome of our meetings to date.

26. Citibank a.s. David Francis, General Director and Chairman of the Board, Frantisek Maslo, Vice President Financial Institutions, and Jan Muller, Vice President Compliance - 03/01/01 4:30 pm (We spoke to each person individually.).

We had learned from previous meetings in Prague that Citibank had indicated an interest in working with Consolidation Bank (KOB) to find ways of disposing the distressed assets which KOB had purchased from Czech banks in the run up to their privatization. The primary purpose of our call therefore was to learn more of the role played by Citibank and its views regarding the sale of distressed assets in the Czech Republic.

Citibank employs 700 people in the Czech Republic, is engaged primarily in corporate banking with about 5% market share, and 10-15% of the foreign exchange/money market activity. Its Czech marketing strategy is to focus initially on those global clients having a presence in the Czech Republic, with subsequent attention being directed to Czech medium and smaller sized enterprises, to be followed eventually by entry into the consumer banking sector. Recent advertisements in the Czech press indicate Citibank has now entered the third phase of its strategy, i.e. consumer banking.

Francis stated that Citibank had held numerous discussions with KOB and the Revitalization Agency proposing approaches that it felt would deal effectively with KOB's non-performing loan portfolio. Citibank's preferred approach was to work with borrowers to reach acceptable work out/loan rescheduling arrangements, thereby allowing borrowers to continue their activities and avoid shutting down. In Francis's view, this approach was best for the creditor, in that it would ensure receipt of a larger percentage of loan repayment than other methods would offer, it would be better for the borrower in that it would allow it to continue to operate, and it would be better for the economy in that the number of jobs lost through this approach would be less than that resulting from other restructuring approaches.

According to Francis, KOB decided to opt for auctioning off distressed asset packages to the highest bidder, and to that end recently held its first pilot auction in which it sold the equivalent of a nominal US$300 million to Goldman Sachs, the successful bidder, at 7%

or .07 cents on the dollar. It is not clear how Goldman will handle these assets, but Francis believes their approach will be to maximize the net present value of these assets through a negotiated settlement with the borrower, a method that provides payment to the creditor in a relatively short time frame but one which does not always result in the survival of the borrower. Francis noted that KOB was motivated to adopt this approach because it demonstrated to the Government that the value of the assets sold was set by the market through the auction process, and not by KOB through some sort of untested valuation process.

After concluding our discussion with Francis, we then met with Frantisek Maslo who spoke at some length about bank privatization in the Czech Republic, the details surrounding the collapse of IPB bank in June of 1999, the role played by the Central Bank in intervening in IPB, IPB's eventual sale to CSOB making CSOB the largest bank in the Czech Republic, and that IPB's non performing assets could be as high as 60-70% of its total assets, apparently the valuation has yet to be completed. He then discussed why he felt the Prague capital market was dying. On the demand side, large Czech companies were sufficiently liquid obtaining funding from offshore sources with local requirements being easily met by Czech banks which are also liquid, thus obviating the need for equity based funding; many smaller companies are also getting adequate funding from local banks so their demand for equity is also minimal, and moreover, they are reluctant to raise capital through the issuance of equity for fear of losing control of their companies.(We had heard similar explanations from the KCP and heard them again at the Stock Exchange).

We then spoke briefly with Muller who is now Citibank's head of compliance in the Czech Republic. Formerly, Muller had headed KCP, during which time he got to know USAID and was therefore familiar with PFS.

27. Charles University, Prof. Michal Mejstrik, Institute of Economic Studies - 3/2/01.

The Institute of Economic Studies is 10 years old, has three levels at which it awards degrees, and has been accredited as first in the Czech Republic. It is both a teaching facility and think tank. The faculty are top practitioners in their fields. There is no tuition; however, application criteria are very high. They are careful to maintain no political orientation, although it is clear that a liberal, market-oriented philosophy is present. With respect to seminars and other activities under PFS, they receive no University funding so all costs must be met through donor assistance.

They are working with EWMI on a banking conference that will probably be held in Sofia. It will have an East-East orientation as Czech bankers will attempt to transfer some of their experiences in banking reform to Bulgaria. EWMI will provide half of the funding. Some recent successful conferences held at the University included one held 10/20/00 on regional capital markets and stock exchanges and one 11/5/98-11/7/98 on corporate governance. For both of these conferences, substantial outside funding was raised from a variety of public and private sources.

Despite the apparent "success" of their conferences, Prof. Mejstrik believed that the precepts advanced by Charles University were slow to be utilized by the marketplace. The Czech Republic had just recently expunged corrupt vested interests that were difficult to fight against. The last to fall will be IPB Bank, with respect to which the Government has finally acted. They have started a Leadership Forum on corporate governance, with the first being held 11/2/00-11/4/00. Another strategy has been to go into individual companies with their message on business ethics. Prof. Mejstrik believed there was a correlation between trust and profits. He thought the Czech Republic needed a local conference on corporate governance. USAID's response was uncertain since FSVC handled bilateral relationships under PFS, yet apparently had never done a local conference.

Prof. Mejstrik's primary concern with PFS was that it was slow, often forcing the University to work on the faith that it ultimately would be paid. Private funding sources were important to supplement USAID (and by implication deliver funding more promptly). Nonetheless, he desired more cooperation with EWMI and FSVC.

28. Prague Stock Exchange, Vladimir Ezr, Secretary General Deputy, and Jiri Opletal, Secretray General Deputy, Director of Licensing Department - 3/2/01.

USAID announced that approval had been given under the PFS for NASDAQ assistance. FSVC would probably be contacted to act as the Implementer. The news was well received; however, this application was apparently submitted last summer.

For this small exchange the primary issues are now disclosure requirements and surveillance, in which areas training is required. It may be necessary some day to affiliate into a regional stock exchange including the Warsaw, Budapest, Bratislava, and Ljubljana exchanges. On all rules/procedures they are looking toward EU accession. Their exchange must be in compliance with these, and currently only a few changes are required. In the past year they have worked better with the Czech SEC.

After some early negative experiences with voucher privatization, Czech investors had not used the local capital market. Of the original 1,700 listings in 1996, only 300 remained and of these only 8 trade with any regularity where the issue could be termed liquid. Trading was on line and there is no trading floor. Most businesses still looked to banks for capital, the traditional Czech source. Privatization of the banking sector is in the process of eliminating the easy credit standards of the old State-controlled banks.

In fact, the exchange might not be termed a capital market since no firm had been able to raise equity capital on it. They did expect the first IPO to happen before mid-year, and others were likely to follow. This would give the exchange much-needed new blood. The common pattern for foreign direct investment was to buy the whole company to avoid manipulation or "tunneling" by others if only a minority stake was purchased. Unless the market could generate new capital for a deserving business, they concluded one might argue that it should be closed.

29. Ministry of Finance, Office of the State Supervision in Insurance and Pension Funds, Petr Svoboda and Vladimir Prikryl (accompanied by Judy Garber, US Embassy) - 3/02/01 1:00pm.

This was our second attempt to meet with appropriate MOF personnel. Our first had resulted in our meeting with macro economists who understood that we were interested in receiving a briefing on recent Czech economic trends. In fact, we were interested in speaking with those MOF representatives at sufficiently senior levels who were familiar with and involved in MOF's interface with KCP, since we had been told on a number of occasions that although KCP was a separate entity, MOF continued to exercise considerable influence over its activities.

As it turned out, these two gentlemen were involved primarily with insurance related activities but stated a willingness to discuss pension matters as long as the discussion did not involve details. They were unable however to discuss anything relating to capital markets. Nor was it clear what they knew or didn't know about the activities of KCP and its relationship with MOF, except they indicated an awareness of proposed changes to the securities law which would remove from MOF and grant to KCP regulatory authority over pension funds (This was consistent with what we had been told at KCP). They estimated that this amendment could be enacted by year-end.

When asked how they saw financial regulation in general evolving in the Czech Republic, they stated that the main issue that needed to be addressed was to ensure that Czech rules and regulations were harmonized with EU directives. In this regard they noted that they were not receiving TA from PHARE at this time. Nor were they members of the EU Insurance Committee, although they had requested application information. However under EU auspices, the MOF was participating in a twinning program with German regulatory authorities.

To the best of their knowledge, nobody from MOF had attended last month's regional conference on pension funds sponsored by EWMI that was held in Budapest (Judy Garber also had not known of this conference). However, they mentioned an upcoming pensions related conference to be held in Bulgaria within the next several months. But they had no further details regarding sponsors, attendees etc.

30. European Bank for Reconstruction and Development (EBRD), Jacob Sadilek - Head of Resident Office and Zdenka Vicarova, Deputy Portfolio Manager for Czech and Slovak Republics (Accompanied by Judy Garber, U.S. Embassy) - 03/02/2001 3:00 pm.

We called on EBRD in Prague to solicit their views regarding the Czech financial sector and to get an update on their current activities. The EBRD's Prague operation is relatively small with a professional staff of three. In banking, it has played an active role in the privatization process having taken equity positions in two previously state owned banks, one of which was eventually sold off to the majority owner, Erste Bank Sparkassen, an Austrian bank. Currently EBRD is helping to identify potential strategic investors in Germany and Austria to take equity positions in KB bank, the last Czech bank to be privatized. Sadilek hopes that by year-end, bank privatization in the Czech Republic will be completed.

For the privatization process to succeed, banks have to be sold "clean", that is all non performing assets must be sold to KOB before a state owned bank can be sold to a private sector buyer. In this regard both Sadilek and Vicarova expressed belief that KOB appeared to be doing a good job, that is they had heard no complaints or comments criticizing the pilot US $300 million auction to Goldman which was priced at 7 cents on the dollar. Interestingly, Sadilek stated that if the auction had not gone well, that is, if private investors had shown little appetite for these assets, EBRD would have stepped in and participated in the auction process.

Commenting on the Czech economic situation, on the positive side they noted that foreign direct investment was strong in sectors such as automotive, electronics and electricity, which they attributed to a skilled work force; and, that some larger Czech companies were being bought by large foreign multinationals which was attributed to modern manufacturing techniques producing competitive goods. On the negative side, concern was expressed over the lack of strong legal system that is needed to encourage the growth of and foster respect for sound and open commercial operating principles.

Regarding the issue of capital markets and the Prague stock exchange, it didn't seem to be clear to either how much of a life there was for a stock exchange operating in small markets particularly for equities. However, they noted that prospects for an active Government bond market seemed far more favorable.

31. Latona Associates of Europe, LLC, Michael Saran, Managing Director (Accompanied by Judy Garber, U.S. Embassy) - 03/02/2001 4:30 pm.

Latona, a small U.S. investment banking boutique, has a mandate with Lazards (New York) to work with the KOB in restructuring certain Czech enterprises, and to package and sell non performing assets purchased by KOB from Czech banks in the run up to the banks' privatization. We called on Saran to get an update of Latona's activities, and in particular to determine whether in Saran's opinion there was a need/place for additional TA for KOB of the type that could be offered under PFS.

Saran outlined Latona's involvement in KOB's enterprise restructuring and asset sale work noting that five companies have been identified by the government as candidates for restructuring although there could be more, that Latona has mandates to work with four of these enterprises, and that currently it is very busy in undertaking this work. In this regard, he noted Latona had a total of 16 people in Prague (expatriates and local staff).

Regarding TA, Saran stated that it is well recognized there is a need to amend/improve the bankruptcy law and that any assistance in this area would be very beneficial. In addition, he noted that TA could be invaluable in helping to structure asset sale packages to ensure transparency, thereby enhancing the package's marketability and attractiveness to potential investors/purchasers. He also noted that a more difficult but nonetheless important area that could benefit from TA would to find effective ways of assessing the social implications of enterprise restructuring.

As a general observation, Saran stated that as a profit making entity Latona's work with the KOB was not going to result in large profits, but rather it would provide an improved appreciation of market conditions and participants, which in the longer run will hopefully enable Latona to become a successful strategic investor in the region.

APPENDIX E

USAID – PARTNERS FOR FINANCIAL STABILITY

FINAL INTERVIEWS IN THE U.S.

All interviews were conducted by Messrs. Greene and Lentz from FWA.

1. Financial Services Volunteer Corps (FSVC), Salvatore J. Pappalardo, Managing Director – 3/14/01.

FSVC is still working under a pre-PFS generic Cooperative Agreement dated 2/17/98. It originally expired 12/31/98, some seven months before PFS was launched, but has been extended. The most recent extension runs through 3/31/01; however, another to 9/30/01 is anticipated by FSVC. The current budget is $350,000 for the period 1/1/00 through 3/31/01. The Agreement, as amended, does not require submission of a work plan, although an annual work plan was required in the original version. Cost sharing of not less than 65% of USAID contributions is required as is USAID approval of key personnel. However, there is no stipulation that USAID-funded projects exceeding $10,000 must be approved by the TRC. The Agreement also covers some non-PFS countries such as Albania and Macedonia.

Without a work plan, Mr. Pappalardo considered that FSVC was essentially "on call" to provide bilateral technical assistance for the program. Prior to the next expected expiry date of 9/30/01, he hoped to have a more normal "stand alone" contract, directly related to PFS, in place that would provide FSVC with firmer direction and at least include an annual work plan.

At the outset of PFS, Mr. Pappalardo coordinated his travel to the region with EWMI in one instance and as often as possible with USAID. FSVC's current relationship with USAID might be described as informal since it involves relatively few contract requirements. FSVC travel is independent, although some coordination with USAID is attempted through monthly or quarterly discussions. In the absence of a work plan, projects are developed through conversations between both parties. While some of the post-presence countries have acceptable project preparation skills, many of the requests for support required much FSVC hand-holding. In some cases, e.g. Slovakia, initial negative reactions from the U.S. Embassy were reversed after the project had been fully explained. He believed that most Embassy personnel have very little time to devote to PFS, even when the activity is bilateral.

He identified the PFS projects that FSVC has worked on since 1/1/00, as follows: early 2000 and March 2000 for the Czech Securities Commission; two lawyers assigned at different times to the Czech Consolidation Bank on debt workout issues; visits from

Slovakia from the Association of Securities Dealers to U.S. markets; and a pension conference in Budapest this past January where FSVC provided a speaker (although the meeting was sponsored by the World Bank, not PFS). The program of Slovak training visits was delayed within USAID until the issue had to be forced by near-term meeting dates that could not be postponed.

Mr. Pappalardo believed bilateral technical assistance was the essence of PFS with the regional conferences being decidedly secondary as a vehicle to impart useful knowledge. Nonetheless, he confirmed that FSVC could sponsor a conference on bilateral issues and considered that in Slovakia on capital markets to have been in this category although it was ultimately given to EWMI. FSVC was concerned with the upcoming PFS Agreement that USAID proposes to sign with the FDIC since FSVC had recruited FDIC staff in the past and was prepared to continue doing so. USAID had given him no clear reason why a separate Agreement with FDIC would be desirable. He mentioned that the U.S. Department of Labor cooperated with USAID a few years ago on provision of technical assistance related to pension reform, but had withdrawn.

In general, he thought USAID’s management of PFS had improved since the beginning of this year; however, much remained to be done. FSVC is comfortable working under a flexible arrangement, but PFS is a still a disorganized program with structural problems relating to the State-USAID relationship, role of the TRC, and USAID speaking with many voices. Possibilities for TRC modification were discussed, with Mr. Pappalardo gradually being convinced that certain proposals might be more than just bureaucratic and lead to clearer guidance and greater sharing of information. He had no problem with a general PFS structure along the following lines: (1) top level overall policy formulation, (2) policy adaptation on an annual basis to particular country strategies for each of the eight post-presence countries, and (3) demand-driven generation of specific projects within the country strategy, many of which might be considered by a modified TRC.

In conclusion, he questioned whether PFS could be managed from Washington without substantial field support that was unlikely to be forthcoming from Embassies. He believed an alternative might involve placing PFS management responsibility with a single contractor, namely FSVC.

2. <u>East-West Management Institute (EWMI)</u>, Susan K. Gurley, Program Director – 3/16/01.

Their Cooperative Agreement has not been managed by USAID in the spirit of a partnership with an entity in which confidence is place and that is funding half of project costs. The underlying concept of trust in the Implementer as an expert in its sector of activity is understood by a few at the USAID management level; however, they have apparently not communicated this to the operating level staff who continue to treat the relationship with EWMI as one of standard contracting. Consequently, USAID has not only interfered in operational details, but also instituted unilateral contract changes on an oral basis with no inclination to commit them to writing. Often it was the USAID PSCs, believing they had better technical knowledge, that got in the middle of what was essentially supposed to be a “faith based” Agreement.

Specific examples involved: (1) the selection process for the new Budapest office director where USAID demanded more than the usual single candidate be nominated by EWMI, (2) virtual elimination of SEE country activity, although this is permitted under their Cooperative Agreement, and (3) USAID requests to review internal EWMI grant-making procedures.

Despite the Agreements’ terms, EWMI is under informal oral instructions not to undertake any unilateral technical assistance delivery in the SEE (USAID reasoning appears to be that SEE assistance is covered under bilateral programs). Representatives from that region may be invited to conferences held in the CEE and addressing CEE issues, but this is the extent of what is permitted. Ms. Gurley indicated that EWMI was most desirous of amending its Cooperative Agreement to accommodate such changes in a businesslike manner, but that USAID seemed to favor the informal, oral route since the agency’s cost sharing formula would not have to be revised (and possibly its share increased) as under a contract amendment.

A risk to EWMI was that USAID would informally circulate the message it was an “unresponsive” contractor to the Institute’s detriment in bidding on future work. While a few in USAID viewed the Cooperative Agreement concept in the right light, they were a minority and had not brought the others along. EWMI desired to cooperate and fulfill its PFS responsibilities, but USAID should make them clear and put contract amendments and policies in writing.

Communication with USAID to resolve these issues had not been satisfactory. The agency tended to speak with many, sometimes contradictory voices, i.e. there was no counterpart for EWMI. This led to USAID being unable to identify who EWMI’s counterparts were in the agency; consequently, calls were received from many different sources. In addition, there little communication between partners. A further point was the lack of PFS information. Ms. Gurley was concerned that the importance of EU accession was insufficiently appreciated by USAID as the driving force behind most financial sector reform. To the extent that our message differed, there was a question of whether anyone was listening. An example were the Baltic countries, where USAID desired PFS projects, but unless they were attuned to EU or Scandinavian practices the advice would probably be ignored.

She believed recipients were generally pleased with the technical assistance delivered. The PFS management problems had apparently not trickled down. Despite this feeling, it was almost impossible to measure the effectiveness of assistance delivered through regional conferences as compared with bilateral assistance for a specific problem. It would be helpful if EWMI were permitted to deliver bilateral support that stemmed directly from a conference (although FSVC would surely protest).

She made it clear that EWMI would never have entered into such a contracting arrangement de novo. It was incompatible with their cost contribution and "high maintenance" in terms of EWMI's senior staff time.

3. Department of the Treasury, G. Edwin Smith III, Director, Office of Technical Assistance (OTC) – 3/26/01.

The OTC was organized in 1990, and began its activities in Poland. Currently, its staff comprises: 40-45 advisors in the field, about 100 specialists on call for specific assignments, 45 in Washington to handle contracting and finance issues, and a senior management of 8 located in Budapest and Washington. Activities are worldwide; however, a large share of aggregate budget of some $30 million ($13.5 million) is allocated to CEE and SEE countries. Work is divided into five functions and assigned to two-person functional teams. The individuals assigned to the jobs had a strong professional background in their areas. Treasury's burdened cost to keep an advisor in the field was about $475,000 per annum. The fact that USAID operated on a geographic basis had sometimes led to problems. Mr. Smith described his role as Director as one of allocating work and budget to fit within the functional breakdown.

OTC's annual budget was prepared in the spring for the upcoming fiscal year beginning September 30. Funds were obtained from the Support for Eastern European Democracy (SEED) Act of 1989 that was administered by the State Department, not USAID. SEED Act countries included both CEE and SEE countries, many of which have not been "graduated". The SEED Coordinator in State was a key individual that had to approve individual projects which was usually done only after checking with the relevant Embassy. These projects had been previously negotiated between Treasury and (1) the SEED Coordinator, or (2) senior Embassy officials, often the Ambassador. USAID was tangentially utilized as a "pass-through" agency between the SEED Act Coordinator in State and OTC in Treasury. USAID has no discretion in the pass-through exercise.

PFS funding, through other provisions of the SEED Act might have gone to the SEC and the two NGOs (EWMI and FSVC), but it did not come to Treasury. Often, however, the projects of these other entities and those of Treasury were related and had Treasury approval. An example was KOB in the Czech Republic. For the FY beginning 9/30/01, $0.5 million was being proposed by Treasury to State for regional work in the graduated countries. It would be Treasury's decision as to utilization of these funds.

Treasury markets its availability to provide technical assistance in its five areas of expertise to the countries of the region. Sometimes the country will decide a World Bank, IMF, or EU form of assistance is more appropriate and Treasury backs off. The presence of some overlap between PFS NGOs is desirable as it keeps them competitive and it would be almost impossible to avoid at the margins. This competition and marketing is desirable as it leads to an effective marketplace.

PFS had been funded with very modest amounts as there was an issue with respect to trust in the program. Treasury had understood the PFS concept at the outset of the program, but had become less clear as time passed. Treasury was prepared to cooperate with PFS, but received no funding from it. PFS had now reached a point where the program was in jeopardy of being eliminated by either the SEED Coordinator or the Congress. If this occurred, it would make no difference to Treasury's program of financial sector technical assistance in the CEE and SEE countries.

4. Securities and Exchange Commission (SEC), Robert D. Strahota, Assistant Director, Office of International Affairs – 3/27/01.

Neither of the NGOs nor the USG agencies participating in PFS had any input when the decisions were made to "graduate" the eight post-presence countries. For the SEC this meant that they couldn't host post-presence country representatives at their U.S. conferences unless there was the requisite cost sharing. With respect to SEC conferences, the country paid their air fare and SEC took care of per diem expenses with PFS funding through the SEED Act. PFS might be summarized as encompassing discrete projects of 2-4 weeks in duration, cost sharing, and vetting by the TRC. There had been about two TRC meetings last year, the last in July, and none so far in 2001.

USAID/Washington ought to consider closer work with the Embassies since they had no direct representation. In the absence of better communication, the program might be reorganized. The graduated countries need varying degrees of assistance with their capital markets. Many, if not most, are EU oriented with respect to designing regulations. In most cases the SEC has no problem working with this as the EU model is usually better that what is currently in place. An exception was enforcement where the EU tended to rely on judicial enforcement of securities regulations which tended to result in almost no enforcement at all given the problems in their court systems.

A few long-term financial sector technical assistance projects might be viable, but the great bulk of the SEC's program could be handled on a short-term basis and thus fitted in well with PFS. Long-term help also could waste scarce program funding. Finally, the cost sharing requirement under PFS inhibited long-term assistance. Despite its drawbacks, USAID should keep an open mind about possible support for a few long-term PFS-type programs.

The SEC had good relations with FSVC which delivered professional experts from the private sector to compliment those on the USG side. FSVC assistance was cost effective, and cost sharing with the SEC had gone well. The SEC had only recently met EWMI, but believed it had an advantage through local presence. The first association with EWMI would be through a Budapest securities conference being jointly arranged for this June.

Mr. Strathota himself appears to have done most of the SEC's work under PFS, although he has the ability to seek out others in the agency or in related agencies. FY 2000 budgetary arrangements under PFS were ad hoc, but FY 2001 is the first year there is an actual budget ($200,000). There funds, as well as the agency's own, are allocated carefully since a number of proposals made by Embassies or USAID/Washington are declined as inappropriate. Sometimes these cases are referred to another agency, and at others to FSVC. Since inception of its program of technical assistance in Europe in 1992, USAID reimbursements to the SEC had totaled about $3.0 million.

Information was provided on: (1) a draft PFS program summary dated 5/11/99, (2) a cable of 7/11/99 announcing the program, and (3) a suggested format for PFS assistance requests.

Mr. Strahota believed that if PFS were terminated, the SEC's program of technical assistance would continue, but that the agency would have to be more critical as to what projects were approved. Also, the host countries would have to engage in greater cost sharing. The SEC had its own technical assistance budget (details were not revealed) that had been used entirely in some countries, e.g. an east Caribbean legal review; however, there were various sources of complimentary funding from the IMF, World Bank, and IADB that had been used for other countries such as Mexico.