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**USAID / SERBIA MONTENEGRO  
CENTRAL BANK OPERATIONS, PENSION  
AND INSURANCE REFORM**

**ANNUAL REPORT**

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**Contract No. PCE-I-00-00014-00, Task Order 811**

**Prepared For:**



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**TABLE OF CONTENTS**

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<b>1.0</b>	<b>Executive Summary .....</b>	<b>1</b>
<b>2.0</b>	<b>Objective 1: Assist the NBS Leadership to formulate strategy focusing on internal policies and procedures related to internal controls. ....</b>	<b>5</b>
2.1	Enhance Internal Controls at the Central Bank .....	5
<b>3.0</b>	<b>Objective 2: Assess, modernize and rationalize NBS Operations .....</b>	<b>8</b>
3.1	Operational Enhancement Study .....	8
3.2	Information Technology Management.....	8
3.3	Accounting Reform .....	11
3.4	Payments System Reform.....	13
3.5	Human Resources (HR) Department .....	14
<b>4.0</b>	<b>Objective 3: Strengthen the capacity of the NBS to regulate and monitor the banking system .....</b>	<b>17</b>
4.1	On-Site and Off-site Bank Supervision.....	17
4.2	Deposit Insurance.....	22
4.3	Problem Bank Assistance.....	22
4.4	Assistance to the Financial Intelligence Unit .....	23
<b>5.0</b>	<b>Objective 4: Provide technical assistance for development of pension and insurance supervision agencies/departments, among other tasks related to these market segments. ....</b>	<b>25</b>
5.1	A comprehensive analysis of the pension system reform and restructuring .....	25
5.2	Insurance Industry Strengthening and Regulation .....	30
<b>6.0</b>	<b>Attachments.....</b>	<b>33</b>

## 1.0 Executive Summary

USAID's Serbian Central Bank Operations, Pension and Insurance Reform Project was executed on April 17, 2003 and Advisors began arriving in Belgrade soon thereafter. Building on earlier USAID/BearingPoint technical assistance, this program was designed to strengthen the institutional capacity of the National Bank of Serbia's (NBS) Bank Supervision Department. The current Task Order also launched USAID assistance to the insurance and pension sectors. Other areas addressed under this Task Order have included central bank organization; auditing; accounting reform; information technology upgrading; and anti-money laundering. Nearly forty long- and short-term BearingPoint advisors have taken part in the assistance during the past two years.

The beginning of this second year of the USAID Project essentially coincided with the appointment of a new Governor for the National Bank of Serbia (NBS), Mr. Radovan Jelasic. With a new leadership at the National Bank, the priorities and the focus of the project were contoured to reflect new counterpart priorities.

Accordingly, BearingPoint assistance was concluded for the accounting training to commercial banks and NBS supervision; and for developing a human resource function, and upgrading internal and external communications (with the exception of IT support). Thus, during this past year, resources were primarily focused on: a) NBS supervision functions (banking and insurance), and b) NBS IT upgrading and associated information flows.

BearingPoint, under a USAID Contract, has been providing assistance to the NBS Bank Supervision Department since 2001. Banking in the former regime was largely contoured by political exigencies. This essential character was also reflected in the Central Bank's Bank Supervision Department, which did not, in the former system, have a mandate to enforce market-based prudential standards. Thus, the first years of USAID assistance could be characterized as laying the fundamentals (the laws, the accompanying regulations, the on-site methodology, the off-site analytics); as well as dealing with the wide-scale bank insolvencies inherited from the prior socio-economic system.

During this past year, however, we can broadly speak about entering a new phase of bank supervision development. With the fundamentals reasonably in place, the primary task in more recent months was to move ahead with the familiar risk-based approach to supervision. Important characteristics of risk-based supervision are: the focus on processes rather than working only from a checklist; the decomposition of risk analytically into different components; and the heavy reliance on examiners' judgment (which is particularly important in the evaluation of management).

Also during this reporting period some important bank supervision tools and refinements to existing methods were added, such as a ratio driven CAEL system archived into a master

database (for off-site analysis); and the rapid development of the portfolio management approach (which gives an individual examiner more bank-specific responsibility). For the first time too during this past year, foreign advisors began to accompany NBS examiners into the banks – the most effective form of training. Looking ahead we will continue the current focus on developing the risk-based supervision approach.

As a result of the new Insurance Law (promulgated May 2004) in September 2004 the Insurance Supervision Department was transferred from the Ministry of Finance to the NBS. Assistance to this Department has been an important focus of our work during the last eight months. While insurance and banking are profoundly different market segments, there are some fundamental principles, which are common to both in terms of the enabling environment. Both banking and insurance supervision need laws and regulations to empower the supervisor; both need on-site inspections to gain first-hand knowledge of the institution, and make informed judgments; and both need good statistical information (based on International Accounting Standards) as input into a rigorous off-site analytic system. Both of these market segments too have international associations working on developing core principles of best practice.

Because of these similarities, our expectation is that there could be less startup costs for the Insurance Supervision Department, building on the work already done for Bank Supervision -- and progress in developing the fundamentals could be rapid. In the short time the Insurance Supervision Department has existed some important things have already been achieved, with assistance from BearingPoint Advisors.

These achievements include financial diagnostics of all existing insurance companies, and subsequent closures of many insolvent ones. The development and implementation of standardized reporting to the NBS for the insurance companies. Training has been given to the staff in IAS principles and methodology. Actuarial training has also begun, and will gather momentum over the last part of the Project. Looking ahead, helping the Insurance Supervisory Department to develop the fundamentals of its mandate, and improve its practice will be one of our most important activities.

This USAID Project also focuses on upgrading of IT functions, and associated information flows between different elements of the NBS. The last twelve months have seen important accomplishments, and if anything the pace of change has accelerated compared to the first year of the Task Order. Part of the reason for this accelerated pace, no doubt, is the strong support given to BearingPoint Advisors by NBS Senior Management.

BearingPoint IT advisors also support the Financial Intelligence Unit (FIU), which coordinates government “anti-money laundering activities”. This work too has moved along in a number of areas. The caveat is that delays in passage of a new law, which includes the FIU’s budget, has necessitated flexibility in designing our support activities.

Looking ahead, our IT support will continue to be a centerpiece of the assistance for both the NBS and the FIU. Several new initiatives are in process. The implementation of HRMS software for a new Human Resources (HR) function is scheduled to begin in June 2005 and take nine months to complete. The BearingPoint Advisor, working with NVB's IT and HR Departments, is assisting with the implementation on the project management side. SIDA (the Swedish government technical assistance agency) will provide funding for necessary procurements. Also in March 2005, a tender was launched for procuring the new NBS internal accounting system. This project is projected to take a year to complete. BearingPoint did much of the groundwork for this project earlier in the reporting year. The BearingPoint Advisor will provide overall project management assistance for the solution implementation.

Another IT-related area, in which the USAID project will be active is the reform of the NBS Treasury. Specifically, a BearingPoint Advisor will be involved in a plan for the reorganization of two NBS Departments as preparation for the eventual transition of debt management functions to the Ministry of Finance. This will include setting up IT systems for associated business functions at the NBS.

In the pension component of the project, a comprehensive actuarial analysis to test the sustainability of the current pension system (Pillar 1) was completed in June 2004. The actuarial model used had been developed internally by the project. According to the simulations run, the system will require significant reforms if it is to become sustainable. The conclusions of the simulations, together with a detailed list of potential measures and their fiscal effects were presented in two documents: The Preliminary Fiscal Analysis of the National Pension System in Serbia prepared in June 2004 and Report on the Pension Reform in Serbia issued in October 2004 and discussed with high officials of the Ministry of Labor, Employment and Social Affairs (MLESA), the Ministry of Finance and the State Pension Fund.

In the remaining part of the project too, there could be a sizeable increase of assistance in the pension area if, as projected, the Law on Voluntary Private Pension Funds is passed by the Serbian Parliament during the next several months. This Law, prepared with the assistance of the BearingPoint Advisors, should establish the NBS as the domicile for the supervision function. Once the Pension Law is enacted, the NBS will need considerable assistance in the start-up phase of the pension supervision function – for example, developing the supporting regulatory structure.

It should also be noted that between January and April 2005 several of our activities with the Ministry of Finance and the Ministry of Social Welfare (in which we were involved through the interagency collaboration of the NBS) were suspended because of US State Department directives regarding technical assistance to the Serbian Government. The primary areas impacted were insurance and pension activities; and in particular work we had been doing to draft and amend relevant laws, and actuarial modeling work for the State Pension System.

### **How This Report Is Organized**

This report is organized around the four USAID Task Order Objectives. Under each Objective the corresponding Task/Work requirements are listed, as delineated in the Task Order, with a short explanation of our progress on each of these requirements during the past year. Also included, when pertinent, are important obstacles we have faced or those we foresee, or any other developments or events, which have the potential to significantly affect advancement towards Project Objectives. Tables attached to the report list foreign and domestic training, and conferences, which BearingPoint has participated in during the reporting period. (A separate attachment presents draft work plans for each of the main components during the remainder of the project.)

## **2.0 Objective 1: Assist the NBS Leadership to formulate strategy focusing on internal policies and procedures related to internal controls.**

Promote the ongoing institutional development of the National Bank of Serbia focusing on governance, management and organization. Advisors will assist the NBS leadership to formulate and implement strategy focusing on internal policies and procedures specifically those related to internal controls.

### **Progress on Specific Tasks**

#### **2.1 ENHANCE INTERNAL CONTROLS AT THE CENTRAL BANK**

##### **2.1.1 Assess progress in strengthening internal controls and the capacities of the relevant department(s) responsibilities**

An important part of effective internal controls at a central bank is the existence of a professional internal audit group, which provides not only the statistical background, but also serves more generally as a management arm of senior executives of the NBS. This group is mandated to ensure that best international practices are adhered to, that processes are up-to-date, and that procedures are consistent throughout the institution.

Our USAID Project conducted a review of the structure, procedures and resources of the Internal Audit department (IA) at the National Bank of Serbia (NBS) in April 2004. As a way of reviewing the methodologies and effectiveness of the NBS IA capacity, the BearingPoint Advisor reviewed the extensive documentation from the full-scale audit of the NBS conducted in September-October 2002 (approximately six months after the IA Department was created). The Advisor also reviewed regulations, job descriptions, and the organizational chart of the IA Department, and its relationship to other parts of the NBS, among other things.

The BearingPoint Advisor's conclusion from this assessment of the 2002 full-scale audit was that impressive progress had been made in a short time; and moreover, many of the recommendations, which were made at the time of the 2002 audit, were subsequently implemented. He also noted that the management of the IA Department was very supportive and receptive to his own work.

##### **2.1.2 Recommend and implement more efficient business practices, as well as optimal staffing requirements.**

Notwithstanding, the BearingPoint Advisor still felt that many more changes were needed. In particular he pointed out:

- The IA Department is seriously understaffed. At the time of the Advisor's review there were ten staff. He recommended a total contingent of about 24 people, composed of a manager and deputy, five mid-level experienced managers and a pool of about 16 rank and file. He further recommended that a university degree, or equivalent experience,

should be mandatory, given the technical nature of the work. Finally, the Advisor emphasized the importance of IT capacity in the Department. He recommended that at least three staff members should have a solid background in IT. In particular, the staff should include at least one IT security analyst.

- A second area of concern was the NBS accounting system. The Advisor urged greater participation of the IA staff in the development of the NBS accounting system. The IA Department has been one of the driving forces in the development of a new accounting system; and has a vested interest in assuring that an excellent accounting package is in place.
- At the time of the Advisor's review there was no ongoing reporting support of the Internal Audit's functions. He suggested there should be designated people in the IA to receive and review well-defined periodic reports. Ideally these should be indicative reports, highlighting instances of non-compliance or unusual events.
- Finally, he pointed out that NBS procedures needed to be brought up to date if the IA Department is to have a proper basis for its evaluations.

### **2.1.3 Assist the Office of Internal Controls to develop and implement an operations manual, and provide on-the-job staff training.**

The BearingPoint Advisor provided the IA management with a standard Bank Internal Audit Manual, which has electronic templates of work papers and questionnaires. He suggested that a team of about four employees should begin assemble of current documentation based on definitions in this Manual, once additional staff is recruited. Moreover, the Advisor emphasized that there should be provisions made for the systematic revision and updating of the manual. For this he suggested the development of a portal, which would make it easier to make revisions, in line with evolving practice. Finally, to be current with international best practice, the Advisor suggested using OECD and BIS guidelines on corporate governance for central banks.

The Advisor also provided the IA Department with a standard questionnaire, which describes how to go about developing an analysis of training needs and implementing a strategy for training. He sketched an 18-month to two-year plan, which could be a basis for staff upgrading, once a full compliment of staff is reached. However, he felt the staff was too small, and encumbered with day-to-day duties to actually begin training modules.

#### **Other Achievements**

A document detailing the internal audit requirements and 'controls' needed in the NBS new Accounting System was produced. This should facilitate the IA department's role. The reviews conducted in the IA department have highlighted the inadequacies of the current accounting system as a significant problem.

**Challenges**

As noted in the discussion above, the staff of the IA Department needs to be expanded in order to handle the substantial amount of responsibilities under its venue; to have sufficient time for specialized training; and to be able to devote resources to special projects such as developing and implementing an internal audit manual. Currently, the staff is eleven people (and two additional positions are being recruited), as opposed to a level of nineteen planned for the Department.

### **3.0 Objective 2: Assess, modernize and rationalize NBS Operations**

Assess, modernize and rationalize NBS operations in areas such as human resource management, information technology, accounting, internal control, public relations, cash and portfolio management, consolidation of regulatory reporting requirements, etc.

#### **Progress on Specific Tasks**

#### **3.1 OPERATIONAL ENHANCEMENT STUDY**

During the first year of this USAID Project a number of reviews were conducted pertaining to different aspects of NBS operations. These included reviews of the Departments of Internal Audit, Monetary Policy, Foreign Exchange and Human Resources Departments, review of NBS communications policies and a review of NBS branch operations. Recommendations for each of these sectors were given to the National Bank Governor.

Unfortunately, however, no action has been taken by the Parliament on proposed changes to the Internal Act of the National Bank of Serbia, which was presented over a year ago. Amendment to the NBS statute is necessary before many of our recommendations can be implemented.

Despite this bottleneck, during 2004 the NBS took actions, which resulted in downsizing by approximately 1500 people. This is the largest downsizing in terms of absolute numbers, achieved by a public sector entity to date. And, as noted, BearingPoint provided pro-active support in identifying operational areas, which could be operated with greater efficiency, for example the BearingPoint review of NBS branch operations.

#### **Challenges**

Further assistance will depend upon passage by the Parliament of the proposed changes to the National Bank of Serbia Statute (with the exception of IT support described elsewhere in this Report).

#### **3.2 INFORMATION TECHNOLOGY MANAGEMENT**

##### **3.2.1 Assist the NBS to strengthen all information management functions at the Central Bank.**

IT advisors have worked on virtually a daily basis with the NBS Information Technology and Payment Systems Departments, as well as with the National Payment Cards Center.

Probably the most notable achievement this past year was the development of the retail payment system, which was completed in a surprisingly short time. BearingPoint Advisors facilitated the development of the Central Payment cards switching infrastructure, which directly supports rapid expansion of payment cards issuance and accruing network. This new model replaced the previous practice of using deferred personal checks for financing consumer purchases.

During the last year too, major activities were planned and executed in the area of internal reporting. The objective was to streamline reporting processes and data flows. As a result of this work on NBS internal reporting processes a new, intranet based reporting system was introduced. In this intranet system all data in the form of predefined reports is available to the authorized users at any time. As a result of BearingPoint's assistance, all standard reports, generated within the NBS, are given to the Governor in electronic form. This electronic based reporting ensures both better quality and better control of the data.

The next phase in this internal reporting upgrade will include final optimization of the business requirements and processes. This should take place over the remainder of the Project. It should be noted that the technology, which has been implemented for the reporting upgrade will also serve as a basis for new NBS reporting requirements related to pension and insurance supervision functions.

Other notable achievements included:

- Developing the NBS Accounting requirements that are planned for implementation within the new IT system in 2006 (also see Accounting section of this report).
- Streamlining front office functions.
- Beginning the preparatory work for the NBS Treasury modernization. Treasury IT upgrading is perceived as a critical step for the mid- to long-term organization changes and IT upgrades in other core NBS departments.
- Supporting development of the NBS auction platform and repurchase operations. Specifically, BearingPoint IT Advisors guided the project management and design processes
- Maximizing performance of the Interbank Payment System, which has resulted in virtually 100 percent system availability (amount of up time)
- Introducing new payment system services (i.e. RTGS look alike small payments transactions)

Looking ahead, our IT Advisors will play a prominent role in the implementation of the HRMS software for a new Human Resources (HR) function scheduled to begin in June 2005 and take an estimated nine months to complete. The BearingPoint Advisor is leading the implementation on the project management side; working with NBS's IT and HR Departments. SIDA (the Swedish government's technical assistance agency) will provide funding.

### **3.2.2 Devise and implement IT policies and procedures that ensure compliance with Basle Core Principles and other relevant international conventions.**

The BearingPoint Team had already assisted the Bank Supervision Department to develop a comprehensive electronic reporting system, which enables commercial banks to provide

electronic data. Thus, Off-Site Supervisors are able to access the statistical information provided by the banks in an efficient and timely way; and used electronic methods to analyze this data, increasing the speed and accuracy of their work. Currently our Advisors are involved in ongoing discussions with the Bank Supervision Department's Management and On-site and Off-site Units regarding the second stage technical IT requirements for updating the Department. The expectation is that requirements for on-site supervision will be finalized over the next several months.

The insurance supervisory function was transferred to the NBS in September 2004 from the Ministry of Finance. The BearingPoint experts are working closely with the Department Management to identify specific needs. Already the Advisors have helped the Department to customize the NBS IT system so that it is able to accept electronic supervisory reports from insurance companies. This system will serve as a strong base from which to develop the off-site analysis capacities of the Insurance Supervision Department in the coming period.

More generally during the reporting period, BearingPoint IT advisors continued to guide NBS and lead its efforts in introducing strong and industry standard IT management Policies and Procedures. Accordingly, project management processes and procedures were revised and new ones developed. Rollout of Software Quality Assurance (SQA) processes was successful as well, so that the IT department now performs these activities on a regular and comprehensive basis. This was also backed up by further development of the NBS Project Office function and overall IT portfolio planning.

By developing a NBS IT management style which is process oriented, the operational and technology risk inherited in using technology is minimized. The contributions of our IT Team are enhancing the capacity of the NBS to have timely, reliable and secured information.

### **3.2.3 Support training for the NBS's IT staff.**

Training takes place both informally, on a day-to-day basis, and through formal classroom sessions. On a day-to-day basis Bearing Point Advisors review and comment on all the most important project management documents and plans which are generated in the IT sphere (i.e. project plans, draft procedures, number of business requirements). The most important of these are related to the NBS Accounting Reform, Payments System and National Cards Center. Formal classroom training also takes place, most notably for the IT management team, but also for the SQA Group Project Managers.

The Advisors have also arranged foreign study tours. One such example was a visit to the UNCTAD DMFAS Program in Geneva. And in April 2005, BearingPoint arranged a trip for NBS experts to the National Bank of Hungary to see how that institution has organized its Treasury and its interface with the Ministry of Finance Debt Management Office, with particular emphasis on the IT system.

### 3.3 ACCOUNTING REFORM

#### **3.3.1 Support the Central Bank's effort to adopt International Accounting Standards (IAS) in the NBS, and to IAS system-wide. This effort will include training for the Central Bank and all licensed banks and non-bank financial organizations under the NBS supervision. Specifically, develop and implement an appropriate training program for Central Bank staff and commercial bankers. There needs to be wide spread training for the bank supervision staff and commercial banks.**

National Bank of Serbia (NBS) and banking system: With BearingPoint support, progress has been made in the adoption of IAS by the NBS. The year-end audit is in compliance with IAS. Detailed business requirements have been developed, and training has been provided to NBS accounting staff in the functionality of a modern accounting system. New accounting processes have been developed and recommendations have been presented to improve and strengthen the existing ones.

In 2004, a project was begun to automate the accounting system at the NBS. The Advisory Team produced basic documents, such as a draft general ledger procedure, and a "best practice requirements". Licenses were procured, and initial staff training given. The Advisory Team also prepared the technical requirements for the tender and prepared tender documents. The NBS project Steering Committee approved the business requirements, the technical specifications and the implementation budget estimate, and recommended to start the procurement process for this new accounting IT solution. However, it was not until March 2005 that a tender was actually launched for procuring the new NBS internal accounting system. This project is projected to take a year to complete. The BearingPoint Advisor will provide overall project management assistance for the solution implementation.

At the Governor's request (and USAID concurrence), assistance was also provided, in the development of business requirements, and in changes to existing applications pertaining to accounting. The objective was to assist NBS and ZIN (Serbian Mint) to clearly define processes that require modification in order for NBS/ZIN to meet their objectives. The final draft was completed by the Advisors in October 2004 and presented to NBS management. Process design documents were completed for the general ledger, fixed assets, receivables and payable processes.

Separately, intensive training for NBS examiners in IAS accounting principles was conducted. On-the-job training, and periodic seminars by outside accounting professionals have supplemented these formal training programs at the NBS. The last formal IAS training session for NBS bank examiners by a BearingPoint Advisor was conducted in October 2004.

BearingPoint also gave limited assistance to the banks during 2004 in their efforts to develop IAS consistent reports for the NBS. (Banks have been required to report their financials according to IAS for the year ending 2003.) During 2004 the BearingPoint Accounting Advisor made a number of trips to commercial banks in Belgrade and Novi Sad as well as to Delta and

Jubanka. Moreover, through the assistance the Advisors have given the NBS Off-site and On-site Supervision Units, the quality and transparency of financial statements of the banks are continuously improving.

Insurance: During 2004, through Advisory support, substantial progress was made in the transition of the insurance industry to International Accounting Standards. IAS-complaint financial statements and a new chart of account were developed and approved by the government. As of January 1, 2005 insurance companies too were required to report on an IAS basis. By now, most of the companies have already provided such financial statements. Over the last six months, the staff of the NBS Insurance supervision department has been provided comprehensive training in International Financial Reporting Standards and their first-time application.

Other: During the past two years, BearingPoint Advisors gave formal courses on accounting to students at Belgrade University and BK University. Through these courses approximately 400 students were introduced to IAS. Our Advisor also worked in close association with Belgrade University to establish a new accounting and finance curriculum. This new program, scheduled to begin in 2006, will offer courses in accounting standards and IAS, finance and audit.

Additionally, the BearingPoint Advisor arranged for, and accompanied the head of the Accounting Commission (who is a professor of accounting at Belgrade University) to a three-day conference on IAS in Prague. During 2004 there was also ongoing work with the Serbian Accounting Association and professors from Belgrade University to develop comments to the revised Law on Accounting.

### **3.3.2 Coordinate efforts with other relevant agencies, counterparts and donor organizations**

The absence of an official government accounting body has hindered systematic coordination between donor organizations and relevant government entities. Informal coordination, however, did continue through 2004 with the Ministry of Finance and the former Accounting Commission.<sup>1</sup> This informal relationship built on the work established at the end of 2003 when a translation of IAS into Serbian was delivered to these entities. As noted above, the Advisor developed a close collaboration with accounting professionals at leading Serbian Universities and the Serbian Accounting Association, collaborating with these parties to revise the Accounting Law.

#### **Challenges**

While BearingPoint's work in the banking accounting area was completed in late 2004, in line with Task Order benchmarks, there is still substantial institution building tasks remaining at the

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<sup>1</sup> Because of US State Department directives between January and April 2005, prohibiting work with the Serbian Government, this activity was terminated.

NBS. While different Departments at the NBS deal with accounting issues in their own sphere, what is needed is an integrated approach and an internal task force which has the responsibility to deal with accounting issues, standards, and governance principles. (It would be particularly timely since there is no other official body undertaking these responsibilities and issues.)

This is important because international standards are constantly being changed, and new ones are being added. More generally, the international accounting profession is in a period of flux, and new issues and topics are constantly developing. And, the Serbian financial market is developing rapidly and becoming more variegated. As new financial products are introduced in Serbia, the products must be properly accounted for and disclosed. Without systematic oversight of this fluid situation, and continual training, the NBS will not be able to keep abreast and respond to new risks, and to institute best international practices.

In addition, there is an ongoing challenge to bring international accounting standards for the insurance sector up to par. Accounting for insurance companies differs in some important ways from IAS (e.g., in the treatment of assets that can be counted against reserve requirements). The insurance unit of the NBS and the insurance industry will need significant assistance to meet international standards for this sector.

### **3.4 PAYMENTS SYSTEM REFORM**

#### **3.4.1 Support NBS efforts to accommodate new roles and responsibilities incumbent upon it as a result of the dismantling of the National Payments Bureau (ZOP).**

In 2004 there were two issues, which the Advisory Team worked with the NBS to resolve. First was the “Enforced Collection of Blocked Accounts”. Work was done on stabilizing the processes and technology of this function because a number of major issues had surfaced in 2003. These problems were successfully resolved and today the NBS is operating this legacy function without any significant problems.

A second legacy function, initially performed by ZOP, was the technology support to all the private foreign exchange offices. With BearingPoint Advisory support, the NBS completely redesigned this function. The NBS now maintains and fully controls the technology behind the required processes.

#### **3.4.2 Assist the NBS to implement the new system to clear and settle payments transactions.**

In January 2003 the Payment System was successfully connected to the Commercial banks, and NBS started production of its RTGS and Clearing systems. Even so, a number of system refinements were required to maximize the Payment’s System’s performance. During the reporting period, our IT Advisors worked with the NBS to implement a number of technology enhancements. The result is that there is virtually 100 percent availability of the RTGS/ACH system to the banking community. BearingPoint also assisted the NBS in implementing

processes for settling domestic payment cards transactions. Finally, BearingPoint Advisors worked with the NBS in developing system backup. As a result of this work, the Novi Sad COB Payment System backup site has been tested and is fully operational.

### **3.4.3 Develop and disseminate policies and procedures related to the NBS settlement function.**

During 2004 BearingPoint Advisors worked with NBS colleagues to implement new procedures related to the settlement function. The most important achievement was the introduction of a RTGS type of transaction for small payments. This allowed commercial banks to offer real time small payment service to their customers, at a reasonable fee. The expansion of the system has also helped to level out clearing transaction peaks.

### **3.4.4 Ensure that commercial banks are capable and competent to clear and settle payments transactions for which the NBS is not responsible.**

The 2004 monitoring of the commercial banks by the NBS, with Advisor assistance, determined that almost all of the inherited RTGS/ACH risks were properly managed. One issue, however, identified in Q4 2004 concerns the settlement of authorized, but not cleared, domestic payment cards' transactions when a bank is closed. (This is not an issue for international cards). The Advisors are currently working with the NBS to correct the problem.

### **Other Achievements**

During 2004, with USAID concurrence, the Advisors gave Operation & Technology support to the Ministry of Finance. In particular, BearingPoint successfully facilitated:

- Development of the Customs IT strategy development. This strategy was approved by the Minister of Finance in early 2005
- Implementation of Ministry of Finance (MoF) Project Center (Project Office)
- Development of the requirements process for the new MoF treasury system (budget execution and debt management).
- Coordination of interagency and inter donor projects. There were in particular, excellent results from cooperation with the European Agency for Reconstruction.

## **3.5 HUMAN RESOURCES (HR) DEPARTMENT**

### **3.5.1 Develop and implement a personnel management plan for the HR Department with an eye to creating an institution staffed with the most qualified and motivated people.**

The BearingPoint Advisors over the last two years have introduced new, and different concepts of personnel management into the National Bank of Serbia. Based on an assessment of the existing personnel activities done approximately one year ago, a work plan was developed to transform the existing Personnel Department into a more far-reaching HR Department.

According to this concept there would be management of NBS staff performance based on a strategic plan and transparent, consistent criteria. In conjunction with this diagnostic, a full review of laws and regulations of the NBS, relevant for the establishment of the Human Resources Department was completed

A report was presented to the NBS Governor analyzing the current situation; making recommendations for change; presenting a work plan to accomplish these recommendations; and suggesting deliverables. The report to the Governor was done in close collaboration with the Personnel Department staff members, who were enthusiastic about these new ideas. Among the recommendations:

- Training of Personnel Department employees on new roles in performance management.
- Developing a new format for position descriptions, which would be coordinated with performance evaluation forms and processes, and updating position descriptions so that critical job elements are clearly identified.
- Developing a model for Individual Development Plans and coordinating these plans with performance evaluation criteria.

Shortly after the diagnostic and its recommendations were presented to the Governor, the BearingPoint Advisor reviewed all necessary documentation and prepared draft amendments to NBS internal acts, which were subsequently incorporated.

Another BearingPoint Advisory contribution accepted by the NBS was the consolidation of human resource activities in one Department. Prior to this, human resource activities had been spread throughout the bank. Specifically, all payroll functions and performance evaluation activities were put into the Personnel Department. The Advisors also assisted in the preparation of necessary amendments to all legal and internal acts.

Although a higher organizational position was recommended for the HR Department, it was decided that it would maintain its present organizational position within the General Secretariat. Activities would be classified across the specialized Units that would be opened within the Department

### **3.5.2 Advance appropriate policies and procedures that promote retention and which facilitate recruitment.**

Advisors reviewed the existing NBS Performance Evaluation System and job descriptions. Based on the recommendations, a new Employee Performance Evaluation System, with policy and procedures for its administration and new job description format, was constructed. Our expectation is that once the New Statute is passed by the Parliament, there is a high probability that this Evaluation System will be adopted. If so, this would represent a useful and practical tool, which will enable a more constant and stable process of evaluating individual employee

performance as well as the methodology to adjust the employee capacities to the actual requirements.

During the reporting period too, our Advisors reviewed a proposed plan for restructuring employee salaries at the NBS to make the institution more competitive in the marketplace.

**3.5.3 Develop and institutionalize a training and education curriculum that ensures that all staff is capable and qualified to dispatch their duties and responsibilities.**

In August 2004 the Academy of Banking and Finance was established at the initiative of the National Bank of Serbia and the Serbian Bankers Association. The objective of the new institution is to provide ongoing professional training to staff of both the NBS and of Serbian financial institutions. This training will help to introduce best international practices in banking and finance, tailored to address Serbian-specific needs.

Our HR Advisor, collaborating with a German Government Advisor (GTZ), assisted in the creation of the new Academy, both identifying NBS staff for the Academy, and supporting the organizational work. The BearingPoint Consultant also advised the NBS Governor on the selection of a director for the Banking and Finance Academy. The BearingPoint Advisor gave input into the development of the course curriculum and at his urging the NBS Personnel Department's training function was transferred to the Academy. .

**Challenges**

Changes related to organizational positions and structures are predicated on passage of the NBS statute, which has been before Parliament for a year. With the concurrence of USAID, BearingPoint concluded this component of the project in December 2004, except for the IT component, which is described elsewhere in this Report.

#### **4.0 Objective 3: Strengthen the capacity of the NBS to regulate and monitor the banking system**

Strengthen the capacity of the NBS to regulate and monitor the banking system and individual banks by working closely with the Bank Supervision Department. Particular attention will be dedicated to on-site and off-site supervisory functions and will focus on the adoption of risk-based examination procedures (CAMEL, CAEL). Simultaneously, continue the efforts related to the new Payment System implementation.

##### **Progress on Specific Tasks**

#### **4.1 ON-SITE AND OFF-SITE BANK SUPERVISION**

##### **4.1.1 Sustain ongoing efforts to develop risk-based examination procedures manuals governing both on-site and off-site supervision. Draft new chapters as may be required due to legislative changes or as a result of new or changing examination responsibilities.**

The Advisory Team delivered a new report of examination template to the NBS management in March 2005. (See 4.1.6 of this section for further discussion.) Once the new report of examination is reviewed and adopted, BearingPoint Advisors will work closely with NBS colleagues to make the necessary changes to the on-site examination manual. The manual will also be revised to reflect changes in banking law, focus greater attention on risk, and address changes in the organizational structure of the department, including the introduction of portfolio managers. Additionally, work has begun on specific procedures to address emerging products in the Serbian market such as automated credit-decision models, evaluation of effective interest rates, and analysis through statistical sampling of homogeneous consumer loans.

##### **4.1.2 Promote the adoption and use of CAMELS and CAEL rating system in on-site and off-site examinations respectively.**

In line with Advisor recommendations, the Supervisory Review Committee of the Bank Supervision Department adopted the qualitative description of CAMEL elements and ratings in early 2003. The rating system was implemented by the Bank Supervision Department during the second and third quarters of 2004 for internal use. Portfolio managers drafted a supervisory strategy for each bank as of March 2004. CAMEL components form the core of the supervisory strategy document prepared by portfolio managers following each on-site examination. The report of examination template uses CAMELS elements as the framework for evaluation of the bank.

The BearingPoint Team also supported the Bank Supervision Department's efforts to develop CAEL ratings, which apply to the off-site analytic work of the supervision department. The assigned off-site inspector prepares a quarterly review for each bank, using data from submitted statistical reports and the summary CAEL reporting system developed in 2003 under this USAID project. When the quarterly reviews are complete, off-site inspectors meet as a group to review

risks in each bank, assign CAEL ratings, and stratify banks based on their relative amount of risk within the banking system.

#### **4.1.3 Assist the NBS to coordinate bank and non-bank regulation associated with securities, insurance and pension regulation.**

As newly appointed regulator of the insurance industry in Serbia, the NBS has taken steps toward consolidated supervision. Separate sections of this report address assistance provided to the insurance and pensions regulation functions.

BearingPoint Advisors have worked closely with NBS colleagues in promoting integration of bank and non-bank regulation in the following areas:

- Assistance with the Decision on “Closer Requirements as to Licensing Banks to Perform the Custody Bank Activity” (May 2004)
- Delivery of presentations on consolidated supervision to 40 people from various departments within the NBS including banking supervision, insurance supervision, legal department, and pensions specialists (February 2005)
- New draft law on banks (February 2005)
- Legal review of the draft law on insurance (March 2005)
- Legal review of the draft law on bank bankruptcy and liquidation of banks and insurance companies (March 2005)

#### **4.1.4 Strengthen the capacity of the off-site examination and recommendations to promote cooperation with external auditors. This includes designing and implementing standardized regular supervisory reports; developing and implementing an early warning system; and providing extensive on-the-job training.**

The NBS Bank Supervision Department has developed and implemented regular supervisory reports with the assistance of BearingPoint Advisors from this project include the following:

- CAEL reports with ratio indicators and peer group benchmarks were developed with the assistance of Advisors in 2003 and implemented 3Q 2003. During this current reporting period, these CAEL reports were revised to fit IAS-compliant chart of accounts.
- Advisors designed, and summary-level CAEL reports were implemented during 2Q 2004.
- A basic early warning system was designed by Advisors during 1Q 2004 and has been used regularly by the Supervision Department since 2Q 2004.
- Supervisory strategies were designed by Advisors in 2003 and implemented during 2004 for all banks. Off-site inspectors participated in the preparation of the first set of these reports.

- Quarterly updates were designed by Advisors and implemented by off-site supervisors during 3Q 2004. These reports have been used regularly since that time.
- On-the-job training continues for off-site supervision, including Advisor-facilitated discussions in 1Q 2005 regarding application of CAEL ratings to ensure consistency across banks.
- Over the last year our Advisory Team promoted systematic collaboration between the NBS and external auditors in respect to the implementation of IAS and the training of auditors. More recently the NBS has made initial contacts and started a dialogue on collaboration with representatives of key firms that audit banks. We expect these ties to strengthen in the coming months since the recently appointed General Manager of Bank Supervision was recruited from an auditing firm.

#### **4.1.5 Assist the off-site unit to build a modern bank-reporting database**

With earlier BearingPoint assistance, banks today submit systematic reports to the NBS every quarter. Moreover, as of 4Q 2004, all such data is submitted electronically. Some reports, including balance sheet and income statement, are generated based on the bank's general ledger. The banks submit additional data regarding liquidity, capital, and asset classifications as well. These data, available since 3Q 2003, form the core database. Advisors continue to work with the off-site supervisors and the NBS information technology (IT) group to find ways to extract and use data from previous periods for customized reports.

Additionally, Advisors are working closely with the NBS Off-site and IT groups to identify key qualitative reports that will be stored in a centralized database for use by senior management and portfolio managers. This report storage and retrieval system is targeted for implementation by the end of summer 2005.

#### **4.1.6 Provide continued assistance to Bank Supervision to implement, test and refine the recently developed format of the 'report of examination'.**

Previous format for report of examination was proposed in January 2002 by the then BearingPoint Advisory Team, and was adopted by the Supervisory Review Committee in 1Q 2003. Parts were implemented during 2003. During 4Q 2004 and 1Q 2005, the Advisors reviewed the existing report of examination and determined that perceived legal compliance issues had caused the report to be change over time, and expand increasingly to a point where the version in use by the NBS bore little resemblance to the one recommended by this USAID project. In March 2005, the Advisors recommended a new report of examination, intended to focus comments in a CAMELS framework with a view toward the effectiveness of risk management. (Additional comments are provided in 4.1.1 and 4.1.2).

**4.1.7 Meet with examiners at the conclusion of each examination and critique performance... making recommendations for improvements as needed.**

During 2Q 2004, Governor Jelasic approved participation of USAID-sponsored advisors in on-site examinations. Advisors participated in on-site examinations with NBS inspectors during 2Q and 3Q 2004, including several “training visits” with newly hired inspectors. Following redefinition of activities and deliverables, with the concurrence of USAID and new NBS senior management, the advisors focused on the report of examination as reflective of on-site results. (See 4.1.6 of this section for further discussion.) With a new report of examination template delivered, Advisors will resume participation in on-site examinations during 2Q 2005.

**4.1.8 Institutional development of the NBS-Bank Supervision Department: Review the existing organizational structure and make recommendations to enhance the structure.**

During the past year, NBS management requested recommendations in several key areas:

- The Advisors drafted systematization for bank supervision department at the request of Vice Governor Stojanovic (July 2004). Most changes were not implemented due to Mr. Stojanovic’s subsequent departure from the NBS.
- The Advisors recommended structural changes to the supervision department in November and December 2004; these changes were announced in December 2004 and finally implemented with the new systematization during March 2005. Changes implemented included the following:
  - Addition of a “research and development group” to consider systemic issues and review the banking system as a whole,
  - Appointment of new on-site and off-site managers, who are versed in risk-based supervision concepts.
  - Strengthening the cadre of portfolio managers with fewer, more-capable examiners who are better equipped to provide consistent, risk-based analysis, and who are flexible in their supervisory approaches.

**4.1.9 Recommend techniques to ensure that constructive communication occurs within the organizational structure; and between the NBS and the banks it regulates and other government entities (i.e. BRA and the FIU, the MofF and the Public Revenue Agency)**

Comments provided in 4.1.8 and 4.1.13 of this section discuss enhancements recommended by USAID Advisors and recently implemented by NBS management. Five portfolio managers serve to strengthen communication between the NBS and the banks it regulates. The portfolio managers are expected to maintain regular communication with each bank’s management, as well as to communicate across the various areas of the supervision department. Their primary role is to be the responsible party for ongoing monitoring of risks and risk management in each institution. The only way to do that well is to talk with bank management, review statistical data submitted by the bank, consider the bank’s place within the entire sector, and keep abreast of

developments and strategies within the banking sector. As noted in 4.1.13 below, USAID Advisors are very much involved in the development of this group of high-level generalists.

**4.1.10 Legal/Regulatory Framework: Strengthen the overall supervisory policy, legal and regulatory frameworks; based upon the review of current laws and regulations (particularly prudential regulations, recommend changes as may be necessary.**

Since April 2004, USAID advisors worked closely with NBS with regard to the following regulatory measures, administrative actions, and policy decisions:

- Examples of various supervisory actions used in the United States and progressive enforcement processes (April 2004)
- Assistance with the “Decision on Closer Requirements as to Licensing Banks to Perform the Custody Bank Activity” (May 2004)
- Draft Law on Banks (March 2005)
- Draft Law on Bank Bankruptcy and Liquidation of Banks and Insurance Companies (March 2005)

**4.1.11 The advisors will provide classroom training to supplement the on-the-job training. The advisors, together with the on-site director will identify potential trainers to be trained to deliver courses.**

- A formal classroom-training program was developed early on in the Project and has been systematically implemented by the Bank Supervision Department..
- Classes are held monthly. Among the recent topics have been specialized portfolio management training; consolidated supervision; camel rating harmonization; asset-liability management; financial analysis and risk management.
- Approximately one-year ago the Advisors’ recommended an examiner certification program that included core curriculum and a testing program. The NBS has not acted on this recommendation to date.
- Nor has a formal train-the-trainers been initiated.

**4.1.12 Provide continued assistance to the NBS in developing regulations and supervisory policies to implement all laws that impact bank operations and supervision.**

Since April 2004, USAID advisors have assisted the NBS with regard to the following regulatory measures, administrative actions, and policy decisions:

- Consumer protection measures, disclosures, and annual percentage rate calculation (May 2004, January 2005)
- Probationary period for newly hired examiners (June 2004)

- Revised “supervisory strategy” and “quarterly update” templates (September 2004)
- Systemic-level reports (January 2005)

#### **4.1.13 Linking on- and off-site supervision: Assist in the development and implementation of an integrated risk-based approach to bank supervision.**

Some of the structural changes to formally integrate and link on- and off-site supervision are described in 4.1.8 above. The Advisors also helped the Bank Supervision Department to establish a Supervisory Review Committee as a decision-making body spanning all units in the Department.

However, arguably most important in fostering an integrated Department has been the introduction of the portfolio management structure by the NBS Bank Supervision Department. The Advisors work closely with newly appointed portfolio managers. These individuals serve in key roles as coordinators of information and risk evaluation under the new system. Advisors meet with and provide training and advice to portfolio managers as a group about once every 10 days. Advisors meet with on-site and off-site management regularly as well.

#### **Challenges**

Not unlike many other transitional economies in the first years, one of the greatest challenges has been staff turnover, particularly at the management level. Since the beginning of this reporting period (May 2004) there has been at least one change in the Vice Governor in charge of bank supervision, the General Manager, the Deputy Manager and the On-site and Off-site Managers. In fact from August 2003 until December 2004 the General Manager position was vacant. Moreover there was a change in the Governor in March 2004. This has meant, that with new individuals, no matter how capable, there will inevitably be some startup costs. There has also been some shifting in priorities and time schedules as these new managers place their own stamp on the work.

#### **4.2 DEPOSIT INSURANCE**

As may be required by the Vice Governor in charge of Bank Supervision or other designated party, support the Office of Deposit Insurance... in implementing a stable, sound and fair system of deposit insurance that complies with European Union Directives.

A BearingPoint Advisor has reviewed and made comments on the draft law on Deposit Insurance at the request of NBS Management.

#### **4.3 PROBLEM BANK ASSISTANCE**

Continue providing assistance to support the strengthening of the NBS Problem

Bank Unit, building its capacity to effectively manage and administer banks placed under its special supervision.

The NBS Problem Bank Unit was dismantled as a separate entity and its staff and responsibilities were integrated into on-site supervision. Problem institutions were distributed to different portfolio managers of the On-site Division and became the responsibility of the Bank Supervision Department's management through its "Komicija" or Supervisory Review Committee. Corrective measures are now recommended by portfolio managers; reviewed by the NBS Legal Department; endorsed by the "Komicija"; and forwarded to the Vice Governor/Governor for approval. Once a bank's license is rescinded it is transferred to the Bank Reconstruction Agency.

#### **4.4 ASSISTANCE TO THE FINANCIAL INTELLIGENCE UNIT**

Working closely with the US Treasury team, develop and refine the policies and procedures of the newly created Financial Intelligence Unit; with an eye on compliance with the highest international standards in the area of anti-money laundering and financial crime prevention.

BearingPoint Advisors provided assistance to the Serbian FIU to finish the first phase in the creation of the basic IT infrastructure. One important task was the development of the infrastructure that deals with the communication and analysis of reported information in electronic form from obligated parties and the National Bank of Serbia. This was accomplished by developing a Web-secure electronic reporting form that is used for receiving information from the obligated parties through the Internet. Specific application modules included: transaction validation for paper and electronic forms; generation of error reports using existing validation rules supplied by the Analytical Department; and automatic registration of log of transactions electronically and on paper. The process will be institutionalized in the new law, which the Serbian Parliament is expected to enact in the coming months.

Another important contribution of our Advisor during the reporting period was the design of the Terms of Reference document for an advanced phase of the IT strategic plan. The infrastructure will connect the FIU with other pertinent government institutions (NBS, Customs Administration, Ministry of Finance and Tax Administration). The BearingPoint Advisor together with FIU colleagues, have already begun the discussions with Telekom Srbija regarding lines leasing. Advisory support to the FIU for the implementation of the next phase of IT infrastructure development is expected to continue throughout the remainder of the Project.

Other contributions of the BearingPoint Advisor include:

- The development of a set of basic analytical tools (early 2005), which are in the process of being tested and refined, and should be implemented soon.
- Specifications of the information needed to establish a leased line between the FIU and Customs (in preparation of the next phase) for the FIU Legal Department.

**Challenges**

The new law was originally scheduled to enter the Parliament procedure in early 2005, but it has been delayed. Some planned project initiatives will be affected because the FIU budget is part of the law. The Advisory Team has worked with the FIU to modify the FIU IT project strategy in light of the uncertain funding. A second issue impinging on our work is that the FIU is currently without a director.

## **5.0 Objective 4: Provide technical assistance for development of pension and insurance supervision agencies/departments, among other tasks related to these market segments.**

Provide technical assistance to the Ministry of Social Welfare and the Ministry of Finance as they develop the Pension and the Insurance Supervision Agencies/Departments; provide assistance to a multi-pillar system comprising mandatory and voluntary schemes. Assistance will also be directed at the establishment and institutional strengthening of relevant regulatory and supervisory bodies that will oversee the pension and insurance industries. The implementer will deliver specialized training and will structure public education components related to both pension and insurance reforms. The overall goal is the creation of a stable, sound and broad financial system.

### **Progress on Specific Tasks**

#### **5.1 A COMPREHENSIVE ANALYSIS OF THE PENSION SYSTEM REFORM AND RESTRUCTURING**

**5.1.1 The Contractor shall conduct a comprehensive analysis of the existing pension system and shall deliver a detailed set of recommendations on the means by which to strengthen the system and ensure the solvency of the existing single pillar pension system. The Contractor shall prepare an overall design of a mandatory private pension system (Pillar II), as well as a voluntary scheme (Pillar III) along with a timetable in accordance with the Government's guidelines.**

A comprehensive actuarial analysis to test the sustainability of the current pension system (Pillar 1) was completed in June 2004. The actuarial model used had been developed internally by the project. According to the simulations run, the system will require significant reforms if it is to become sustainable. The conclusions of the simulations, together with a detailed list of potential measures and their fiscal effects were presented in two documents: The Preliminary Fiscal Analysis of the National Pension System in Serbia prepared in June 2004 and Report on the Pension Reform in Serbia issued in October 2004 and discussed with high officials of the Ministry of Labor, Employment and Social Affairs (MLESA), the Ministry of Finance and the State Pension Fund.

One important recommendation of the BearingPoint Team, for further reforming the pension system and providing adequate and sustainable retirement income for future generations was the introduction of the mandatory private pension scheme (Pillar II). The paper "Designing the Second Pillar, Serbia" prepared in November 2004 (and elaborated upon in a second paper in February 2005) provides prerequisites and options for the introduction of Pillar II. There is general agreement among government officials on the necessity of further parametric measures to the existing system, and to the desirability of developing Pillar II. So far, however, the government has not developed a plan/ nor taken even modest steps towards the development of the mandatory private pension scheme.

The BearingPoint Advisors also played an important role in working with the Ministry of Finance, the Ministry of Labor, Employment and Social Affairs (MLESA) and the NBS in developing legislation for Pillar III during the last reporting year. The draft Law on Voluntary Pension Funds and Pension Schemes was completed early in 2005. Additionally, the Advisory Team previously had prepared for the government justifications for the Law, and assisted in the review of comments received from the relevant government bodies. This Law is expected to be promulgated during the summer of 2005.

However, between January and April 2005, because of US Department of State directives regarding suspension of technical assistance to the Government of Serbia, assistance to government Ministries was temporarily suspended. This impacted several ongoing pension activities relating to the finalization of the Pillar III Law; to, assistance for the MLESA in the development of the actuarial function and transfer of the actuarial model to that Ministry; and to participation of Government officials in the study tours to Sofia and Washington D.C.

**5.1.2 The Contractor shall assist the Government in all aspects of the pension reform implementation including the drafting of the enabling legislation and regulatory framework, institutional strengthening of relevant ministries' abilities to oversee and manage the pension system (actuarial training, data management, revenue collection and funds management, communications, etc.) and the design and implementation of competent and effective regulatory capacity.**

*Actuarial Model:* As noted earlier, the Advisory Team developed an actuarial model, which can be used for forecasting and scenario testing the long-term liabilities of the state pension system. This model was revised and refined regularly. For example, changes were needed to revenue assumptions in 2004, given an unexpectedly strong increase in revenue collection; and changes introduced during the year with the passage of a new Law on Mandatory Social Contributions. The results of the modeling exercise were systematically communicated in reports to government counterparts (and the World Bank). These reports analyzed different options for changing the system and the fiscal savings associated with each option. As part of this modeling exercise the Advisory Team has developed a data bank and data management system which can be kept up-to-date and used for forecasting exercises even after the technical assistance is completed. The Actuarial Model was to be transferred to the MLESA. However, because of lack of trained actuarial staff at the Ministry and temporary suspension of technical assistance, the transfer has not taken place.

*Tax Issues:* The Advisors worked with the Fiscal Department of the Ministry of Finance on defining amendments to tax legislation needed in order to provide appropriate tax incentives for promoting the Pillar III Law during the last part of 2004. During the year meetings were also held and recommendations made on levels of compliance, enforcement measures and data availability to the Collection Department of the Tax Administration.

**Training:** The BearingPoint team organized a series of training sessions, in cooperation with the Bankers Association, on various topics relating to the development of the private pension funds industry during the first half of 2004. In April 2004, the project organized actuarial training for commercial courts judges that are dealing with insurance claims. The seminar was well attended by the representatives of the High Commercial Court and commercial courts across the country. The overall aim of the seminar was to initiate a “train the trainers” program on key actuarial issues that judges are facing in their daily proceedings.

**Revenue collection and fund management:** The Project’s reviews of revenue collection and fund management were used as a basis for preparation of Terms of References for the work of the Pension Reform Council created within the Government. The Council was established in December 2004 to direct the process of pension reform in Serbia. The BearingPoint Team has been asked by the government to play an advisory role to the Council. The Advisory Team also prepared a roadmap of steps needed in order to prepare an effective examination and licensing process for portfolio managers.

**Communications:** Throughout the period BearingPoint was instrumental in bringing together representatives of government and the private sector, both formally and informally in numerous events. BearingPoint has collaborated with the Serbian Chamber of Commerce, the Belgrade Stock Exchange and the Bankers Association, among others.

For example in November 2004 the Advisors, in collaboration with the Serbian “Ekonomist” Magazine prepared a conference on the introduction of the voluntary private pension funds. This conference was widely attended by both government and private sector representatives, and received wide media coverage. The Serbian “Ekonomist” magazine subsequently issued a twenty-four-page addendum to their magazine with transcripts of presentations and discussions from this round table.

That same month BearingPoint sponsored an event celebrating the 110th anniversary of the Belgrade Stock Exchange. There were close to three hundred attendees, who listened to panels on the development of institutional investors in Serbia and on international best practice.

**Laws:** As noted above, the BearingPoint’s USAID project played an important role in drafting legislation for Pillar III. Recommendations for the Law on Voluntary Pension Funds and Pension Schemes covered ways to strengthen areas dealing with supervision, investment limits, licensing, transfer procedures, custody banking and reporting and disclosure of pension funds.

**Custodial Banking regulation:** Advisory assistance was provided to the National Bank of Serbia throughout the period in specifying custodial banking regulation. Over a year ago a presentation was made to the NBS summarizing what other Eastern European countries require of custodial banks; what are the main functions of custodians; and what more is needed in the regulations of the National Securities Commission (enacted in October 2003). Subsequently, BearingPoint

provided advisory assistance in the preparation of the decree for the licensing of custody banks. By the end of 2004 the NBS had licensed two banks to perform custodial functions.

**Foreign Training:** Another important aspect of capacity building was foreign training. The BearingPoint Advisors organized several foreign study tours including to Croatia in September 2004 and to Bulgaria in February 2005. On these tours were representatives of the MofF, the NBS, and the MLESA. The Croatian model was particularly instructive because Croatia recently implemented a three-pillar pension reform. This included changes to Pillar 1 (the state pay-as-you-go system), as well as introducing mandatory and voluntary private pension programs. In Bulgaria NBS representatives visited the Financial Supervision Commission's Social Insurance Supervision Division, and attended the Conference on Evaluation of Pension Reforms Also, in July 2004 BearingPoint sponsored a trip for NBS representatives to attend an OECD conference on pension reform in emerging markets.

**5.1.3 The pension supervisory/regulatory agency will be established either as a stand-alone entity, or in some combination with insurance, securities or other regulatory bodies. Training and capacity-building activities will be pursued in coordination with other donor organizations delivering assistance in the same area.**

Supervision of Pillar III funds will be located in the NBS as a separate department, alongside the Banking and Insurance Supervision Departments. The staff will be appointed after the Government approves the Draft Pillar III Law, which is anticipated during the summer of 2005. BearingPoint has been actively educating key experts of the NBS on private pension issues.

Once the law is passed BearingPoint will provide full support to the NBS for a wide variety of activities involved in the establishment of the Pension Supervision Department, and in the training of staff, among other things. BearingPoint Advisors will also play an active role in assisting NBS colleagues to develop the regulatory structure needed to implement the new law. Moreover, to jumpstart the process, BearingPoint will hire a group of five economists, on a short-term contract, to train them in pension supervision issues. Once the supervision department is established, this group will be employed by the NBS to continue work on the development of the department.

**Other Achievements**

**Investment Funds Law:** The Advisors' worked with the Ministry of Finance during 2004 on the preparation of the Investment Funds Law. Many of the Advisor's recommendations were incorporated into the draft law, which is now finalized. The Investment Funds Law should be enacted at the same time as the Law on Voluntary Pension Funds, which, as noted, is tentatively scheduled for the summer of 2005. There has been a need in the market for this law for several years. Its enactment should positively stimulate the development of capital markets and the introduction of new financial instruments. Additionally, the BearingPoint Team presented educational seminars for banks and brokerage firms on key aspects of the investment fund business during the last part of 2004.

**Securities Act:** The project gave initial assistance with the amendments to the Securities Act by providing comments and recommendations for amending the existing law. Due to the temporary suspension of technical assistance to the government for the first part of 2005, the project was unable to provide further assistance in drafting amendments to the law.

**Central Securities Depository (CSD):** With USAID concurrence, in July 2004 a BearingPoint Advisor did a “needs assessment” of the information technology area at the Central Securities Depository. Recommendations were made about upgrading the IT system to ensure that the CSD would have sufficient capacity to carry out its functions over a longer time frame, in line with expected rapid growth in the market.

**NBS Employees Pension Scheme:** During early 2005 the Advisory Team provided assistance to the NBS in reviewing options for the establishment of the pension scheme for its employees. Recommendations were communicated to the NBS Governor.

**Coordination:** There was systematic coordination with the Deputy Minister of Finance and the periodic World Bank Missions to define the division of work between USAID (BearingPoint) and the World Bank; and to discuss the ongoing design processes of the pension reform process.

### **Challenges**

Completion of the pension reform in Serbia will require the government to further reform the state pension system, and to decide on the introduction of Pillar II. Once this decision is taken, the Government will require extensive support in analyzing and selecting parametric measures, preparation of regulations for the second pillar, design and establishment of the system and public education. Although the Government has not been prepared to deal with these issues to date, these remain at the top of their agenda, and are continually stressed by the World Bank and IMF. In this respect, the newly established Pension Reform Council could have a significant role and influence in speeding up the process.

However, the most critical need in the development of private pension funds and investment funds will be the development of capital markets, including the design of new financial instruments. It is likely that the investment funds and voluntary pension funds laws will be enacted simultaneously over the next several months. Thus, as we have seen in other countries, there will be a surge in demand for new instruments to accommodate the inflow of money into funds. However, at the current time, the enabling environment in Serbia is seriously underdeveloped.

Thus, in order to promote implementation of these laws in a financially sound and orderly fashion, the Securities Commission, to give just one example, will need assistance in developing regulation and capacity building for successful performance of its supervisory function. It will also need to organize examination and licensing of portfolio managers and investment advisors to enable registration of management and pension companies.

As noted earlier, the NBS will also need to develop its supervisory capacity. The Central Bank's experience in the banking and insurance supervision facets of the market suggests that a good foundation has been laid and experience is available in developing the fundamentals. However, there can only be a partial transfer of knowledge between market segments; each has its own individual characteristics and supervisory needs.

## **5.2 INSURANCE INDUSTRY STRENGTHENING AND REGULATION**

**5.2.1 The Contractor shall advise the Ministry of Finance and participate in drafting new insurance legislation and regulations. Once enacted, the contractor shall assist in implementing the new Law, which will provide a comprehensive framework for the operation, management and regulation of the insurance industry, consistent with principles established by the EU and International Association of Insurance Supervisors.**

The passage of a new Insurance Law in May 2004 was a major accomplishment. The Law is largely in compliance with both EU Directives, and with the standards issued by the International Association of Insurance Supervisors. Among other things, the new Law provides stricter requirements for founding an insurance company; elaborates the protection afforded shareholders and the rights of insurance holders and beneficiaries; lays down guidelines for privatization of state-controlled/owned companies; and delineates penalties (which include criminal prosecution).

From May 2003 until May 2004 the Bearing Point Project was working with the Ministry of Finance in developing the Law. The enactment of the Insurance Law in May 2004 resulted in the broadening of our activities, because an important stipulation of the new Insurance Law was that the supervisory function would be transferred from the Ministry of Finance to the NBS. Thus, over the last twelve months, while continuing to work on refinements of the Law, our emphasis has shifted towards providing assistance for the development of the insurance supervisory functions of the NBS. These activities are described below.

**5.2.2 The insurance supervisory/regulatory agency will be established either as a stand-alone entity, or in some combination with pension, securities or other regulatory bodies. Training and capacity-building activities will be pursued in coordination with other donor organizations delivering assistance in the same area.**

In September 2004 the Insurance Supervision Department of the Ministry of Finance became part of the National Bank of Serbia (NBS). The NBS has had several years of experience with the bank supervision, which meant that some of the startup costs of the new function were minimized. (Moreover, the appointed General Manager of the Insurance Supervision Department, Ms. Eric, already has supervision experience as former head of the Bank Supervision Department.)

Between September and December of 2004 a team of BearingPoint advisors, worked with NBS counterparts to complete the diagnostics of the majority of the existing insurance companies.

Subsequently, the NBS revoked the licenses of eighteen companies, almost cutting in half the number of insurance companies on the market to twenty-two. Other companies were required to provide restructuring plans in order to be in compliance with the new Insurance Law.

The diagnostic reports prepared by the BearingPoint Team provided the General Manager of the NBS Insurance Supervision Department with critical information in order to make these decisions. The exercise also provided Serbian examiners with important training in on-site examination techniques. Over the length of the Project a more formal training program will be developed for both the On-site, Off-site, and Actuarial Units of the Insurance Supervision Department in such areas as financial statements analysis, solvency, and risk assessment.

Furthermore, the Bearing Point Team worked with the Insurance Supervision On-site Unit in developing an on-site supervision manual grounded in risk-based supervision principles. The manual should be approved and implemented within the next several months as more formal and systematic on-site examinations are instituted. However, the change in the approach of supervisory staff from “compliance-based supervision” to “risk-based supervision” will be a challenge.

An initial step in building an effective Off-site Supervision Unit is the collection and verification of insurance companies reports. This work has progressed rapidly. The Bearing Point Team and the NBS supervisors are developing high-level and detailed reporting requirements, together with the templates and instructions on how to analyze reports. The consolidated ratios for the insurance industry are also being developed.

In addition, the Bearing Point Team provided assistance to the NBS Insurance Supervision Department in developing the supporting regulatory structure. The NBS instituted numerous by-laws following the enactment of the new Law. The Bearing Point Team provided the NBS with by-law drafts for each of the main areas requiring secondary regulation. The Bearing Point Team has provided the Insurance Supervision Department too with a comprehensive and detailed set of recommendations to strengthen the Insurance Law. During the first quarter of 2005 the Insurance Supervision Department of the NBS, with Bearing Point Team assistance, prepared further improvements/amendments to the Insurance Law, which have been submitted to the Parliament.

A Bearing Point Team Advisor has been actively working with the NBS Insurance Supervision Department to develop a three-year strategic plan. A draft with a set of recommendations has been presented to the NBS Department. In the months ahead the Team will have an ongoing dialogue with NBS colleagues in development of a strategic plan.

With Bearing Point advisory assistance, the NBS IT system is being customized to accept electronic supervisory reports from the insurance companies. This system will serve as a strong base from which it will be possible to develop the off-site analysis capacities of the Insurance Supervision Department in the coming period.

And, advisory assistance was provided to the NBS Insurance Supervisory Department in guiding and regulating insurance companies in the application of International Accounting Standards (IAS). As part of this effort, staff members of the On-site, Off-site and Actuarial Units of the Insurance Supervision Department were given IAS training, over the first part of 2005. The Advisory Team also assisted the NBS in developing IAS-complaint financial statements, and a new chart of accounts, which will soon be a requirement for all insurance companies.

Finally, BearingPoint advisory assistance is provided on a regular basis to the Actuarial Unit of the Department. Key areas of discussion have included claim reserve testing using triangular matrix form, claim log data and mapping the assets with the technical reserves.

### **Challenges**

There are continuous improvements and significant changes of global standards and practices in the areas of risk-based insurance supervision and of IAS. Currently the NBS Insurance Supervision Department is making strides towards complying with these international best practices. However, to keep current, the Department will have to develop a systematized process for regular review and revision of its practices. It will also need a policy for staff skills upgrading. These tasks, among others will be an important part of the Team's mission in the months ahead.

Of concern too is the underdeveloped actuarial profession in Serbia, and the small number of professionals trained in modern actuarial approaches and techniques. The need to upgrade human capital quickly represents a challenge in strengthening the financial foundations of the insurance industry.

## **6.0 Attachments**

1. Foreign Study Tours
  - 2004
  - 2005
2. BearingPoint Supervisory Training for National Bank of Serbia Staff
3. Conferences

16 May 2005

EMERGING MARKETS

## Attachment 1: Foreign Study Tour 2004

No	Duration	Location	Name / Type of Course	Short Description
1	March 31 - April 2	Budapest, Hungary	Central and Eastern Europe Regional Seminar	Insurance core principles, Int. Account. Standards, Life Insurance
2	March 31 - April 4	Prague, Czech Republic	Annual Congress of European Accounting Associations	Implications of implementing IFRS, Emerging issues in accounting and reporting of SMEs
3	April 17-22	San Diego, USA	RIMS 2004 Annual Conference	Insurance Conference
4	May 25	Split, Croatia	Third Meeting of the SEEMFN Working Group	Standardization of the criteria for mortgage and foundation of the national credit bureaus
5	June 1 -3	Washington, DC	World Bank / IMF / Federal Reserve Board International Seminar for Policy Challenges for the Financial Sector	The objective of the seminar is to provide a balanced discussion of Basel II, including: (i) aspects of design and potential effects in terms of lending behavior and financial sector stability, (ii) a discussion of implementation issues including precondi
6	June 21 – July 2	Washington, DC	Bank Analysis and Examination School, Federal Reserve System	Bank Analysis and Examination School presents concepts of bank examination, loan classification, risk-focused supervision, surveillance, and holding company inspections. Participants will strengthen analytical skills through application of the concepts pr
7	June 7-9	Sofia, Bulgaria	Visit to Bulgarian National Bank	To send Mr. Rangelov and part of the accounting steering committee to a Bulgarian National Bank to see the Oracle accounting system in operation
8	June 23-26	Geneva, Switzerland	United Nations Conference on Trade and Development	Visit to UNCTD to observe the DMFAS- Debt Management System
9	July 12 -13	Paris, France	INPRS/OECD Forum on Private Pension Reform in Emerging Economies	The goal of the forum will be the creation of a new, formal association of pension supervisors, the International Organisation of Pension Supervisors (IOPS).
10	August 30 - September 3	Washington, DC	Risk Management and Internal Controls Course, Federal Reserve System	Risk Management and Internal Controls course is designed to provide participants with an understanding of the importance of internal controls and risk management in banking organizations and how these key functions fit into the overall assessment of the b
11	September 7 - 10	Zagreb	Series of meetings	The study tour will provide a platform for government officials to understand the pension reform process evolved in Croatia, how the private pension fund industry was originally structured and is functioning today.
12	October 10-12	Cavtat, Croatia	The 3 <sup>rd</sup> International Conference on Pension Funds, Capital Markets and Financial Environment	The conference's aim is to facilitate exchange of experience from different countries and facilitate the transfer of best practice among states involved in pension reform

16 May 2005

EMERGING MARKETS

### Attachment 1. Foreign Study Tours 2005

No	Duration	Location	Name / Type of Course	Short Description	Participants
1	February 15-18	Sofia, Bulgaria	International Conference "Evolution of Pension Reforms: Bulgaria's Experience and Regional Perspectives"	USAID Integrated Approach to Pension Reform, World Bank and IMF perspective on the Bulgarian model, the approach to the pension reforms, implemented in other countries and the countries in the region - Country cases, the challenges ahead in the retirement provision sphere.	Slobodanka Pops-Dragic, NBS Private Pensions Coordinator; Milanka Novakovic, NBS Legal Advisor
2	February 23-25	Sofia, Bulgaria	PFS Program Southeast Europe (SEE) Regional Workshop - Deepening Financial Markets: A Regional Vision for SEE	Two-day workshop to discuss regional approaches to developing a more dynamic, stable and competitive financial sector in Southeast Europe (SEE). The goal of this workshop is to cast a regional vision for SEE financial sector development by helping participants understand the catalytic role of regional activities in deepening financial markets.	Kori Udovicki, Economic Institute
3	March 5-16	Krakov and Warsaw, Poland	Toronto International Leadership Center's Program in Krakow Poland; Meeting with the National Bank of Poland's General Inspectorate of Banking Supervision (Warsaw, Poland)	The Toronto Center is one of the premier leadership programs offered specifically to senior management of supervisory agencies. Their program focuses on case studies of real events, and involves a high amount of interaction between the participants. one-day meeting at the General Inspectorate of Banking Supervision ("GINB") at the National Bank of Poland, a recent European Union entrant.	Ms. Dragana Ivkovic, Director of Bank Supervision, NBS
4	April 9-17	Washington DC	World Bank Contractual Savings Conference	The conference will focus on global standards for insurance and pension, risk-based supervision, risk management with a specific focus on asset and liability management, investment process and retirement products. Particular attention will be given to implementation issues related to the topics above mentioned as well as case studies to ensure a combination of technical skills and international experiences are delivered to the audience.	Ms. Mira Eric, Director Insurance Supervision at NBS; Mr. Vladimir Jelacic, Advisor at NBS



16 May 2005

EMERGING MARKETS

## Attachment 3

No	Duration	Location	Name / Type of Conference	Short Description	Participants
1	February 12	Bankers' Association	Round Table "Pension Reform in Serbia"	First in the series of round tables organized with Bankers Association to introduce bank representatives to pension funds operations	Representatives from commercial banks, members of Bankers' Association
2	February 13	Montenegro	Consolidated collection of contributions in Montenegro	BP delivered presentation on international experiences in consolidated collection of pension contributions	
3	March 18-19	Belgrade, Hotel Palace	Pension reform in Serbia	Recent reforms and next steps - Conference is organized by the AFL-CIO Solidarity Center and BearingPoint - USAID	Serbian Labor Unions, Pension Fund, USAID, Solidarity Center, HAGENA - Croatia, KNSB - Bulgaria, SZVOH - Croatia, LIGA - Hungary, Bearing Point
4	March	Bankers' Association	Round table "Pension reform in Serbia and custody banks",	Part of a series of round tables dedicated to activities of custody banks	Representatives from commercial banks, members of Bankers' Association
5	April 2		Actuarial Training for Judges	Training organized for commercial court judges by BP and IBM projects	Judges from High Commercial Court, and lower level commercial courts
6	April 29	Bankers' Association	Round table "Investments and pension reform in Serbia"	Part of a series of round tables dedicated to investment activities of pension funds	representatives from commercial banks, members of Bankers' Association
7	September 17 & 22	Belgrade Stock Exch.	Investment Fund Seminar	Bankers' Association and Stock Exchange - 2. Investment funds seminars for banks and brokerage houses	Representatives from commercial banks, brokerage houses, Stock Exchange, Securities Commission
8	November 17	Belgrade	Belgrade Stock Exchange Conference	110th Anniversary of the Belgrade Stock Exchange. BearingPoint representatives made presentations on voluntary pension funds and investment funds.	300 participants from both the government and the private sector
9	November 12	Belgrade	"Economist" Round Table "Pension Reform"	To initiate a high level discussion with key Government stakeholders on the current situation in the state pension system in Serbia; as well as present the Law on Voluntary Pension Funds and Pension Schemes that the Government is currently preparing in cl	The National Bank of Serbia, Ministry of Finance, Ministry of Labor, Employment, and Social Assistance, Faculty of Economics, major banks and insurance companies and independent experts, HAGENA and MAPAS from Croatia