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10 YEARS

FINANCIAL SECTOR ADVISORY CENTER

ANNUAL REPORT

2021

WORLD BANK GROUP
Finance, Competitiveness & Innovation

1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

Contents

Abbreviations used in this report:

BRRD	EU Bank Recovery and Resolution Directive
ECA	Europe and Central Asia region
EU	European Union
FCI	World Bank Finance, Competitiveness & Innovation Global Practice
FINREP	EU Financial Reporting Regime
FinSAC	World Bank Financial Sector Advisory Center
GDP	Gross Domestic Product
IADI	International Association of Deposit Insurers
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
NPL	Non-Performing Loan

Foreword

Jean Pesme
Global Director
Finance, Competitiveness & Innovation
The World Bank

Financial stability is an essential ingredient for generating the sustainable, long-term economic growth required to promote better living standards. After two years, the COVID-19 pandemic continues to negatively affect health and economic activity, even as a recovery in growth and bank profitability appeared to take off during 2021. Pandemic-related uncertainty is now compounded by the devastating impact of Russia's invasion of Ukraine on the region. These challenges highlight the interconnectedness of economies and people and the potential for financial fragility in the face of unexpected events. For a decade, FinSAC has helped client countries build resilience in their financial systems by adopting international best practices in regulation and supervision, enabling them to better weather adverse events and provide more support for economic recovery.

During 2021, FinSAC helped client countries implement reform programs, in areas such as deposit insurance, corporate debt restructuring and resolving non-performing loans, and prudential reporting. These reforms are direct preparation against the possibility that unsustainable debt—sovereign, corporate, and individual—could usher in a wave of insolvencies that could slow investment, weaken financial institutions, and slow economic recovery.

Over time, FinSAC has proven to be an effective driver of change. With the steadfast support of the Austrian Government, FinSAC has been able to support countries throughout wider Europe and Central Asia to improve the foundations of financial stability. We expect that over the next years, it will continue to help clients build strong financial systems that can underpin green, resilient, innovative, and sustainable economic growth. This annual report presents a snapshot of this work, that we hope will provide examples for others seeking a stronger foundation for growth.

Federal Ministry
Republic of Austria
Finance

Harald Waiglein

Director General
Economic Policy, Financial Markets & Customs
Federal Ministry of Finance, Republic of Austria

I am pleased to welcome you to the 2021 FinSAC Annual Report. When the Center opened close to the Danube River in Vienna in 2011, we hoped that it would be supportive of our friends further down the river and beyond in strengthening financial systems and making them more resilient to future crises. This has been achieved and more. The challenges of the last few years, especially of the COVID-19 pandemic, have clearly demonstrated the benefits of well-functioning banking supervision and financial safety nets. FinSAC has been a trusted partner for its client countries in building more resilient and stable financial systems for the last decade, and the fact that all client countries managed to avoid systemic financing crises during the pandemic testifies to the success of that engagement. During the last two years, banks, businesses, and regulators have shown that they can be agile and can adjust their business models to ensure recovery, and even show some profits. However, there is no room for complacency. Just as we thought that we might have overcome the worst of the pandemic, the region is shocked by the war inflicted on Ukraine. The situation remains very fragile and the recovery path, hence, is less clear than ever. The health of the banking systems is yet to be tested and it may take some time for credit risk to surface in banks' books, as the public support and borrower relief measures are fully phased out. FinSAC's assistance continues and evolves, with a welcome new work stream emerging on building capacity among regulators and helping them frame strategies to deal with risks stemming from climate change. We continue to support FinSAC's important work, especially in Ukraine to whom we have promised our full support.

Chapter 1: Introduction

The FinSAC Annual Report for 2021 marks 10 years of the Center's operations from its office in Vienna. Originally conceived as a follow up to the Vienna Initiative[1], FinSAC has spent the last decade helping countries in the Europe and Central Asia (ECA) region address some of the legacy issues in the banking system that proved so destabilizing during the 2008/09 global financial crisis and to understand and adapt to emerging financial stability issues. This has been possible thanks to the unwavering support of the Austrian Government, including their provision of a Trust Fund which has allowed the World Bank to develop specialized knowledge and offer a range of targeted technical assistance to its regional neighbors and partners.

This annual report looks back at activities over the last year and assesses the achievement of objectives of recent projects. It also takes a broader look at the impact of FinSAC over the last ten years. Much of FinSAC's work is very targeted, such as updating legislation, advising on regimes for failing banks, or proposing measures to tackle large numbers of bad loans. While the successful completion of each individual project or activity makes a difference in a very specific way, this year's annual report also seeks to take a step back and consider how FinSAC's package of assistance, knowledge activities, and regional stakeholder engagement has also contributed to broader financial stability objectives in each of its client countries and more widely.

Since this annual report was written we have unfortunately witnessed the tragic events unfolding in Ukraine. These will have lasting, as yet unquantifiable, impacts on Ukraine and other client countries. This annual report records the remarkable progress that Ukraine had made in securing financial stability to contribute to the country's growing economic prosperity.

The following chapters outline FinSAC and its role, consider the economic environment and factors influencing client countries' technical assistance requirements, summarize activities over 2021 and assess the outcome of completed projects and the impact of FinSAC's work, and take a look ahead at FinSAC plans for 2022.

2021 marked 10 years of FinSAC opening in Vienna

1 The Vienna Initiative is a framework launched in January 2009 by European banks and governments at the height of the financial crisis to safeguard the financial stability of emerging Europe.

Highlights of 2021

The year 2021 continued to bring new challenges globally as the COVID-19 pandemic evolved with new variants of the virus triggering follow-up lockdowns, while country authorities and businesses were trying to adjust to new realities. Due to numerous borrower relief measures introduced by banking supervisors worldwide, a substantial number of businesses were able to restructure their debts and avoid bankruptcies. While public measures helped to mitigate the impact of economic recession on bank asset quality, the health of banks' credit portfolios is yet to be tested during the recovery. This will come into sharper focus as remaining borrower relief and other support measures are phased out.

The deep recession most FinSAC client countries plunged into in 2020 was halted in 2021. The year saw accelerated rebound for many, with recovery taking place at a faster-than-expected pace. It remains a concern though that with vaccination levels in most client countries below 50 percent as of end-2021, they may be less prepared than advanced economies to cope with new waves of the virus or new variants that emerge, making the recovery path more fragile, with unceasing risks for countries' financial stability.

FinSAC completed 13 projects in 2021, working largely remotely and virtually with client countries

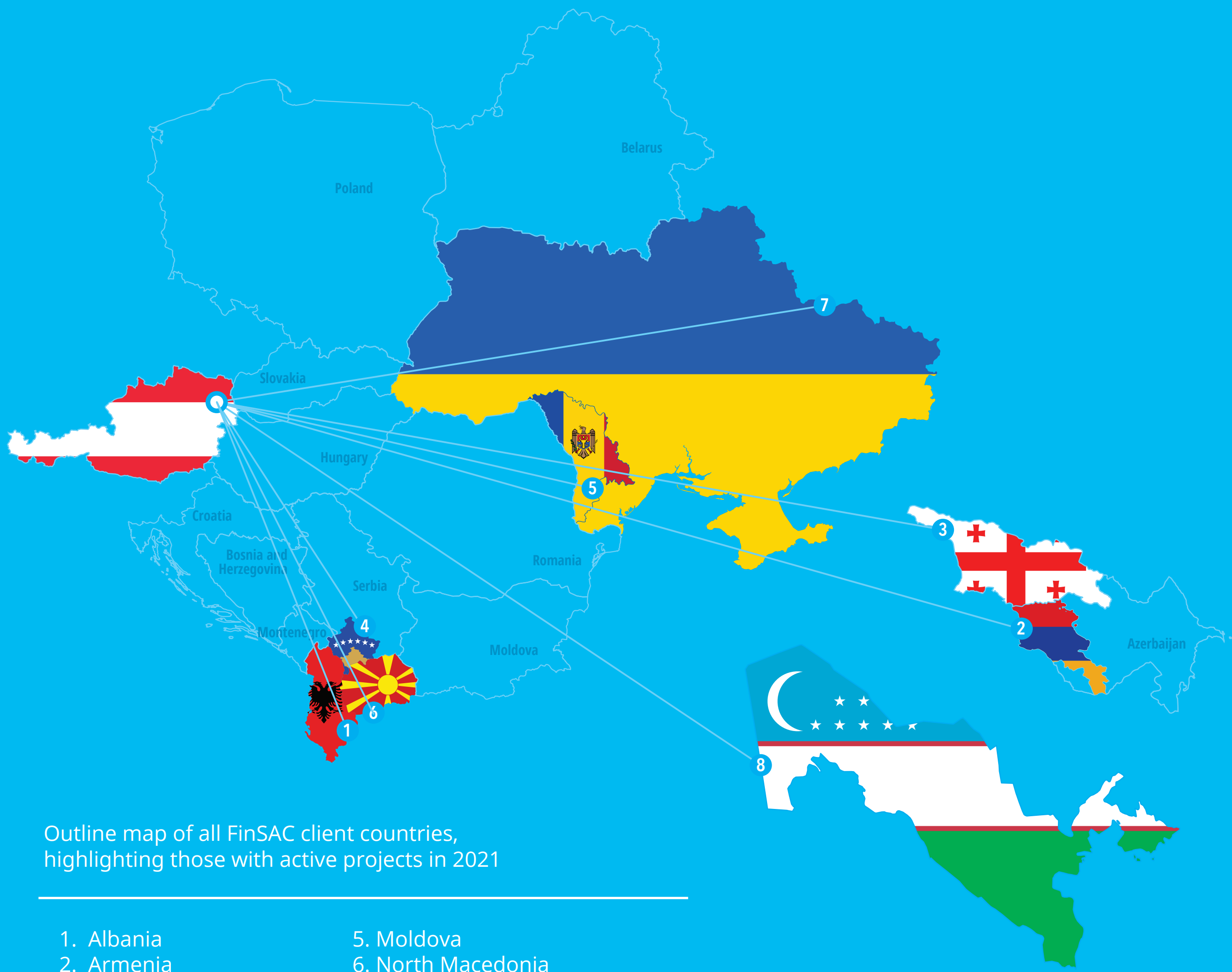
FinSAC continued home-based work on technical assistance projects in 2021. Its virtual missions during the year proved to be very effective, with both FinSAC and client county teams well attuned to the new way of doing business. Frequent virtual calls and interactions helped ensure project delivery remained very high. FinSAC managed to complete 13 projects over the course of 2021, 10 technical assistance projects (of which four were programmatic) and three knowledge products. Although the ongoing pandemic was still restrictive for organizing conferences with physical participation, online events such as the series of four virtual workshops to disseminate the policy note on non-performing loan (NPL) resolution in ECA proved popular with interlocuters. The ongoing travel restrictions, preventing FinSAC missions and prohibiting bringing clients together physically for events, resulted in reduced FinSAC annual expenditure in comparison with earlier years of €1,837,795. Towards the end of the year, when the virus was more contained, FinSAC was able to visit four client countries to discuss the engagement pipeline for the next two or three years.

In 2022, FinSAC will continue its tailored support to client countries with at least 10 technical assistance projects and 2-3 knowledge events. An exciting new area of focus for FinSAC in 2022 is to naturally embed the green finance and sustainability dimensions in its current lines of work, including making this a focus for the much delayed annual international conference.

Chapter 2: FinSAC at a Glance

THIS CHAPTER PROVIDES A BRIEF OVERVIEW OF FINSAC AND THE WORK IT UNDERTAKES.

FinSAC is a technical unit of the World Bank based in Vienna, Austria. The eight dedicated staff, together with specialist contractors and colleagues from World Bank headquarters and in other regions, work with client countries in ECA to address financial stability concerns.



Outline map of all FinSAC client countries, highlighting those with active projects in 2021

1. Albania
2. Armenia
3. Georgia
4. Kosovo
5. Moldova
6. North Macedonia
7. Ukraine
8. Uzbekistan

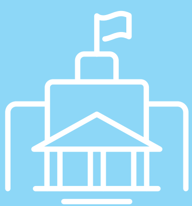
FINSAC OFFERS TECHNICAL ASSISTANCE PROJECTS AND UNDERTAKES RESEARCH AND KNOWLEDGE BUILDING ACTIVITIES ON SUBJECTS RELATED TO FINANCIAL STABILITY.

FINSAC WORKS WITH

Central banks, banking supervisors, ministries of finance, financial stability committees, deposit insurance funds, and other stakeholder authorities

FINSAC COLLABORATES WITH

International standard setters, international financial institutions, and bilateral partners, including: European Commission, European Central Bank, European Banking Authority, Single Resolution Board, Basel Committee on Banking Supervision, International Association of Deposit Insurers, International Monetary Fund, European Bank of Reconstruction and Development, and many regional central banks and regulators.



FINSAC WORKS ON

EU alignment, supervisory frameworks and practices, institutional structures, cross-border banking supervision, microprudential and macroprudential regulatory standards, bank recovery and resolution, deposit insurance, financial stability and crisis management, financial stability committees, NPL resolution, digitalization and cyber security, regulatory aspects of green finance, and many more.

FinSAC operations and direction are guided by its Steering Committee, comprising two representatives of the Austrian Federal Ministry of Finance's Department of International Financial Institutions, the World Bank Global Director of Finance, Competitiveness & Innovation (FCI), the ECA FCI Practice Manager and the FCI Practice Manager responsible for Financial Stability and Integrity globally. The FinSAC Coordinator serves in an ex officio capacity. Meetings consider the annual work plan and any specific topic reviews undertaken by Steering Committee members. It was agreed at the Steering Committee meeting in July 2021 that the FinSAC work program was on track to meet its delivery targets. The Steering Committee expressed appreciation for FinSAC's contributions to the knowledge agenda, through the publication of policy notes on borrower relief measures / NPL resolution and the organization of series of webinars to disseminate the main findings. The Steering Committee also discussed the importance of FinSAC working with client countries to integrate the green finance and climate risk agenda in its work streams and agreed in principle with the approach proposed by the FinSAC team.

FINSAC'S WEBSITE OFFERS INFORMATION ON EVENTS AND IS A REPOSITORY OF FINSAC KNOWLEDGE MATERIALS.

FinSAC organizes its technical assistance within three pillars. All FinSAC activities are grounded in the expertise and experience of its team and informed by international best practices that are specifically adapted to the local context as appropriate. Projects are normally focused within one pillar but some programmatic projects combine activities across pillars if this is relevant.

Pillar 1

Financial Stability, Macroprudential Frameworks, and Crisis Management

Strong macroprudential institutional frameworks underpin national financial stability arrangements. FinSAC assistance focuses on identifying and addressing legal, regulatory, institutional, and operational gaps and building capacity and frameworks to monitor and mitigate threats to financial stability and strengthen preparedness to face episodes of financial stress. This includes detailed technical advice on strengthening capabilities for the timely detection and mitigation of threats to financial stability, and on building robust financial stability committees. FinSAC has supported client countries to reinforce financial sector safety nets, including deposit insurance and lender of-last-resort facilities, and improve financial crisis policy coordination. FinSAC crisis simulation exercises allow client countries to test their crisis management and cyber security arrangements in a simulated environment.

Pillar 2

Microprudential Frameworks & NPL Reduction

Banks are the cornerstone of financial systems in FinSAC client countries which makes their well-functioning critical to financial stability. FinSAC assistance focuses on strengthening the safety and soundness of banks through robust prudential regulations and forward-looking supervision. This includes improving prudential regulations, including capital and liquidity requirements, loan classification and provisioning, and large exposure and related party limits. FinSAC works with banking supervision departments to strengthen supervisory enforcement, including onsite/offsite cooperation, supervisory plans, the development of remedial action and enforcement, and bank recovery planning. FinSAC also actively supports authorities to tackle NPLs, advising on regulatory and supervisory policies aimed at ensuring that banks report economically realistic measures of asset quality, and developing tools and strategies to be used in NPL resolution.

Pillar 3

Bank Resolution

An effective resolution regime should ensure that failing banks can be promptly and effectively dealt with; preserving the public interest in financial stability, ensuring losses are borne by shareholders and creditors, and protecting taxpayers from contingent losses. FinSAC assistance includes guidance on improving legal and regulatory frameworks for banking resolution that are aligned with post-global financial crisis standards and enhancing the capacity of recently established dedicated bank resolution departments. FinSAC also offers detailed information to assist with the adoption of intervention powers and adaptation of resolution tools and options in preparation for dealing with future bank failures.

The FinSAC core team

Vahe Vardanyan
Lead Financial Sector Specialist,
FinSAC Coordinator

Juan Ortiz
Senior Financial Sector
Specialist
Microprudential supervision

Nurgul Irsalieva
Program Assistant
Administrative support, trust fund administration, procurement and budgeting, event management

Pamela Lintner
Senior Financial Sector
Specialist
Bank recovery & resolution

Karlis Bauze
Senior Financial Sector
Specialist
Non-performing loans

Ismael Ahmad Fontán
Senior Financial Sector Specialist
Supervisory and
regulatory affairs

Milica Nikolic
Financial Sector Specialist
Bank recovery and
resolution

Nan Zhou
Financial Sector
Specialist
Analytics and modeling

Chapter 3: The Regional Economic Environment and Financial Sector Priorities

THIS CHAPTER OUTLINES THE ECONOMIC ENVIRONMENT OF FINSAC CLIENT COUNTRIES AND THE EU IN 2021 AND CONSIDERS THEIR ONGOING FINANCIAL SECTOR PRIORITIES.

The European Union

During 2021, the EU continued its recovery path, although supply chain disruptions, rising commodity prices, and emergence of new COVID-19 variants continued to weigh on the growth prospects. To cope with the new waves of the pandemic, some EU countries introduced tighter containment measures during the year, which slowed down recovery, especially in the services sector. Shortages of equipment and materials in some manufacturing sectors hindered the production of goods, also causing delays in construction. Helped by ample policy support, the labor market continued improving during 2021, with fewer people relying on job retention schemes, but some labor shortages restricted further acceleration of economic recovery. In addition, rising energy prices began to impact households and firms. As vaccination rates increased, the EU economy was affected less and less by each wave of the pandemic, while the factors restraining growth were gradually fading, allowing more breathing space for the economy to pick up. The pre-pandemic output level was regained by the third quarter of 2021 and, although there was a further moderate slowdown recorded at the year-end, a strong recovery of 5.3 percent was recorded in 2021 with economic expansion likely to continue over the course of 2022, though with slower pace, effected by the Russia/Ukraine war. Effective implementation of the Next Generation EU program will further contribute to a stronger, greener, and resilient recovery in Europe. This program has mobilized an unprecedented funding volume of up to €807 billion to date, of which €581 billion has been already requested by EU Member States.

Spurred by higher energy prices, the euro area annual inflation rate reached 5.0 percent for 2021, the highest on record. A substantial rise in prices for fuel, gas, and electricity also pushed the prices of goods and services up across many sectors. Seasonal factors combined with elevated transportation and fertilizer costs led to rising food prices. For 2022, the outlook for euro area inflation has become very uncertain and will depend crucially on how the Russia/Ukraine war unfolds and on the impact of imposed sanctions and other measures.

The European Commission adopted its 2021 Enlargement Package, providing a detailed assessment of the progress made and prioritizing the future reform agenda for Western Balkan countries on their respective paths towards EU accession. The first political intergovernmental conferences with Montenegro and Serbia were held in June 2021.

Albania and North Macedonia continue to fulfill the conditions to open accession negotiations and both countries advanced steadily on the EU reform path. In Bosnia and Herzegovina and Kosovo, significant reforms remain to be implemented before the European Commission could recommend granting candidate status to both countries.

> The unfolding war in Ukraine may slow EU economic expansion and makes the euro area inflation outlook extremely uncertain

EU FINANCIAL SECTOR DEVELOPMENTS

European banks entered the COVID-19 crisis with relatively strong capital and liquidity buffers which, coupled with ample state support and introduced borrower relief measures, helped the banks to weather the pandemic crisis moderately well. Nearly all loan moratoria and government guarantee schemes which helped to support banks' asset quality have already expired, and suggested restrictions on dividend distributions and share buybacks imposed on euro area banks were lifted in September 2021. The fiscal stimulus was gradually reduced to 4.6 percent of gross domestic product (GDP) in 2021, aiming to further limit it in 2022. While the termination of moratoria and reduced fiscal incentives have not immediately translated into a deterioration of banks' asset quality, the full impact of the pandemic on bank credit portfolios could take up to two years to become apparent. The corporate sector would likely be the primary channel for credit risk re-appearance. Numerous corporate loan restructurings, that were supported by public and borrower relief measures, mitigated a wave of corporate bankruptcies in the short-term. However, highly leveraged and more vulnerable firms may be challenged by the phasing-out of policy support measures and, in the medium term, be unable to service the sizeable debt accumulated during the pandemic. These risks, if materialized, will inevitably transform into NPLs, jeopardizing banks' capital position. While during 2021 the NPL ratio dropped to levels last seen before the global financial crisis, asset quality concerns may resurface, reinforcing the need for effective NPL solution tools.

Against the backdrop of accelerated recovery in 2021, the profitability of euro area banks has improved, explained by lower loan loss provisions and stronger revenue streams. However, the profitability outlook continues to depend on the path of overall economic recovery and, lessening but still continuing, constraints caused by the pandemic. While at the inception of the pandemic, the European Central Bank allowed banks to operate below the level of Pillar 2 guidance and capital buffer requirements until the end of 2022,

Rising residential real estate vulnerabilities can cause the accumulation of financial stability risks in the medium-term

the latest stress test it conducted in October 2021 reconfirmed the initially suggested timeline of Pillar 2 guidance replenishment. Moderately favorable macro-financial conditions in some euro area countries provide an opportunity to establish additional macroprudential policy buffers by increasing the amount of releasable capital requirements, further strengthening the ability of macroprudential authorities to act countercyclically in the event of systemic shocks, like the global pandemic. Of concern are rising residential real estate vulnerabilities, which can root the accumulation of financial stability risks in the medium-term, stressing the need for proportionate and targeted macroprudential measures.

A swift growth of digital channels for the provision of financial services during the pandemic significantly increased banks' exposure to cybersecurity risks. While cyber incidents reported by euro area banks remained largely unchanged in 2021, going forward the banks are likely to face a growing need to address digital transformation challenges and also manage the implications of the transition to a greener economy. During the year, a swift deepening of green financial markets in Europe continued, indicating an increasing awareness of the need to transition to a low-carbon economy. However, as financial markets play an important role in financing this transition, greenwashing concerns persist, warranting the need for careful monitoring by financial sector regulators.

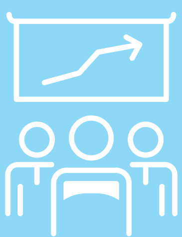
At the same time, there is a need for structural improvements to the regulatory framework to ensure long-term resilience of the financial system in the EU, that supports more robust and sustainable economic growth. In that context, the implementation of the final Basel III reforms is essential to address the shortcomings of the existing framework. The reforms should include implementation of the output floor, with all risk-based capital measures and buffers calculated on the basis of one single set of risk-weighted assets; implementation of the new Basel standardized approach for credit risk; and, most importantly, the reduction of EU specific deviations. The EU Commission's legislative proposals for amending the Capital Requirements Regulation III, and the Capital Requirements Directive VI were published on October 27, 2021. These included the full implementation of the Basel III Package, as well as new rules to strengthen the resilience of the banking sector to environmental, social, and governance risks and rules that underpin the fit and proper regime applicable to financial institutions. In July 2021, the European Commission also published the outcomes of a public consultation on the review of the crisis management and deposit insurance framework in the EU. It is expected that the next step will be the European Commission preparing a Legislative Proposal for the European Bank Recovery and Resolution Directive (BRRD) and the Directive on Deposit Guarantee Schemes. To strengthen the EU NPL resolution framework, the European Parliament approved a new Directive on Credit Servicers and Credit Purchases in November 2021. Furthermore, the European Commission issued a targeted consultation document on improving the transparency and efficiency in secondary markets for NPLs.

Revised legislation and full implementation of Basel III in the EU will further strengthen financial system resilience

Western Balkans

In 2021, the Western Balkans recorded an accelerated rebound from the recession that all six economies experienced in 2020. Recovery came at a faster-than-expected pace. It was supported by a combination of domestic reopening, despite high infection rates and low vaccination, allowing for a recovery in consumption and tourism and favorable external conditions for exports. A strong recovery in advanced economies, due to rapid vaccination, compounded with fiscal stimulus, also provided a welcome boost for the region's exports. However, the unemployment rate remained elevated in most Western Balkan countries in 2021, especially for women and youth, calling for close policy attention.

As a result of stronger economic performance, the fiscal positions started to improve in 2021, but deficits across all economies of the Western Balkans were above pre-pandemic trends, and the stock of public debt in most countries reached historic highs.



Western Balkan countries experienced faster than expected recovery from recession but public debt remains high

The vaccination rates remained below 50 percent of the population in most Western Balkan countries, significantly behind more developed European neighbors, with much higher vaccine hesitancy. This implies that the Western Balkans will be less resilient to withstand new COVID-19 variants that might emerge, which together with potential negative implications from the unfolding Russia/Ukraine war could further risk the path of sustainable economic recovery for the region.

Western Balkan countries are beginning to acknowledge the looming need for greener economies, as they cannot stay entirely isolated from EU progress towards implementation of the Paris Agreement on climate change. Despite the difficult challenges and potentially significant costs, the green transition can offer opportunities for the Western Balkans, through closer integration into European value chains, as well as access to EU resources to help fund climate related change. Going forward, enhanced resilience and green transition should become a main focus for the Western Balkan's reform agenda, including reforms aimed at greening the financial system.

In 2021, the financial systems of Western Balkan countries remained resilient to pandemic related shocks, backed by continued COVID-19 support measures, and growth recovery across the countries. Capital buffers and bank liquidity stayed largely stable. There was positive credit growth in all Western Balkan countries, with household loans growing faster than corporate loans. Bank profitability recovered in 2021, in some countries reaching the highest levels during the last decade.

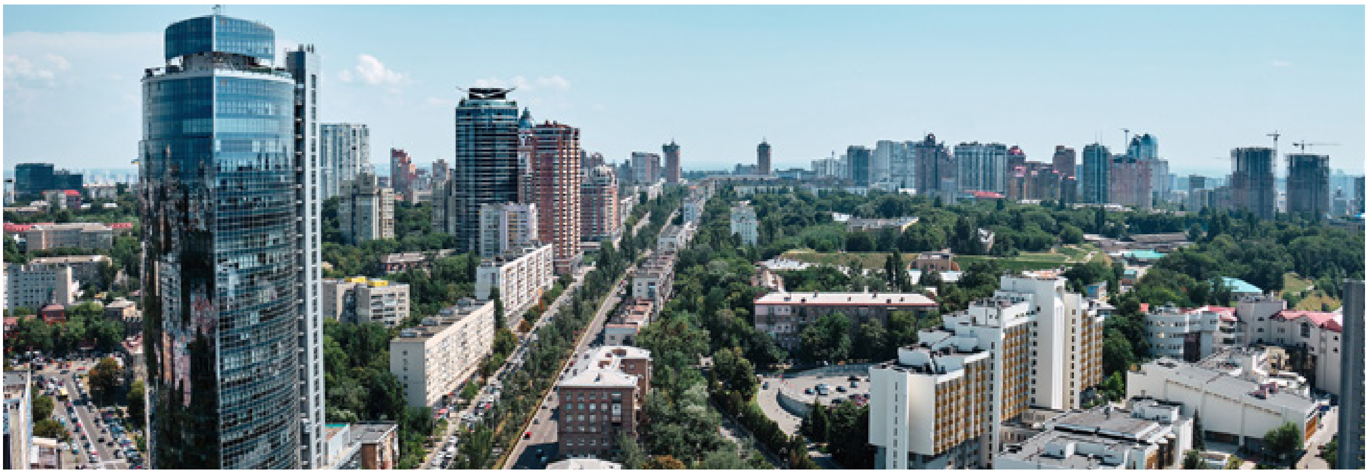
Financial sectors are proving resilient, focused on closer alignment with the EU

Public measures implemented in most jurisdictions mitigated the negative effects of the pandemic on bank asset quality, resulting in no substantial growth of NPLs yet recorded. However, the health of the banking system is yet to be tested in 2022 and beyond as the remaining borrower relief measures are phased out and the restructured borrowers need to prove their financial viability after the grace periods introduced during restructurings expire.

Against this backdrop, financial sector reforms in Western Balkan countries continued to be focused on alignment with EU frameworks. An important achievement for Bosnia and Herzegovina and North Macedonia in 2021 was the European Commission decision to consider the supervisory and regulatory frameworks in both countries as equivalent to that applied in the EU. The decision was acknowledged by the European Banking Authority, which implied that EU credit institutions can apply preferential risk weights to relevant exposures to entities, including the governments, in both countries.

Going forward, maintaining financial stability will be of the utmost importance to preserve the ability of the financial sector to play its key role in providing funding to support economic recovery. Continued vigilance, with particular attention to restructured loans, will be key to the early detection of any buildup of vulnerabilities. Authorities should continue strengthening NPL resolution capacity, embark on reforms aimed at greening the financial sectors, and refocus on medium to long-term reform priorities of aligning financial systems in the region with EU and international standards.

The European Commission recognized the supervisory and regulatory frameworks in Bosnia and Herzegovina and North Macedonia as equivalent to the EU



EU neighbors – Belarus, Moldova, and Ukraine

Following a sharp economic contraction in 2020, EU neighboring countries showed signs of a strong recovery in 2021. This advanced ahead of expectations, despite high COVID-19 infection and low vaccination rates, as domestic reopening enabled increased consumption and tourism and there were favorable external conditions for exports in response to the strong recovery in advanced economies. However, the tragic developments in Ukraine mean the economic outlook for 2022 is highly uncertain, with substantial economic damage to Ukraine and potential negative spillover both regionally and globally.

Following a relatively mild downturn in 2020, the Belarusian economy recovered to its pre-pandemic level in 2021, while inflation sparked, reaching 10 percent at year-end. Against this backdrop, the banking sector weathered the impact of the pandemic and sanctions relatively well, though a fairly large volume of softly classified restructured loans suggests that the credit risk in banks' books remains high. Sizable exposures to low-performing state-owned enterprises further exacerbated asset quality pressures in the banking system, posing notable future solvency risks. While the eased liquidity regulations at the onset of the pandemic allowed the system to overcome liquidity problems at the time, banks remain vulnerable to potential liquidity shocks, highlighting the need for decisive policy actions to build up buffers to withstand future liquidity and credit risk shocks, including those derived from the war in Ukraine.

After a severe drought and the COVID-19 crisis induced contraction of 7 percent in 2020, the Moldovan economy rebounded by 7.5 percent in 2021, driven by a stronger than expected recovery in demand. The impact of the pandemic on the financial sector was mitigated by high capital buffers, early regulatory measures by the National Bank of Moldova, as well as other support measures

EU neighborhood countries also experienced strong recovery although the full extent of credit risk may not yet be evident introduced by the Government. The capital ratios exceeded the minimum requirement, including the substantial buffers introduced after the National Bank supervisory review. Having risen slightly early in the pandemic, banking system NPLs remained on a relatively low level, though the real impact of the pandemic and the Russia/Ukraine war on the quality of credit portfolio is yet to be seen in 2022. The National Bank continued its effective convergence to a new bank supervisory model based on EU standards.

Ukraine came through the pandemic in a stronger position than had initially been anticipated. Following a 3.8 percent contraction in 2020, the economy grew by 3.2 percent in 2021. Financial stability was maintained, while the banking system received a record-high net profit, partly explained by a reduction in loan loss provisions. Recent regulatory reforms enabled the restructuring and write-offs of NPLs in state-owned banks, resulting in a substantial NPL decrease from 48 percent to 31 percent during 2021. At the end of the year, the capital adequacy remained sufficiently high, at the level of 18 percent, to allow banks to absorb the influence of new capital requirements on operational risk and higher risk weights on unsecured consumer loans and foreign-currency sovereign bonds, that are in force since 2022. However, the asset quality risks remained high, further exacerbated by the evolving military conflict. The real effect of the war is yet impossible to quantify, but it is expected that both capital and liquidity positions of the banking system will be significantly impacted.

> The tragic developments in Ukraine make the economic outlook for 2022 extraordinarily uncertain, with potential negative spillover both regionally and globally

Southern Caucasus and Uzbekistan

Despite the COVID-19 crisis causing the worst economic hit in their modern history for Armenia, Azerbaijan, Georgia, and Uzbekistan, a robust recovery was recorded in all four counties in 2021, some even exceeded pre-pandemic level output. As in other client countries, the war in Ukraine could hinder future economic growth in these countries, posing elevated risks for financial sector stability.

Reinforced by Government economic support measures, the Armenian economy rebounded in 2021 with close to 5.5 percent growth, following a 7.4 percent contraction in 2020. The financial sector weathered the pandemic relatively well, with the capital position staying well above the required minimum. Most of the borrower relief and capital support measures introduced by the Central Bank of Armenia during the pandemic have expired or been withdrawn. To improve the resilience of the financial sector, the Central Bank required all banks to maintain a capital conservation buffer of 1.5 percent. The systemic banks will be required to maintain an additional 1.0 percent buffer from January 2022. During 2021, the Central Bank continued the effective implementation of the new supervisory review and evaluation process framework, aiming to introduce Pillar 2 capital requirements and assess banks' internal capital adequacy assessment process (ICAAP) in the future.

Economic activity in Azerbaijan is projected to recover in 2021, following a real GDP decline of 4.3 percent in 2020. The exceptional prudential easing measures introduced in 2020 remained in place in 2021, pointing to yet notable vulnerabilities accumulated in the banking system. Delaying the reversal of those forbearance measures could further disguise the growing risks in the banking sector, dilute credit quality and market discipline, and put at risk the country's financial stability. A thought-through plan

to phase out those exceptional measures is needed, given the still outstanding restructured loans portfolio in the banking sector.

After a significant economic drop of 6.2 percent in 2020, the recovery of the Georgian economy gained momentum with growth of close to 10 percent in 2021. The banking system survived the pandemic crisis relatively well, confirmed by the stress tests conducted during the 2021 Financial Sector Assessment Program, indicating that under the stress scenario capital losses were not substantial and were deemed to be manageable. The stressed scenario of high deposit withdrawals also found that banks were sufficiently liquid. While no substantial NPL growth was recorded in 2021, the restructured loans constituting 19 percent of the portfolio could potentially influence asset quality, thus negatively influencing banks' profitability and sustainability of capital buffers.

The COVID-19 pandemic was the most severe crisis Uzbekistan has faced since independence. GDP growth slowed sharply to 1.9 percent in 2020, but the economic situation steadily improved in 2021, with real GDP growth reaching 7.4 percent in 2021. While the pace of structural reforms slowed somewhat due to the pandemic, the authorities remained strongly committed to advancing reforms in the banking sector, aimed at transitioning towards a greater role for private capital in the state-dominated banking sector, attracting reputable strategic investors, and strengthening the regulatory and supervisory framework. The banking system remained resilient during the pandemic but faced rising NPLs reaching 5.2 percent at the end of 2021. In the meantime, many loans received multiple deferrals during 2020-2021. Though capital and liquidity buffers of the banking system remained well above the regulatory minimum, the full effects of the pandemic, as well as the rapid and lax lending over the past few years, are yet to be seen, indicating the possible build-up of credit risk in banks' books.

Robust recovery but ongoing concerns about the longer term impact of restructured loan portfolios

Chapter 4: Technical Assistance in 2021

THIS CHAPTER OUTLINES WORK UNDERTAKEN BY FINSAC DURING 2021. FINSAC COMPLETED 10 TECHNICAL ASSISTANCE PROJECTS IN 2021. THESE ARE SUMMARIZED BELOW TOGETHER WITH AN ASSESSMENT OF THEIR OUTCOMES AGAINST THE INDICATORS SET FOR EACH AT THE INCEPTION OF THE PROJECT. ONE TECHNICAL ASSISTANCE PROJECT IS ONGOING INTO 2022, ITS AIMS AND THE WORK COMPLETED DURING 2021 IS ALSO INCLUDED IN THIS CHAPTER.

Pillar 1
Financial Stability, Macroprudential Frameworks, and Crisis Management

Pillar 2
Microprudential Frameworks & NPL Reduction

Pillar 3
Bank Resolution

Albania: Deposit Insurance Legal and Regulatory Review

COMPLETED PROJECT PILLAR 1

Effective deposit insurance schemes are an important part of the financial safety net and play a key role in contributing to the stability of the financial system and the protection of depositors. This is particularly relevant for Albania, considering its experiences in 1996/1997 when pyramid schemes amounting to almost half the country's GDP started to collapse, causing profound instability. This project aimed to support the Albanian Deposit Insurance Agency strengthen its operations by further enhancing its legal and regulatory framework towards alignment with the International Association of Deposit Insurers (IADI) Core Principles and EU Directives, as spelled out in the Agency's 2021-23 Strategic Plan.

For this project, FinSAC reviewed Albania's Deposit Insurance Law; identified areas for improvement taking into account international standards and best practices, findings and recommendations from previous technical engagements, as well as the Agency's operational experiences in the local context; and provided implementation advice to enhance the Agency's operations. Six virtual missions were organized in 2021 to support streamlining of the depositor compensation process, modernization of premium and contingent funding mechanisms, and harmonization of creditor hierarchy treatments across applicable financial sector laws. Consultations with the Bank of Albania and the Ministry of Finance and Economy were also held to diagnose areas where liquidator coordination and funding backstop could be enhanced.

The review process produced a set of detailed recommendations on the Deposit Insurance Law and Regulation on the Compensation of Insured Deposits that have been formulated for consideration by the authorities in future financial sector reforms. In December, FinSAC presented the project's outcomes to the Agency's Board of Directors meeting, summarizing and highlighting near- and medium-term reform priorities.

> "The project enhanced the analytical arguments and rationale for review of the legal framework for compensation, broadening knowledge on cross-country experiences, in particular on back-stop funding, subrogation of rights and creditor hierarchy, and helped raise stakeholder awareness of other issues that need to be addressed."
>
> **Silvana Sejko**
> Deputy General Director
> Albanian Deposit Insurance Agency

OUTCOMES

This project has facilitated the Agency's alignment with the IADI Core Principles, especially Principles 8 (coverage), 9 (sources and uses of funds), and 15 (reimbursing depositors), in addition to the EU Directives. The activities have strengthened the Agency's legal and regulatory framework, including on premium assessment strategy, deposit exclusion principles and payout procedures, and enriched operational knowledge. Additionally, the project advanced the client's analytical capacity through the transferal of a modeling toolkit integrating the evaluations for coverage, premium, and fund size policy options, which has since been applied in internal analysis.

In recognition of the positive operational impact and continued reform needs, topics for future FinSAC support have been identified. These areas include operationalization of the backstop funding mechanism and further improvements in coordination practices with the supervisory and resolution authority, as prescribed collectively in IADI Core Principles 4 (relationship with other safety-net participants), 9 and 13 (early detection and timely intervention), and 14 (failure resolution).

Outcome indicator	Assessment
Approval of the legal draft by Albanian Deposit Insurance Agency Board of Directors	**Expected to be achieved.** The project's outcomes have been presented to the Board of Directors and are expected to be approved in early 2022.

Albania: Bank Supervision, Resolution, and Deposit Insurance

COMPLETED PROJECT PROGRAMMATIC – MAINLY PILLAR 3 IN 2021

This programmatic project ran from 2019 until 2021. It was centered on the Bank of Albania and operationalizing the EU-aligned bank resolution framework. It built on earlier FinSAC projects to offer technical assistance in a more integrated way, including on enhancing the deposit insurance framework and addressing NPLs. It further evolved during 2020 as the COVID-19 pandemic led to the emergence of potential new priorities that FinSAC responded flexibly to. The focus in 2021 was on readiness to address any systemic problems and ramifications for the range of feasible resolution options. A combination of bail-in and bail-out was agreed and an internal manual on the application of bail-in combined with the bridge bank tool was developed.

The ability to rapidly identify assets and liabilities is an essential success factor for taking quick resolution action. A workshop with experts from the Austrian Financial Market Authority and the EU Single Resolution Board was organized in early 2021 to discuss resolution valuation, including on related procedures to enter into framework agreements for hiring independent valuers. Capacity building workshops were also conducted on the organizational aspects of the due diligence process and the identification of assets and liabilities to be transferred to a third party or a bridge bank and including topical developments such as bail-in playbooks (the requirements from banking to industry to facilitate bail-in execution). The application of the public interest test was discussed and examples from EU countries shared to raise awareness of current shortcomings in the Banking Law to apply purchase and assumption powers for small(er) banks.

FinSAC also provided comments on four draft Bank of Albania sub-legal acts required under their Resolution Law on the conditions for the establishment and operation of an asset management company; the types of agreements that will be protected in partial transfer; contractual recognition of write down and conversion powers; and conversion of debts into equity during the exercise of write down and conversion powers.

OUTCOMES

This project contributed to a strengthened framework for bank supervision and bank recovery and resolution in Albania and enhanced preparedness for taking resolution action. As a result there is improved awareness and understanding of triggering conditions (increasing legal certainty), available resolution tools, and evaluation of systemic impacts of resolution actions. The Bank of Albania has an improved analytical capacity to carry out the public interest test; increased understanding of resolution tools and the pros and cons of different resolution options; benchmarking for the adoption of bank specific individual plans; better preparedness for taking resolution action in case of need; and an increased understanding of legal techniques and practical aspects of applying bail-in.

Outcome indicator	Assessment
Supervisory Framework	
Support for developing a set of by-laws based on the new Resolution Law.	**Achieved.** Successful capacity building; adoption of manuals guidelines and by-laws.
Bank Recovery and Resolution	
Methodology note for assessing systemic impact of resolving failing banks.	**Partially achieved.** Shared information on aspects of the public interest test and good international practice.
Development of generic resolution plan adapted to Albanian environment.	**Achieved.** Enhanced resolution plans. Improved understanding of available options in a systemic event.
Provide comments on "failing or likely to fail" guidelines.	**Achieved.** Capacity building and sharing of good practice examples on triggers.
Note on bail-in and staff training.	**Achieved.** Note on bail-in combined with bridge bank delivered. Training workshop held on bail-in playbooks.
Develop draft valuation arrangements.	**Partially achieved.** Capacity building and good practice examples provided, including sharing of generic agreements; adoption of country specific agreements outstanding.

Albania: Supporting Alignment with the EU Financial Reporting Regime (FINREP)

COMPLETED PROJECT PILLAR 1

FinSAC supported the Bank of Albania in moving to the implementation of full International Financial Reporting Standards (IFRS), which will begin in 2022. This project focused on strengthening the architecture of prudential supervision, through the introduction of a new prudential reporting framework aligned with the EU's FINREP. The project aimed to develop prudential reporting templates that would enhance the availability, transparency, reliability, and comparability of financial information and, hence, bank supervision, bringing it further in line with good European practices.

FINREP represents a common standardized reporting framework with the objective to increase comparability of financial information produced by credit institutions for prudential purposes. By implementing a FINREP approach, the Bank of Albania: establish a central repository for banking data; enable improved risk identification and management across institutions; facilitate peer group analysis, trend predictions, risk analysis, and provide greater transparency regarding the accumulation of risk in the industry as a whole; and enable the sharing of information with other national and international competent authorities, for institutions with cross-border operations.

> "FinSAC usefully explained the rationale behind EU regulation and methodologies and different application and adoption by different European countries."
>
> **Jonida Kaçani**
> Deputy Director, Supervision Department
> Bank of Albania

Albanian reporting standards had been using national generally accepted accounting principles. As FINREP is based on IFRS, FinSAC's focus for this project was mapping templates and identifying the more granular data to fill in the templates. FinSAC worked with the supervisory authorities to help develop reporting templates aligned with FINREP and adapted to the specific needs of the Albanian banking system. A report was provided, summarizing the main outcomes of the mapping exercise, and there were discussions on this and other technical requirements of the new framework.

OUTCOMES

The anticipated outcome of the project is the adoption of new templates for financial reporting based on FINREP. The Bank of Albania aims to implement FINREP and IFRS 9 during 2022. Monitoring is not yet in scope and will be reported on in the 2022 Annual Report.

Outcome indicator	Assessment
New financial reporting templates for banks adopted.	To be assessed one year after completion of project.

Armenia: Risk-Based Supervision and Financial Sector Safety Net

COMPLETED PROJECT PROGRAMMATIC - MAINLY PILLAR 2

This programmatic project was a natural continuation of earlier FinSAC work and aimed to contribute to more robust prudential oversight by the Central Bank of Armenia and to enhance the response capacity to episodes of potential financial instability. The project had two objectives: 1) to strengthen the Central Bank's supervisory framework through the development and implementation of an advanced supervisory approach (the EU Supervisory Review and Evaluation Process); and 2) to strengthen the financial sector safety net by improving the legal and institutional frameworks for crisis management, including the lender of last resort function and bank resolution.

FinSAC activities included an organizational review of the Central Bank's supervision department with suggestions for new potential functions and roles, and revised hiring policies. FinSAC assisted with the definition and integration of a revised risk-based supervision methodology with integrated quantitative indicators and thresholds for the assessment of material risks. Specific steps were detailed and standardized templates were provided for the annual risk-based supervision assessment. Appropriate software tools, linked with other supervisory applications (automatic feedback from supervisory reporting, ICAAP, stress testing, recovery plans), and benchmarking functionalities were developed.

Triggers linked to supervisory ratings and other applicable requirements were established and a procedure for the adoption of early intervention measures, consistent with the Law, was defined. A concept note on ICAAP was prepared, explaining the different possible approaches, laying out its different sections (risk assessment, capital planning and stress testing, and economic capital), and proposing linkages with the risk-based supervision approach. A draft regulation and ICAAP assessment methodology were prepared. FinSAC also assisted the Central Bank to review recovery plans submitted in 2020.

FinSAC supported the Central Bank and other relevant stakeholders to comprehensively assess their current legal framework for banking resolution and prepare new or amended laws to establish a modern bank resolution regime, in line with applicable international standards but tailored to the Armenian context. The new regime establishes a special resolution regime for banks, setting them apart from the corporate insolvency framework, and providing a robust legal basis for recovery and resolution planning among others. A draft framework for emergency liquidity assistance was prepared, including policies for lender-of-last-resort function and internal coordination procedures.

The Central Bank, with FinSAC assistance, started preparations for a first round of supervisory bottom-up stress tests that are planned to be conducted in the spring of 2022. A concept note was written, describing the key building blocks and components of the exercises such as calibrating scenarios, preparing methodologies for individual risks, designing suitable templates, and challenging the results submitted by banks, and then an operational plan was drafted, laying out the timeline for the preparatory phase and the actual stress testing exercise. An international stress testing workshop was organized, with representatives of the European Banking Authority, central banks of the Czech Republic, Croatia, Hungary, and Bosnia & Herzegovina, and two private banks, to share experiences of supervisory stress tests. Guidance for banks and stress testing templates were then prepared and the baseline and adverse scenarios calibrated. Four banks are expected to participate in this first stress testing exercise.

> "FinSAC delivered tailored methodologies and templates and shared experience via online workshops. We received clear and comprehensive explanations on different topics, which enriched our understanding of the problem and possible approaches for solutions."
>
> **Karine Hambaryan**
> Head of Financial Stability Monitoring
> and Crisis Management Division
> Central Bank of Armenia

OUTCOMES

The outcomes of the project included some strengthening of bank supervision, sound first-time assessment of bank recovery plans, enhancements to the framework for assessing bank recovery and resolution, some improvements to the early intervention framework, and progress on a bank resolution legal framework and an enhanced emergency liquidity assistance framework.

> "We highly appreciate the FinSAC support. The trainings and workshops were tailor made to our specific needs. The expert team was very professional, available, and flexible."
>
> **Astghik Gevorgyan**
> Head of Risk Expert Service
> Central Bank of Armenia

Outcome indicator	Assessment
Supervisory Framework	
New risk-based methodology and operational framework for conducting the Supervisory Review and Evaluation Process adopted by the Central Bank.	**Partially achieved.** The Central Bank is currently testing a new risk assessment framework for banks using new methodologies and new procedures.
Central Bank letters to banks with supervisory assessment. Methodology for assessing recovery plans adopted by the Central Bank.	**Achieved.** The Central Bank has a new methodology to assess banks' recovery plans. Plans were assessed and letters delivered to banks.
Early intervention framework with triggers linked to supervisory risk based ratings adopted by the Central Bank.	**Partially achieved.** The new risk-based supervisory methodology includes ratings for banks which determine the supervisory intensity, including for early intervention measures.
Bank Recovery and Resolution	
Draft legal framework for bank resolution endorsed by Central Bank management.	**Partially achieved.** A new Law for Bank Resolution, aligned with international standards (key attributes) is being drafted.
Resolution unit established at the Central Bank.	**Not achieved.** The resolution unit has not yet been established.
Emergency liquidity assistance operational framework approved by Central Bank senior management.	**Partially achieved.** A new emergency liquidity assistance framework has been prepared.

Georgia: Strengthening the Deposit Insurance Agency

COMPLETED PROJECT PILLAR 1

This project, from May 2019 to September 2021, built on earlier technical assistance to further strengthen the institutional capacity of the new Georgian Deposit Insurance Agency, including its payout procedures, and develop a deposit insurance system in line with international best practice.

FinSAC activities under this project included detailed comments, guidance, and discussions (the work was fully remote during 2021 due to COVID-19 travel restrictions) on developing internal acts, guidelines, instructions, and regulations on insured deposits payout workflow and business processes; comments to the draft technical specifications for a management information system and payout instructions; inputs to a draft Strategy Plan; comments on the amendments to the Law on Deposit Insurance; support in developing risk-based premium methodology; calculation of contingency funding options and projections; analysis of changes in coverage; in-house training to Agency staff on deposit payouts, risk analysis, strategy planning, and contingency financing; and support for a public awareness survey instrument design.

"The system underwent significant changes during the project. Particularly, the initial insurance coverage level increased, the Legal Entities have been added to the system, and the Law was amended to ensure approximation to EU standards. The risk based premium system has been introduced and a management information system has been developed."

Eliso Beridze
Financial Expert
Georgian Deposit Insurance Agency

OUTCOMES

The Agency has identified medium term strategic goals and prioritized actions, developed systems to better manage premium flows and insured deposits' payouts, introduced regulatory changes to increase level and scope of the deposit insurance scheme, introduced risk based contributions (premiums), amended instructions for banks' regular reporting to reflect these changes, is aware of risks and funding needs, has better trained staff, and is beginning to focus on raising public awareness of the scheme. Amendments to the Law on Deposit Insurance that expand the coverage to include legal entities under the scheme were adopted in early 2021 and enter into force in January 2022.

Outcome indicator	Assessment
Increased compliance with the IADI Principle 16 on reimbursing depositors.	**Achieved.** Management information system for reporting and deposit payout is operational, payout procedures have been drafted, and Deposit Insurance Agency staff have been trained.
Roadmap for approximation to EU Directive 2014/49/EU established.	**Achieved.** Agency adopted a Strategy Plan for 2020 – 2023. Georgian version published on Agency's web page;
Increased compliance with IADI Principle 8 on coverage.	**Achieved.** Deposit insurance scheme coverage for household deposits increased three-fold starting from July 1, 2020, and coverage was expanded to legal entities.
Risk-based premiums are introduced.	**Achieved.** Methodology for calculating risk-based premiums and individual premiums for all commercial banks for calendar year 2021 approved.
Increased compliance with the IADI Principle 9 on sources and uses of funds.	**Partially achieved.** Agency is aware of risks. Adoption of the formal procedures is pending.
Increased compliance with IADI Principle 10 on public awareness.	**Partially achieved.** Various public awareness events have been conducted. The public awareness survey was postponed to 2022 due to COVID-19.
Concept note/regulation on contingency financing arrangement approved.	**Partially achieved.** Agency is aware of contingency financing arrangements. Adoption of the formal procedures is pending.

Kosovo: Strengthening the Deposit Insurance Fund

COMPLETED PROJECT
PILLAR 1

The Deposit Insurance Fund of Kosovo is part of the financial safety net in the country. It has been established as an independent agency to insure deposits of natural and legal persons in member banks and compensate insured deposits in case of a license revocation according to the criteria and limits set by the Deposit Insurance Law. This project, building on earlier assistance, aimed to strengthen the Fund's internal governance, operational capacity, and readiness to respond to contingencies by creating an internal control and risk management framework. It also aimed to propose improvements to the Deposit Insurance Law, a key priority foreseen in its 2018-22 Strategic Plan.

In reviewing the Deposit Insurance Law, FinSAC identified a broad range of regulatory topics for potential amendment, encompassing the Fund's institutional mandate, approach to internal governance, requirements for member institutions, compensation procedures, and legal protection issues, among others. Developments at the European level regarding resolution financing were elaborated to the client so as to underpin a suggested legal approach, in view of Kosovo's upcoming resolution regime as specified in the draft Banking Law. Hands-on training was provided to facilitate empirical estimations of its fund size objective using supervisory data, extending previous support regarding the Deposit Insurance Fund's coverage and funding policies. An expert review of the draft risk management policy was performed against international standards and practices, clarifying the risk taxonomy, identification process, measurement, and mitigation strategies by the Fund, as well as relevant governance and control mechanisms.

Among the outputs of the project are a complete draft Law on Deposit Insurance with suggested wording for amendments, supported by detailed documentation of rationale and EU benchmarks; an Excel-based stress test calculation package for assessing Fund adequacy; and a risk management policy adopted by the Fund's Management Board in November 2021.

OUTCOMES

Through the legal review component, this project has facilitated further alignment by the Deposit Insurance Fund with the IADI Core Principles in broad terms, incorporating new administrative and procedural enhancements and formalizing previous technical assistance suggestions into the draft Deposit Insurance Law. The risk management policy component has improved adherence to Principles 3 (governance) and 6 (contingency planning and crisis management), as well as the 2020 IADI Guidance on Risk Management and Internal Control System. Building on FinSAC's role in the revision of banking and deposit insurance laws, further technical engagements to develop the Fund's capacity in implementing Kosovo's upcoming resolution regime are envisioned. The design of a business continuity plan will also be carried out by FinSAC in its 2022 engagement with the Fund.

Outcome indicator	Assessment
Risk management framework adopted by Deposit Insurance Fund of Kosovo Management Board.	**Achieved.** Risk management policy adopted by the Management Board during its November 2021 meeting.
Approval of the Concept Document by the Government. Preparation of a new Law, ready for submission for Parliamentary approval	**Achieved.** The need to prepare a full Concept Document was withdrawn by the client. A complete legal draft of the Law on Deposit Insurance was prepared and will be submitted by the Fund for the 2022 Parliamentary process through the Ministry of Finance.

Kosovo: Macroprudential Analysis and Financial Stability Policy Coordination

COMPLETED PROJECT PILLAR 1

FinSAC worked on this project with the Central Bank of Kosovo from May 2020 to November 2021. It aimed to strengthen the Central Bank's capacity to monitor emerging threats to financial stability in Kosovo and improve joint decision capacity for Central Bank, Ministry of Finance, and Deposit Insurance Fund officials to react to emergent systemic risks and manage future financial crisis, better supported by technical advice and regular monitoring analysis. The aims also included modernizing interagency policy coordination, improving understanding of the sustainability of credit growth in relation to the evolutions of demand and supply determinants, and strengthening the capacity of the Central Bank Financial Stability Department to utilize macroeconomic, supervisory, and transactional data to address empirical research questions.

Building on work as part of this project in 2020, which focused on the development of a methodology for estimating the growth rate of credit under an equilibrium setting, FinSAC assisted the Central Bank in testing a long list of demand- and supply-side determinants and characterized the contributions of macroeconomic and financial stability variables to historical market developments up to the onset of COVID-19 crisis. The actual credit growth path since 2020 were evaluated against counterfactuals without crisis support policies so as to inform the displacement in the quantity and price of credit intermediation, given ongoing macro financial development. Staff economists from the Central Bank's Department of Economic Analysis and Financial Stability were trained by FinSAC through a series of methodology workshops, covering topics including econometric approaches, programming techniques, and projections of policy scenarios in the COVID-19 context. A computational package including codes and calibration worksheets was also delivered to the Central Bank as part of the knowledge transfer, facilitating review and application of the empirical approach as documented in a methodology paper. Furthermore, taking into account the experience of conducting the empirical analysis, an assessment of data gaps for financial sector monitoring was also undertaken, based on a benchmarking exercise against the European Systemic Risk Board standards. While further internal capacity at the Central Bank is needed to replicate and adopt the analysis for policy purposes, the client appreciated the technical engagement, which offered insights into the possibility of employing existing macroeconomic and supervisory information to enhance the Central Bank's systemic risk surveillance framework.

Progress to support Kosovo's Financial Stability Committee faltered due to changes in the political landscape and reprioritizations of some signatories to the 2019 Memorandum of Understanding, despite efforts by FinSAC to facilitate renewed engagements in this area. It is hoped that consensus-building on the basis of previous agreements will be reinitiated.

OUTCOMES

The outcomes of this project include the development of analytical methodology for the evaluation of credit growth sustainability in Kosovo, as characterized in a background paper, as well as capacity building, including through transferal of analytical toolkits and practical training workshops. A gap analysis in the framework for systemic risk monitoring was also conducted and revealed areas for improvement particularly concerning household and corporate sector balance sheets, real estate market transactions, and credit portfolio conditions in the COVID-19 context.

While FinSAC's engagement as part of this project has advanced groundwork in financial stability monitoring and analysis, it fell short of realizing the objectives as originally envisioned to translate technical work into concrete macroprudential policymaking, in part due to capacity constraints and reprioritization among financial stability stakeholders in Kosovo caused by the pandemic. High-level commitment will be needed to facilitate continued modernization of work processes and operations in the Central Bank's strategic plan regarding financial stability in the medium term.

Outcome indicator	Assessment
A high-level committee of the financial stability committee hold biannual discussions to determine and implement crisis preparedness measures. Quarterly workgroup meetings to organize technical and analytical input in support of high level committee discussions. Availability of minutes and public statements regarding high level committee decisions.	**Not achieved.** While there is willingness from the client to operationalize the financial stability committee agenda as facilitated by FinSAC, the necessary political commitment has not yet reached a critical level to bring all stakeholders into renewed activity on the basis of the memorandum of understanding.
Progress in implementing recommended measures to address pressing macroprudential data gaps.	**Partially achieved.** A diagnostic exercise with input from the Department of Economic Analysis and Financial Stability identified the main monitoring gaps (private sector balance sheets, real estate market, and credit portfolio under COVID-19 relief measures). However, the design of an implementation strategy to address such shortcomings was not carried out given current capacity constraints.
The Central Bank undertakes internal evaluation of credit growth as part of enhanced systemic risk surveillance for macroprudential policy purposes. The Central Bank disseminates key findings to the high-level committee of the financial stability committee.	**Partially achieved.** An analytical methodology was prepared, summarized in a report, and the outcomes presented to the Department of Economic Analysis and Financial Stability. All staff at the Department received hands-on training on the implementation of the credit growth sustainability evaluation methodology. However, replication and continued implementation of the methodology faces constraints in terms of staff resources, before empirical results can be adopted by the Central Bank for macroprudential implementation purposes.

Moldova: Strengthening the Bank Resolution Framework

COMPLETED PROJECT PILLAR 3

Following the raider attacks, Moldova embarked on a comprehensive set of reforms to clean up the financial sector, with particular emphasis on improving shareholder transparency and bank diagnostics, to arrive at economically more meaningful measures of asset quality and capital. The authorities also pushed ahead with fundamental reform of the bank resolution framework, passing a new Bank Recovery and Resolution Law in 2016 (subsequently amended in 2020) that mirrored EU legislation.

This FinSAC technical assistance project was requested by the National Bank of Moldova as a continuation of earlier engagements aimed at operationalizing the toolkit to deal with failed banks. During 2021, it focused on the introduction of secondary regulation, as a first step in ensuring that banks have sufficient loss-absorbing instruments that can be either converted or written down if the bank is resolved. Activities also included assessment of the existing resolution planning framework and reviewing banks' resolution plans and resolvability assessment prepared by the National Bank. FinSAC offered a set of recommendations for streamlining the resolution planning process and supported their implementation.

FinSAC prepared and delivered two draft by-laws (on bail-in and minimum requirements for own funds and eligible liabilities) and a reporting template on the latter for submission by banks. The team also assisted the National Bank in answering the most relevant questions on resolution, preparing methodologies and templates, and resolving outstanding issues to operationalize the 2020 recommendations. Activities included workshops and the provision of methodologies to address separability issues in resolution, especially relevant when a significant proportion of the Moldovan banking sector is owned by foreign banking groups. The FinSAC team also reviewed the amended National Bank resolution planning procedure.

"We had a very close and efficient communication with the FinSAC team. At all stages, the experts consulted with us to identify topics of interest, the ways of cooperation and the agenda of the meetings organized during the assistance. Therefore, the entire assistance was useful, focused on covering the specific needs identified by us."

Maria Iovu
Head of Section, Banking Resolution Division
National Bank of Moldova

OUTCOMES

Most of the recommendations were satisfactorily addressed in 2021, although a minority (e.g. resolution scenarios) were postponed for 2022, which is a very positive development considering the large number of the issued recommendations. Furthermore, the FinSAC team offered assistance to the National Bank in the organization of a workshop with the sector to discuss the new approach to resolution planning to help banks gain a better understanding of their role and ensure a closer and more relevant involvement in the process.

Outcome indicator	Assessment
Minimum Requirements for Own Funds and Eligible Liabilities bylaw drafted and presented for approval.	**Achieved.** The draft by-law was prepared and entered the internal procedure for approval. It is expected to be approved in early 2022.
Secondary legislation related to bail-in drafted and presented for approval.	**Achieved.** The draft by-law was prepared and entered the internal procedure for approval. It is expected to be approved in early 2022.
Improved procedure for drafting resolution plans prepared and presented for approval.	**Achieved.**

Moldova: Bank Recovery and Supervision

2020 PILLAR 2 PROJECT, SUBJECT TO ENHANCED MONITORING IN 2021

This project was completed in 2020 (and reported in the 2020 FinSAC Annual Report) with enhanced monitoring for 2021 to assess progress towards the outcomes of a strengthened framework for bank recovery and resolution and a more robust supervisory framework that is further aligned with EU approaches.

Outcome indicator	Assessment
Methodology for assessing recovery plans is actively used by the National Bank of Moldova.	**Achieved.**
Recommendations identified in the Report followed up and implemented.	**Achieved.**

Moldova: Bank Resolution

2020 PILLAR 3 PROJECT, SUBJECT TO ENHANCED MONITORING IN 2021

This project was completed in 2020 (and reported in the 2020 FinSAC Annual Report) with enhanced monitoring for 2021 to assess progress towards the outcome of a strengthened legal and regulatory framework for bank resolution.

Outcome indicator	Assessment
Amended and improved Resolution Law in place.	**Achieved.** The draft by-law was prepared and entered the internal procedure for approval. It is expected to be approved in early 2022.
Secondary legislation issued and in force.	**Partially achieved.** Part of the work was transferred and completed in 2021, while some of the work will be completed in 2022 due to the large amount of work and need to complete some prior activities.
Upgraded 2020 Resolution Plans approved by the National Bank.	**Achieved.**
Amended and improved Deposit Insurance Law in place.	**Partially achieved.** The draft Law has been provided and it is expected to be adopted in 2022.

North Macedonia: Macroprudential, Crisis Preparedness, and Bank Recovery & Resolution

COMPLETED PROJECT PROGRAMMATIC MAINLY PILLAR 3 IN 2021

This project aimed to assist the National Bank of North Macedonia in macroprudential frameworks, crisis preparedness, bank recovery and resolution, and the development of a supervisory challenger model. The project was designed as programmatic technical assistance and was initiated in February 2019, following the 2018 Financial Sector Assessment Program Update. Originally it was scheduled to be completed in December 2020. In response to delays in reforms caused by COVID-19 disruption and the National Bank's need to focus on monitoring and responding to the crisis, the project was extended to the end of 2021.

Work on the macroprudential component started in 2019. In the area of macroprudential frameworks, FinSAC reviewed and provided detailed comments on the new draft memorandum of cooperation for maintaining financial stability. The memorandum aimed to delineate the roles and responsibilities of all financial sector regulators and the Deposit Insurance Fund in terms of macroprudential policy, crisis preparedness, and crisis management. The Memorandum of Understanding on Financial Stability was signed in April 2020 by all financial regulators. This was then used as the basis for a new draft Law on Financial Stability. FinSAC provided comments on the draft, which was released for public consultation in December 2020. This process was completed in 2021 and the draft Law was adopted by the Government and submitted to the Parliament for consideration. It is expected to be voted on in mid-2022.

> "FinSAC's experience and readiness to answer our questions and dilemmas were most useful. It assisted us in drafting the Law, understanding the relevant EU regulation and how it could be adapted to the local environment. The operationalization of the Law and its implementation will contribute to building a more resilient banking sector."
>
> **Lidija Pusevska Markovska**
> Senior Advisor
> National Bank of the Republic of North Macedonia

On bank recovery and resolution, FinSAC worked extensively with the National Bank on drafting a new Bank Recovery and Resolution Law and on establishing a Resolution Department in the National Bank. FinSAC supported the assessment of bank recovery plans, based on the recovery plan assessment methodology developed with FinSAC assistance in 2019. FinSAC also provided continuous assistance on the preparation of the new Law on Resolution through several virtual meetings and reviews of the draft Law. One specific area in which FinSAC provided advice and drafting assistance was on the articles related to minimum requirements for own funds and eligible liabilities. The approach for that section was to follow the EU BRRD 2 as closely as possible while tailoring it to the country context. Although progress on the Law slowed due to initial COVID-19 disruptions in early 2020, the insolvency of a small bank in the summer of 2020 provided new impetus to move the reforms forward. FinSAC support in 2021 focused primarily on bylaws for

"Assistance was tailor made i.e. it reflected the EU standards and legal provisions, but also took into account the characteristics of the domestic banking system. We did not feel that there was only one solution for each problem, but through discussions and exchange of views with the experts we have managed to produce what is best for our market."

Frosina Celeska PhD
Manager
Banking Regulations and Bank Resolution Department
National Bank of the Republic of North Macedonia

the bank recovery and resolution framework. In late 2021, the Resolution Law was in its final stages of review by the Ministry of Finance, before being sent to the Government for adoption and then to the Parliament for enactment. Some policy options on the framework remained under consideration. However, the authorities are keen to finalize the draft as soon as possible, aimed at approval by the Parliament in the first half of 2022.

The development of a supervisory challenger model started in 2019. The model was built to serve as a benchmark to assess banks' internal provisioning models for stress testing and other possible uses. Work on preparing the database and developing a draft rating system and risk quantification model, based on data stored in the National Bank's national credit and central registries, was completed in 2019. Staff then received intensive training on modelling techniques and directly applied acquired knowledge in the modelling process. However, work slowed down in 2020 due to COVID-19 and finalization of the supervisory challenger model was delayed. During 2021, the National Bank continued refining the corporate probability of default model. FinSAC experts provided support in carrying out this work and prepared the stage for building a loss given default model. A workshop was held on the validation of the model. By the time of project completion, the probability of default model for corporates was finalized, the model was validated through back testing, and a new batch of data was added (further years, construction of diverse macroeconomic scenarios) to enhance its predicting ability.

"The FinSAC technical assistance was useful regarding the appropriate internal organization to ensure operational independence and to prevent conflicts of interests in performing as a resolution authority and as a competent supervisory authority. FinSAC supported the preparation of a new Law and bylaws and amendments to other existing laws were discussed."

Blagica Skenderovska
Senior Advisor – Analyst
National Bank of the Republic of North Macedonia

OUTCOMES

The project was completed by the end of 2021 having already achieved its overall objectives of strengthening macro-prudential, micro-prudential, and bank recovery and resolution frameworks and contributing to building capacity at the National Bank. Outcomes included the preparation and adoption of a memorandum of understanding on financial stability, preparation of the draft Financial Stability Law and Bank Recovery and Resolution Law, and the finalization of the challenger model. The National Bank, through a letter in November 2021, conveyed its gratitude for the fruitful cooperation and effective implementation of the project and noted that work undertaken under the project had contributed to the European Commission Decision to consider the banking prudential requirements applied in North Macedonia as equivalent to those in the EU. The National Bank requested continued assistance to further operationalize the systemic risk and macroprudential framework, crisis preparedness, bank recovery and resolution, and development of a household probability of default model. FinSAC visited in December to discuss the details of the request and to program the new technical assistance.

Outcome indicator	Assessment
Financial Stability, Crisis Prevention and Macro-Prudential Frameworks	
Systemic risk monitoring framework is enhanced and used by the National Bank.	**Partially achieved.** Law on Financial Stability was adopted by the Government and expected to be enacted in the Parliament in 2022.
Upgraded Financial Stability Report.	**Not achieved.**
Financial Stability Committee is reconstituted and meeting regularly under the new structure and undertakes policy action.	**Achieved.** Memorandum of Understanding on Financial Stability was signed in April 2020 by all financial regulators.
Micro-Prudential Frameworks and NPL Resolution	
Internal model for obtaining probability of default is developed and used by the National Bank.	**Achieved.** A probability of default model for corporates has been built. The model was validated through back testing and new batch of data was added (further years, construction of diverse macroeconomic scenarios), to enhance its predicting ability.
Bank Recovery and Resolution	
New Resolution Law is adopted.	**Partially achieved.** The draft Law is prepared and discussed with the National Bank and expected to be approved in 2022.
Internal methodology for assessing recovery plans is developed and used by the National Bank and assessment letters are drafted and sent to banks.	**Achieved.** Recovery Plans for systemic banks reviewed according to the methodology and letters were submitted to the banks.

Ukraine: Bank Recovery, Resolution, Micro-Prudential, and NPLs

COMPLETED PROJECT PROGRAMMATIC MAINLY PILLAR 2 IN 2021

This programmatic project assisted Ukraine in several areas. The first was bank recovery and resolution and deposit insurance. This aimed to realign the sub-laws/regulations of the National Bank of Ukraine and Deposit Guarantee Fund with the overhauled bank resolution and deposit insurance legal framework that introduces the BRRD and Deposit Guarantee Scheme Directive in Ukraine. The project worked to ensure the Ukrainian Parliament adopted a legislative package introducing the new framework and then the revised sub-laws and regulations.

The second focus area was banking supervision and regulation. This aimed to bring Ukraine closer to international standards in the areas of capital adequacy and liquidity for banks and improve the quality of banking regulation in line with international standards. FinSAC also supported the authorities to establish a leverage ratio for banks, amend the regime for large exposure limits, and initiate a risk weight asset calculation for credit risks under the Basel standardized approach.

The third focus area was NPL resolution, aimed at implementation of the new NPL Governance and Workout Regulation. This included NPL workout strategies and resolution planning, as well as enhancement of the asset valuation framework in Ukraine. A focus in 2021 was on state-owned banks, that account for the bulk of the outstanding stock of NPLs. FinSAC actively worked with the State Property Fund to improve the asset valuation framework by contributing to the development of an automated asset valuation model and helping to improve the Valuation Law.

OUTCOMES

The project contributed to 1) an improved bank recovery and resolution framework and increasing alignment with the EU (as stipulated in the EU Association Agreement), 2) enhanced bank supervision and regulations, 3) creating an environment more conducive to reducing NPLs and reduce Ukrainian banks' exposure to troubled assets, and 4) the alignment of asset valuation practices with international standards.

"The most helpful part is article-by-article amendments to the Law of Ukraine on Households Deposit Guarantee System taking account of national resolution peculiarities and practical experience of implementing resolution tools."

Olga Bilay
Deputy Managing Director
Deposit Guarantee Fund of Ukraine

Outcome indicator	Assessment
Draft amendments to regulations and sub-laws are adopted by National Bank and Deposit Guarantee Fund.	**Partially achieved.** The draft Law has been developed and is expected to be submitted to Parliament by end-March 2022.
Draft amendments to banking regulations are adopted and enforced by National Bank. Endorsement of new net stable funding ratio by National Bank Board.	**Partially achieved.** New regulations on liquidity coverage ratio, net stable funding ratio, and new capital structure have been adopted and enacted. The last few remaining elements of Basel III are in the implementation stage.
Report recommendations are implemented by National Bank and Ministry of Finance. Improvement of asset quality indicators, including (i) reduction of the stock of legacy NPLs and (ii) reduction of the NPL ratio.	**Achieved.** (i) NPL ratio dropped from 41.0 percent in December 2020 to 30.7 percent in December 2021, (ii) NPL coverage ratio increased to 99 percent in December 2021. (National Bank of Ukraine Financial Stability Report).

Uzbekistan: Banking supervision and regulation

ONGOING PROJECT INTO 2022 - PILLAR 2

Building on FinSAC 2019-20 technical assistance, this ongoing FinSAC project is helping the Central Bank of Uzbekistan to further improve its prudential regulatory and supervisory framework and close identified gaps relative to the Basel Core Principles. Specifically, it helps implement a risk-based supervisory approach—including advancing supervisory internal procedures, guidelines, and products; implementing the framework for early supervisory interventions; and providing hands-on training to increase the Central Bank's capacity to supervise banks effectively. During 2021, several new regulations and amendments thereof were developed and approved, including those on internal audit, external audit, and asset classification. A number of internal regulations were developed for the Central Bank, including a supervisory manual on risk based-supervision (*work in progress*), bank licensing manual, domestic systemically important banks methodology, and manual on sanctions and early supervisory actions (*work in progress*). Moreover, FinSAC is supporting the Central Bank's preparation of a multi-year SupTech strategy to reform data collection, processing, and analytics. The project is also providing on-going advice on supervisory and regulatory measures related to the COVID-19 pandemic. These activities remain critical for enhancing the Central Bank's supervisory effectiveness and fostering financial stability.

Chapter 5: Knowledge Activities in 2021

THIS CHAPTER OUTLINES FINSAC'S KNOWLEDGE ACTIVITIES DURING 2021. FINSAC COMPLETED THREE KNOWLEDGE PROJECTS IN 2021. THESE ARE SUMMARIZED BELOW TOGETHER WITH AN ASSESSMENT OF THEIR OUTCOMES AGAINST THE INDICATORS SET FOR THEM. SIX KNOWLEDGE ACTIVITIES ARE ONGOING INTO 2022. THIS CHAPTER ALSO SUMMARIZES FINSAC PARTICIPATION IN EXTERNAL EVENTS RELATED TO FINANCIAL STABILITY IN ITS ROLE AS A KNOWLEDGE CENTER.

Policy Note on NPL Resolution in ECA Region

COMPLETED KNOWLEDGE ACTIVITY – PILLAR 2

In an effort to respond to the financial stability challenges brought on by the pandemic, FinSAC prepared a series of policy notes in the early stages of the COVID-19 pandemic on moratoria and borrower relief measures, followed by a note published end-2020 about NPL resolution. Aggregate NPL ratios generally remained stable while moratoria and other borrower support measures were in place, but policymakers and bankers anticipated that rising levels of borrower distress would inevitably translate into fresh pressures on asset quality in the banking sector that over time would become increasingly apparent in banks' earnings, capital, and financial statements. These developments give a renewed relevance to the NPL resolution agenda, discussed in the policy note. The note identified a series of lessons from the ECA region's experiences in NPL resolution in the aftermath of the global financial crisis that were relevant for actions in addressing the impact of the pandemic. The paper adopted a holistic perspective on NPL resolution by discussing three mutually reinforcing components: regulatory and supervisory policies relevant for the timely identification of NPLs, bank-led and system-wide measures for resolving large volumes of NPLs, and the enabling legal environment.

FinSAC focused in 2021 on dissemination of the NPL note and its key messages, with well-attended separate sessions for client countries and for internal World Bank audiences. A set of four online presentation events were held, first a high-level walkthrough of the note and the main policy recommendations, followed by three technical sessions focusing on (i) priorities for banking regulation and supervision aimed at ensuring a timely recognition of problem loans, and avoiding the occurrence of uncaptured credit risk; (ii) strengthening banks' operational readiness to work out rising volumes of problem loans, and public policy interventions supplementing banks' individual NPL resolution efforts; and (iii) the legal, regulatory, and institutional environment for NPL resolution, that affects the ease and speed with which problem loans can be worked out, enforced, or sold.

OUTCOMES

The policy note was well-received and the presentations were well attended, with 180, 190, 180, and 210 participants respectively at each of the four sessions. The note has also been translated into Russian and Arabic, to expand its potential outreach.

Outcome indicator	Assessment
Policy paper downloaded Client country participation in webinars/ outreach events	**Achieved.** Paper (in three language versions) distributed to interested parties and available on FinSAC website (99 additional downloads of English version). At least 180 participants at each event.

Financial Sector Cybersecurity: A Regulatory Digest 6th Edition

COMPLETED KNOWLEDGE ACTIVITY – PILLAR 1

FinSAC published a 6th edition of its Cybersecurity Digest on its website in mid-September 2021 which included 67 new documents. Cybersecurity concerns remain high on the global agenda, with a proliferation of ransomware, supply chain attacks through third party providers, and wide-spread exploits of vulnerabilities in software. The Digest aims to help authorities update existing regulations that mitigate cyber risk challenges to financial stability and strengthen financial sector resilience to cyber incidents. The Digest gathers all recent laws, regulations, guidelines, and other significant cyber-security literature for the financial sector in one accessible reference document, organized in reverse chronological order. The Digest aims to address a gap identified by FinSAC between traditional counterparts in supervision and the more technical staff inside and outside the financial sector regulatory and supervisory institutions. The Digest offers financial sector authorities a 'one-stop shop' to familiarize themselves with cyber-risk issues and practices.

FinSAC also began planning ways to further operationalize the Digest. These include convening "webinars" for external clients, especially for a more senior audience in supervisory and regulatory authorities who may not be familiar with the importance and role of cyber resilience to the stability of the financial sector. A presentation on the Digest was included in a webinar on cybersecurity for the financial sector hosted by the World Bank Seoul Center in December with a wide audience from the East Asia Pacific region and beyond.

OUTCOMES

This activity enables client authorities to acquire a better understanding of different jurisdictions' cybersecurity regulations and practices and enhances the World Bank as a trusted adviser and convener in developing/assessing cybersecurity regulations. The Digest was noted as a useful resource in publications including the Carnegie Endowment for International Peace's International Strategy to Better Protect the Financial System Against Cyber Threats and in the Cybil Portal by the Global Forum for Cyber Expertise. It has been a catalyst for discussions and knowledge sharing. As a result of interest in the Digest, for example, FinSAC connected the National Bank of Georgia (previous FinSAC cybersecurity focused technical assistance client) to present their cybersecurity tools and references to the Digest at the Financial Inclusion Global Initiative Symposium in June and responded positively to an approach by FinCoNet – a network of supervisory authorities with financial consumer protection responsibilities, hosted at the Organisation for Economic Co-operation and Development – for a panelist on 'Market Conduct Supervisors Responding to the Impacts of the COVID-19 Pandemic' during their 2021 Annual General Meeting.

Outcome indicator	Assessment
1. # of downloads and views of the Digest. 2. # of Webinar participants. 3. Inquiries for cybersecurity expertise, mention of the Digest, or feedback on its usefulness. 4. Technical assistance requests made related to cybersecurity. 5. Regulatory and supervisory reforms in client countries to enhance cyber resilience. 6. Number of new/updated cyber regulations informed by the Digest.	1. **Achieved.** 528 views of LinkedIn post of the 6th edition. 82 downloads from FinSAC website. 2. **Partially achieved.** Digest included in East Asia Pacific webinar (93 participants from 11 countries). FinSAC webinar planned. 3. **Achieved.** Acknowledgement in global publications and requests for discussions and panel invitations. 4. None in 2021. 5. & 6. These outcomes require a longer time horizon to observe.

Judicial Practice of Bank Resolution: Collection of Selected EU and USA Court Rulings

COMPLETED KNOWLEDGE ACTIVITY – PILLAR 3

The FinSAC paper on court rulings concerning appeals against bank resolution/liquidation decisions was published in June 2021. The paper was developed in response to demand from client countries, who were looking for guidance on the role of the judiciary in bank resolution and liquidation. It includes rulings from EU countries and the United States, covering a variety of legal aspects pre and post BRRD. Case studies aim to provide a source of information for authorities and to support FinSAC technical assistance projects, for example as guidance in the design of resolution regimes and on the alignment of resolution frameworks with international good practice, to assess potential litigation risks, as well as improve understandings of constitutional and fundamental rights concerns in bank resolution.

OUTCOMES

The paper aims to increase understanding of international principles of bank resolution and support decision makers when preparing regulatory changes, in the adoption of bank resolution decisions and possible litigations, and on action for damages against them. In addition, the collection is a valuable reference source for FinSAC technical assistance projects.

Outcome indicator	Assessment
Correct / increased interpretation of current local legal resolution framework. Judicial decisions which are in line with good international practice.	**Partially achieved.** It has been widely disseminated among the target readership and should be useful background for judges and others in informing their understanding and judgments, but this will only become evident over time.

Supervisory Challenges and Green Transition in Post-pandemic Environment

ONGOING KNOWLEDGE ACTIVITY INTO 2022 – PILLAR 2

FinSAC has been unable to hold its annual international gathering for the last two years due to the COVID-19 pandemic restrictions on travel and meeting. Rather than add to the overload of virtual meetings, it was decided to again postpone this set piece event in the hope of being able to host an in-person event in 2022. It is now scheduled for May 2022—ideally in Vienna but, if need be, in a mixed format or virtually. The objective is to once again bring together colleagues from client countries with a range of international experts to discuss the series of critically important regulatory and supervisory topics, including the challenges that authorities may face in the post-covid environment, while transitioning to more advanced credit risk assessment methodologies. As countries seek to build back better and greener the conference will also focus on how an emphasis on sustainability can be operationalized in new and improved regulatory and supervisory frameworks.

Financial Stability Committees in Eastern Europe and Central Asia – a Stocktake

ONGOING KNOWLEDGE ACTIVITY INTO 2022 – PILLAR 1

Work continued in 2021 on examining the extent to which the performance of financial stability committees in facilitating macroprudential policies can be attributed to their underlying design features. Analysis continued of institutional arrangements for the monitoring and timely mitigation of threats to financial stability. In 2020, a detailed stock-take was undertaken of de jure institutional characteristics, in terms of mandate, legal basis, power, lead agency, and decision-making mechanism. In 2021, FinSAC continued to quantify the technical assessments regarding the severity of systemic risk factors, including on general credit and liquidity conditions, sectoral risks, and transmission channels. This was accomplished by applying natural language processing methods to a large body of financial stability reports and other official documents to determine the perceived intensity of specific risks over time. Work also continued on classifying implemented macroprudential policies, as documented by the International Monetary Fund, World Bank, European Central Bank, and previous research. The aim is to provide guidance on the optimum design of financial stability committees for client countries, and the research and findings are already informing FinSAC discussions in this area. The final paper was due to be published in 2021 but time pressures prevented its completion. It will now be published on the FinSAC website in 2022 and shared with relevant contacts.

Policy Note on Bank Crisis Management in ECA Region

ONGOING KNOWLEDGE ACTIVITY INTO 2022 – PILLAR 3

Economic challenges stemming from the COVID-19 crisis could affect banks' capital and liquidity buffers, if corporates and individuals experience difficulties servicing their debt obligations, resulting in loan-loss provisions to cover credit losses. Subdued client activity may also result in lower bank revenues. This increases the risk of banks facing difficulties in meeting capital adequacy requirements, or even outright failure. Supervisors and other resolution authorities must be prepared for the possible need to use the early intervention measures and special resolution regimes that have been introduced across the region. However, while these enhanced early intervention and bank resolution frameworks strengthen authorities' capacity to manage idiosyncratic banking crises, it is less clear whether and how these new tools could be applied in the context of potentially broad-based banking distress following a horizontal shock that originated in the real economy, rather than the financial sector. Situations may arise that require the use of systemic rather than bank-specific resolution tools, with a potential role for public backstops.

FinSAC are working on a policy note, to be published in 2022, that aims to provide guidance to supervisory and resolution authorities in client countries on the use of existing early intervention and bank resolution frameworks, their limitations, and possible systemic policy responses aimed to overcome them.

Cyber-Crisis Management for Financial Sector Authorities

ONGOING KNOWLEDGE ACTIVITY INTO 2022 – PILLAR 1

The aim of this project is to raise awareness and help prepare financial sector authorities to manage cyber incidents in their own institutions and the institutions they regulate and supervise. Given the interest in its Cybersecurity Digest, FinSAC will publish two further editions. To add value, future editions will include notes to assist policymakers to quickly grasp the pertinent topics in cybersecurity: describe recent cyber threats, outline trends in regulation and supervision of cyber risk in the financial sector, and discuss relevant topics to better guide authorities and promote.

There will be enhanced dissemination efforts and a greater emphasis on use of the Digest as a catalyst for FinSAC technical assistance, for example cyber-crisis simulation exercises. FinSAC webinars will be held after publication of each new edition for client countries to discuss the policy implications of selected topics. Opportunities will be sought to include discussion and dissemination of the Digest in regional conferences and/or through other events for financial sector authorities and the authorities of supervised institutions to reinforce the importance of improved cybersecurity practices across jurisdictions.

Policy Brief on Big and Small Bank Resolution

ONGOING KNOWLEDGE ACTIVITY INTO 2022 – PILLAR 3

The Policy Brief aims to deepen decision makers' understanding on the legal safeguards required in light of fundamental rights protection for different types of resolution powers. It makes the case for the introduction of a broader harmonized bank resolution framework which is applicable to all banks, irrespective of their size, under a two-tier legal safeguard. This policy brief suggests that the principle of "no public interest = no bank resolution", as currently established under the BRRD, is too restrictive for most FinSAC client countries that do not require full alignment with the BRRD. Instead it is argued that more emphasis should be put on making basic resolution powers, like purchase and assumptions, operational also for small(er) banks.

The paper will analyze issues FinSAC client countries encounter when aiming to adapt good international and EU bank resolution practice to the local context and suggest a general analytical framework to inform the design of effective, legally sound, and implementable bank resolution schemes. Activities completed so far include an analysis of resolution systems in FinSAC client countries and a comparative analysis with the EU and the US, taking into account evolving case law in the EU. The Policy Brief will be sent for internal and external review in early 2022 and is planned to be published in Q2 2022.

Paper on Related Parties Transactions and Associated Risks

ONGOING KNOWLEDGE ACTIVITY INTO 2022 – PILLAR 2

This FinSAC knowledge product, *Banks' Transactions with Related Parties: Why We Should Care More about the Risks?* aims to strengthen supervisory authorities' capacity to effectively oversee related parties transactions and associated risks and their operational readiness to preempt problems that may lead to bank failure.

As policymakers in emerging and developing countries have focused on implementing the post-global financial crisis regulatory agenda this has inevitably taken some attention from basic prudential topics, such as problems arising from related parties transactions. Multiple recent cases of bank failures highlight the issue of inter-related lending (loans to shareholders, affiliates, and associates) often involving complex circles of financing that easily escape scrutiny. The paper aims to address the lack of guidance on how to treat risks associated with related parties transactions. It will consider the role of related parties transactions in specific bank failures; discuss the different types of related parties transactions and associated risks from a supervisory standpoint: and outline the most recent developments and regulatory best practices to address related parties transactions risks, including the role that Fintech and big data can play to foster surveillance of risks deriving from related parties transactions.

The team has conducted several country visits in a sample of targeted jurisdictions, both advanced (e.g. Portugal, Spain, and Ireland) and emerging (Moldova and Ukraine), where related parties transactions problems have been acute. Discussions with supervisory authorities and banks have provided important insights to the team, in particular on domestic legal regimes, supervision of connected lending, and recent regulatory reforms taken to address the related parties transactions problem (e.g. issuance of code of practice on lending to related parties). Concomitantly, discussions with standard setters and regional bodies were arranged, including with the European Banking Authority and the European Central Bank. Desk review of a collection of reports produced in the context of Financial Sector Assessment Programs has also been performed and allowed the team to identify main issues and weaknesses around RPTs in client countries. While the pandemic has delayed the completion of this project, drafting of the report is on-going and should be finalized by mid-2022.

EXTERNAL KNOWLEDGE SHARING ACTIVITY

As a knowledge center, FinSAC is often asked to take part in events and activities related to financial stability by a wide range of partners. In 2021 these included:

March 30: FinSAC met with the European Commission Directorate-General for Financial Stability, Financial Services and Capital Markets Union to discuss and exchange views on the ongoing EU reform agenda on **crisis management, resolution, and deposit Insurance**.

May 14 and **June 4**: FinSAC organized two virtual workshops related to **NPL resolution** for Tunisian authorities at the request of the Central Bank of Tunisia. The first focused on asset management companies for participants from institutions including the Central Bank, Ministry of Finance, Ministry of Justice, Ministry of Economy and Planning, and local banks. During the workshop, international examples and key preconditions for establishing an asset management company were presented. The second workshop, on corporate viability assessment frameworks, provided local authorities an opportunity to review different approaches on how to assess the financial viability of companies. The expected exit from COVID-19 debt payment moratoria in Q3 2021 and associated increase in NPLs were the main reasons for organizing this workshop. Close to 90 local experts participated and there are high expectations that some of the principles discussed could be implemented in Tunisia.

May 18-21: FinSAC presented on "Challenges in establishing efficient **bank resolution** frameworks in FinSAC client countries" to the Deutsche Bundesbank online course, "Recovery and Resolution with a focus on Credit Institutions".

May 20–June 10: FinSAC presented on NPL resolution for an Asian Development Bank/Joint Vienna Institute online training targeted to Asian asset management companies. FinSAC explained collateral valuation approaches in ECA and organized two working sessions with practical examples of **NPL resolution** for viable and non-viable companies.

Positive feedback was received from the almost 50 participants from 8 countries.

July 12-16: FinSAC organized the third Joint Vienna Institute/FinSAC/European Central Bank Online Course on **NPL Management and Resolution**. The event was targeted to central bank and ministry of finance experts from ECA region. FinSAC presentations addressed the situation with NPLs in Emerging Europe, borrower relief measures in ECA region, corporate restructuring, and collateral valuation.

September 30: FinSAC participated in a panel discussing "**resolution tools and approaches** for small banks and small jurisdictions" at a virtual seminar organized by the South East Asian Central Banks/Bank of Japan/Financial Stability Institute/International Association of Deposit Insurers on problem bank intervention and resolution.

September 27-October 1: FinSAC presented on methods for **assessing corporate viability** at the Joint Vienna Institute's online course on policy support to the private sector.

November 4: FinSAC presented at a workshop on regulatory frameworks for **NPL resolution** and private sector participation organized by the International Finance Corporation in cooperation with the State Bank of Vietnam aimed at deepening knowledge of NPL resolution options for Vietnamese experts from the state and private sectors.

November 25-26: FinSAC presented at the 2nd Asian Development Bank virtual training course on **NPL resolution**. The event was targeted at asset management company experts from Asia. FinSAC experts provided presentations on collateral valuation, loan restructuring, and conducted two case studies (Excel based) on resolving viable and non-viable NPLs.

Chapter 6: Impact and Results

CHAPTERS 4 AND 5 INCLUDED AN ASSESSMENT OF OUTCOMES FOR EACH OF THE PROJECTS COMPLETED IN 2021. THIS CHAPTER SUMMARIZES THE RESULTS OF FINSAC ACTIVITIES IN 2021 AND CLIENTS' PERCEPTIONS OF THEIR IMPACT.

This second year of work under COVID-19 conditions was much easier for both clients and the FinSAC team as all had fully adjusted to the new modus operandi. This allowed improved productivity and results. Although it was still not possible to organize physical missions and work with clients directly in the field, all parties gave their best to overcome the challenges and find ways to work effectively together. The absence of mission travel allowed the FinSAC team to support multiple countries at the same time, increasing productivity and responsiveness.

Demand for FinSAC support continued to be strong, showing that even in these exceptional circumstances FinSAC is a reliable partner to clients, ready to devote its expertise and work with them on building stronger and more resilient financial sectors.

The reform of financial systems is a long-term process, and its effects are not immediately visible. Each technical assistance therefore includes monitoring during the project and indicators for monitoring after the technical assistance is completed (sometimes immediately but for others at a fixed future point, for example one year after project completion).

A Snapshot of 2021

FinSAC completed a total of 13 projects during 2021, 10 country specific technical assistance projects (out of which four were programmatic) and three knowledge products with a regional focus. With this, FinSAC fulfilled its commitment to complete at least ten technical assistance projects and at least one analytical paper per year.

Work was undertaken within each of FinSAC's three pillars. Four programmatic approach projects were completed in 2021, in Albania, Armenia, North Macedonia, and Ukraine. These projects included different elements of engagement across two or three of the pillars. For the purposes of this section, however, each has been assigned to one pillar which represented the bulk of work in the project.

FinSAC knowledge products covered topics of NPL resolution, court rulings related to bank resolution, and cybersecurity regulation. Unfortunately, for a second year FinSAC was unable to organize its annual conference, due to the COVID-19 situation. Smaller, online knowledge events, as part of technical assistance projects, were however possible.

Table 1 presents a complete overview of all projects by pillars and deliverables.

Table 1: Structure of completed projects by deliverables, pillars, and countries

Completed products by deliverables	Pillar 1	Pillar 2	Pillar 3	Total
Knowledge events/products	1	1	1	3
Technical assistance	4	3	3	10
Total	5	4	4	13
Completed products by country/pillar	**Pillar 1**	**Pillar 2**	**Pillar 3**	**Total**
Albania*	1	1	1	3
Armenia*	-	1	-	1
Georgia	1	-	-	1
Kosovo	2	-	-	2
Moldova	-	-	1	1
North Macedonia*	-	-	1	1
Ukraine*	-	1	-	1
Regional	1	1	1	3
Total	5	4	4	13

* Projects in Albania, Armenia, North Macedonia and Ukraine were Programmatic Approaches. However, in this table we assigned them to the pillar in which the majority of work was done.

Table 2: List of completed technical assistance projects and knowledge products in 2021

Country	Technical Assistance
Albania	Deposit Insurance: Legal and Regulatory Review
Albania	Programmatic Approach on Bank Supervision, Resolution, DGS and NPLs
Albania	Implementation on FINREP Prudential Reporting
Armenia	Programmatic Approach on Risk-based Supervision and Financial Sector Safety Net
Georgia	Strengthening the Deposit Insurance Agency
Kosovo	Strengthening Deposit Insurance Framework
Kosovo	Macroprudential Analysis and Financial Stability Policy Coordination (Credit Growth Analysis)
Moldova	Strengthening Bank Resolution Framework
North Macedonia	Programmatic Approach on Macroprudential, Crisis Preparedness, and Bank Recovery and Resolution
Ukraine	Programmatic Approach on Bank Recovery, Resolution, Micro-Prudential, and NPLs
Date	**Knowledge Events/Products**
Q1, 2021	Policy Note on NPL Resolution in ECA Region
Q2, 2021	Judicial Practice of Bank Resolution: Collection of Selected EU and USA Court Rulings
Q3, 2021	Financial Sector's Cybersecurity: A Regulatory Digest (6th Edition)

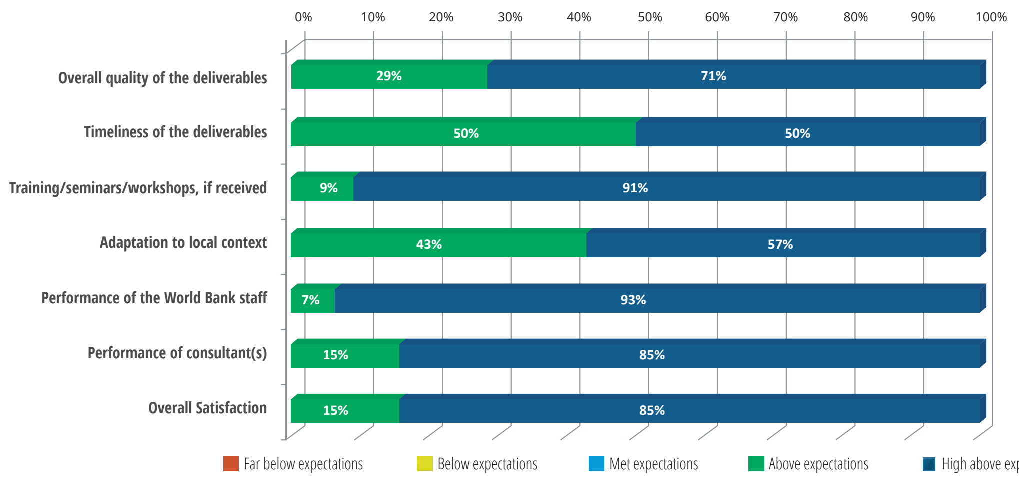
Client country feedback

An integral part of the annual report each year is the client feedback survey. This invites client countries' input on projects completed that year. It seeks to help FinSAC better understand the effectiveness of its projects, identify drivers of clients' demand, assess satisfaction with technical assistance projects, and identify areas for improvements. Furthermore, it provides a good overview of the main topics of interest for FinSAC client countries to help guide the design and targeting of new products.

The survey is designed such that for each project one response is collected. However, as the programmatic projects involve different workstreams and authorities, where multiple parties are involved, separate responses were collected for each workstream. This year the response rate was 95.5 percent. Despite the COVID-19 challenges and travel restrictions, feedback for 2021 showed the highest client satisfaction since 2017 when the survey was introduced.

FinSAC clients reported high satisfaction in all aspects of provided technical assistance (each category was assessed 4.5 or higher out of 5). The performance of World Bank staff received the highest score (average 4.93 out of 5, compared to score 4.6 in 2020) followed by the training and seminars provided (average 4.91 out of 5, compared to 4.57 in 2020). The timeliness of deliverables remains the weakest point, although still scoring relatively high at 4.5 out of 5. This is a significant improvement compared to last year when the score was 3.6 out of 5. This year all participants responded that all aspects of technical assistance provided to them were above or significantly above their expectations. Figure 1 presents the breakdown of different aspects of technical assistance and clients' satisfaction with them.

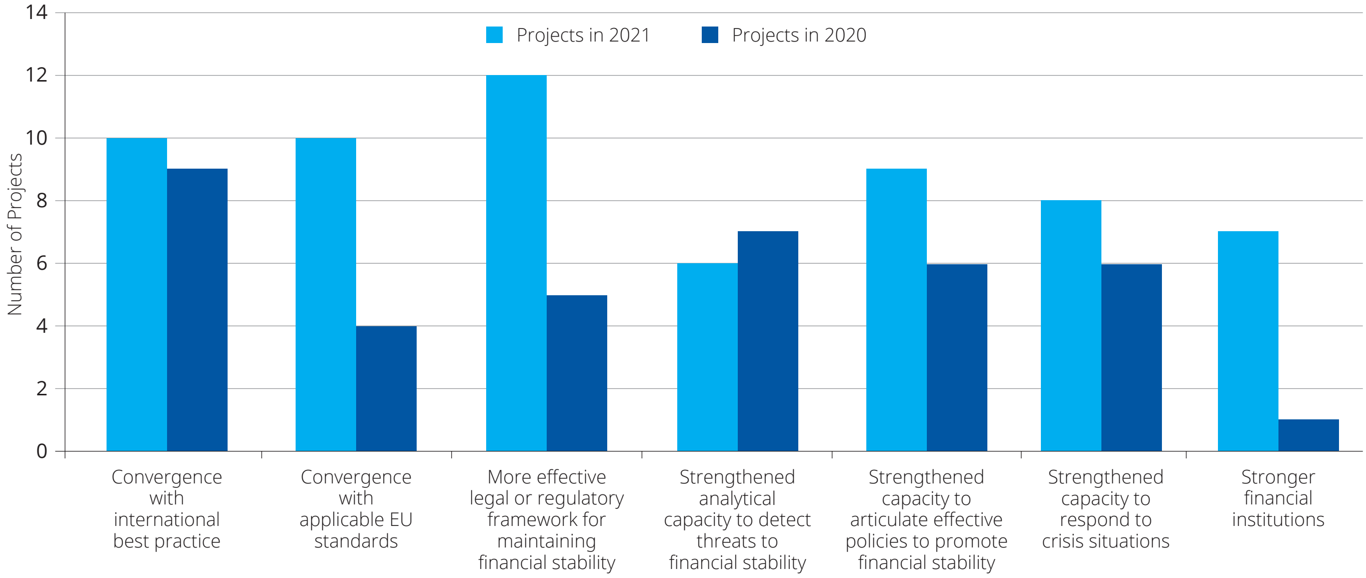
Figure 1: Client satisfaction with FinSAC technical assistance



2021	2020	2019	2018	2017
4.71	4.10	4.11	4.00	N/A
4.50	3.60	4.00	4.08	3.90
4.91	4.57	4.25	4.10	4.11
4.57	4.10	4.11	4.00	4.11
4.93	4.60	4.67	4.37	4.40
4.85	4.63	4.13	4.46	4.37
4.85	4.30	4.22	4.19	4.20

Clients' reflections on the short- and medium-term outcomes of FinSAC technical assistance clearly show that certain goals became more prominent than before. More effective legal and regulatory framework for maintaining financial stability was recognized as a key outcome of FinSAC supported projects by most participants. Convergence with international best practice and applicable EU standards were also assessed as important outcomes by many. Finally, there was a significant increase in participants recognizing stronger financial institutions as a main outcomes of technical assistance provided this year. Figure 2 shows clients' views on the main outcomes of the technical assistance provided by FinSAC.

Figure 2: Main outcomes of FinSAC technical assistance in 2021



When asked about ways in which technical assistance could be improved, there were clear indications that clients were keen to be able to once again have contact in person and not just virtually. As one client pointed out, the physical presence of a FinSAC expert allows for the widest possible discussion of the issue and enables questions or any gaps in understanding to be addressed immediately. Another client asked for more technical details to be included in some of the internal guidelines.

A majority of clients hoped for further cooperation with FinSAC and expected to request follow up projects. The main areas of future work they identified included interagency coordination, operationalization of resolution regimes, introducing or strengthening the supervisory approach to green finance, and the identification of financial stability risks stemming from climate change.

Chapter 7: 10 years of FinSAC

THIS CHAPTER MARKS 10 YEARS OF FINSAC ACTIVITIES FROM ITS VIENNA BASE, SUMMARIZING SOME OF ITS ACHIEVEMENTS AND REFLECTING ON ITS IMPACT IN FOUR CLIENT COUNTRIES.

The global banking crisis of 2008–2009 highlighted a need to address complex financial sector development issues. The activities under the Vienna Initiative and cooperative approach by International Financial Institutions and public and private entities inspired the creation of a dedicated World Bank technical assistance unit to go beyond the short-term crisis response and provide longer-term support. It was agreed that the effective delivery of best practice financial sector advisory services aimed at strengthening prudential regulatory and supervisory frameworks in European candidate and neighborhood countries, should be supported through the creation of FinSAC.

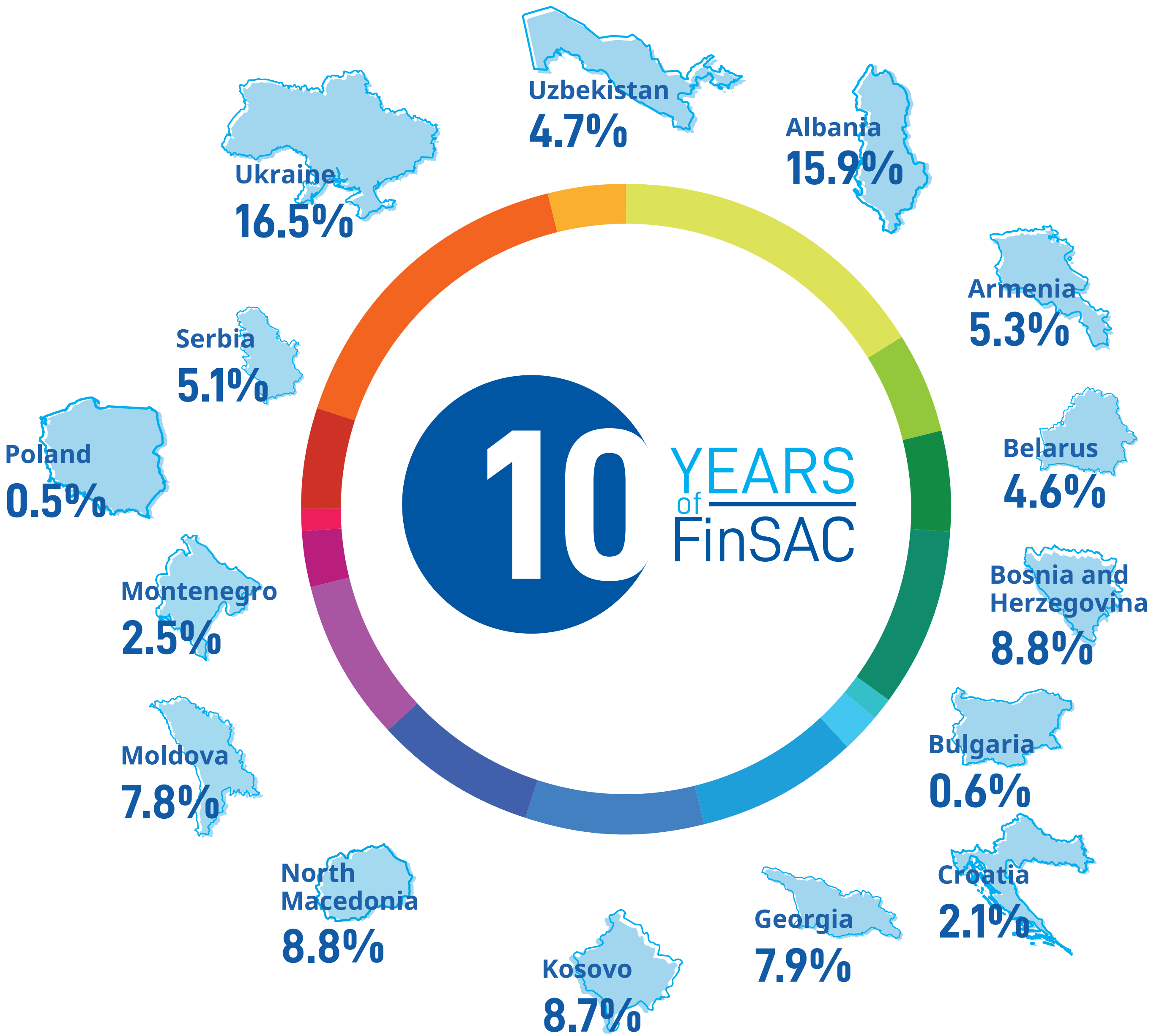
Thanks to the close collaboration and generous financing of the Austrian Federal Ministry of Finance, FinSAC opened as a regional knowledge sharing and advice center based in Vienna in 2011. This geographical proximity to beneficiary countries and key EU institutions, along with a targeted focus on financial technical assistance, was considered essential for close coordination with all stakeholders.

FinSAC opened its offices in September 2011 with a core staff of five, assisted by consultants and World Bank headquarters staff. It began with overall objectives to address financial stability issues focused on 1) crisis prevention and macro-prudential regulatory frameworks; 2) micro-prudential regulatory frameworks (Basel III, Capital Requirements Directive IV, home/host issues, bank core capital, NPL workouts); 3) bank recovery and resolution (improving legal and institutional frameworks and closer alignment with updated EU requirements); and 4) consumer protection and financial literacy.

Over its 10 years of operation, it has grown and evolved in response to events and client country needs. By 2021, FinSAC has become widely acknowledged as a center of excellence for targeted knowledge and technical assistance.

FinSAC has completed technical assistance projects and knowledge events in 15 client countries over the last 10 years. It has additionally offered its expertise for projects in other countries, for example in Romania funded by the EU.

Percentage of FinSAC projects in each client country 2011-2021



Completed FinSAC technical assistance projects 2011-2021

Albania

- 2013-15: Recovery and Resolution Plans
- 2015: Crisis Simulation Exercise
- 2013-16: NPL Resolution
- 2015-16: Legal Reform – Banking Resolution Framework
- 2015-16: Assessment of Recovery Plans for Systemic Banks
- 2017-18: Guidelines for the Implementation of Multi-Lender NPL Restructuring “London approach"
- 2017-19: Assessment of Recovery Plans for Systemic Banks
- 2017-19: Bank Resolution Framework
- 2019-20: Deposit Insurance Strengthening
- 2019-21: Bank Supervision, Resolution, and Deposit Guarantee Scheme
- 2021: Deposit Insurance Legal and Regulatory Review
- 2021: FINREP Reporting

Armenia

- 2014-15: Crisis Simulation Exercise
- 2016-18: Cyber Crisis Simulation Exercise
- 2020-21: Diagnostic on Crisis Management and Supervisory Framework
- 2021: Risk-Based Supervision and Financial Sector Safety Net

Belarus

- 2017-19: Improvement of the Bank Resolution Framework
- 2017-19: Strengthening Deposit Insurance Framework
- 2019: Assessment of Cybersecurity Regulations

Bosnia and Herzegovina

- 2013-14: Macroprudential Capacity Building
- 2015-17: Deposit Insurance Strengthening Project
- 2016-17: Quantitative Impact Study for the Introduction of Basel III
- 2016-18: Bank Resolution Framework
- 2016-18: Support in Development and Implementation of European Supervisory Approach
- 2016-19: Support in Development and Implementation of European Supervisory Reporting Standard
- 2018-20: Bank Supervision and Resolution

Croatia

- 2013: Crisis Simulation Exercise
- 2014-15: NPL Resolution Diagnosis

Georgia

- 2013-14: IFRS Implementation - Prudential Interactions
- 2017: Crisis Simulation Exercise
- 2015-19: Development and Implementation of Deposit Insurance System
- 2019: Cyber Crisis Simulation Exercise
- 2019-21: Strengthening the Deposit Insurance Agency

Kosovo

- 2013-14: Consumer Protection and Financial Literacy Implementation
- 2013-14: Consumer Protection and Financial Literacy Complaints Handling
- 2013-15: Financial Education
- 2015: Crisis Simulation Exercise
- 2015-16: Assessment Analysis of NPLs
- 2015-16: Contingency Planning

Kosovo

2018-19: Crisis Management and Strengthening Deposit Insurance Fund
2019-20: Stocktaking Paper on the Evolution of the Corporate Governance of South European Banks
2020: Deposit Insurance Fund Capacity Development
2020-21: Macroprudential Analysis and Financial Stability Policy Coordination
2021: Deposit Insurance Fund Strengthening

Moldova

2013: Liquidity Stress Testing
2014: Crisis Simulation Exercise
2014-16: Bank Resolution
2016-19: Bank Resolution & Restructuring
2019-20: Bank Recovery and Supervision
2019-20: Bank Resolution
2020: Bank Resolution
2021: Bank Resolution

Montenegro

2013: NPL Resolution
2013-14: Crisis Simulation Exercise
2016-19: Deposit Insurance Strengthening Project
2018-19: Strengthening Bank Recovery and Resolution Framework

North Macedonia

2014: Crisis Simulation Exercise
2015-16: Assessment of Microprudential Supervision
2016-17: Assessment of the processes of Licensing and Banking Regulation
2017-19: Bank Recovery and Resolution
2017-19: Risk Management Regulation and Supervision Implementing IFRS 9
2019-21: Macroprudential, Crisis Preparedness, and Bank Recovery & Resolution

Romania

2018: Romania: Resolution Crisis Simulation Exercise*
2020: Romania: Improving implementation of bank resolution*

Serbia

2014-15: On-Site Examination Procedures and Structuring of Pillar 2 Dialogue
2016-17: Operational Aspects of Micro Stress Testing
2018-19: Strengthening the Foundations and Analytical Basis for the Deposit Insurance System
2019-20: Prevention of Formation and Accumulation of New NPLs

Ukraine

2013-15: Capital Requirements Directive IV Assessment
2015-16: Supervisory Needs Assessment and Prioritization of Reforms for Banking Supervision
2015-16: Liquidity Stress Testing
2016: Early Warning System
2016: Financial Stress Index
2016-17: Financial Conditions Index
2017: Conference on the Role of the Judiciary in Bank Resolution
2016-18: Strengthening the Resolution Framework
2018: Analytical Tools for Assessing the Systemic Risk in Consumer Lending
2017-19: NPL Restructuring and Workout Guidelines
2017-19: Strengthening Resolution Framework
2016-19: Improving the Quality of Banking Regulation in Line with the EU Framework
2019-20: Bank Recovery and Resolution, Deposit insurance, and New Legal Framework
2019-21: Bank Recovery and Resolution, Micro-Prudential Frameworks, and NPL Resolution

Uzbekistan

2018-19: New Banking Law and Guided BCP Self-Assessment
2019-20: Licensing, Prudential Regulation, and Supervision
2021: Banking Supervision and Regulation

* These projects were funded by EU and implemented by FinSAC

FinSAC Knowledge Events

In its role as a knowledge center, FinSAC has hosted a series of workshops and conferences focused on relevant topics of financial stability that bring together key players from client countries and international experts to discuss challenges, learn from each other's experiences, and build useful networks of contacts. The following list is of regional or international events that were held in addition to the many workshops and seminars under specific country-focused technical assistance projects.

Date	Event	Venue
February 13-14, 2012	Building Efficient Debt Resolution Systems Workshop – a stock-taking event, Europe and Central Asia region	Vienna, Austria
June 7, 2012	Vienna Initiative Outreach Workshop on NPL Report	Podgorica, Montenegro
June 8, 2012	Vienna Initiative Outreach Workshop on NPL Report	Tirana, Albania
October 25, 2012	Conference on 3rd Generation Reforms in Bank Resolution	Vienna, Austria
September 18-19, 2013	NPL Resolution Seminar with National Bank of North Macedonia	Skopje, North Macedonia
October 17, 2013	From NPL Forbearance to NPL Resolution in Ireland – An Evolving Supervisory Toolkit Workshop	Vienna, Austria
December 5, 2013	Banking Recovery and Resolution Regional Seminar	Vienna, Austria
May 26, 2014	Podgorica Approach Launch – Conditions For Success Conference	Podgorica, Montenegro
June 10-11, 2014	Financial Consumer Protection and Financial Literacy Seminar	Sofia, Bulgaria
October 21-22, 2014	Credit Risk Management and Regulatory Provisioning in an IFRS Environment Workshop	Vienna, Austria
February 26, 2015	Challenges for European Deposit Insurance Systems - Funding, Investment Practices, and Reimbursement High-level Seminar	Warsaw, Poland
April 23-24, 2015	From Experts to Experts: Recovery & Resolution Plans Workshop	Vienna, Austria
May 18-19, 2015	Cyber Security Preparedness Regional Seminar	Vienna, Austria
November 3-4, 2015	Single Supervisory Mechanism Regional Seminar	Frankfurt, Germany
November 12-13, 2015	The Financial System in the Western Balkans in 2025 – Using Scenarios to Explore Future Challenges & Opportunities in a Changing World High-Level Seminar	Vienna, Austria
June 2, 2016	Macroprudential Policymaking in Emerging Europe Workshop	Vienna, Austria
December 12, 2016	Bank Resolution Regional Conference	Vienna, Austria
December 13, 2016	Bail-in and Minimum Requirements for Own Funds and Eligible Liabilities Workshop	Vienna, Austria
April 19, 2017	Resolution Regimes in Europe: Implementation of Effective Resolution Regimes in the Region Workshop	Vienna, Austria

Date	Event	Venue
October 5-6, 2017	The Role of the Judiciary in Bank Resolution Judges Workshop	Kyiv, Ukraine
November 28-29, 2017	International Committee on Credit Reporting Meeting	Vienna, Austria
November 30, 2017	Deposit Insurance Systems: Addressing Emerging Challenges in Funding, Investment, Risk-based Contributions, & Stress Testing Workshop	Vienna, Austria
March 22-24, 2018	Regional Innovation Forum for Europe and Central Asia	Bratislava, Slovakia
May 15-16, 2018	Comprehensive Approach to NPL Resolution – International Experiences Conference	Vienna, Austria
October 30-31, 2018	Ukraine National School of Judges – Bank Resolution: National Law Enforcement Practice and International Experience Conference	Kyiv, Ukraine
November 15, 2018	Bank Recovery & Resolution Planning Regional Conference	Tirana, Albania
February 5, 2019	Banking Supervision and Resolution from A Small Host Country Perspective under The European Union Framework Event	Vienna, Austria
May 15, 2019	Development of a New Bank Resolution Framework in Ukraine Stakeholder Event	Kyiv, Ukraine
May 16, 2019	International Developments in Bank Resolution and Potential for Reform in Ukraine - Challenges in Operationalizing Recovery and Resolution Frameworks Workshop	Kyiv, Ukraine
May 22-23, 2019	Fintech International Conference	Vienna, Austria
May 18, 2020	Borrower Relief Measures in ECA Webinar	Virtual
June 16-17, 2020	Federal Deposit Insurance Corporation / FinSAC Bank Resolution Workshop	Virtual
December 15-17, 2020	Bank of Albania Resolution, Valuation, and Resolvability Assessment Workshops	Virtual
February 10-11, 16, 2021	Bank of Albania Resolution, Valuation, Resolvability Assessment, and Resolution Financing Workshops	Virtual
March 2, 2021	COVID-19 & NPL in ECA: Lessons from the GFC for the Pandemic Workshop	Virtual
March 10, 2021	COVID-19 & NPL in ECA: Recognizing Problem Assets: Regulatory & Supervisory Context Workshop	Virtual
March 25, 2021	COVID-19 & NPL in ECA: Bank-Led and Systemwide NPL Reduction Strategies Workshop	Virtual
April 27, 2021	COVID-19 & NPL in ECA: Insolvency and Creditor Rights Workshop	Virtual
May 24-25, 2021	Central Bank of Armenia Supervisory Stress Testing Workshop	Virtual
July 5, 2021	Bank of Albania Bank Recovery & Resolution Workshop	Virtual
September 24, 27, 2021	Central Bank of Armenia IFRS9 Workshop	Virtual
October 12, 2021	Central Bank of Armenia Recovery Planning Workshop	Virtual
November 16, 2021	Central Bank of Armenia ICAAP workshop	Virtual

Knowledge Products

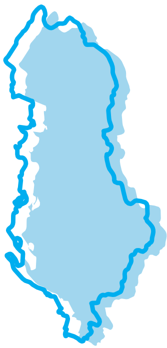
Working closely with client countries on technical assistance projects often highlights challenges or knowledge gaps that may also be experienced by others. To help address these, FinSAC has developed a range of material. Many of the more recent documents and those that are in the public domain may be accessed on the FinSAC website.

1. Brochure on FinSAC: Advisory Services for Financial Sector Stability and Development, 2014
2. Micro-Prudential Supervision: A Key FinSAC Business Line, 2014
3. Loan Classification and Provisioning: Current Practices in 26 Europe and Central Asia Countries, 2014
4. Financial Crisis Simulation Exercises in Europe and Central Asia: Lessons Learned, 2015
5. Cybersecurity: The Role of Central Bank and Bank Supervisors, 2015
6. Policy Note on Macroprudential Policy in ECA Countries, 2015
7. Working paper: Financial Crisis Simulation Exercises in Europe and Central Asia: Lessons Learned, 2016
8. Knowledge Brief Cybersecurity: The Role of Central Bank and Bank Supervisors, 2016
9. Brochure: Supporting Financial Sector Stability and Resilience, 2016
10. Understanding Bank Recovery and Resolution in the EU: A Guidebook to the BRRD, 2016
11. Bank Resolution and 'Bail-In' in the EU: Selected Case Studies Pre and Post BRRD, 2016
12. Policy brief: Are Non-Performing Definitions Comparable Across Countries, 2016
13. The Use of the Deposit Guarantee Funds for Resolution Purposes, 2016
14. Policy Brief: Macroprudential Policymaking in Emerging Europe, 2016
15. Deposit Insurance Systems: Addressing Emerging Challenges in Funding, Investment, Risk-Based Contributions, and Stress Testing, 2017
16. Policy brief: Regulatory and Supervisory Developments for Non-Performing Loans, 2018
17. Paper on Cross Border Banking Supervision and Resolution: The Small Host Perspective, 2018
18. Paper on Governance of Financial Sector Policy Functions in Europe and Central Asia, 2019
19. Paper on Banking Supervision and Resolution in the EU. Effects on Small Host Countries in Central, Eastern and South Eastern Europe, 2019
20. Note on the Strategic Development of an Enhanced Bank Resolution Framework for Ukraine in Alignment with the EU Acquis, 2019
21. Policy Brief Non-Performing Loan Write-Offs: Practices in the CESEE Region, 2019
22. Policy Brief on Public Asset Management Companies and International Experiences, 2019
23. Policy Note on Borrower Relief Measures, 2020
24. Stocktaking Paper on the Evolution of the Corporate Governance of South European Banks, 2020 (produced for the Central Bank of Kosovo)
25. Policy Note on NPL Resolution, 2020
26. Judicial Practice of Bank Resolution: Collection of Selected EU and USA Court Rulings, 2021
27. Financial Sector's Cybersecurity: A Regulatory Digest 6th Edition, 2017/2018/2019/2020/2021

FinSAC making a difference over the last decade

Each of FinSAC's projects since 2011 have targeted very specific outcomes, for example legislative change or support to establish new methodologies or structures. While each has been assessed following completion in the terms of the outcome of the project, after 10 years it is now possible to take a wider view of how the individual projects have contributed to the broader goal of improved financial stability.

The following section reflects on the value added by FinSAC activities in four client countries, Albania, North Macedonia, Ukraine, and Uzbekistan.



Albania

FinSAC's cooperation with Albania began in 2013 and has continued since then with deepening and expanding tailored technical assistance. Focus areas have been Albania's key financial stability challenges, including recovery from the 2008/09 global financial crisis, adoption of new and revised post crisis global financial regulatory standards, and alignment with EU banking sector Directives, as well as the recent COVID-19 related issues.

Having one of the highest levels of NPLs in the region in the post financial crisis period, the Albanian authorities prioritized resolution of the stock of existing NPLs while limiting any new flows. FinSAC cooperation under Pillar II (micro-prudential, regulatory and supervisory framework) concentrated on identifying and implementing measures that would facilitate the reduction of the NPL stock in the Albanian banking sector and encourage the resumption of lending to viable companies and households. This stream of work had several phases stretching out between 2013 and 2018. The length of the engagement and its programmatic nature reflects the sophisticated, hands on technical advice along the full range of phases from diagnostics to implementation.

With the objective of developing an Albania-specific NPL resolution strategy, FinSAC first launched a comprehensive diagnostic, encompassing the review of prudential and supervisory actions, banks' debt restructuring efforts, the enabling environment (legal, tax, regulatory obstacles), and policy action-oriented corporate debt mapping. FinSAC identified specific revisions to the Civil Procedural Code and Civil Code to facilitate creditor rights, which were approved by the Parliament in April 2013. To promote restructuring of large, economically viable corporate debtors, the Bank of Albania adopted a more intrusive approach in tackling coordination failures between the major creditors, while also helping banks develop their skills and expertise in operational and financial restructuring. A voluntary out-of-court framework for large multi-creditor defaults was developed, in line with the INSOL principles and informed by the London and Istanbul experiences, tailored to the specificities of the Albanian context. An innovative approach was adopted to operationalize this framework, and a pilot was launched to evaluate the restructuring potential of the largest, most complex corporate defaults. This brought together the largest Albanian banks, hosted and managed by the Bank of Albania, with support from FinSAC through the engagement of two restructuring specialist firms. By 2015, a sample of 50 defaulted corporate obligors, representing approximately 25 percent of total NPLs in the system, had been reviewed through the pilot program. FinSAC then supported the authorities in further developing and revising the NPL Action Plan, which was endorsed by the Ministry of Finance and the Bank of Albania in August 2015. Work subsequently continued to draft guidelines and improve the framework for the out-of-court restructuring of multi-lender large corporate NPLs in Albania. The new out-of-court restructuring framework was issued by Bank of Albania in 2018 (the "Tirana Approach").

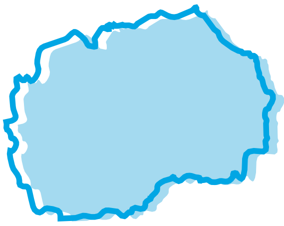
A second important area of cooperation between 2013-19 was under FinSAC Pillar III (bank recovery and resolution framework). The technical assistance was aimed towards the development of a resolution regime for savings and credit associations and for domestic systemically important banks. FinSAC conducted a comprehensive review of the existing recovery and resolution regime, prepared a gap analysis to identify discrepancies with the EU BRRD, assisted with the drafting of legislative text, and analyzed the potential impact of introducing a minimum bail-in requirement (such as the 8 percent rule under the BRRD) on individual banks' balance sheets. Activities included workshops, expert discussions, providing background information, and answering questions.

As a result of the assistance, bank recovery and resolution plans were introduced - the first recovery plans of systemically important banks were reviewed by the Bank of Albania with support from the FinSAC during 2015 – and a new bank resolution law – drafted with FinSAC input - was adopted by the Albanian Parliament in December 2016. Assistance continued in 2017 and 2018 to operationalize the new resolution framework and advance the assessment of banks' recovery plans. Progress included the creation of a resolution unit within the Bank of Albania and by-laws on valuation, and on recovery and resolution planning including the adaptation of European Banking Authority and Single Resolution Board bank information templates to the local framework.

Vasilika Kota, Head of the Resolution Department at the Bank of Albania said, ***"FinSAC has played a pivotal role in the operationalization of the resolution framework in Albania. The Bank of Albania, in its mandate as the Resolution Authority, particularly appreciates the hands on and tailored approach provided to finalize resolution plans and draft the bail-in note. FinSAC has engaged extensively, providing personalized feedback on resolution planning issues and implications on the local market, the legal and operational challenges towards operationalizing the bail in strategy, and communicating minimum requirements for own funds and eligible liabilities, as a crucial step towards improving banks' resolvability and strengthening the financial stability of the country."***

A third area of customized technical support was a FinSAC Crisis Simulation Exercise in June 2015, amid the escalation of the Greek sovereign crisis. Given the exposure of the Albanian financial system to Greek banks (the share of Greek banks in total bank assets was 17 percent in Albania), the Crisis Simulation Exercise and subsequent FinSAC recommendations allowed the Bank of Albania and other national authorities to become better prepared and focused by the time the real crisis reached them.

Projects and longer-term programmatic engagements under all the areas of cooperation achieved their objectives and became good practice examples of FinSAC support, encompassing diagnostics, legal and regulatory framework development, and operationalization. The establishment of an out-of-court restructuring framework for multi-lender corporate NPLs and new bank recovery and resolution framework aligned with BRRD had both been included in the recommendations of the 2014 Financial Sector Assessment Program evaluation of Albania. FinSAC's activities also supported other World Bank projects including 3 Development Policy Loans during 2014-18, which included prior actions related to NPL and bank resolution. FinSAC engagement with Albania continues, mainly focused on capacity development of the Deposit Insurance Agency and preparation of financial reporting templates in line with European Banking Authority requirements.



North Macedonia

FinSAC's cooperation with North Macedonia dates back to 2013 and a joint seminar on NPL resolution held at the National Bank. Since then, the relationship has evolved and extended to all three thematic pillars of FinSAC operations. FinSAC has provided tailored technical assistance and has been a trusted partner in addressing key financial sector stability challenges including the recovery from the global financial crisis, adoption of new and revised global financial regulatory standards, alignment with EU banking sector directives, and COVID-19 related challenges.

Although North Macedonia was among the countries in the Balkans which showed signs of a more sustained recovery on the back of rising exports after the 2008/09 financial crisis, it was also one of the countries in the Western Balkans where Greek banks had a strong presence and ultimately was facing negative spillover risks from Greek banks. The North Macedonian authorities had been intensively updating the country's crisis preparedness framework for several years, with help from the World Bank, and felt it timely to test their new arrangements. The FinSAC crisis simulation exercise took place in September 2014 in Skopje, with the participation of about 40 staff from the National Bank, the Ministry of Finance, and the Deposit Guarantee Fund. The exercise included a very productive debriefing to discuss preliminary observations and potential gaps in terms of policy tools and reaction times for the different bank cases examined during the exercise. The experience and the lessons learned helped North Macedonian authorities to deal with the new wave of potential contagion from Greece that re-emerged at the end of 2014 and at the beginning of 2015.

Cooperation continued on the micro prudential framework in 2015 and 2016. FinSAC reviewed the architecture and control framework within the bank supervision department and assessed the effectiveness of the licensing and regulation-writing functions. Most of FinSAC's findings and proposals to improve the efficiency of on- and off-site micro prudential supervision were implemented. FinSAC next supported North Macedonian banks to transition to the new accounting standard, IFRS 9, which was made mandatory for Macedonian banks starting January 2018. FinSAC worked with the National Bank, and with technical experts from the Banco de España, on the construction of the necessary tools and systems including an expected credit loss model, using data from the National Bank's credit registry.

The North Macedonia Financial Sector Assessment Program update was finalized and shared with the authorities in April 2019. FinSAC engaged with the implementation of key recommendations by developing a programmatic assistance project covering the areas of macroprudential frameworks, crisis preparedness, micro prudential supervision, and bank recovery and resolution. This project was completed at the end of 2021 (after being extended by one year due to COVID-19 disruption and the National Bank's need to focus on monitoring and responding to the crisis). Its achievements included capacity building at the National Bank, adoption of a memorandum of understanding on financial stability, preparation of draft Financial Stability Law and Bank Recovery and Resolution Law, and finalization of a challenger model. The National Bank noted that work undertaken under the project had contributed to the Decision adopted by the EU Commission, to consider the banking prudential requirements applied in North Macedonia equivalent to those in the EU. FinSAC continue to support the National Bank in operationalizing the systemic risk and macroprudential framework, crisis preparedness, bank recovery and resolution, and development of a household probability of default model as well as potential forward looking new areas of engagement including supervisory and regulatory aspects of greening the financial sector.

Milica Arnaudova Stojanovska, Advisor to the Governor of the National Bank of North Macedonia, said: ***"We express our sincere gratitude for the continuous support FinSAC has offered the National Bank of the Republic of North Macedonia in its efforts to adequately implement relevant international standards and best practices in the field of banking regulation and supervision, financial stability, and macroprudential policy. The FinSAC experts have demonstrated admirable competence, thoroughness, and dedication, for which we are highly grateful. Apart from their sheer dedication and sincerity, they have managed to adjust the provided technical assistance to our needs and circumstances, i.e. to reflect EU standards and best practices, and also took into account the features of the domestic banking system. Through this tailor made approach and the comprehensive discussions and exchange of views with the experts, we have managed to develop a set of essential legislative initiatives and macroprudential policy framework which will be instrumental in our future operation and efficient fulfillment of the National Bank's responsibilities."***

Ukraine

FinSAC has been working since 2014 to support Ukraine improve stability in its financial sector. Significant progress has been made to address the handling of failing banks. The Ukrainian Deposit Insurance Agency was transformed into a bank resolution authority and, with World Bank and FinSAC engagement, its operational, financial, and regulatory capacity were strengthened to cope with bank failures. New resolution tools were introduced and a mechanism for state participation in the resolution of systemically important banks was defined.

FinSAC continued its support to the authorities during 2014 and 2015, when Ukraine experienced a unique systemic banking crisis. The banking system was under enormous stress due to the sharp economic downturn and major political changes that allowed exposure to widespread long-lasting related-party lending. With help from FinSAC as well as other international financial institutions, the authorities put in place a framework to resolve and recapitalize banks and strengthen the regulatory and supervisory framework. As a result of the crisis, more than half the banks in Ukraine exited the system, while the Deposit Guarantee Fund effectively managed to repay all the insured deposits and prevented a systemic financial crisis.

Svitlana Rekrut, Managing Director of the Deposit Guarantee Fund, said: ***"The World Bank has been and remains our important partner. We greatly appreciate FinSAC support that has been provided to Ukraine and, in particular, the Deposit Guarantee Fund in recent years. At one time, the World Bank experts contributed to the development of the Law under which the Deposit Guarantee Fund currently operates, and became our reliable partner during the unprecedented 2014-2017 banking crisis in Ukraine. Now, our joint efforts are aimed at harmonizing the Ukrainian legislation on the deposit guarantee scheme and insolvent banks resolution with the EU regulations, notably Directive 2014/59/EU, which will be an effective safeguard against possible turmoil in the banking sector in years to come."***

FinSAC support over the years has focused on four areas. The first is bank recovery and resolution and deposit insurance. This is aimed at realigning the legal and regulatory framework of the National Bank of Ukraine and Deposit Guarantee Fund with newly overhauled bank resolution and deposit insurance legal framework that introduces the BRRD and Deposit Guarantee Scheme Directive in Ukraine. Work on draft legislation continues in 2022.

The second focus area is banking supervision and regulation. This seeks to bring Ukraine closer to international standards in the areas of capital adequacy and liquidity for banks. With FinSAC assistance, notable steps were achieved in the areas of capital and liquidity for banks and there was continued progress on improving the quality of banking regulation in line with international standards in particular introduction of the liquidity coverage ratio and net stable funding ratio, a new capital structure of banks compliant with the EU Capital Requirements Directive IV, as well as work on numerous ad-hoc legislative changes in the banking legislation.

The third focus area is NPL resolution, aimed at implementation of the new NPL Governance and Workout Regulation. This includes NPL workout strategies and resolution planning, as well as enhancement of the asset valuation framework in Ukraine. With the help of FinSAC, two important regulations were adopted by Ukrainian authorities in 2020, enabling state-owned banks to effectively resolve the high stock of NPLs. FinSAC activities directly contributed to the impressive reduction of the NPL ratio from a peak of 58 percent in mid-2017 to 31 percent at the end of 2021.

The final area of focus is financial stability. A high-level Financial Stability Council was established with FinSAC support, which proved very effective throughout the crisis and Privatbank nationalization and continues to operate well. FinSAC has also supported the National Bank of Ukraine establish a Financial Stability Department, which also serves as a Secretariat for the Financial Stability Council. With FinSAC assistance, the National Bank of Ukraine has also adopted regulations defining specific requirements for systemically important banks.

Kyrylo Shevchenko, Governor of the National Bank commented, ***"the World Bank has always been a good and reliable partner of the National Bank of Ukraine. Together we have implemented a number of reforms in the Ukrainian financial sector that enhanced the resilience of the financial system of Ukraine. We appreciate our cooperation with the World Bank, and FinSAC in particular, rely on our partnership and look forward to further successful implementation of our joint projects."***

Uzbekistan

In 2017, Uzbekistan embarked on an ambitious and broad reform agenda, touching almost every sector of the economy. The financial sector, and the banking sector in particular, were no exception and ranked high on the priority list of the Government. To steer the transition to a market economy, Uzbekistan committed to restructuring and privatization of state-owned banks—which dominated the financial system—in its national Banking Sector Reform Strategy. With the goals of improving financial sector efficiency, enhancing access to finance for firms and individuals, and preserving financial stability, the strategy is expected to help the economy to find its private sector drivers of growth and shared prosperity.

Fundamentally reforming the banking sector required a major overhaul of the legal framework for banking and institutional strengthening of regulatory and supervisory functions to avoid costly financial crises experienced by earlier transition countries. The legal framework underpinning the Central Bank of Uzbekistan oversight function over the banking sector was a core element of the legal overhaul and institutional strengthening.

At the request of the Central Bank, the work on the new Banking Law started in October 2018 under a pilot World Bank project funded and staffed by FinSAC. In six months, the Central Bank and FinSAC redrafted every article of the old Law to transform it into a modern legal foundation for banking.

> **Abror Turdaliyev**, Central Bank Deputy Governor, stated: ***"The technical discussions with the World Bank team over the new draft Law was a truly revealing experience and a radical paradigm shift for our entire team. Not only did we learn about the international standards and good practices, but we also started appreciating why they are important in Uzbekistan's context and how they can benefit our country in the future."***

The new fit-for-purpose Banking Law was adopted in November 2019. It established, among other things, a robust gatekeeper mandate for the Central Bank and empowered it to exercise supervisory judgment when confronting dynamically evolving banking risks. The new Banking Law, together with the newly adopted Central Bank Law, significantly enhanced Central Bank independence and had a galvanizing effect on banking sector reform in Uzbekistan.

While the legal reform was key, it cannot alone ensure improved efficiency and effectiveness of bank supervision without changes in human capital and the approach to supervision, which ultimately decide whether institutional reforms produce results. Acknowledging this, FinSAC initiated a comprehensive technical assistance to support the Central Bank in transitioning to an effective risk-based supervision framework.

With support from FinSAC, the Central Bank conducted a comprehensive self-assessment of its banking regulation and supervision against the Basel Core Principles for Effective Banking Supervision. This self-assessment informed the preparation of a Central Bank supervisory roadmap in December 2019, which laid the foundation for the further reforms in the regulatory and supervisory framework for the following years.

The FinSAC technical assistance focused on the early phases of the supervisory cycle: (i) regulatory framework, (ii) market entry, (iii) off-site and on-site supervision, and (iv) supervisory enforcement, while complementary technical assistance from the Financial Sector Reform and Strengthening Initiative focused on market exit (bank resolution) to complete the supervisory cycle. FinSAC's support for the supervisory framework entailed drafting of a comprehensive risk-based supervision manual (using EU Supervisory Review and Evaluation Process methodology) and other internal manuals and procedures, hands-on support for developing and continuously improving supervisory products, capacity building for supervisors on various topics, and drafting a multi-year SupTech strategy aimed at leveraging digital means to boost the Central Bank's effectiveness in supervision.

Abror Turdaliyev, Central Bank Deputy Governor, commented: ***"The World Bank support has been truly comprehensive, far-reaching, and invaluable. Working with the World Bank team gives us the confidence that we are moving steadfast in the right direction. We already see improvements in our day-to-day supervision. More importantly, we observe that banks' attitude toward the Central Bank of Uzbekistan and behavior to internal risk management are gradually changing in a positive direction."***

Chapter 8: A Look Ahead to 2022

As a result of the Russian invasion of Ukraine on February 24, the regional outlook for 2022 has become extremely uncertain. At the time of publication, the economic impact of the war, its magnitude, and duration are yet to be seen. The global economic fallout is expected to be significant as the war and sanctions have disrupted commodity and energy trade, surged the related prices, interrupted the financial flows, and added to the level of uncertainty caused by the pandemic. The impact on European countries will be amplified by the strong trade and financial links with Russia and Ukraine, and the additional challenge of a significant number of refugees fleeing Ukraine to neighboring countries. Commodity and energy prices quickly showed a significant rise, with natural gas and oil prices reaching historic maximums. Sanctions against Russian banks, coupled with restrictions on foreign currency transfers, triggered the failure of the European arm of Russia's Sberbank. A notable negative impact is expected on European banks that have a presence and exposure in Russia and Ukraine, and the indirect effects could be significant for European banks in a wider context.

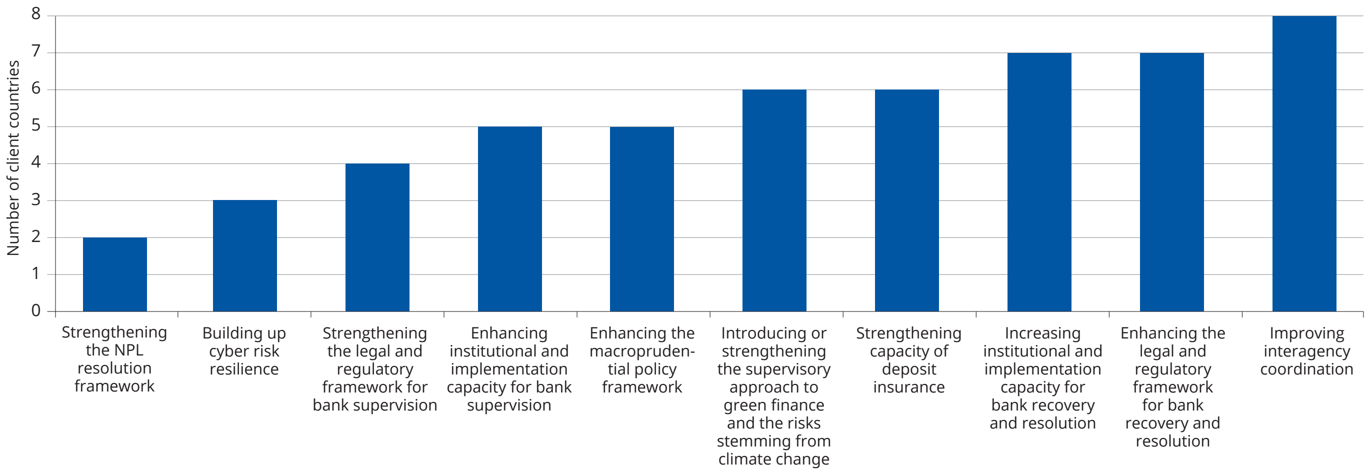
While the banking systems of client countries weathered the pandemic crisis relatively well, they are yet vulnerable to elevated credit risk shocks due to full exit of borrower relief and public support measures which, together with spillover risks of the Russia/Ukraine war, could further amplify the financial stability risks in the region. Being a long-standing partner and provider of stability-oriented financial sector technical assistance, FinSAC stands ready to bring hands-on and tailored support to client countries that face these stability challenges. While the scope of the technical assistance to Ukraine could be negatively impacted by the war, it is expected that FinSAC will continue its active full-fledged engagement with client countries, gradually returning from a virtual to a physical modus operandi as the pandemic subsides. FinSAC will continue its activities across all three pillars, primarily reflecting client countries' demand and focusing on containment of risks stemming from the pandemic and spillover from the war. Furthermore, in 2022, FinSAC intends to naturally embed the regulatory and supervisory aspects of green and sustainable finance in its product line.

MEETING CLIENT COUNTRY DEMAND

As part of efforts to better understand clients' needs, areas of future reforms, and potential demand for FinSAC support, the Client Feedback Survey asked for information on short- to mid-term plans and areas of envisaged external support. The main areas identified for short-term (1-3 years) policy reform are interagency coordination, further enhancement of regulatory frameworks for bank recovery and resolution, and operationalization of bank recovery and resolution regimes. Strengthening deposit insurance also remains important. Client countries report increasing focus on the green agenda, and are looking to introduce or strengthen the supervisory approach to green finance and climate change risks. Figure 3 shows all areas where FinSAC client countries plan to introduce reforms in the following couple of years.

Respondents indicated that capacity building is the area in which they will most need external support. 12 of 14 respondents plan to or have already initiated a follow-up project with FinSAC as a continuation of previous work. This is additional evidence of clients' satisfaction with FinSAC work and previously achieved results.

Figure 3: Areas of policy reform focus in the next 1-3 years



FINSAC'S PORTFOLIO

Building upon ongoing strong engagement with client countries, bilateral technical assistance projects will continue to be the main engagement product for FinSAC activities in 2022. As usual, the new year started with a full work program for FinSAC, including seven technical assistance and four analytical projects. Following the successful completion of projects in 2020 and 2021, discussions on new technical assistance projects are currently ongoing with Albania, Armenia, Moldova, North Macedonia, Bosnia and Herzegovina, Kosovo, Ukraine, and Georgia, aiming to have at least 10 projects in 2022, including with new counterparts like the Deposit Insurance Fund in North Macedonia.

As the impact of the pandemic diminishes and vaccination numbers in the region rapidly rise, FinSAC is planning to gradually return to the office and resume in-person missions as soon as is practical. While the home-based work and virtual missions allowed FinSAC to keep engaged with its counterparts and effectively deliver on the work program, the resumption of onsite visits will enhance the scope of engagement with different counterparts and generate a new pipeline of activities to benefit client countries.

EXPECTED CLIENT COUNTRY DEMAND ACROSS FINSAC'S THREE PILLARS

Although the pandemic has somewhat shifted authorities' attention to handle the acute challenges their financial systems faced in 2020 and 2021, the alignment of client countries' regulatory and supervisory frameworks with international best practices and EU standards remains to be of high priority. In that context, the thematic three-pillar structure of FinSAC activities continues to be highly relevant, as new financial stability risks appear in the region. European countries are actively moving toward implementation of the Paris Agreement, and so the topic of green finance and the risks stemming from climate change are gradually becoming a priority focus for FinSAC's client authorities, thus paving a way for new technical assistance projects, naturally embedded within FinSAC's thematic three pillars. While most of the work on the green agenda during 2022 is expected to cover the second pillar, FinSAC aims to engage with resolution authorities and deposit insurers to also consider the green agenda in aspects such as resolution planning, by resorting to green bonds to meet any loss-absorbing requirements, or when deciding on the investment policy of the assets of the deposit insurance or resolution funds.

Pillar 1

Financial Stability, Macroprudential Frameworks, and Crisis Management

The elevated risks to financial stability stemming from the Russia/Ukraine war could potentially change the financial sector landscape in Europe triggering an increased technical assistance demand from FinSAC client countries to strengthen their crisis preparedness framework and financial sector safety nets. In that context, FinSAC is well positioned to conduct relevant diagnostics and provide tailored technical assistance to authorities, including on topics like early intervention measures, lender-of-last-resort facilities, operational readiness, and interagency coordination mechanisms. Client countries continue to express strong interest in deposit insurance-related work, with a particular focus on deposit insurance coverage, target fund ratio, risk-based premiums, and the role of the deposit insurer in the bank resolution process. Triggered by pandemic-related limitations, banks in the region moved to an online form of provision of financial services, thus increasing their exposure to cybersecurity risks. Against this background, FinSAC can support client countries with cybersecurity-focused crisis simulations exercises, and provide a follow-up technical assistance to address the identified regulatory gaps. Moreover, conventional crisis simulation exercises could still serve as a good instrument to test existing crisis management frameworks and prioritize areas for improvement.

Pillar 2

Microprudential Frameworks & NPL Reduction

The potential deterioration in asset quality in the post-COVID-19 environment would inevitably increase the demand for NPL resolution work, further exacerbated by enlarged credit risk pressures coming from the Russia/Ukraine war. The international experience shows that a functional and efficient NPL resolution framework is required to effectively overcome the rising pressures on asset quality in the aftermath of the crisis. From that perspective, FinSAC is well-placed to support client countries with comprehensive diagnostic and follow-up technical assistance on a wide range of topics related to NPL resolution, including NPL recognition and classification, NPL measurement and provisioning, NPL write-off methodologies, operationalization of workout units in banks, as well as enabling the legal framework to enhance the NPL secondary market. FinSAC also expects a growing demand for technical assistance on microprudential supervision and regulation, mainly focused on alignment of bank regulatory frameworks with good international practice and EU Directives, strengthening of supervisory processes and supervisory architecture, the introduction and implementation of supervisory review and evaluation process methodologies, as well as the assessment of bank business models. FinSAC's special focus in 2022 will be engaging clients on regulatory aspects of green finance and risks stemming from climate change. It is essential that supervisors and central banks increase their awareness on physical and transition risks that climate change may pose to a country's financial stability, and adopt relevant regulations, policies, and risk management practices to mitigate those.

Pillar 3

Bank Resolution

The financial stability challenges associated with the Russia/Ukraine war have triggered action by the European Single Resolution Board which considered Sberbank Europe AG as non-viable and began a resolution process on February 28, 2022. As a result, Sberbank Europe AG was liquidated, its subsidiaries in the Federation of Bosnia and Herzegovina, Republika Srpska, Serbia, Croatia, and Slovenia were sold, and those in the Czech Republic and Hungary were liquidated. These developments have put the recently refitted bank resolution frameworks in many of those countries to the test, which could stimulate regulatory or operational revisions in affected countries, but also motivate countries that have not yet modernized their resolution regimes to initiate that process. FinSAC envisages a robust pipeline of projects aimed at strengthening bank resolution frameworks in client countries, with a view to aligning their resolution regimes with best international practices and, as applicable, with EU Directives. The extensive support provided in recent years, especially to Western Balkan countries, in establishing legal frameworks on bank resolution will steadily refocus on supporting the operationalization of those enhanced regimes. However, many client countries are yet in the early stages of reform and FinSAC will still have significant engagement on legal and sub-legislative bank resolution frameworks. With increased solvency-related risks spilling over from the Russia/Ukraine crisis, there could also be demand from client countries for hands-on support in dealing with problem banks. FinSAC, having extensive experience in advising on both regulatory aspects of bank resolution regimes and practical aspects of bank resolution, will stand ready to provide the required support to client country authorities.

KNOWLEDGE ACTIVITIES

FinSAC will continue to advance on its knowledge agenda in 2022, focusing on key topics of concern to financial sector policymakers in client countries. The pandemic and related travel restrictions prevented the holding of knowledge events in Vienna in 2020 and 2021. As vaccination numbers grow, cases flatten, and counterparts are again able to travel, FinSAC plans to hold its Annual Flagship Conference for policy makers in May 2022. This will be a welcome opportunity to reestablish personal connections and discuss the supervisory and green transition challenges they may face in the post-pandemic environment. FinSAC will also continue its analytical work in 2022, aiming to finalize and publish at least four policy briefs and working papers covering the topics of bank crisis management, financial stability committees, related party transactions, as well as bank resolution for big and small banks. Analytical work on regulatory aspects of green transition will be launched in 2022 as well, with the aim to have a working paper published in early 2023, summarizing existing approaches to green transition in client countries and prioritizing the development objectives towards greening the regulatory and supervisory frameworks.

Annex A: Financial Stability Indicators for FinSAC Client Countries

Economy		Capital			Liquidity			Profitability	
		Regulatory capital / RWA	Tier 1 capital / RWA	Tier 1 capital / total assets	Liquid assets / total assets	Liquid assets / short-term liabilities	Deposits / total noninterbank loans	Return on assets	Return on equity
European Union member states	Bulgaria	22.4	21.8	↑ 11.7	28.2	35.0	147.0	1.1	8.7
	Croatia	25.6	25.2	12.3	37.3	49.1	130.6	1.3	13.3
	Poland	19.9	17.6	9.1	↑ 28.1	↑ 42.4	114.0	0.1	1.4
	Romania	23.1	21.4	9.5	↓ 13.3	↓ 18.5	108.7	1.5	13.6
EU candidate and potential candidate countries	Albania	18.0	16.9	8.8	32.9	44.9	209.3	1.5	12.9
	Bosnia and Herzegovina	19.2	18.4	10.3	28.5	49.9	120.5	1.4	11.2
	Kosovo	15.2	13.5	9.5	27.3	35.7	129.1	2.4	17.8
	Montenegro	18.5	17.5	9.6	27.1	41.3	126.3	1.3	9.6
	North Macedonia	17.3	15.9	↑ 11.4	21.6	35.9	121.3	1.6	13.2
	Serbia	21.7	20.6	12.9	38.6	51.2	118.0	1.2	7.4
EU neighboring regions	Belarus	18.4	15.4	12.9	17.0	-	80.4	1.9	12.8
	Moldova	25.9	25.7	12.6	48.4	-	160.3	2.3	↓ -1.2
	Ukraine	18.0	12.0	6.9	69.2	-	140.3	4.5	35.0
South Caucasus and Central Asia	Armenia	17.1	15.1	11.3	↑ 28.7	-	115.4	0.8	6.2
	Georgia	19.6	15.6	13.0	20.2	26.3	81.6	↑ 3.9	↑ 30.7
	Uzbekistan	17.5	14.6	13.2	18.6	46.9	↑ -	↓ 1.3	↓ 6.1

Note: The statistics, represented in percentages, are prepared using latest information available by March 6, 2022. They typically reflect conditions of financial systems as of September 2021. Albania, Georgia, Kosovo, Ukraine, and Uzbekistan are reflected using December 2021 data; Poland and Armenia June 2021. The background colors of indicators represent their rankings among the countries, with deeper blue reflecting more favorable positions and red otherwise. The arrows left of values indicate changes beyond one historical standard deviation away from the most recent three-year averages. The icons on the right illustrate indicator evolutions over a 10-year timespan. Underlines indicate calculations for countries that unilaterally adopted euro (Kosovo and Montenegro) as their domestic currency. "." and "-" respectively indicate cases of missing and censored report values.

Economy		Exposures					
		NPLs net of provisions / capital	NPLs / total gross loans	Large exposures / capital	FX-denominated loans / total loans	FX-denominated liabilities / total liabilities	Net open FX position / capital
European Union member states	Bulgaria	18.0	5.1	58.6	22.3	37.6	0.0
	Croatia	4.5	6.3	55.1	54.1	51.5	3.4
	Poland	7.4	3.4	.	19.4	15.2	↓ 0.1
	Romania	8.0	3.6	75.9	24.3	29.5	-0.5
EU candidate and potential candidate countries	Albania	7.1	5.4	102.2	48.8	51.0	9.2
	Bosnia and Herzegovina	6.3	5.5	.	51.8	45.5	7.8
	Kosovo	3.5	2.1	101.2	0.1	↓ 4.3	3.1
	Montenegro	22.4	6.6	120.6	0.3	5.0	0.4
	North Macedonia	-4.8	3.5	247.1	40.7	44.8	4.4
	Serbia	6.7	3.6	80.1	62.8	60.7	1.1
EU neighboring regions	Belarus	17.2	5.6	179.6	42.1	62.6	6.9
	Moldova	9.7	6.8	12.1	26.7	42.8	-12.5
	Ukraine	13.8	31.7	108.7	31.6	33.7	30.7
South Caucasus and Central Asia	Armenia	11.6	↓ 3.4	150.3	46.1	49.6	1.9
	Georgia	↓ 3.9	1.9	.	50.6	57.7	2.6
	Uzbekistan	↑ 13.1	↑ 5.1	221.1	49.2	57.5	6.0

Note: The statistics, represented in percentages, are prepared using latest information available by March 6, 2022. They typically reflect conditions of financial systems as of September 2021. Albania, Georgia, Kosovo, Ukraine, and Uzbekistan are reflected using December 2021 data; Poland and Armenia June 2021. The background colors of indicators represent their rankings among the countries, with deeper blue reflecting more favorable positions and red otherwise. The arrows left of values indicate changes beyond one historical standard deviation away from the most recent three-year averages. The icons on the right illustrate indicator evolutions over a 10-year timespan. Underlines indicate calculations for countries that unilaterally adopted euro (Kosovo and Montenegro) as their domestic currency. "." and "-" respectively indicate cases of missing and censored report values.

Annex B: Disbursement of the Trust Fund by FinSAC

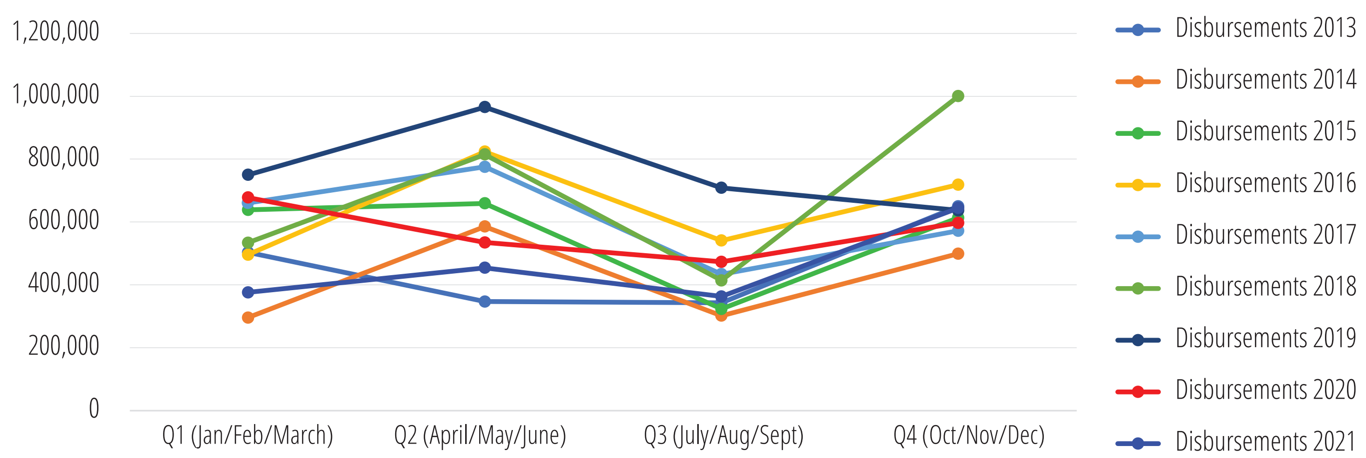
As of January 1, 2022

FINSAC 3 (TF072993 – disbursement end date is 31 July 2023)*	
Contributions paid-in	€ 13,300,000.00
Contributions to be paid	€ 800,000.00
Investment Income**	€ (69,237.01)
Disbursements	€ 5,109,926.10
Fund Balance incl. commitments	€ 4,077,890.46

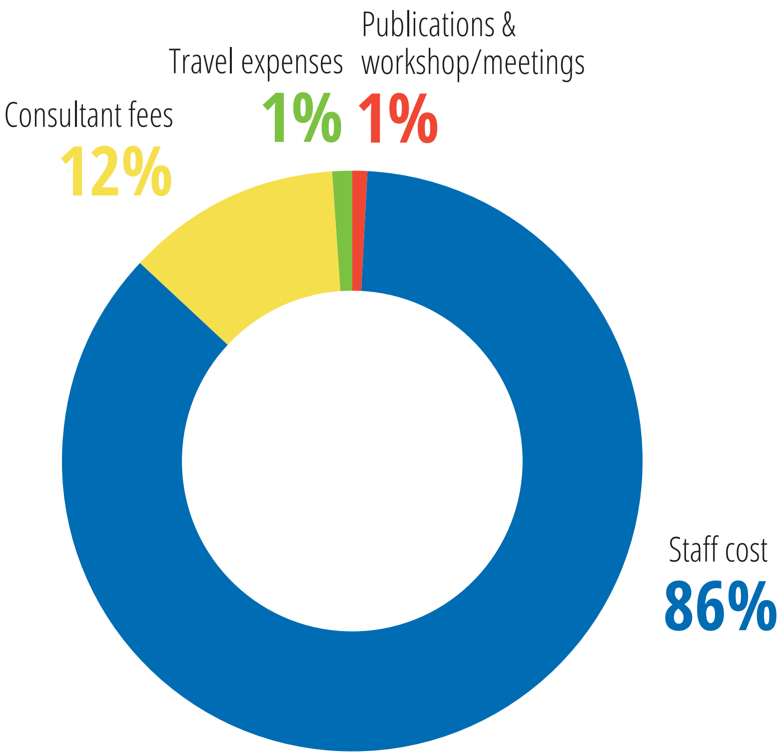
*FinSAC 3 Trust Fun includes original Administrative Agreement of €8 million and amendment to the Administrative Agreement of €5.3 million
**Due to negative savings rate in EUR

Disbursement	2013	2014	2015	2016	2017	2018	2019	2020*	2021*
Q1 (Jan/Feb/Mar)	€ 503,296	€ 295,836	€ 638,483	€ 495,853	€ 660,469	€ 533,788	€ 749,983	€ 677,770	€ 376,105
Q2 (Apr/May/June)	€ 346,791	€ 585,282	€ 659,242	€ 823,747	€ 775,256	€ 814,793	€ 965,546	€ 534,821	€ 454,119
Q3 (July/Aug/Sept)	€ 343,023	€ 301,968	€ 323,288	€ 540,713	€ 433,911	€ 414,172	€ 708,361	€ 473,043	€ 362,921
Q4 (Oct/Nov/Dec)	€ 649,640	€ 499,193	€ 613,310	€ 718,554	€ 572,154	€ 1,000,470	€ 637,033	€ 597,110	€ 644,651
Total	**€ 1,842,749**	**€ 1,682,278**	**€ 2,234,323**	**€ 2,578,867**	**€ 2,441,790**	**€ 2,763,223**	**€ 3,060,923**	**€ 2,282,744**	**€ 1,837,795**

*includes FinSAC3 TF072993

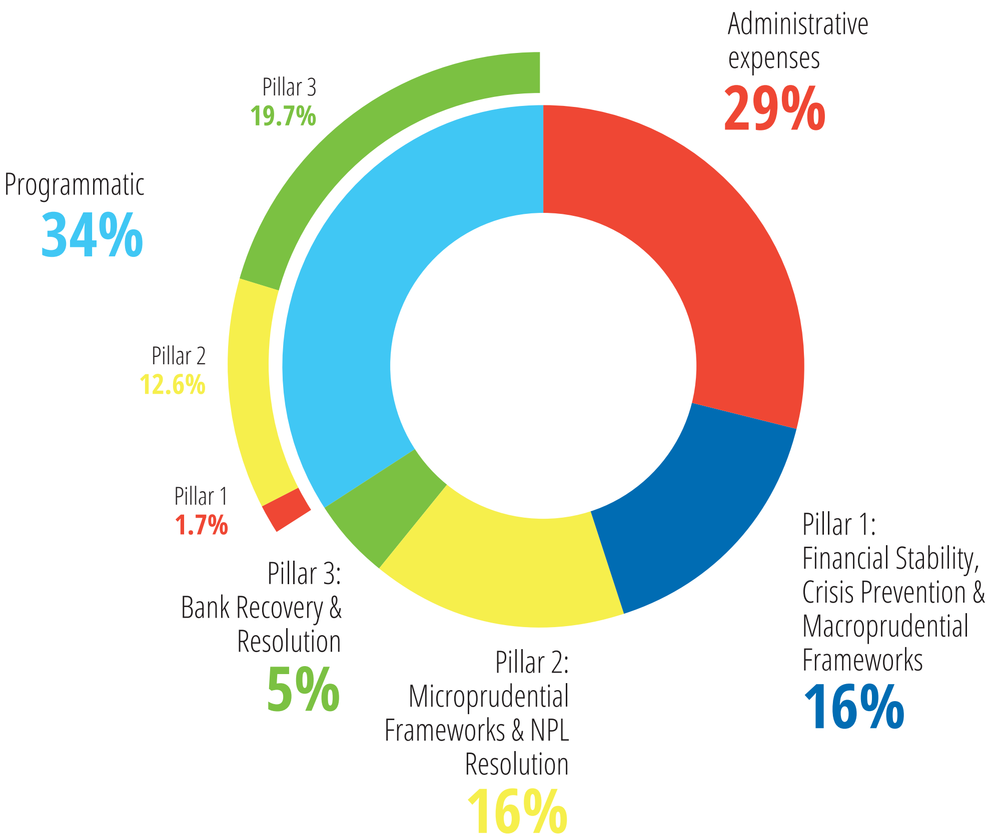


Disbursement by categories (for the period of January 1, 2021 – December 31, 2021)		
Staff costs[2]	€ 1,585,298.82	86%
Consultant fees[3]	€ 219,006.67	12%
Travel expenses[4]	€ 16,529.98	1%
Publications & workshop/meetings	€ 16,959.61	1%
Total	**€ 1,837,795.08**	**100%**



2 Incl. FinSAC Coordinator, one program assistant, six task team leaders and related unit task team leaders supporting FinSAC program
3 Incl. short term consultants and consultant firms
4 Incl. travel expenses of staff

Disbursement by pillars (for the period of January 1, 2021 – December 31, 2021)		
Administrative expenses[5]	€ 535,276.43	29%
Pillar 1: Financial Stability, Crisis Prevention & Macroprudential Frameworks	€ 299,553.18	16%
Pillar 2: Microprudential Frameworks & NPL Resolution	€ 284,393.32	16%
Pillar 3: Bank Recovery & Resolution	€ 96,340.41	5%
Programmatic[6]	€ 622,231.74	34%
Pillar 1		1.7%
Pillar 2		12.6%
Pillar 3		19.7%
Total	**€ 2,282,744.42**	**100%[7]**



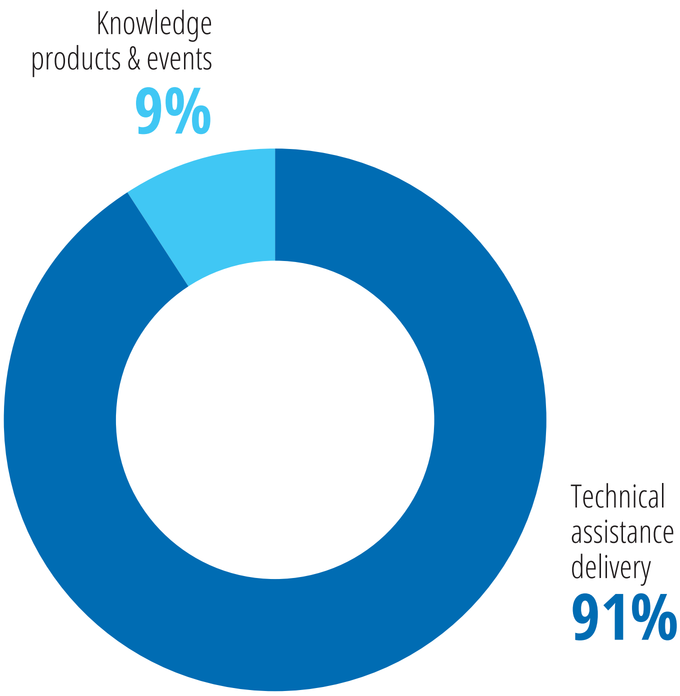
5 Includes cost of all types of categories not related to the particular Trust Fund activities activities and all general expenses: program management, contracts of designer, editor, staff cost of coordinator, program assistant/back up, travel cost for staff for training, general translations services, utilities, office maintenance, office supplies, depreciation, publications and other related services, representation cost, coordination and some business development activities.

6 See also percentages by country below.

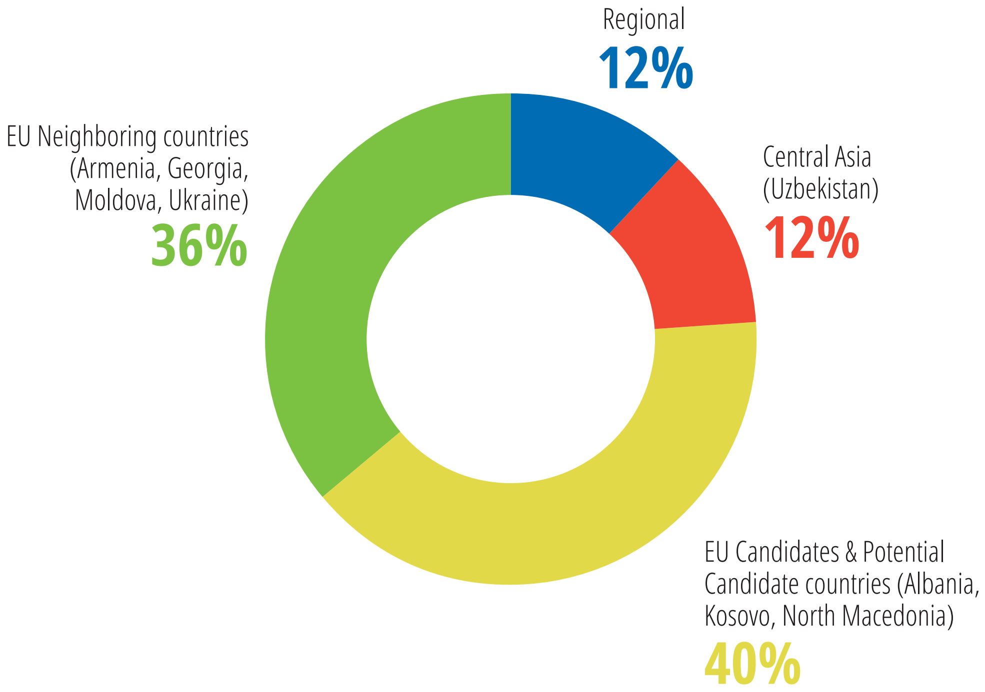
7 In this graphic percentages have been rounded to the nearest whole number.

Disbursement by pillars for programmatic projects (for the period of January 1, 2021 – December 31, 2021)	Pillar 1	Pillar 2	Pillar 3
North Macedonia: Macroprudential, Crisis Preparedness, Bank Recovery & Resolution	5%		16%
Armenia: Risk-based Supervision & Financial Sector Safety Net		15%	14%
Albania: Bank Supervision, Resolution, & Deposit Insurance		9%	21%
Ukraine: Bank Recovery & Resolution, Micro-Prudential Frameworks & NPL Resolution		13%	7%

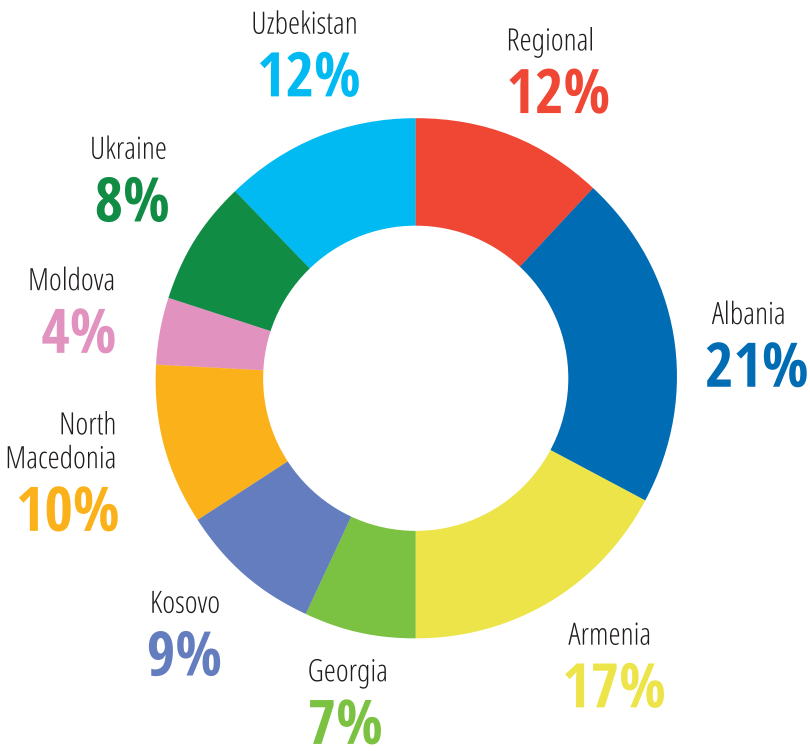
Disbursement by output (for the period of January 1, 2021 – December 31, 2021)		
Technical assistance delivery	€ 1,186,276.79	91%
Knowledge products & events	€ 116,241.86	9%
Total (excl admin expenses)	**€ 1,302,518.65**	**100%**



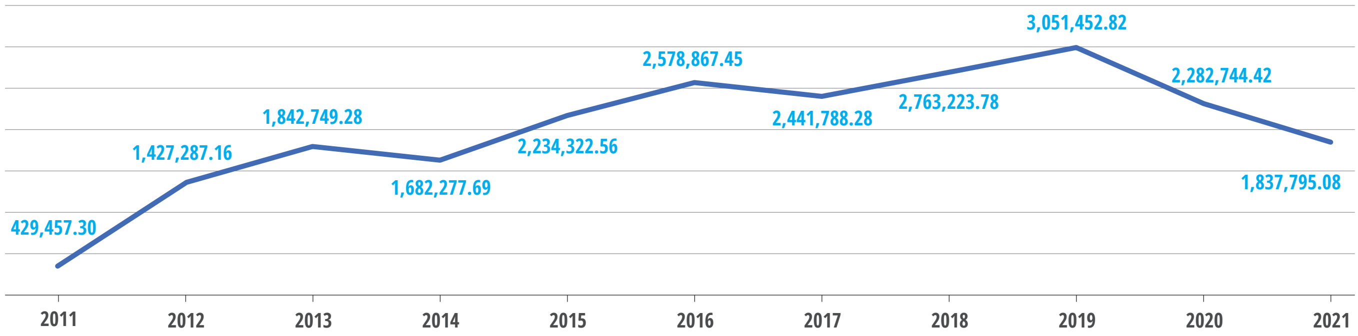
Disbursement by country groups (for the period of January 1, 2021 – December 31, 2021)		
Regional (includes knowledge products and events)	€ 151,418.74	12%
EU candidates & potential candidate countries (Albania, Kosovo, North Macedonia)	€ 528,410.53	40%
EU neighboring countries (Armenia, Georgia, Moldova, Ukraine)	€ 471,730.04	36%
Central Asia (Uzbekistan)	€ 150,959.34	12%
Total (excl admin expenses)	**€ 1,302,518.65**	**100%**



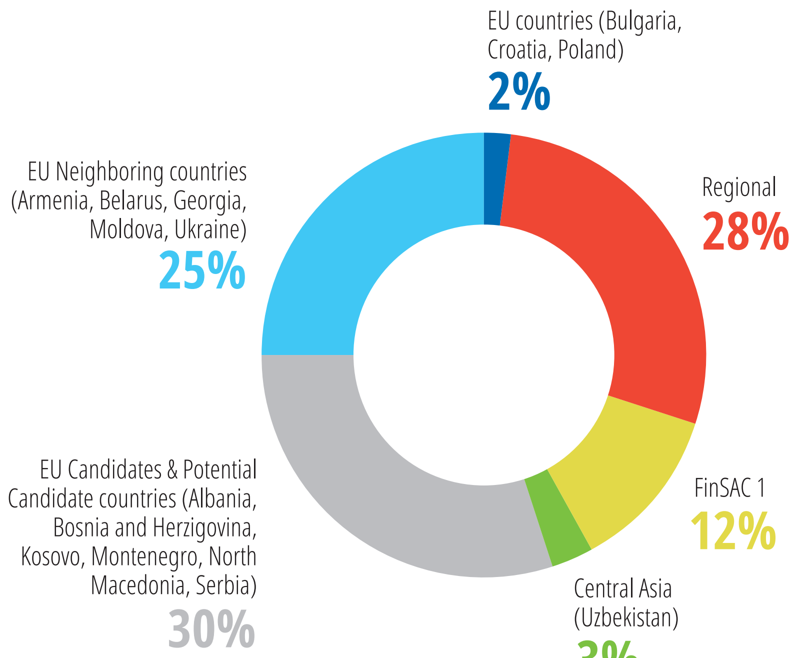
Disbursement by countries (for the period of January 1, 2021 – December 31, 2021)		
Regional (includes knowledge products and events)	€ 151,418.74	12%
Albania	€ 279,229.66	21%
Armenia	€ 223,072.37	17%
Georgia	€ 88,594.58	7%
Kosovo	€ 123,558.81	9%
North Macedonia	€ 125,622.06	10%
Moldova	€ 55,059.01	4%
Ukraine	€ 105,004.08	8%
Uzbekistan	€ 150,959.34	12%
Total (excl admin expenses)	**€ 1,814,560.85**	**100%**



10 YEARS OF FINSAC IN THE REGION AND COUNTRIES

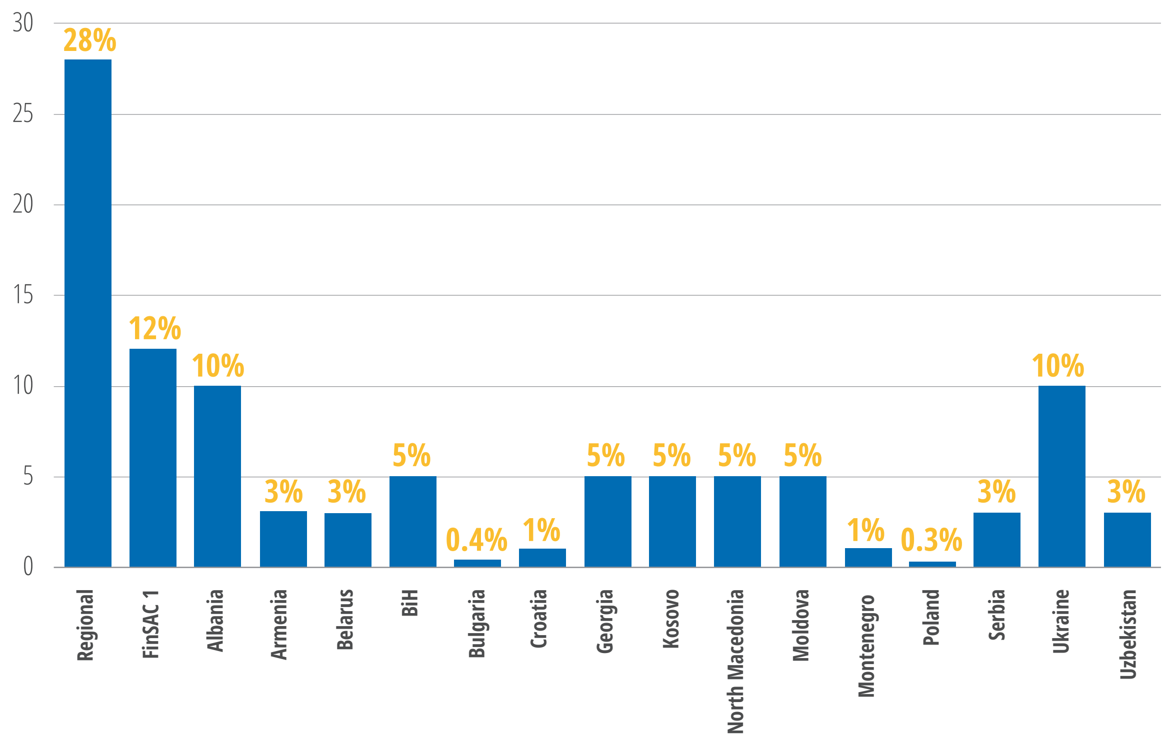


REGIONAL (includes knowledge products and events)	€ 4,860,022.08	28%
FinSAC 1[8]	€ 2,065,916.83	12%
EU candidates & potential candidate countries (Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, Serbia)	€ 5,268,558.51	30%
EU neighboring countries (Armenia, Belarus, Georgia, Moldova, Ukraine)	€ 4,453,955.24	25%
Central Asia (Uzbekistan)	€ 500,716.58	3%
EU countries (Bulgaria, Croatia, Poland)	€ 347,421.43	2%



8 Expenditure on FinSAC 1: In its early 18 months of operation all FinSAC expenditure (including set up costs, staff costs, and all projects, technical assistance, and knowledge products/events) were assigned to a single budget.

REGIONAL (includes knowledge products and events)	€ 4,860,022.08	28%
FinSAC 1[10]	€ 2,065,916.83	12%
Albania	€ 1,677,420.04	10%
Armenia	€ 564,516.09	3%
Belarus	€ 485,455.77	3%
Bosnia and Herzegovina	€ 932,720.96	5%
Bulgaria	€ 67,697.28	0.4%
Croatia	€ 224,379.44	1%
Georgia	€ 834,632.33	5%
Kosovo	€ 920,663.27	5%
North Macedonia	€ 932,430.80	5%
Moldova	€ 820,970.87	5%
Montenegro	€ 261,049.45	1%
Poland	€ 55,344.71	0.3%
Serbia	€ 544,273.99	3%
Ukraine	€ 1,748,380.18	10%
Uzbekistan	€ 500,716.58	3%



10 Expenditure on FinSAC 1: In its early 18 months of operation all FinSAC expenditure (including set up costs, staff costs, and all projects, technical assistance, and knowledge products/events) were assigned to a single budget.

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