FINANCIAL SECTOR ADVISORY CENTER

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ANNUAL REPORT 2018

WORLD BANK GROUP
Finance, Competitiveness & Innovation

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Financial Sector Advisory Center

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BMF
AUSTRIAN FEDERAL MINISTRY OF FINANCE

Abbreviations

BRRD	Banking Recovery and Resolution Directive
CRR/CRD IV	Capital Requirements Regulation/ Capital Requirements Directive IV
ECA	Europe and Central Asia Unit, World Bank
EU	European Union
FCI	Finance, Competitiveness, and Innovation Global Practice, World Bank
FinSAC	Financial Sector Advisory Center, World Bank
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
NPL	Non-Performing Loans
SREP	Supervisory Review and Evaluation Process

Contents

Alfonso Garcia Mora
Global Director
Finance, Competitiveness, &
Innovation Global Practice (FCI GP)
The World Bank

Financial stability is a precondition for any financial system to fulfil its potential in supporting economic development and is therefore critical in achieving the World Bank's twin goals of reducing poverty and fostering shared prosperity. The promotion of financial depth and stability in developing countries is one of the Finance, Competitiveness, and Innovation (FCI) Global Practice's three major global mandates in the financial sector, together with financial inclusion and finance for development.

As part of the Global Practice's regional Europe and Central Asia unit, the Financial Sector Advisory Center (FinSAC) makes a valuable contribution to FCI efforts. FinSAC is a dedicated unit supporting selected countries to strengthen their financial sector regulatory and supervisory frameworks and create stable conditions that facilitate economic growth in client countries in Eastern Europe and Central Asia. Originally established to help countries in wider Europe respond to the challenges of the global financial crisis for the banking industry, the Center has evolved and grown over its seven years of operation to become a trusted partner and source of knowledge and high-quality technical assistance. The Center's accessibility, responsiveness, and expertise is greatly valued by client countries and is all made possible by the steadfast support of the Austrian government, for which we are very grateful.

Reform is a long term process but I believe this Annual Report helps demonstrate that with FinSAC's support, client countries are achieving real and sustainable outcomes. The team looks forward to consolidating early reforms and building ever more resilient national frameworks.

Harald Waiglein
Director General Economic Policy, Financial Markets, and Customs Duties
Federal Ministry of Finance
Republic of Austria

The Austrian Ministry of Finance has been proudly supporting FinSAC's operations since 2011. We recognize that building financial systems that can withstand shocks and can maintain public trust requires determined and concerted action.

It can be challenging to understand and appropriately implement the many and varied initiatives being proposed to improve different aspects of financial sector frameworks, particularly for World Bank client countries that are constrained in their capacity to implement complex reform packages and whose financial sectors still face important developmental challenges. This is where we believe FinSAC's role is so important. Its experts can share global experience and help countries implement international best practice in a manner that best suits their individual national circumstances. We applaud the commitment of partner countries to this reform process.

This Annual Report reflects a real record of achievement, but there is still more to be done. International efforts to strengthen prudential regulation and supervision continue unabatedly, and we remain committed, including through FinSAC, to helping share good practice and support the establishment of strong financial systems that help insulate economies against future shocks.

1. Introduction

The Financial Sector Advisory Center (FinSAC), in operation since 2011, is part of the World Bank's regional Europe and Central Asia (ECA) unit of the Finance, Competitiveness, and Innovation (FCI) Global Practice. FinSAC supports client countries in the ECA region to build more resilient and more stable financial sectors

A dedicated Vienna-based technical unit of the World Bank, FinSAC delivers implementation-oriented technical advice to client countries with funding from Austria's Federal Ministry of Finance. It assists countries in the region in dealing with some of the legacy issues of the global financial crisis, including the resolution of non-performing loans (NPL) and fragmented crisis management frameworks, and in implementing new international and regional regulatory and supervisory initiatives. These activities have a special relevance for the ECA region, which despite recent improvements stands out as the World Bank region worst affected by the financial crisis.

FinSAC's work is organized around three thematic pillars: pillar 1 - macroprudential supervision and crisis management, pillar 2 - microprudential oversight and NPL management, and pillar 3 - bank resolution. Bilateral technical assistance engagements with counterparts in eligible countries are the cornerstone of FinSAC's activities, but it also organizes technical workshops, conferences, and seminars and undertakes research projects.

A distinguishing feature is the availability of in-house technical experts who take the lead in delivering FinSAC's work program. The FinSAC team bring applicable knowledge and hands-on experience of the stability themes that they cover. Their skills are critical to FinSAC's capacity to provide policy advice that is appropriately tailored to client countries' needs. Their proximity to beneficiaries of FinSAC support allows for frequent short and cost-effective missions, giving central banks and regulators in client countries easy access to technical expertise.

Highlights of 2018

2018 was a productive year for FinSAC. The year began with an active portfolio of 14 technical assistance projects, most of which were fully concluded at year-end. In addition to direct technical assistance FinSAC undertook analytical work and also hosted knowledge events, including a well-received two-day international conference for client country authorities on NPL reduction.

FinSAC extended into a third phase in December 2017, with a commitment of €8 million for the first three years from the Austrian Federal Ministry of Finance. FinSAC 3 continues to provide direct technical assistance to client countries and expands its potential with the introduction of programmatic windows, which aim to address a broader range of financial stability components in a single project. Eight new technical assistance projects financed under FinSAC 3 were initiated in 2018, including a new programmatic window project in Bosnia and Herzegovina. Among the new projects is FinSAC's first one in Central Asia. This project in Uzbekistan is providing assistance to the Central Bank in rewriting the banking law, which urgently needs updating in light of an expected change in ownership structures in the banking system and considering the need to introduce core elements of international best practice. Further information on all FinSAC activities in 2018 is included later in this report.

To keep pace with client country demand, the FinSAC team grew this year to include two new colleagues (a financial sector analyst and a financial sector specialist), while an additional senior financial sector specialist onboarded in January 2019. With this expanded team in place FinSAC will be better able to meet the continued strong interest, particularly for bilateral technical assistance, and to effectively balance a high operational work load with analytical work and the organization of knowledge events.

FinSAC committed €2,763,224 to its activities in 2018, up from €2,441,790 in 2017. The increase in expenditure reflects efforts to try to complete projects financed under FinSAC 2, as well as higher staff costs due to increases in headcount and salary increments. Key themes in 2018 included enhancing recovery and resolution frameworks for failing banks, cybersecurity for financial institutions, and technological advances more broadly.

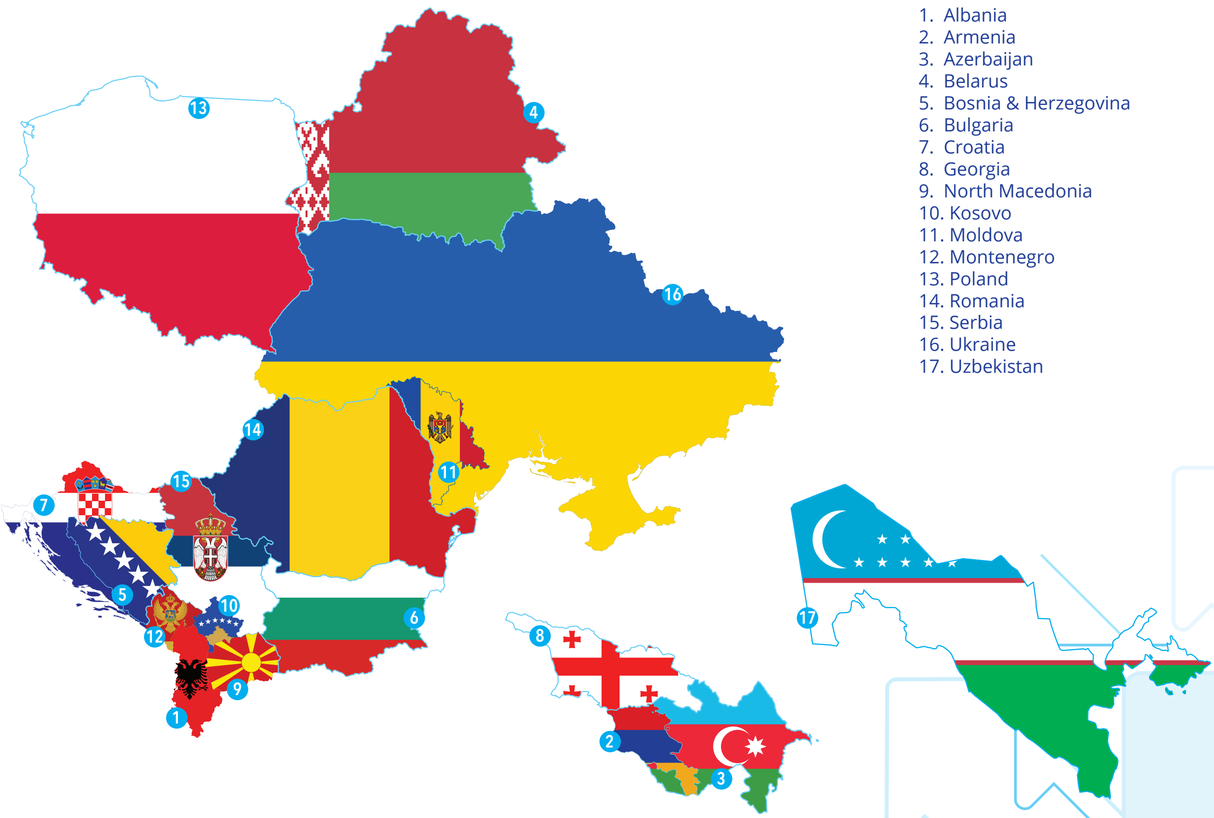
FinSAC is proud to play a key role in building and maintaining FCI ECA's deep and continuous engagement with eligible countries on stability-related topics, a high-priority policy area in the aftermath of the global financial crisis. To date, with a relatively small staff, it has delivered more than sixty technical assistance assignments in fifteen ECA countries, organized ten regional conferences, and published nearly ten research and policy papers/briefs. FinSAC has helped ensure the implementation of wide-reaching reforms in crisis-affected client countries that would likely have taken much longer to achieve without this support. This has been made possible thanks to the continued generosity of the Austrian Federal Ministry of Finance, and thanks to the commitment of FinSAC client countries to financial sector reform. The newly expanded FinSAC team looks forward to working with its client countries in 2019 and beyond.

2. The purpose and structure of the Financial Sector Advisory Center

Delivering targeted financial sector reform advice and implementation assistance

FinSAC supports client countries in building more resilient and more stable financial sectors. It does this primarily through direct technical assistance, and also undertakes analytical work and organizes knowledge events. FinSAC is set up as a Trust Fund, funded by the Austrian Ministry of Finance. It provides independent and tailored expertise, technical advice, and implementation support to eligible client countries that helps implement concrete legislative, regulatory, and institution-building initiatives tailored to their national circumstances that strengthen the resilience and efficiency of financial systems.

FinSAC Client countries



Initiated as a response to the global financial crisis

The global financial crisis of 2008 had a significant impact on countries in emerging Europe. Given high levels of private debt to foreign banks and significant foreign-currency exposure, there was concern that lending would be scaled back and that foreign-owned banks might even withdraw. The World Bank with the European Investment Bank, European Bank for Reconstruction and Development, the International Monetary Fund (IMF), the European Commission, and other international financial institutions launched the Vienna Initiative in 2009, a private-public platform which initially aimed to shore up the financial sector and to maintain a flow of credit to the economies of the region. FinSAC was established in Vienna in 2011, as a follow-up mechanism of the Vienna Initiative in which it continues to play a role.

The crisis and its aftermath not only unveiled serious flaws in capital and liquidity requirements, but also exposed shortcomings in supervisory tools and powers, cross-border coordination, bank recovery and resolution, and deposit insurance schemes. In response, there has been revision of global financial regulatory standards and institutional frameworks by the G-20, the Financial Stability Board, the Basel Committee on Banking Supervision, the European Union (EU), and all major prudential regulators and central banks.

Addressing legacy problems and building new resilient frameworks

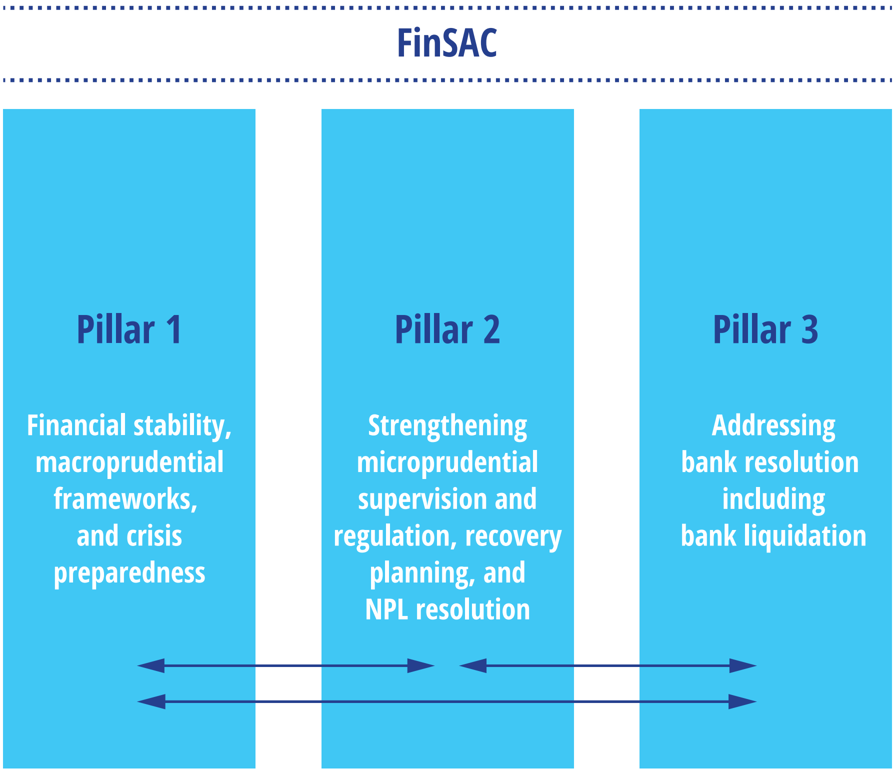
FinSAC engages with policymakers in the region and global standards setters to:

1. Provide hands-on support to client countries faced with systemic crisis situations, helping navigate episodes of systemic distress and seeking to address legacy issues from the crisis such as high level of NPLs and fragmented crisis management frameworks.
2. Support countries to upgrade their legal, regulatory, supervisory, and resolution frameworks to implement relevant good practice and align with appropriate global and EU standards in a way that is proportionate.

A three pillar approach to improving financial stability

FinSAC organizes its technical assistance within three distinct areas, covering financial stability, macroprudential frameworks and crisis management; microprudential regulation and supervision, recovery planning, and NPL resolution; and banking resolution. In addition to dedicated work streams within each of the pillars, the FinSAC team works cooperatively between and among the pillars as appropriate and feasible.

The three FinSAC pillars



A core team of financial sector experts

FinSAC comprises a team of seasoned experts with hands-on knowledge of relevant issues for client countries. It is able to respond to client demand with speed and flexibility. External consultants help augment implementation of its work program for highly specialized requests.

FinSAC team

Miquel Dijkman
Lead Financial Specialist, FinSAC Coordinator
Macroprudential supervision, crisis management

Aquiles Almansi
Lead Financial Specialist
Macroprudential supervision, Cyber Crisis management

Juan Ortiz
Senior Financial Sector Specialist
Microprudential supervision

Pamela Lintner
Senior Financial Sector Specialist
Bank recovery & resolution

Karlis Bauze
Senior Financial Sector Specialist
Non-performing loans

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

Ismael Ahmad Fontán
Senior Financial Sector Specialist
Supervisory and regulatory affairs

Milica Nikolic
Financial Sector Specialist

Nan Zhou
Financial Sector Analyst

Harnessing and synthesizing global good practices and experience

FinSAC uses its global knowledge to develop and disseminate international best practices and assists client countries in transposing them in a manner that best suits the local context. It does so in close cooperation with global and regional organizations including, for example, the Basel Committee on Banking Supervision, the Financial Stability Board, the Financial Stability Institute, the European Commission, the European Banking Authority, the Single Resolution Board, the Vienna Initiative, and the European Central Bank.

FinSAC is fully integrated with the World Bank FCI Global Practice, ensuring that FinSAC's work program is well-aligned with FCI's priorities for the Eastern Europe and Central Asia region. In addition, FinSAC cooperates closely with FCI's global solution teams and with other financial sector centers. It also contributes its specialist knowledge in other regions as appropriate through participation in technical assistance projects, knowledge events, and the joint IMF-World Bank Financial Sector Assessment Programs.

Targeting assistance in response to demand

FinSAC has developed effective working relationships with the authorities in client countries to assess areas of weakness and to design appropriate responses to these. For most projects the client country establishes a local project team that works closely together with the FinSAC experts. This helps FinSAC tailor support to the specificities of the local context and ensures that the ultimate end users are closely involved throughout the project, strengthening ownership of reforms and facilitating effective knowledge transfer.

Each stage of reform brings its own challenges, FinSAC assistance is therefore designed to advance cumulatively in pace with progress made. Projects are varied, including crisis simulation exercises, guidelines on NPL reduction, and the effective introduction of recovery and resolution planning, while also addressing newer topics such as cybersecurity for financial sector authorities.

Developing transferable knowledge and tools

Different client countries are moving at various speeds in their reform efforts, and from different starting points. Technical advice and tools developed initially for one project, can subsequently be adapted and used with other countries as they reach that stage, with the added benefit of gaining from the implementation experience of regional neighbors.

FinSAC seeks to further distill and disseminate reform experience for the benefit of wider audiences including through conferences and seminars, and in FinSAC publications in the form of working papers and policy briefs. These knowledge events and publications in turn often trigger new technical assistance requests and provide feedback to global policymakers on the impact of international standards and requirements.

A trusted and committed reform partner

FinSAC has been able to engage with client countries on a range of stability related topics that are of high relevance to a region still recovering from the impact of the financial crisis. FinSAC works with clients to understand their specific needs and to ensure projects are appropriate, effective, and timely. Client countries have confirmed their trust in FinSAC as a partner on their reform journey through their demand for ongoing and new assistance.

Funded by the Austrian Government

The Austrian Federal Ministry of Finance fully funds FinSAC and implementation of its program through a Trust Fund. This has allowed the Center to begin a significant third phase covering a five-year period, comprising three years with a two-year renewal conditional upon a favorable mid-term assessment. An increase in staff in 2018 and early 2019 has allowed FinSAC to expand and deepen its commitment to client countries.

3. The regional economic environment and financial sector priorities

The European Union

2018 saw the EU economy enter its sixth year of uninterrupted growth. All EU Member States registered positive growth figures, but the moderation of momentum since the start of 2018 suggested that economic growth peaked in 2017. From 2.4% in 2017, GDP growth in the EU 28 fell back to 2.1% this year, slightly below earlier estimates.

The mild slowdown reflected an interplay of domestic and external factors. Homegrown factors included the lingering uncertainty over Brexit, amidst protracted negotiations with the EU and an uncertain policy outlook in the UK. In addition, economic activity weakened against the backdrop of tightening labor markets and more binding supply side constraints in some of the stronger EU economies. External factors included the fading of world trade growth amidst rising trade tensions, higher oil prices, and increasing global interest rates. The latter have weighed on financial market sentiment, which also contributed to the emergence of pressures in some emerging market economies, notably Argentina and Turkey.

Broadly positive economic conditions helped to sustain European banks' efforts to clean up their balance sheets. European banks continued to make progress in 2018 in reducing exposures to non-performing assets. The total stock of NPLs held by large EU banks had declined by around one-third and the (gross) NPL ratio had nearly halved since end-2014. However, the pace of NPL reductions continued to vary significantly across countries, with limited progress in some of the countries with the highest NPL burdens.

Bank profitability remained broadly stable in 2018, which was the outcome of opposing trends. Despite a one-off increase in provisioning charges due to the adoption of International Financial Reporting Standards (IFRS) 9, declining impairment costs was the largest positive contributing factor to profitability in the first six months of 2018. At the same time, the positive impact of lower impairments was offset by declining operating profits and non-recurring revenues. Overall, banks continued to face challenges in a low interest rate environment, a relatively flat yield curve, and growing competition from new technology players which put pressure on banks to improve operational efficiency.

Sovereign risk concerns resurfaced in Italy, triggering apprehension about a renewed sovereign-banking nexus. Italian sovereign bond yields became increasingly volatile amidst tensions with the EU over a draft budget, triggering significant fluctuations in sovereign bond prices, and impacting the banking sector's capital base. Although no contagion effects to other EU member states occurred, these events suggested that the link between banking business and sovereign bonds is not severed, with banks' holdings of sovereign debt amplifying the potential for a renewed round of transmission of sovereign stress to bank lending and solvency risk.

Operational risk continued to present a considerable challenge for EU banks, particularly through cyber risks threatening the data integrity, data confidentiality, data protection, and business continuity of the increasingly digitalized European banking sector. Banks also became increasingly reliant on outsourcing of information technology services and data to third-party service providers. The rapid evolution of cyber risks put a high premium on banks' continued efforts to update and improve their information technology infrastructures. Potential disruptions of online banking services not only affect banks' profitability but could potentially entail significant losses to the real economy and might endanger the stability of the whole financial system.

Compared with previous years, the number and volume of alleged cases related to money laundering, terrorist financing, and sanction noncompliance involving European banks rose in 2018, as illustrated by events surrounding Danske Bank's branch in Estonia. A criminal investigation unveiled irregularities with non-resident accounts, representing €200 billion of suspicious transactions. Deficiencies related to anti-money laundering and countering financing of terrorism were also among the key drivers that led to the demise of Latvia's third largest bank, ABLV Bank, in February 2018. The US Treasury's Financial Crimes Enforcement Network issued a notice in February, accusing ABLV of money laundering. The notice triggered a spike in deposit outflows. Less than a week later, to prevent the bank's disorderly collapse, the Latvian regulator and the European Central Bank froze all payments out of ABLV. Subsequently, the European Central Bank determined that ABLV was failing or likely to fail, in accordance with the Single Resolution Mechanism Regulation. ABLV is being liquidated in accordance with Latvian law.

Banking pressures emerged in Italy and in Poland. In Italy, Banca Carige's balance sheet was hit by a fraud scandal. The European Central Bank gave the bank until the end of 2018 to recapitalize or to find an acquirer. Banca Carige failed to raise €400 million in December 2018. After the missed deadline, the European Central Bank appointed three temporary administrators and a surveillance committee to replace Banca Carige's board of directors. Italy's cabinet then proceeded towards pre-emptive recapitalization of the distressed lender through a state guarantee on the bank's future bonds, rather than pushing the distressed bank towards resolution or liquidation in line with the Banking Recovery and Resolution Directive (BRRD). In Poland, stress emerged in Bank Getin and Bank Idea, to which the authorities responded by easing reserve requirements while preparing for an assisted merger. The crises then set the stage for a broader corruption scandal over allegations that the banking regulator had solicited bribes in return for support to one of the distressed banks.

EU candidate and potential candidate countries – Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Montenegro, and Serbia.

Economic growth in the Western Balkans strengthened to an estimated 3.5% in 2018, up from 2.6% in 2017. Growth was strongest in Albania and Kosovo, at 4%, while Serbia and North Macedonia registered significant improvements. Serbia's economy rebounded strongly from 2017's weather-related slowdown while North Macedonia benefitted from a restoration in investor confidence. Growth was stimulated by higher public investment and credit growth, which helped to boost consumption. While lending to households has picked up across the region, lending to non-financial corporates is more uneven and overall credit to the private sector continues to significantly lag levels in the EU.

The uptick in economic growth contributed to further reductions in NPL volumes to less than 8% of total loans (see Annex A with financial stability indicators for FinSAC countries). Albania and Serbia registered the most significant improvements thanks to write-offs and sales, although NPLs still represent more than 10% of the portfolio in Albania. New insolvency laws are in place in Albania and the Bosnia and Herzegovina entity Republika Srpska, and Albania has made preparations for a new voluntary out-of-court restructuring system (the "Tirana approach"). Despite these encouraging developments, there are important unresolved challenges related to overindebted corporate borrowers. This conclusion was confirmed by an IFC-funded benchmarking study, overseen by FinSAC, that assessed the financial health of large Albanian corporates.

While banks in the region are generally well-capitalized profitability is low on average, with a regional average return on assets of 1.8%, and pockets of vulnerabilities did emerge in 2018. In Montenegro, the central bank placed two small banks, representing some 6% of banking assets, under temporary administration in December due to the poor financial condition of the two lenders. The decision was made after audit results demonstrated that the banks' capital fell short of regulatory requirements.

While institution-specific factors played an important role in these events in Montenegro, there are broader issues regarding the structure of the banking sector in the Western Balkans, which are characterized by small domestic markets and – in several cases – the presence of a significant number of small banks. This raises questions whether banks have the necessary scale to be commercially viable and to deliver financial services in a cost-effective manner. Although some countries seem likely candidates for further consolidation in the banking sector, it remains to be seen whether it is feasible under the current circumstances to attract qualified and reputable investors. Since the global financial crisis, the pool of potential candidates has shrunk considerably as EU parent banks' appetite for cross-border acquisitions and expansions in non-core markets has declined. This reflects the continuing need to rebuild capital and liquidity buffers at the parent bank level and recent regulatory changes. A transitional arrangement for Article 114 of the EU's Capital Requirements Regulation (CRR) expired at the end of 2017, so sovereign exposures of EU banks' subsidiaries in non-investment grade third countries (including in the Western Balkans) are now assigned a 100% risk weight. In addition, investor appetite from more recent investors, particularly Turkish banks, was also affected by an increasingly challenging economic outlook in their home markets.

Financial sector reform priorities in the Western Balkans continued to be heavily influenced by EU accession. Countries understandably focused their reform efforts at aligning regulatory and legal frameworks with the EU, notably the Capital Requirements Directive (CRD) IV and the CRR, as well as the BRRD. Given the overall early stage of financial market development in the Western Balkans it is challenging to maintain sufficient pools of high-quality liquid assets to meet liquidity standards contained in Basel 3, the international regulatory framework for banks, and to create sufficient mass of financial instruments that can be "bailed-in" in times of crisis. The latter leaves resolution authorities with few options but to bail-in uninsured depositors, which is politically contentious and can cause potentially significant adverse wealth effects among households and corporates.

Western Balkan countries continued their transition towards expected credit loss models, as required by IFRS 9. Although the new standard became mandatory as of January 2018, further efforts were necessary to train staff and to address data challenges. Lastly, Western Balkan countries continued preparations to obtain an exemption from Article 114 of the CRR, aimed at undoing the increase in risk weights on sovereign exposures. This is understandably a high priority in banking sectors that are dominated by EU-based parent banks. An exemption requires that supervisory and regulatory arrangements are assessed by the European Commission as “equivalent”, using a multi-faceted methodology that considers the institutional framework, banks’ own funds, credit risk, market risk, operational risk, liquidity and capital buffers, and macroprudential tools, among others.

EU neighboring regions – Belarus, Moldova, and Ukraine

Belarus, Moldova, and Ukraine sustained their recovery from the 2015–2016 recession, with growth oscillating between 3.5% and 4%. The favorable economic tide underpinned ongoing efforts to address legacy issues in the financial sector, including a substantial volume of NPLs and a high degree of dollarization in the financial system.

In Belarus, the largely publicly owned financial sector remained highly exposed to state-owned enterprises. The authorities completed asset quality reviews for all banks and followed in some cases with remedial actions, contributing to a strengthening of capital positions. In addition, authorities continued efforts to de-dollarize the financial system, including through the differentiation of prudential policies to reflect the higher risk posed by foreign-currency denominated lending and deposits. Nonetheless, exposure to forex-related liquidity risk, and forex-induced credit risk posed by unhedged borrowers continued to be material.

In Moldova, authorities continued wide-ranging efforts to clean up the banking sector in the aftermath of the so-called raider attacks, in which illicit schemes were used to gain control of the majority of the banking sector’s assets. The focus was on enhancing transparency in systemic banks and strengthening the legal framework to remove unfit shareholders. While encouraging progress was made, challenges were still reported in relation to the identification of beneficial owners and related party exposures, including credible time bound plans to unwind excessive exposures.

Ukraine's financial sector continued to be affected by the aftermath of the 2014 banking crisis, which led to the liquidation of more than ninety banks, nationalization of a significant chunk of the remaining sector, and which continues to make itself felt through a high volume of NPLs. The authorities were still engaged in a sustained effort to clean up the banking sector, including through the establishment of a framework for the resolution and recapitalization of banks, a more realistic representation of credit risk on banks' balance sheets, the identification and reduction of hitherto undisclosed related party exposures, and enforcing transparency in ownership structures. Bank recapitalization plans and timely enforcement action helped to strengthen solvency in the sector, though a considerable number of banks still fell short of the 10% capital adequacy requirement. In addition, the resolution of problem banks in a manner that maximizes asset recovery and minimizes costs to the state continued to present a considerable challenge.

South Caucasus and Central Asia – Armenia, Azerbaijan, Georgia, and Uzbekistan

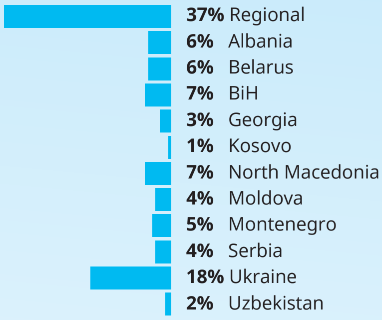
With growth of between 5.5-6%, the economic outlook of Armenia and Georgia continued to be strong, while Azerbaijan turned the corner after a protracted recession and the most severe financial crisis since independence. The favorable economic environment and increased capital requirements in Armenia and Georgia contributed to a strengthening of the banking sector's capital buffers, lower NPLs, and robust profitability. Dollarization, however, continued to present a considerable challenge, with banks struggling with structural vulnerabilities related to their exposure to external shocks and risks from high levels of financial dollarization, including credit risks and insufficient liquidity cushions in foreign currency. Credit growth also picked up, but the volume of credit to the private sector remained low compared to peers.

Strong oil prices contributed to an improvement in the operating environment of Azeri banks, although the macroeconomic outlook remained volatile due to an increase in real funding costs, and lingering concerns about a further devaluation of the domestic currency, exposing forex-related liquidity risks. In addition, the banking sector remains burdened by weak asset quality, with reported NPLs of 18% of total loans. The overall financial performance of banks remained subdued, as high costs, insufficient growth of income earning assets, and a legacy of underreported NPLs and related party loans continued to affect financial results, with a significant number of banks reporting losses. Against this backdrop, the stock of outstanding credit to the private sector has continued to drop. Restructuring of the largest state-owned bank, the International Bank of Azerbaijan, was completed in 2018. Later in 2018, preparations for the bank's privatization were initiated although no change materialized by the end of the year. The overall costs of the 2015 – 2018 banking system restructuring reached more than 30% of GDP and included (i) a transfer of Azerbaijan Manat 15 billion of NPLs from banks to a state entity (Aqrarkredit) at book value, (ii) the restructuring and transfer from the International Bank of Azerbaijan to the sovereign of senior foreign currency denominated debt of US$ 3.3 billion in 2017, and (iii) the injection of new capital of Azerbaijan Manat 650 million in 2018.

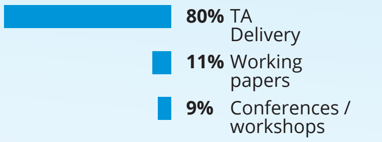
Uzbekistan continued apace with its financial sector reform program, launched in 2017 following the alignment of its official and informal exchange rates. Reforms were announced to improve governance of commercial banks, remove non-core administrative functions from banks, and increase minimum capital in banks. Supported by the World Bank Group and other development partners, the Uzbek Government's financial sector reform program is gaining speed and expanding to cover a wider spectrum of issues and subjects, including stress-testing of banks, the amendment of prudential regulations on capital, liquidity, and asset classification, and the preparation of new regulations on governance and risk management.

4. Technical assistance in 2018

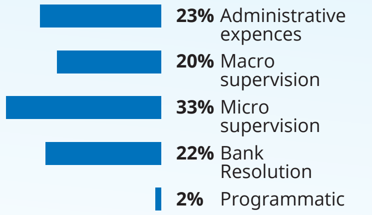
Percentage disbursement of expenditure by client country



Percentage disbursement of non-administrative expenditure by activity type



Percentage disbursement of expenditure by category



FinSAC's activities in 2018 were driven by its objective to support eligible client countries in establishing stronger, more resilient financial sectors through the provision of bilateral technical assistance projects, analytical work, and the organization of knowledge activities. FinSAC had bilateral technical assistance activities in eleven countries, as well as several regional engagements. 11 country technical assistance projects were completed in 2018, with seven more ongoing into 2019. Three knowledge events were organized, and a set of three policy briefs were produced. As was the case in previous years, bilateral technical assistance projects accounted for the bulk of FinSAC's work, representing more than 80 percent of its disbursements, with the remainder spread evenly between analytical work and knowledge events.

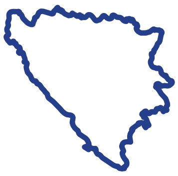
FinSAC committed a total of €2,763,224 to its activities, representing a 13% increase compared to 2017. FinSAC spent most on work related to pillar 2, which accounted for about a third of FinSAC's total expenses. The remainder was fairly evenly distributed over pillar 1 (20%) and pillar 3 (22%), while expenses on the newly established programmatic window represented some 2% of total expenditure. FinSAC's administrative expenses accounted for the remaining 23%, up from 17% in 2017. This increase reflects that 2017 was a transitional year, with several months gap between the outgoing and incoming program manager, lowering administrative expenses. Additional detail on expenditure is included in Annex B.

Programmatic windows working across the pillars

There is a great deal of synergy and interlinkage between the overarching pillars and FinSAC has always sought to work across the pillars as appropriate. Countries such as Albania, Bosnia and Herzegovina, North Macedonia, and Ukraine have been provided with multiple projects at the same time, simultaneously covering several FinSAC pillars.

To better reflect these cross-cutting projects, FinSAC 3 allows for programmatic projects which combine assistance across two or even all three pillars. This offers a more joined-up approach for clients and more efficient use of resources in administering one project with different aspects rather than a series of smaller separate projects. The programmatic window allows FinSAC to offer more comprehensive and systematic technical assistance to countries whose financial stability needs cover a broader range of areas.

FinSAC programmatic technical assistance to Bosnia and Herzegovina: Bank supervision and resolution



Following a series of smaller earlier projects, in 2018 FinSAC launched a multi-pillar project programmatic window to effectively support Bosnia and Herzegovina as it seeks to further strengthen financial stability. The project is underpinned by analysis from the IMF/World Bank Financial Sector Assessment Program. FinSAC's activities in 2018 focused on designing and implementing a new forward-looking, risk-based supervisory approach, and assistance and capacity building in the operationalization of the new bank resolution framework.

These themes were priority areas for FinSAC work in Bosnia and Herzegovina, as the recent banking law revision generated strong impetus for the country to improve convergence in supervisory and resolution approaches towards EU standards. Taking into account the enhanced powers and new responsibilities of authorities, FinSAC prepared overarching proposals for amendments to agency statutes. Working groups from the banking agencies engaged with FinSAC to develop a new supervisory review and evaluation process (SREP) as well as a stronger bank recovery and resolution framework. These are based on the European Banking Authority's SREP and the EU BRRD but tailored specifically to local contexts to ensure fully harmonized processes between the entities.

FinSAC helped finalize the SREP methodology particularly for the assessment areas of business models, internal governance and risk management practices, and capital and liquidity adequacy. The banking agencies published draft decisions for banks regarding SREP internal capital and liquidity adequacy assessments. Supervisory reporting procedures have been published in the Federation of Bosnia and Herzegovina and will be for Republika Srpska.

To further enhance the operational capacity of the banking agencies, FinSAC advised the authorities on organizational specializations and decision-making processes and conducted a series of workshops for on- and off-site supervisory staff, discussing topics including consolidated supervision, pillar 2 risk evaluations, and recovery plan assessments. This programmatic window will continue in 2019.

Pillar 1: Financial stability, macroprudential frameworks, and crisis preparedness

FinSAC assistance under Pillar 1 focuses on strengthening financial stability frameworks and improving the detection of and response to emerging systemic risks.

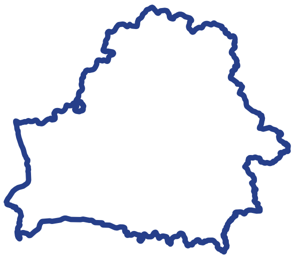
Since its inception, FinSAC has been helping countries address legal, regulatory, institutional, and operational gaps in order to build strong macroprudential institutional frameworks. It works with client countries to design and test their national financial stability arrangements, this includes supporting the establishment of financial stability councils and other coordinating bodies and the development of tools that can be used to monitor and analyse risk factors and mitigate them with macroprudential policies.

FinSAC offers client countries crisis simulation exercises which help test policies and procedures and build human capacity in managing situations of severe financial sector distress, including cyber-security incidents in a virtual environment. Exercises can be intra-agency, inter-agency, or a combination of both, and participants can be from one or more national jurisdictions. A comprehensive analysis and report, outlining the main lessons and policy recommendations, is shared and discussed with the participating authorities after each exercise. This often leads to requests for technical assistance to address areas identified for improvement.

The existence of an operational national deposit insurance or guarantee system is an important feature of a financial sector safety net. Funded by banks, these schemes exist to compensate depositors in the event of a bank failure, helping maintain depositor confidence and make bank runs less likely. FinSAC promotes the adoption of deposit insurance schemes that are in line with international best practices. FinSAC technical assistance to countries introducing or improving their deposit insurance system includes practical guidance on the set up and operation of the scheme, advice on a model to take into account the individual risk of banks, developing means of calculating the deposit insurers' financial needs, and guidance on stress testing the system to be better prepared for future crises and ensure rapid responses to different scenarios.

Pillar 1 technical assistance projects completed in 2018

FinSAC technical assistance to Belarus



Strengthening the deposit insurance framework
As part of a working group with the Central Bank and Deposit Insurance Agency, FinSAC continued its support of deposit insurance reform in Belarus in 2018. The working group's reform proposals were contained in a white paper endorsed in late 2017. The focus in 2018 was on implementation and ensuring a smooth transition from the permanent blanket guarantee of retail deposits to a limited coverage consistent with international best practice. Assistance was also directed at helping strengthen the institutional capacity of the Deposit Insurance Agency including to apply the methodology for risk-based premiums, set the target ratio for the deposit insurance fund, and define funding sources.

FinSAC technical assistance to Georgia

FinSAC Focus: Creating a deposit insurance system in Georgia

Following the global financial crisis, many countries rushed to enhance financial safety nets by strengthening or creating deposit insurance systems. In 2015, Georgia was one of the few remaining ECA region countries without an explicit deposit insurance system. FinSAC partnered with the Georgian authorities between 2015 and 2018 to prepare, implement, and successfully launch a deposit insurance system. FinSAC assistance was in two phases: deposit insurance preparation (June 2015-June 2017, and deposit insurance implementation (July 2017-November 2018).

In phase 1, FinSAC supported the authorities to design and prepare deposit insurance reform; from concept development, through design of a strategy, to enactment of the deposit insurance law effective from June 2017. During this phase FinSAC provided extensive knowledge sharing and policy guidance to the authorities and conducted a 3-day intensive training course for staff of the Ministry of Finance, National Bank of Georgia, and the Ministry of Economy on international practices and standards, including the International Association of Deposit Insurers' core principles and EU directives on deposit insurance. FinSAC also organized a media workshop and participated in several stakeholders' outreach events with banks to discuss the design of deposit insurance in Georgia and compare it with international standards and practices.

> “FinSAC support was very professional and experienced. Advice, provided materials, comments, and suggestions were always on time and valuable”.

Ana Alania
Payout Expert / LEPL Deposit Insurance Agency (Georgia)

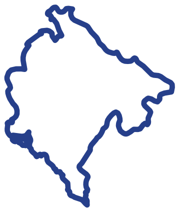
Phase 2 supported reform implementation and the launch of deposit insurance coverage. A tight timeline required extensive capacity building and institutional development assistance. FinSAC provided knowledge sharing, drafting, and capacity building support to the Ministry of Finance. A key element was the creation of a new Deposit Insurance Agency in July 2017. FinSAC offered technical knowledge and support at each stage, for example with its charter, core regulations, organizational chart, staffing plan and job requirements, and funding and budget plans. Within six months of the Agency's creation a director had been appointed and staff hired. Core procedures and regulations required by the Deposit Insurance Law were approved by the Agency's supervisory board, and a memorandum of understanding was signed with the National Bank of Georgia for the exchange of information and cooperation, as advised by the FinSAC project team, in time for the deposit insurance system to become effective and launch coverage for household deposits on January 1, 2018.

In 2018, FinSAC worked with the Agency to ensure the smooth functioning of the system. FinSAC advised on development of procedures and capacity building including (i) regulations on verification of data provided by banks and the application of sanctions for non-compliance, (ii) technical revisions to the Deposit Insurance Law, (iii) the design and content of the Deposit Insurance Agency's website; (iv) a road map and discussion of international experience and best practices in building the deposit payout process (including on management information systems), and (v) technical comments on other issues including calculation of forex deposit premiums.

During phase 2, FinSAC cooperated with both the Deposit Insurance Agency and the National Bank of Georgia to continue updating deposits exposure analysis and calculation of the deposit insurance scheme's funding needs in order to meet the target fund level established in law. The FinSAC team provided advice on additional sources of funds and a contingency financing framework.

Throughout the project FinSAC provided extensive knowledge and capacity building support to the Georgian Government, National Bank of Georgia, and the Deposit Insurance Agency, especially during the critical deposit insurance launch period from June 2017 to July 2018. FinSAC organized monthly or bi-monthly missions and provided regular on-the job training for Deposit Insurance Agency staff, prepared a range of technical presentations, organized workshops, held conference calls, and provided numerous technical comments and reference materials on request, enabling basic capacity to be built quickly. The project's success is evidenced in the Agency having effectively launched its communication campaign in April 2018 and managing its first deposit payout insurance case in July 2018, after the National Bank of Georgia revoked the license of the Georgian subsidiary of the International Bank of Azerbaijan.

FinSAC technical assistance to Montenegro



Deposit insurance strengthening

FinSAC technical assistance to Montenegro in 2018 focused on transposing EU deposit insurance requirements and implementing a risk based premium framework. FinSAC worked with the authorities to strengthen their deposit insurance arrangements in line with the International Association of Deposit Insurers' core principles, the EU Deposit Guarantee Schemes Directive, the European Banking Agency's Guidelines on Risk-Based Method, and the recommendations of the European Forum of Deposit Insurers. FinSAC assisted with the drafting of amendments to the Deposit Protection Law and bylaws. A methodology for a risk based premium framework was developed. At the request of the Deposit Protection Fund, follow-up technical assistance supported implementation of the risk based premium framework and improving the asset management function. Three missions were organized including two workshops, in July and in September.

FinSAC technical assistance to Ukraine

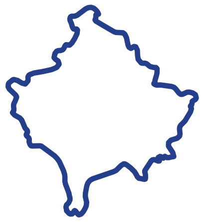
Analytical tools for assessing systemic risk in consumer lending

Following several years of low or negative real credit growth, consumer loans staged a strong comeback, expanding 40% year on year. While the level of consumer loans remained very low, the National Bank of Ukraine expressed concerns about the rapid rate of growth. It requested FinSAC assistance to construct analytical tools to benchmark the growth rate, in order to assess any systemic risk to financial stability.

Together with the Financial Stability Department of the National Bank, FinSAC developed a quantitative model of long-run relationship between the level of consumer loans and a set of explanatory variables, which is used to estimate the dynamics of consumer loan growth rates. During 2018 the Financial Stability Department and FinSAC cooperated on the data collection, specification, and estimation of this panel-vector error correction model, which the National Bank are now using to determine when macroprudential tools should be used to curb excessive consumer lending. As the model itself provides no guidance on which policy tool to select from the multitude available, an additional analytical framework was developed to assess the relative importance of supply and demand in credit dynamics at any point in time. This simple framework, using data on credit volumes, prices (interest rate spreads), and non-price credit conditions from the National Bank's quarterly lending surveys, guides the choice between policy tools that affect credit predominantly through demand and those that work mostly on the supply side. The equilibrium model and the supply/demand framework complement each other and together constitute an analytical suite that aims to provide a full picture for advising macroprudential decision-makers.

Pillar 1 technical assistance projects ongoing into 2019

FinSAC technical assistance to Kosovo

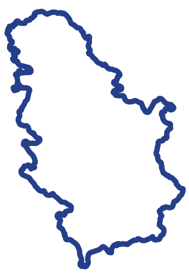


Crisis management and strengthening the deposit insurance fund

FinSAC began working with the authorities in Kosovo in 2018 to improve contingency planning and their capacity to respond to financial distress. The initial focus of the project was to reinvigorate the National Committee for Financial Stability, which acts as the main vehicle for policy coordination and cooperation on crisis management. FinSAC provided hands-on support to the Central Bank to revamp this Committee. It drafted a set of proposed terms of reference detailing membership, powers, accountability, as well as other governance features, to replace existing memoranda for interagency cooperation and discussed the plans with financial safety net stakeholders.

Within the current regulatory framework, operational readiness by the Central Bank to perform its lender-of-last-resort function is also being strengthened with FinSAC advice. A review of internal policies governing the emergency liquidity assistance process revealed areas that could be streamlined for swifter future interventions, in particular regarding actionable liquidity/solvency assessments, contracting and collateralization procedures, and supervisory sanction measures. An initial proposal has been shared with the Central Bank and will form the basis for technical assistance in the next step.

FinSAC technical assistance to Serbia



Strengthening the foundations and analytical basis for the deposit insurance system

In 2018, an assessment of the Serbian deposit insurance system against the International Association of Deposit Insurers' core principles was completed with FinSAC support. The assessment identified opportunities for strengthening the deposit insurance system, particularly in the areas of public policy objectives, mandate and powers, cross-border issues, the deposit insurer's role in contingency planning and crisis management, and sources and uses of funds. The next step is to agree on an action plan based on the assessment that will feed into legislative changes in 2019. FinSAC also supported the development of a target fund size model, which will help the Serbian Deposit Insurance Agency assess its target fund needs based on the local context. The model is being developed in collaboration with the United States Federal Deposit Insurance Corporation. With the initial model and a first round of training completed in 2018, the next step is to further customize it to local circumstances with more Serbia-specific data and to conduct more detailed training. This project will continue in 2019.

Pillar 2: Strengthening microprudential supervision and regulation, recovery planning, and NPL resolution

Banks are at the core of client countries' financial systems. Effective regulation and supervision of banks is therefore critical to maintaining financial stability. FinSAC's activities under pillar 2 aim to ensure safe and sound supervised entities, including through establishing forward-looking supervisory approaches and implementing appropriate prudential regulations in line with international standards and good practice. As the banking systems of many client countries are dominated by foreign, mostly euro area, banks much of FinSAC's support is focused on aligning regulatory frameworks and supervisory practices with applicable regulations, policies, and procedures in the EU. For prudential regulations, this means adopting the CRR/CRD IV, together with the technical standards prepared by the European Banking Authority and issued by the European Commission, and using the SREP, a set of methodologies and standards used to assess banks' risks, their governance arrangements, and their capital and liquidity situation.

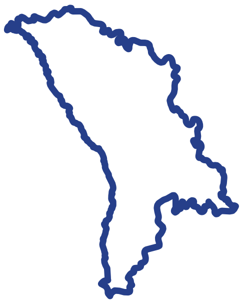
FinSAC assesses supervisory processes and methodologies and makes recommendations for implementing forward looking risk-based supervision. It undertakes gap analysis of compliance with EU prudential regulations, assists authorities in undertaking quantitative impact assessments, and advises on action and implementation plans. It has also assisted several countries in operationalizing recovery and resolution planning, which blends microprudential supervision and regulation (pillar 2) with banking resolution (pillar 3). Whereas resolution planning is focused on mitigating the risk to financial stability from an institution's failure, recovery planning is concerned with avoiding failure altogether.

Technical assistance also covers supervisory reporting arrangements, including financial reporting and common solvency ratio reporting, which can increase efficiency through the provision of coherent and comparable information. FinSAC advises on transitioning to IFRS, including assessment of the preconditions, policy advice on timing, and necessary safeguards when moving to IFRS 9 and adapting regulatory models to the change.

An important area for banks in client countries is ongoing high levels of NPLs. Despite improvements in some countries NPLs continue to depress financial sector performance (due to their adverse impact on profitability, funding costs, and lending volumes) and economic outcomes throughout the region. FinSAC continues to help client countries address NPLs in a holistic way, offering comprehensive assessments and professional advisory services, including producing tailored workout guidelines, regulations aimed at ensuring early detection of deteriorating loan quality, prudent collateral valuation practices, and other tools and strategies.

Pillar 2 technical assistance projects completed in 2018

FinSAC technical assistance to Moldova



Improving corporate governance in banking

FinSAC provided further assistance to the National Bank of Moldova in 2018 in support of their efforts to resolve and restructure the banks that have been under special administration since 2016. Investment in one of the banks by an international strategic investor was successfully completed in 2018. FinSAC continues to respond to requests for targeted advice on the two banks that remain under special administration.

Following the introduction in 2017 of two key pieces of legislation designed to begin upgrading Moldova's corporate governance standards for banks – the Law on Banks' Activities and a Regulation on Internal Governance and Risk Management – FinSAC delivered two training programs on corporate governance in June 2018. These training programs were an important component of the next phase of the work to improve corporate governance. The first program was for the board members of banks. It introduced the board members to modern corporate governance practices, presented the role of the board of directors and how to build a strong board, and used a customized case study to allow participants to discuss how they would improve the corporate governance of a fictional bank. The second program was for National Bank staff, mostly supervisory staff. This program also gave an overview of international standards of modern corporate governance, then focused on the two key issues for supervisors: the challenges of measuring and assessing corporate governance; and developing a supervisory approach to corporate governance.

> “FinSAC contributed significantly to restoring confidence in the banking system by supporting the efforts of the National Bank of Moldova to design and implement the supervisory and restructuring strategies related to ownership structure transformation and for improving the governance, operations, and risk management of the three banks under special administration.
>
> The high-level advice and assistance received from FinSAC was very prompt, relevant, and supported the ambitious reforms in terms of designing a more resilient supervisory framework.
>
> FinSAC assisted both the National Bank and the Banks' board representatives to improve their knowledge about the elements of modern corporate governance and the governance of risk and internal controls in banks”.

Ana Mardari
Principal Economist / External Relations and European Integration Service
National Bank of Moldova

FinSAC technical assistance to Ukraine

Non-performing loans restructuring and workout guidelines
FinSAC continued providing technical assistance to the Ukrainian authorities in 2018 following on from the gap analysis and strategy for NPL resolution developed in 2017.

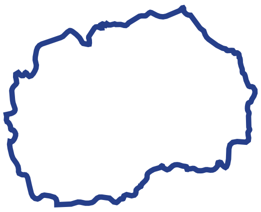
FinSAC finalized a set of guidelines this year for the National Bank of Ukraine on NPL resolution and the operation of workout units in banks. The National Bank transformed the guidelines into a proposed regulation and invited industry comments. As part of this task, a two-day seminar in Kiev in September on good practice for NPL resolution in banks convened around 100 NPL resolution experts, including senior managers from banks and supervisors from the National Bank, to discuss the guidelines and associated themes. The new regulation is expected to be effective from mid-2019.

FinSAC also provided technical assistance to the National Bank, at its request, regarding NPL restructuring methodologies/models to use in the practical NPL work-out of big corporate conglomerates. This was a particularly important task as a substantial part of the NPL stock consists of loans issued to big corporate conglomerates. The Ukrainian authorities continued a review of the insolvency law and worked towards the introduction of personal insolvency, previously absent in Ukraine, in 2018. World Bank legal experts, with FinSAC participation, conducted an in-depth assessment of impediments related to the corporate insolvency and collateral enforcement regimes in Ukraine. Following their recommendations, a new Insolvency Code was approved. The new corporate and personal insolvency frameworks are setting a strong base for meaningful NPL restructuring in the country.

The gradual implementation of the holistic NPL resolution strategy agreed in 2017 has resulted in the removal of many impediments for the resolution of NPLs in Ukraine. However, further work needs to be done (e.g., collateral valuation, state-owned bank governance) to achieve a meaningful NPL ratio reduction from the still high ratio – above 50%.

Pillar 2 technical assistance projects ongoing into 2019

FinSAC technical assistance to North Macedonia

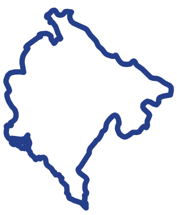


Risk management regulation and supervision implementing IFRS 9
FinSAC assistance to North Macedonia in implementing IFRS 9 made good progress laying the groundwork in 2018. This included discussing the requirements for a simple probabilities of default model and the common sets of data and other building blocks for more sophisticated probabilities of default models, as well as loss given default rates and expected credit losses, that could then be calibrated for different purposes (such as internal ratings based approaches, stress testing, and IFRS 9).

Recovery and resolution planning
FinSAC continued its assistance to the National Bank of North Macedonia in recovery and resolution planning. It delivered training workshops structured to assist teams in the Supervision Department (who lack prior experience or meaningful benchmarks) to begin the task of assessing banks' recovery plans for the first time, including updates on recent EU developments.

Both of these projects will continue as part of a new programmatic FinSAC technical assistance project for North Macedonia that is to start in early 2019.

FinSAC technical assistance to Montenegro



Strengthening bank recovery and resolution
Montenegro is undertaking reforms to strengthen the financial sector supervisory framework and the financial safety net, aiming to adopt European standards including in bank resolution. The Central Bank of Montenegro has also been taking supervisory actions to facilitate recovery and resolution of some weaker banks in the banking sector. In 2018, to support the implementation of these reforms and to build institutional capacity, FinSAC's technical assistance focused primarily on microprudential topics. FinSAC provided comments and revisions to draft laws on bank recovery and resolution and credit risk management. Three FinSAC missions took place, which included delivery of two workshops in July and in September. This project will continue in 2019.

FinSAC technical assistance to Ukraine

Upgrading capital and liquidity requirements

FinSAC supported Ukraine's move towards convergence with international standards in the areas of capital adequacy and liquidity. During 2018, a team of experts provided advice to make the capital definition on a solo basis and to initiate a new workstream on updating the capital adequacy regulation on a consolidated basis. This helped the National Bank's Methodology Department improve their draft regulation. Finalizing the liquidity coverage ratio regulation, with FinSAC assistance in the design, calibration, and impact analysis, was an important achievement in 2018. The National Bank Board endorsed and published the new ratio which requires all banks to make daily calculations and report their liquidity coverage ratio accordingly. An initial cap of 80% will be increased progressively to 100% -at solo basis- by the end of 2019. In 2018, Ukraine also adopted the National Bank Board's new regulatory capital instrument that will help banks raise more capital with loss absorption capacity and started work on a net stable funding ratio.

FinSAC technical assistance to Uzbekistan

FinSAC Focus: New banking law and guided self-assessment of Basel Core Principles in Uzbekistan

In 2018, FinSAC initiated its first ever project in Central Asia. The possibility to expand selectively and on a case-by-case basis to Central Asia was formally introduced as part of the FinSAC 3 extension. Uzbekistan emerged as the most promising candidate for a pilot project. A change in the political leadership of the country boosted reform appetite, offering opportunities to support the authorities with financial sector reforms while other donor agencies were yet to move in.

Uzbekistan launched a comprehensive reform program in 2017, including alignment of its official and informal exchange rates and initiating market-oriented reforms in the financial sector. Presidential Resolution No. PP-3270 (September 12, 2017) called for sweeping reforms to, among other things, governance of commercial banks, removal of non-core administrative functions from banks, and increases in the minimum capital in banks. These reforms raise the possibility of a profound transformation in the Uzbek financial sector, from the current state-led model to one with a much more significant role for private investors.

This transition is associated with the emergence of new risks. Perhaps the biggest concern is that changing ownership structures in the banking sector can be used as an opportunity for investors that

do not meet conventional fit and proper requirements to enter the banking sector, as happened in other former Soviet countries such as Moldova and Ukraine. The consequences can be potentially devastating. Using a variety of techniques to obfuscate affiliations and ultimate beneficiary ownership, banks evolved into vehicles for de facto related party lending – much of which escaped the eye of the supervisor due to the use of opaque structures and weaknesses in shareholder transparency. The results were pocket banks that served the financing needs of their owners, and that were prone to costly banking crises. Uzbekistan wishes to draw on FinSAC expertise to learn from and avoid these issues. The emphasis is on transparency and governance, especially related party lending, group affiliations, licensing, change of ownership, and "fit and proper" criteria, all considered critical to establish the foundations for a modern, stable banking sector.

Priority was given to supporting the Central Bank of Uzbekistan revise the banking law – a piece of legislation that is foundational to any further efforts to promote safety and soundness in the banking system, underpinning regulation, supervision, and resolution. The Central Bank had been working on overhauling its current outdated law but lacked the necessary familiarity with international best practices and core concepts. It decided to withdraw the existing draft and seek FinSAC's support in completely redrafting it to align with international best practices. With the support of World Bank head office colleagues and an expert from the National Bank of Moldova, FinSAC provided extensive drafting suggestions. Over the course of a one-week mission all articles of the law were discussed in considerable detail. As the draft law nears completion, FinSAC continues to provide support to the Central Bank, aimed at familiarizing its staff with the key tenets of a modern banking law.

FinSAC is helping Uzbekistan work towards changing from a supervisory framework focused on checking compliance with administrative requirements to one that is effective in mitigating risks in a private-sector led environment. The Basel Committee on Banking Supervision created a methodology for countries to assess their supervisory systems and identify areas for improvement. FinSAC will support the Central Bank in completing a guided self-assessment against the Basel Core Principles for Effective Banking Supervision, a set of 29 principles that together comprise international best practice with respect to banking supervision and regulation. The self-assessment will be undertaken by an international expert in close cooperation with the Central Bank and the outcomes will feed into a supervisory strengthening program.

Pillar 3:
Addressing bank resolution, including bank liquidation

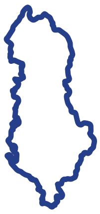
The global financial crisis laid bare the inadequacies of resolving problem banks under the regular corporate insolvency framework, leaving policymakers with a stark choice between bail-outs with public money or uncontrolled failure with prohibitive contagion effects. Far-reaching international and regional efforts to address the so-called "too-big-to-fail" dilemma have led to a complete overhaul of applicable legal and regulatory arrangements, countering the previous presumption of publicly funded bail-outs. FinSAC works with authorities in client countries under pillar 3 to strengthen their national bank recovery and resolution frameworks and adopt modern resolution tools to deal with struggling institutions in line with international good practice. It liaises closely with relevant international and European authorities so that they also take the needs of client countries into consideration in their further work.

FinSAC assists client countries in aligning their frameworks with the Financial Stability Board's "Key Attributes of Effective Resolution Regimes for Financial Institutions", and the EU's transposition of the Key Attributes, the BRRD. These provide the international standard for resolution regimes for financial institutions to address the moral hazard and systemic risks associated with institutions that are systemically important. Technical assistance has included supporting the adoption of international resolution principles modified to be appropriate to the local context.

FinSAC also helps newly established resolution authorities in client countries to operationalize and better understand the BRRD, designed to make sure a failing bank can be resolved swiftly with minimal risk to financial stability and no need for public support. FinSAC has been helping countries to revise their legal frameworks and is advising on the development and assessment of recovery and resolution plans. Bail-in is the most innovative tool given to resolution authorities by the BRRD to absorb loss without closing the bank, either by converting the liability into a common equity instrument, such as a share, or writing down or writing off the principal amount of the liability. FinSAC has developed a bail-in simulator and is helping with the complex task of how to define the loss absorbing capacity for each individual bank in the context of bank resolution.

Pillar 3 technical assistance projects completed in 2018

FinSAC technical assistance to Albania



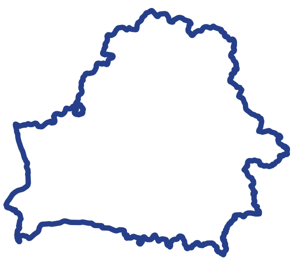
Operationalizing resolution planning

In 2018, Albanian systemic banks submitted recovery plans, observing new requirements for the first time, for assessment by the Bank of Albania in its capacity as prudential supervisor and resolution authority. A recovery plan manual was developed by FinSAC which included analysis of good practice examples for resolution authorities' internal decision making. FinSAC assisted in the adaptation of European Banking Authority and Single Resolution Board bank reporting templates to the local framework. FinSAC also contributed to the development of key by-laws, including providing example resolution fund calculations during preparation of the Resolution Fund By-Law, and on the content of recovery plans, critical functions, valuations, and minimum requirements for own funds and eligible liabilities.

> "We appreciated the possibility to discuss in detail the document provided by FinSAC, in order to fully absorb the knowledge needed, before implementation into the local regulatory framework. We benefited from the large network of specialists provided by FinSAC that covered issues related to many different topics".

Vasilika Kota
Head of Resolution Department
Bank of Albania

FinSAC technical assistance to Belarus



Implementing the upgraded bank resolution framework

FinSAC cooperated closely with the Belarus authorities in 2018 towards implementation of a new bank resolution framework, following the endorsement of a framework concept paper by the National Bank of the Republic of Belarus and the Financial Stability Council in December 2017. The authorities subsequently assessed the major changes required to the banking laws and regulations as well as the proposed enhancement of resolution authority powers. FinSAC acted as an enabler in this process by supporting the working group on bank resolution in establishing the necessary regulatory framework, and by assisting the authorities in dealing with more specific technical queries.

FinSAC technical assistance to Bosnia and Herzegovina

Bank Resolution Framework

15 implementing recovery and resolution by-laws for Bosnia and Herzegovina were drafted with FinSAC support in accordance with the new Banking Law, covering resolution planning, reporting templates, valuation, and the bail-in and bridge bank tools. In March 2018, both banking agencies submitted by-laws for formal adoption to the Parliament. Approved decisions were subsequently shared on the Banking Agency's website. FinSAC shared a recovery and resolution decision-making matrix with the authorities to guide them through the first round of recovery plan submissions in July 2018.

> "FinSAC solved the dilemma we had with regard to bank restructuring, thus significantly accelerating the process of incorporating under the legal framework".

Suada Saric
Acting Director of Department of Bank Resolution
Federal Banking Agency (Bosnia and Herzegovina)

FinSAC technical assistance to Romania

FinSAC focus: Testing Romania's new resolution framework

Many FinSAC client countries are implementing revised bank resolution frameworks, based on the BRRD, to deal with failing banks. FinSAC introduced a new type of crisis simulation exercise in 2018 that can support this process. The objective was to develop the analytical basis for a bank resolution by providing banking supervisors and resolution authorities with the opportunity to "practice" the handling of a bank failure in a simulated environment. Similar to conventional crisis simulation exercises, participants role play a scenario of banking distress, but with greater focus on the policy decisions than on inter-agency coordination of crisis measures. FinSAC developed a framework and case study to guide the new exercise (see also section on FinSAC knowledge activities).

The new exercise was delivered for the first time in Romania in October 2018, in cooperation with the European Commission's Structural Reform Support Service and funded by the EU via the Structural Reform Support Programme. Romania recently overhauled its resolution framework in line with EU requirements so the aim was to help policymakers responsible for the management of potential resolutions become better acquainted with the new framework, and to rehearse inter- and intra-agency information flows and decision-making processes.

The exercise gathered more than 50 key safety net players from various agencies involved in the resolution of banks (including the National Bank of Romania, Bank Deposit Guarantee Fund, Ministry of Public Finance, and Financial Supervision Authority) to test their preparedness in dealing with a carefully designed sequence of events leading to the failure of a bank. Over the course of a single day the failure of a hypothetical bank was simulated, based on FinSAC's case study shared with all parties prior to the exercise. Participants were confronted with information bringing the bank to the point of failure and triggering resolution actions. Documentation required for deciding on the application of certain powers such as scripted supervisory reports, recapitalization plans, valuations, bidding offers, or emergency liquidity assistance requests, were made available to participants during the exercise. The National Bank and FinSAC used their respective bail-in simulators to run calculations analyzing potential resolution options and compare outcomes. FinSAC provided an ex-post report giving a qualitative analysis of the decisions taken, on substance as well as from a procedural point of view. It also made recommendations for the authorities to consider in their efforts to further strengthen the operationalization of their bank resolution framework and establish a "resolution culture" in line with progress made in other EU countries.

The exercise worked well and the resolution decisions undertaken by the Romanian team were well-conceived and in line with applicable requirements, which is a significant achievement given that resolution is still a work in progress in the EU (and worldwide) and few real-life cases have yet occurred under the BRRD.

FinSAC technical assistance to Ukraine

Aligning the bank resolution framework with the BRRD

The Ukrainian Deposit Insurance Agency and National Bank of Ukraine requested technical assistance for the development of a new bank resolution framework in line with the EU accession agreement. In close cooperation with a working group of National Bank and Deposit Insurance Agency experts, FinSAC helped prepare a White Paper on an enhanced bank resolution framework in alignment with the EU. The paper highlighted the current framework's main challenges and outlined the key features and conditions for building up a revised framework in line with the BRRD and international principles. As part of this assistance FinSAC produced a BRRD alignment matrix giving a set of sequenced and prioritized policy recommendations, aimed at providing strategic direction to the legal drafting phase planned to start in 2019.

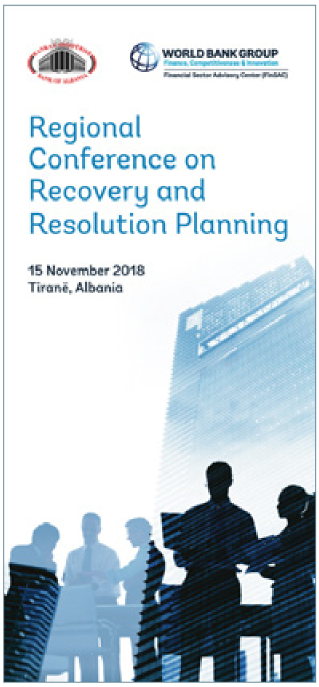
Upgrading capital and liquidity requirements

With FinSAC guidance, the National Bank of Ukraine made progress during 2018 on improving the quality of banking regulation in line with international standards, including a regulation defining the capital for banks. The National Bank has also initiated revision of the capital adequacy regulation that is applicable on a consolidated basis, following a series of amendments to the capital definition at a solo level. The National Bank assessed the impact of the liquidity coverage ratio adopted in February 2018 and discussed their findings with FinSAC, with a view to further fine tuning their monitoring tools. The National Bank also made progress, with FinSAC support, in its analysis of a future long-term liquidity ratio for banks, and in drafting a new regulation governing recovery plans for banks that contains the main components as laid out by the Financial Stability Board's Key Attribute 11 for effective resolution regimes for banks, i.e. early warning indicators, quantitative and qualitative indicators for triggering timely implementation of recovery measures, credible options to restore the financial health of a bank, and identification of critical services.

5. Knowledge activities in 2018

In addition to the bilateral technical assistance it offers, FinSAC also undertakes a range of activities that seek to increase knowledge of key issues, share experience, and develop supportive networks among client country peers and experts. This includes hosting international conferences, participating in/speaking at relevant events, research and reporting on specific areas of relevant financial stability, and developing tools and methodologies for use by and with policymakers in client countries.

FinSAC knowledge activity: Regional conference on bank recovery & resolution planning



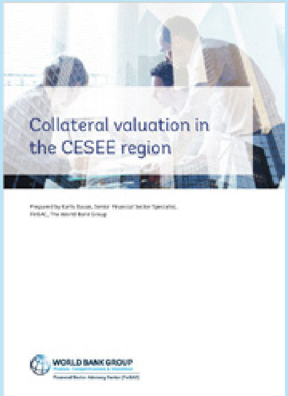
In cooperation with the Bank of Albania, FinSAC held a regional conference on bank recovery and resolution planning on November 15 in Tirana. The conference brought together 50 senior representatives and high-level experts of the supervisory and resolution authorities of the EU, FinSAC client countries, and commercial banks operating in Albania. Speakers included representatives from the Bank of Albania, Single Resolution Board, European Central Bank, Croatian National Bank, Czech National Bank, and Bank of Italy. The focus was on recent developments in recovery and resolution planning in the EU and the implementation challenges in Europe and for small host countries.

All participating client countries had recently completed or were in the process of aligning their framework for dealing with weak and failing banks with EU standards. FinSAC is assisting individual countries establish the most appropriate framework for their circumstances, one that can ensure a broad approach to systemic crises that allows all types of banks to fail safely including in a more extreme economic environment. The conference was a platform for regional authorities to share their experiences, evaluate what had been done so far, and prepare for key challenges in the operationalization of the new framework that still lay ahead to achieve a sustainable financial system, including in case of failure within and beyond geographical boundaries. Participants were encouraged to develop a “resolution culture” with resolution planning viewed as an ongoing process between the supervisor and bank, and to make further efforts to address impediments to resolvability.

FinSAC focus: International conference and policy notes on a comprehensive approach to NPL resolution

Despite recent improvements, NPLs continue to be a significant burden on the financial systems of FinSAC client countries, with many countries in the region experiencing a negative feedback loop between lackluster banking performance, and below-potential economic growth. It remains the case that many countries have made only limited headway in addressing the challenges of primarily corporate distressed debtors. Pressures on asset quality are likely to persist without a comprehensive corporate restructuring program that provides for the orderly exit or closure of unviable companies, and thorough operational restructuring of potentially viable ones. Countries also struggle to develop markets for NPLs, reflecting both deficiencies in the supporting infrastructure (transaction platforms and data deficiencies) as well as a lack of scale that dampens investor interest.

A FinSAC conference in Vienna on May 15 and 16, 2018, focused on holistic NPL resolution. It offered a unique opportunity for client countries to take stock of the current regulatory environment and discuss remaining weaknesses in the regulatory framework and overall creditor rights. FinSAC convened some 100 delegates (including regulators, supervisors, and national authority experts) from 25 countries to discuss ways of resolving NPLs. The objective was to help disseminate good practices and encourage exchanges on the experiences of different countries in the recognition, management, and disposal of NPLs, including the guidance and regulations on NPL management issued by the European Central Bank and European Banking Authority in recent years. Conference participants benefited from a series of panel discussions, with experts from the World Bank, European Central Bank, European Banking Authority, European Commission, and European Bank for Reconstruction and Development as well as client country representatives.



Three policy notes providing good practice and guidance to financial sector regulatory authorities aiming to improve their NPL resolution framework were prepared by FinSAC for the conference and presented to participants, thus enriching and deepening discussions.

The first policy note focuses on internationally harmonized definitions of NPL and forbearance, which is an area where the European Banking Authority and the Basel Committee on Banking Supervision have made proposals to arrive at more internationally comparable regulatory definitions for what constitutes an NPL. This is a priority area, as seemingly inconspicuous technical differences can have far-reaching consequences for the NPL ratio and render cross-country comparisons of asset quality rather hazardous.

The second note addresses the valuation of assets pledged as collateral against loans, an important but often overlooked aspect of prudential regulation. It reviews: i) regulation of collateral valuation in the financial sector; ii) collateral valuation methodology; and iii) good practice and policy options that could be implemented for collateral valuation. It may be used as good practice guidance to assist national authorities review existing collateral valuation practices or introduce improvements by implementing good international practice.

The third policy note considers public asset management companies as a tool to help address financial crises and solve the accompanying high level of NPLs. Asset management companies can lessen the cost of a crisis by managing assets whose value has temporarily declined. However, improper design, political interference, and poor management can erode any benefits, increasing the burden on taxpayers. The note reviews the benefits and drawbacks, gives examples of their use, and outlines the necessary pre-conditions and specific design features required to make them a success. It builds on and compares different country experiences during Asian and European financial crises.

Reducing NPLs in a sustainable manner is a complex task that typically requires a broad range of policy measures. Given the magnitude and complexity of this challenge, the conference was structured in a series of thematic blocks:

1. NPL recognition: including the latest initiatives from standard setters on harmonization of regulatory definitions of NPLs and forbearance, new accounting standards (IFRS 9) that represent a transition from incurred loss to expected loss approaches,

and European Central Bank guidance to banks on the resolution of NPLs. The seminar also included a specific session dedicated to collateral valuation given its crucial role in lending and borrowing processes and the provisioning shortfalls and additional losses that can result from imprudent collateral valuation practices.

2. **Workout strategies:** with presentations by banking representatives from Greece and Bulgaria on their (in-house) approaches to NPL resolution. Another session discussed government-led approaches towards NPL resolution, focusing on practical experiences with asset management companies.
3. **Developing an enabling environment for NPL resolution:** with an emphasis on the legal environment that determines prospects for creditors to recover their claims, considering the state of distress of the debtor;
4. **Development of markets for NPLs:** few client countries have marketplaces for distressed debt, a panel of industry representatives discussed the prospects and preconditions for the further development of NPL markets in the region.

The conference provided a wide range of international experiences, including presentations on two European success stories in NPL resolution, Latvia and Serbia, and examples of experiences in Asia and Africa with discussion of NPL resolution in Malaysia, Korea, and Kenya. A survey of conference participants indicated very high satisfaction, with an overall rating of 4.9 out of 5. All presentations and policy briefs from the conference are on FinSAC's website for use by a broader global audience. They have attracted considerable interest. Conference feedback highlighted significant interest in further opportunities for holistic discussions of the range of NPL resolution challenges and solutions, and in response a similar conference is being planned in Malaysia in 2019.

FinSAC knowledge activity: Workshop on law enforcement in the resolution of failing banks in Ukraine

A two-day conference on bank resolution "National Law Enforcement Practice and International Experience" took place in Kiev on 30-31 October 2018. An initiative of the World Bank Group/FinSAC together with the IMF, the US Treasury, and the National School of Judges of Ukraine, the conference gathered some 50 participants and speakers from the Ukrainian judiciary, National Bank of Ukraine, Household Deposit Guarantee Fund, NGOs, and academics. The aim was to bring together local and international experts to underline the importance of a coherent legal framework and better understand the different challenges faced by public oversight authorities and the judiciary in bank resolution.

Court proceedings play a key role in contributing to the effectiveness of bank liquidation and resolution procedures. The conference highlighted the complexity in striking the balance of taking fast decisive resolution action needed to maintain financial stability while at the same time ensuring legal safeguards and judicial overview in accordance with constitutional principles and fundamental property rights.

Triggered by the 2014-18 financial and economic crisis, the licenses of more than half of Ukraine's 180 banks were revoked by the National Bank of Ukraine. By October 2018, 88 banks had been liquidated by the Household Deposit Guarantee Fund (the resolution authority since 2012), with losses incurred by the state and by depositors in excess of US$20 billion. For all these failing banks the Household Deposit Guarantee Fund approved so called "resolution plans" which involved a liquidation with repayment of insured deposits. Alternative resolution methods, like a transfer to an acquirer or a bridge bank, were applied in only nine cases, while a significant portion of the financial system was effectively nationalized. Affected shareholders and creditors in Ukraine have on occasion successfully challenged the authorities' decisions to take action against a bank that is considered failing or otherwise not complying with regulatory requirements. Judicial claims against the National Bank as supervisory authority and the Deposit Guarantee Fund as resolution and liquidation authority usually seek to declare the National Bank's decision unlawful and cancel revocation of a license, overturn the Deposit Guarantee Fund's liquidation decision, and regularly demand restoration of the bank's operations.

Based on US and EU country examples, the conference discussed a range of issues including: i) justifying the taking of resolution action, ii) legal safeguards for interference with property rights like the no creditor worse off than in liquidation test or the substantiation of claims, and iii) the scope of judicial review including courts reliance on economic technical analysis as assessed by the supervisory authorities. At the conference, the key principles of judicial control were presented, including that judicial control should, as a rule, not allow for a stay on proceedings and that any applicable redress should be awarded through ex-post compensation. These principles, that are reflected in the Key Attributes of Effective Banking Resolution, are critical for taking the decisive and speedy action required to serve the public interest in financial stability.

This was a good opportunity to improve understanding and cooperation among those involved in the Ukrainian judicial and financial system, as well as with international partners. It sought to address a complex local environment while sharing knowledge of international principles, laying the ground for potential future legal reform. The interdisciplinary approach helped better align judicial and financial sector reform. Tackling challenges holistically and improving understandings of others' roles and legal responsibilities is important for future reforms and further strengthening the Ukrainian financial stability concept.

FinSAC knowledge activity: Working paper on the effect of EU banking supervisory, recovery, and resolution reforms on small host countries

The FinSAC working paper "Banking Supervision and Resolution in the EU – Effects on Small Host Countries in Central, Eastern and South Eastern Europe" was drafted in 2018 and will be finalized in early 2019 and made available on the FinSAC website.

The significant presence of subsidiaries of multinational banks, generally with parent banks from the EU, is a common feature of many client countries' banking systems. Most of those subsidiaries are of systemic importance in the host country, but the foreign operation is not material for the parent bank and thus for the home country supervisory and resolution authority. These "small hosts" face a unique set of policy and implementation challenges, which do not feature prominently on the international and EU agenda. EU directives and regulations are not designed with the characteristics of these small host countries' banking systems in mind. Consequently, their implementation is often challenging. Although many FinSAC client countries are EU candidates that are in the process of introducing and implementing complex EU regulations, they are considered third countries that are not involved in the EU rule making process. As a result, client countries often lack insight to the practical application of the EU legal and regulatory framework and face difficulty in finding counterparts with whom they can share their real-world experience candidly.

It is critical for client countries to have a deep and comprehensive understanding of the EU legal and regulatory framework for bank supervision, recovery, and resolution. The working paper explains and analyzes the implications of the recent supervisory, recovery, and resolution reforms in the EU for small hosts, distinguishing between small hosts (i) inside the euro area, (ii) inside the EU but outside the euro area, and (iii) outside the EU. The latter category consists of non-EU candidate countries and third countries. The implications for cross-border supervision and resolution cooperation are distinct in each of these cases and the paper makes specific recommendations for each of these categories.

FinSAC knowledge activity: Working paper on governance of financial sector policies after the crisis

The global financial crisis affected financial systems worldwide irrespective of the institutional set-up for financial sector regulation and supervision. Nevertheless, policymakers' interest in regulatory architecture has subsequently increased, with several prominent G20 members (e.g. China, the euro area, UK, and USA) rearranging institutional responsibilities and adding new tasks such as banking resolution and macroprudential supervision. Regardless of their architecture, countries have been putting in place arrangements to ensure effective information sharing and cooperation, most notably between the micro-prudential supervisor and the central bank, especially in times of stress.

This FinSAC working paper takes stock of current practices and provides guidance on governance of three financial sector policy areas, related to the three FinSAC pillars – macro-prudential policy, micro-prudential banking supervision, and bank resolution – with a focus on mechanisms to ensure effective coordination across policies. The paper builds on the findings of an extensive survey on governance practices in these three policy areas in ECA countries and (high-income) benchmark countries. The survey explicitly sought to disentangle means and ways of sharing information and analysis, communicating all through the decision-making processes, and resolving conflicts when they arise, both in normal and crisis times. The responses were used to identify good practices and policy recommendations on the overarching financial policy governance in ECA countries but could apply to many other emerging and developing countries. This paper will be completed in 2019 and made available for download from the FinSAC website.

FinSAC knowledge activity: Bail-in simulator

FinSAC designed the bail-in simulator to meet demand for a tool to better understand the practical implications of using bail-in. This has emerged as a high priority for policymakers given that this is a new, complex, and largely untested resolution tool (also in most EU countries).

The introduction of bail-in is one of the key post-crisis reforms aimed at refuting the prior presumption of public reimbursement of a failing bank's creditors. The FinSAC bail-in simulator is an Excel-based calculator that allows users to compare different resolution options using a fictitious bank balance sheet. It provides a quantitative tool to better assess the possible effects of bail-in on bank owners and various categories of creditors. The tool can be used for a variety of purposes and should help authorities to make better informed decisions i) when designing a new legal framework, ii) in normal times for contingency planning purposes, and iii) in dealing with actual banking crises, when decisions need to be made on whether and how to use the legal framework of bail-in.

The bail-in simulator is based on the bail-in hierarchy as defined under BRRD 2 and the Single Resolution Board's liability reporting template. The hierarchy ranks can be adapted to country specific circumstances. Its purpose is to quantify up to which seniority layer a bank requires bail-in in order to cover losses and to recapitalize the bank, depending on the resolution tool applied. It also presents the share of control of each priority class and the value of each priority class after bail-in. The standard option, based on BRRD rules, also includes a calculation of an 8% bail-in before any use of public support or the resolution fund (as required in the BRRD), and conditions for using deposit guarantee fund money. A comparison between bail-in and a hypothetical liquidation scenario allows illustration of the no creditor worse off than under (hypothetical) liquidation test.

This generic version of a bail-in simulator can be used for general training purposes and knowledge activities or can be embedded in a crisis simulation exercise. The bail-in simulator is developed in a way to allow for adaptations to country specific circumstances and legal frameworks (like insolvency ranks, classes of creditors, etc.), but it does not reflect a distressed bank's balance sheet and is intended primarily as a training tool. The first version of the bail-in simulator was used in the resolution simulation exercise in Romania. Refinements of the tool will continue in 2019, with plans to make it more user friendly by converting it into a web-based program.

FinSAC knowledge activity: Development of a bank resolution case study

FinSAC produced an initial bank resolution case study in 2018. The objective was to develop the analytical basis for a bank resolution by providing banking supervisors and resolution authorities with the opportunity to "practice" the handling of a bank failure in a simulated environment. Similar to conventional crisis simulation exercises, the basic idea is to role play a scenario of banking distress, but with greater focus on the policy decisions than on inter-agency coordination of crisis measures. The case study is based on simplified but realistic recovery and resolution plans plus a representative balance sheet of a FinSAC client country domestic bank. The case study is used to challenge participants with a set of plausible triggers that brings the bank to the point of failure. They must then decide on which actions they could possibly take within the parameters of their legal framework, and while being guided through the exercise with ad-hoc information. The bank resolution case study was successfully piloted in Romania, along with the bail-in simulator. Further refinements of the case study will continue in 2019.

FinSAC knowledge activity: Collection of court rulings on the role of the judiciary in bank resolution

Responding to increasing demand from client countries for guidance on the role of the judiciary in bank resolution and liquidation, in 2018 FinSAC began collecting court rulings deciding on appeals against bank resolution/liquidation decisions. As evidenced by the latest resolution cases in the EU (as well as worldwide) court proceedings play a key role in contributing to the effectiveness of bank liquidation and resolution procedures. Authorities are confronted with the challenging tasks of taking fast decisive resolution action needed to maintain financial stability while at the same time ensuring legal safeguards and judicial overview in accordance with constitutional principles and fundamental property rights. Affected shareholders and creditors often challenge the authorities' decisions to take action against a bank that is considered failing or otherwise not complying with regulatory requirements. In many FinSAC client countries i) the responsibilities and scope of judicial review of experts/economic assessments are not clearly defined, ii) legal safeguards are not explicit, and/or iii) their practical application is untested. This raises important questions of whether and how the principles of the revised bank resolution frameworks will be upheld when put to the test.

This collection includes rulings from EU as well as non-EU countries and covers a variety of legal aspects pre and post BRRD. These case studies support FinSAC technical assistance projects. They provide guidance in the design of resolution regimes on the alignment of client countries' resolution frameworks with international good practice and to help better assess potential litigation risks, as well as understand constitutional and fundamental rights concerns in bank resolution. A summary and comparative analysis of the most important rulings is planned to be published in 2019.

FinSAC knowledge activity: Sharing FinSAC expertise through international fora

As a knowledge hub, FinSAC financial sector specialists are often asked to share their expertise with non-FinSAC client countries, international organizations and bodies, at international and regional conferences, seminars, and other events, and to cooperate with other World Bank teams on issues of financial stability, for example in assessments and crisis simulation exercises. In 2018 this outreach work included:

Support to other World Bank teams, for example:

FEB Zimbabwe; APR Angola	**Participation in crisis simulation exercises**
JAN — JUN Armenia and North Macedonia	**Financial Sector Assessment Programs**
MAR Slovakia	**Assistance in the preparation and organization of the Regional Innovation Forum in Slovakia**
MAR Morocco	**Support to the Bank of Morocco in amending their regulation on credit risk and resolution of NPLs**
SEP Uganda	**Organization of a two-day NPL seminar and drafting contribution to a regulation for private asset reconstruction companies in Uganda**
OCT — NOV FinSAC	**Contribution to data collection and analysis of World Bank Regulation and Supervision Survey**

As part of its coordination and cooperation with relevant international bodies FinSAC gave presentations to and participated in a range of events including:

Month	Location	Event
JAN	Switzerland	Joint IMF/Financial Stability Institute
MAR	Turkey	Conference in Turkey on "Recovery and Resolution Planning"
MAR	Italy	International Association of Deposit Insurers European Regional Committee International Conference in Italy
MAY	Turkey	International Association of Deposit Insurers annual meeting in Turkey
SEP	Turkey	Conference in Turkey on "Bail-in and Asset Valuation: Principles and Changes"
SEP	Austria	Austrian National Bank's East Jour Fixe
SEP	Austria	European Federation of Deposit Insurers International Conference
SEP	FinSAC	Delegation from National Internet Finance Association
OCT	USA	31st Annual Seminar for Senior Bank Supervisors from Emerging Economies, jointly organized by the World Bank, the International Monetary Fund and the Board of Governors of the Federal Reserve System
OCT	Switzerland	Global Partnership for Financial/Financial Stability Institute inclusion seminar
OCT	Austria	Vienna Initiative – Minimum Requirement on Own Funds and Eligible Liabilities Workshop
NOV	Tunisia	Seminar on NPL resolution

6. Outcomes and results

Demand for FinSAC support continued to be strong in 2018 as client countries sought assistance with the EU accession process and the corresponding need to align legal, regulatory, and supervisory frameworks with applicable requirements and aspire to introduce elements of the post-global financial crisis agenda in local financial sectors, including Basel III and parts of the Key Attributes of Effective Resolution Regimes for Financial Institutions. This demand reflects trust in FinSAC as a provider of technical assistance and high satisfaction rates with previous FinSAC projects and clearly demonstrates the continued relevance of FinSAC's development objective, to support eligible client countries in building stronger, more resilient financial sectors. Following the conclusion of the negotiations for FinSAC 3, there was a noticeable increase in client requests for FinSAC projects, which for the most part has been converted into active projects.

As part of FinSAC's efforts to better understand and demonstrate how its work contributes to its development objective, this chapter reviews the outcomes and results of activities this year. 2018 was a transitional year as FinSAC introduced an enhanced monitoring and evaluation framework being phased in for projects financed under FinSAC 3.

Upgrading FinSAC's Monitoring and Evaluation framework

There is a growing global emphasis on monitoring the results of development programs and projects. This reflects higher standards of accountability of governments, donor agencies, and other partners toward the achievement of results. Internationally agreed principles have underpinned this, including the adoption of the Millennium Development Goals with targets and indicators to provide the basis for measuring progress and overall effectiveness of development aid.

FinSAC is responding to this by continuing efforts to strengthen its monitoring and evaluation framework. Measuring the impact of the type of stability-oriented financial sector work that it undertakes is, however, challenging. Successful projects contribute to a reduction in the likelihood and/or the magnitude of financial crises, neither of which can be observed or measured. In addition, it is hard to determine to what extent changes in outcomes of interest can be attributed to FinSAC intervention (i.e. the attribution problem). In practice, the achievement of the desired outcome (i.e. stabilization of financial sectors) also depends on a whole range of other circumstantial factors, most of which are beyond the influence of FinSAC (e.g. geopolitical events and macroeconomic stress, including pressures on exchange rates and interest rates).

Nonetheless, scope to strengthen FinSAC's results measurement framework, in a manner that is practical and cost-efficient, has been identified. The new framework's starting point is the articulation of a more elaborate and systematic results chain for individual projects, included in the concept notes proposing new FinSAC projects. For new projects financed under FinSAC 3, the project team leader prepares log frames articulating: (a) expected outputs, i.e. what will be done; (b) anticipated outcomes, i.e. the positive medium-term effects that the proposed project seeks to achieve; (c) outcome indicators, i.e. indicators and threshold values that signal whether the targeted outcomes have in fact been achieved; (d) a baseline, i.e. the situation before FinSAC intervention; (e) a time horizon, i.e. the expected period over which the desired outcomes should materialize; and (f) the sources for verifying the outcome indicators. To ease the administrative burden for team leaders and to promote consistency, sample results chains have been prepared for all three thematic pillars. On project completion, a results report is created by the team leader for the project providing a final update of the results chain and tracking table.

The new monitoring and evaluation framework also provides for enhanced post-project monitoring. This includes further strengthening FinSAC's client survey and an ex post assessment whether outcome indicators have been achieved within the indicated timeframe. Input from the recipient authorities will often be needed, including in cases where it has been established that the targeted outcomes have not (yet) materialized.

The new approach applies to all projects financed under FinSAC 3. As these recently initiated projects progress it is to be expected that the enhanced monitoring and evaluation framework will generate valuable additional insights regarding the impact of FinSAC-supported projects and that the outcomes will help to inform the design of future FinSAC projects.

A Snapshot of 2018

15 completed projects

2018 was a productive year for FinSAC. A total of eleven technical assistance projects were completed, covering all three thematic pillars, in eight different countries. Of these completed projects, ten were financed under FinSAC 2, while in 2018 the first FinSAC 3-funded project was concluded in Ukraine, where FinSAC developed a quantitative methodology for assessing the systemic risk in consumer lending. Knowledge activities included three conferences, including a well-received international conference on NPL resolution, and a set of three related policy notes. Other highlights included the initiation of FinSAC's Central Asia pilot in Uzbekistan, the launch of a programmatic window, and the enhancement of FinSAC's product offerings with a resolution-focused simulation exercise. FinSAC starts 2019 with an active portfolio of seven technical assistance projects and six knowledge events and products. Most FinSAC 2-funded projects have now been concluded, all new projects initiated in 2018 were financed under FinSAC 3. Overall, these achievements are in line with FinSAC's commitment to complete 9 – 12 technical assistance projects per year, to organize two knowledge events, and to produce one analytical piece per year.

Structure of completed projects by deliverables, pillars, and countries

Completed projects by deliverables	Pillar 1	Pillar 2	Pillar 3	Total
Knowledge events/products	–	2	2	4
Technical assistance	4	2	5	11
Total	**4**	**4**	**7**	**15**

Completed projects by country/pillar	Pillar 1	Pillar 2	Pillar 3	Total
Albania	–	–	1	1
Belarus	1	1	–	2
Bosnia and Herzegovina	–	–	1	1
Georgia	1	–	–	1
Moldova	–	–	1	1
Montenegro	1	–	–	1
Romania*	–	–	1	1
Ukraine	1	1	2	4
Regional	–	2	1	3
Total	**4**	**4**	**7**	**15**

*This project was delivered by FinSAC in cooperation with the European Commission's Structural Reform Support Service and funded by the European Union via the Structural Reform Support Program

Structure of completed projects by deliverables, pillars, and countries

Country	Technical Assistance
Albania	Bank Resolution Framework
Belarus	Improvement of the Bank Resolution Framework Strengthening Deposit Insurance Framework
Bosnia and Herzegovina	Bank Resolution Framework
Georgia	Introduction and Implementation of the Deposit Insurance System
Moldova	Bank Resolution and Restructuring
Montenegro	Deposit Insurance Strengthening Project
Romania*	Resolution Crisis Simulation Exercise
Ukraine	Analytical Tools for Assessing the Systemic Risk in Consumer Lending NPL Restructuring and Workout Guidelines Strengthening Resolution Framework

Date	Knowledge Events/Products
15-16 May, 2018	NPL Resolution Conference – Vienna, Austria
30-31 October, 2018	Bank Resolution: National Law Enforcement Practice and International Experience – Kyiv, Ukraine
15 November, 2018	Regional Conference on Recovery and Resolution – Tirana, Albania
Q2 2018	NPL Resolution – Policy Notes

*This project was delivered by FinSAC in cooperation with the European Commission's Structural Reform Support Service and funded by the European Union via the Structural Reform Support Program

Client Country Feedback

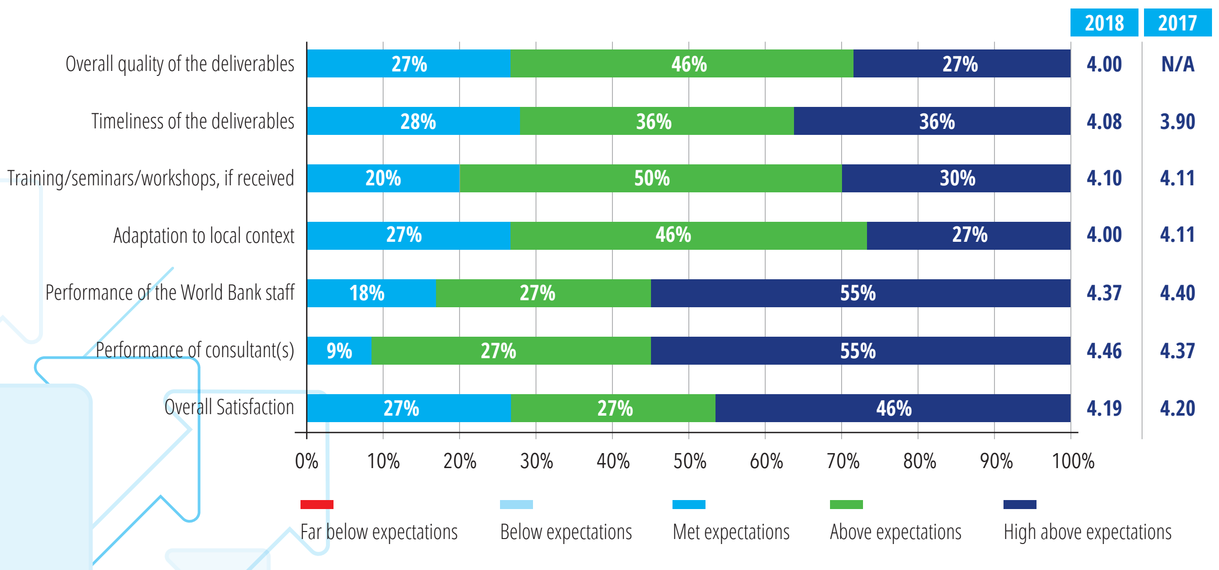
100% client survey response rate

As part of its ongoing efforts to better understand the contribution of individual technical assistance projects to its development objective, FinSAC conducts client surveys for completed projects, inviting end users of its services to assess project effectiveness and identify areas for improvements. This survey helps FinSAC to better understand whether projects have addressed clients' needs, and to help FinSAC to foresee prospective client demand. The outcomes are used to inform the design of new technical assistance projects, thereby strengthening FinSAC's offerings to client countries.

Strong client satisfaction scores

As was the case in previous years, the 2018 survey revealed that FinSAC support continues to be highly valued by the beneficiaries of its technical assistance projects. The response rate this year was 100%. Overall client satisfaction demonstrated very little movement compared to 2017 as illustrated by the average satisfaction scores in the last column of the graph below. Three quarters of FinSAC clients stated that their overall satisfaction with FinSAC services exceeded or greatly exceeded expectations, with particularly high satisfaction scores for FinSAC staff and consultants. One aspect of FinSAC's services that clients particularly liked were training and conferences. Respondents did not highlight any areas where project performance was below clients' expectations.

Client satisfaction with FinSAC services (n = 11)

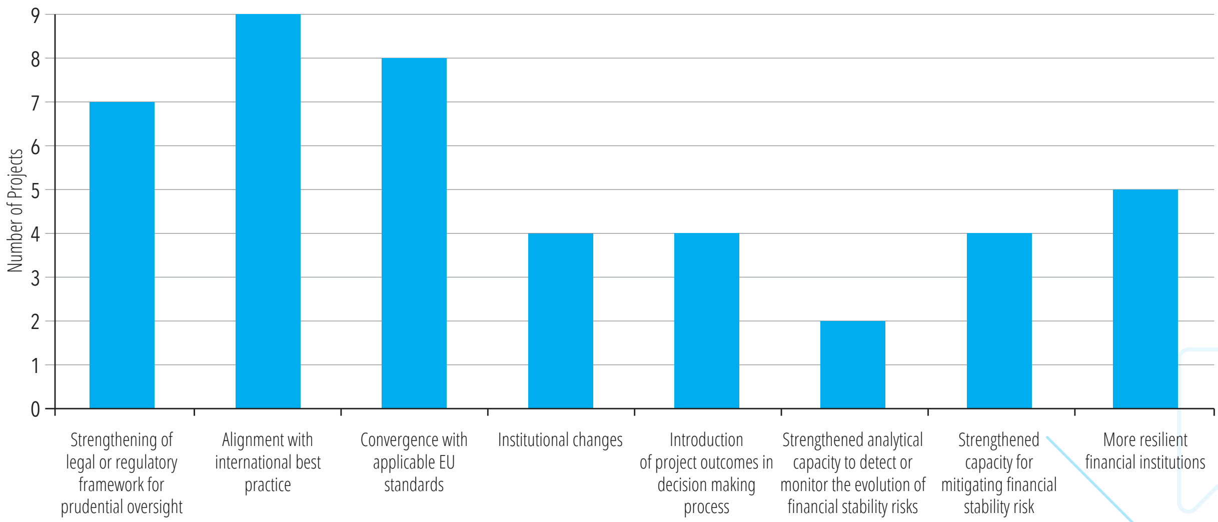


Survey respondents were asked to reflect in more detail about the benefits they obtained from deliverables provided as part of FinSAC technical assistance projects. The outcomes indicate that FinSAC support helped to address various client country needs, particularly the alignment of existing legal, regulatory, and supervisory frameworks with international best practices (nine respondents) and/or applicable EU standards (eight respondents). Survey respondents also indicated that FinSAC support helped them to make institutional and procedural changes and strengthened capacity to mitigate financial stability risk – each of which was highlighted by four respondents. Five respondents indicated that FinSAC support contributed to more resilient financial institutions.

Promoting reform and strengthening capacity

The FinSAC survey used a generic series of questions sent to all project recipients. While these results gave a general insight into clients' views about the main benefits of technical assistance, FinSAC's activities cover a broad range of topics and areas. Different projects have different expected benefits which can fail to be adequately captured in this way. For projects financed under FinSAC 3, the survey will therefore be more specifically tailored to the topic of the technical assistance project.

Main outputs of FinSAC technical assistance in 2018 (n = 11)



*Each project contributed to more than one outcome. Therefore, sum on the graph does not correspond to the total number of projects.

Assessing Outcomes

This year's survey featured several questions seeking respondents' views on the outcomes of FinSAC support, i.e. the likely or achieved short-term and medium-term effects of the outputs prepared as part of FinSAC technical assistance. A predefined list of outcome indicators was included and respondents were asked to indicate which one(s) would apply. To make for a more meaningful analysis, the results distinguish between the three thematic pillars.

Supporting convergence with international best practice

The results indicated that FinSAC support is associated with a series of beneficial short- and medium-term effects. Taken together, the results suggest that FinSAC has been making a positive contribution to achieving its policy objective of assisting eligible client countries in building stronger, more resilient financial sectors. Survey respondents across the board indicated that FinSAC support helped them to build capacity and promote the sharing of knowledge. In addition, they signaled that FinSAC support helped convergence with international best practices and strengthening crisis preparedness. This is particularly true for the work undertaken on banking resolution (i.e. pillar 3). As is expected, some of the outcomes are pillar-specific, with pillar 1 projects contributing to stronger macroprudential frameworks, pillar 2 projects to stronger microprudential supervisory frameworks, and pillar 3 to stronger resolution frameworks.

Key overall outcome indicators

Key outcome indicators	Pillar 1	Pillar 2	Pillar 3	Total
Strengthened crisis preparedness	–	–	1	1
Strengthened macroprudential frameworks	1	1	–	2
Strengthened resolution frameworks	–	–	1	1
Increased compliance with international principles and good practices	1	–	–	1
Enactment of new or improved laws, regulations, and good practices	–	–	1	1
Strengthened microprudential supervisory frameworks	1	–	–	1
Strengthened institutional frameworks and financial architecture	–	–	1	1
Fostered capacity building and promoted knowledge sharing	1	1	2	4

The survey also invited suggestions of how FinSAC support could be made more effective. Responses included interest in additional workshops and training within technical assistance projects, extending the duration of more complex projects, and a desire for more real-life case studies relevant for their project. FinSAC will consider these suggestions and make an effort to incorporate them in future projects.

7. A look ahead to 2019

2019 promises to be another busy year. Additional staff hires agreed as part of the FinSAC 3 extension have been completed, enhancing FinSAC's capacity to meet continued strong client demand, and to better balance a heavy technical assistance work program with analytical projects.

The final FinSAC 2 projects are being concluded and all new projects are financed under FinSAC 3. There is considerable country interest in the programmatic window introduced as part of FinSAC 3, particularly among client countries with financial stability needs that cover a broader range of areas and which over the years have built up a strong reform track record under previous FinSAC projects. The many policy recommendations arising from financial sector assessment programs in Armenia and in North Macedonia in 2018 are expected to boost demand from these countries to further partner with FinSAC.

FinSAC's three pillars remain highly relevant for client countries. For the most part, FinSAC's technical assistance aims to assist countries in implementing the core building blocks of the post-global financial crisis regulatory agenda and alignment with relevant EU standards. It is a priority for FinSAC to ensure that more generic supervisory and regulatory topics receive sufficient attention. These include problems related to shareholder transparency, related party exposures, and the supervision of what are de facto groups with undertakings in the financial and real sectors – which are among the leading causes for banking instability in developing and emerging economies, including Moldova and Ukraine.

In addition, new areas are emerging. Financial systems around the world have been undergoing rapid changes in recent years due to technology, popularizing new words like "FinTech" and new uses for old words like "disruption". It is of paramount importance that the financial systems' regulators and supervisors are aware of and knowledgeable about the main technologies spurring financial services evolution. FinSAC aims to step up its activities in this important area too, starting with its annual flagship conference in 2019. Convening more than one hundred regional policy makers, senior officials, and experts (including representatives of the banking and FinTech sectors), the conference will address challenges and opportunities presented by these developments, focusing on the implications of these technological advancements for central bankers and prudential regulators.

Expected activity within pillar 1 in 2019: macroprudential frameworks, crisis preparedness, and deposit insurance

Growing demand related to cybersecurity

Within FinSAC’s first pillar, client demand for support related to cybersecurity is on the increase. The central banks of Belarus and Georgia have requested technical assistance to improve regulatory frameworks for managing cyber risk in the financial institutions that they supervise. These projects will start in 2019. An innovative element in these projects is the use of machine-based learning tools. After relevant regulatory documents are appropriately translated and made machine readable, they will be exhaustively compared with the body of regulations and guidelines on cyber-security compiled in FinSAC's Regulatory Digest. This comparison with international practices will identify issues not yet addressed by the current standards, as well as significant conceptual departures.

Systemic risk identification and crisis preparedness

Conventional work on macroprudential supervision and crisis preparedness is also attracting increasing client country interest. This includes work on strengthening deposit insurance arrange-ments, contingency planning, and analytical methodologies for the identification of systemic risk for (often newly established) financial stability departments in central banks. In addition, there is consid-erable client country interest in reinvigorating existing financial stability committees, i.e. interinstitutional frameworks for macro-prudential policymaking and crisis management. FinSAC plans to produce a paper on this, stocktaking practices in the region and proposing recommendations for effective committees.

Expected activity within pillar 2 in 2019: microprudential frameworks and NPL reduction

Operationalizing recovery and resolution planning

Within FinSAC's second pillar, recovery and resolution planning is the area that is attracting most client country interest. Particularly in the Western Balkans, many countries have recently revised their banking resolution laws to bring them in line with the BRRD. In the process, they typically also establish dedicated resolution units that in normal times are responsible for drafting bank-specific resolution plans and establish supervisory review processes of banks' recovery plans. Given the newness of these tasks, this is an area where client countries are experiencing considerable difficulties and where FinSAC support can play a useful role. In addition, several client countries have expressed their interest in support to introduce IFRS 9 (including through quantitative methodologies that supervisors can use for estimating probability of default and loss given default that together determine expected losses) as well as support with the equivalence assessment to obtain an exemption from Article 114 of the CRR. Although ultimately the European Commission decides whether countries meet the requirements, FinSAC can provide support to client countries by peer reviewing national self-assessments, combined with tailored advice to resolve specific gaps and shortcomings.

The basics of banking supervision and regulation

FinSAC will also provide support to client countries in dealing with more basic aspects of banking supervision and regulation. It will continue providing support to the Uzbek authorities in conducting a comprehensive self-assessment of the soundness of the regulatory and supervisory framework (using the Basel Core Principle for Effective Banking Supervision methodology) and rewriting the banking law. The latter involves the introduction of many new concepts to ensure that the regulatory authorities have the necessary tools to effectively exercise a gatekeeper function for new entrants in the banking sector (and avoid the aforementioned problems related to shareholder transparency, related party exposures, and consolidated supervision of mixed groups).

Continuing focus on tackling NPLs

Although NPLs have shown a downward trend in most FinSAC client countries, the NPL resolution agenda continues to be highly relevant as several countries are still grappling with double digit NPL ratios. In addition, there are considerable remaining challenges even in countries that have made significant headway in reducing NPL volumes due to an unfinished corporate restructuring agenda (with a high share of distressed corporate borrowers with limited viability prospects), deficiencies in the credit environment, as well as the prospect of higher interest rates.

Broadening knowledge of relevant new technologies

New areas under pillar 2 include "SupTech" (i.e. the use of new technologies to assist supervisors in assessing and addressing bank-specific risks) and "RegTech" (i.e. new technologies to increase the efficiency and effectiveness of regulatory and compliance requirements). FinSAC will seek to initiate a project in this area, which may involve the use of machine-based learning tools and big data. The FinSAC international conference in May will help in gauging client country demand, and in obtaining access to relevant expertise in this new area.

Expected activity within pillar 3 in 2019: bank resolution

Supporting revision of bank resolution laws

FinSAC will continue supporting client countries in 2019 in overhauling their legal and regulatory frameworks for banking resolution and to align resolution regimes with applicable best practices, particularly the BRRD and Key Attributes of Effective Resolution Regimes. FinSAC will provide legal support to North Macedonia and Ukraine in revising their bank resolution laws. As was earlier the case in similar projects in Albania and Bosnia and Herzegovina, subsequent support consists of drafting the necessary body of bylaws, and to establish minimum rules for own funds and the operationalization of the bail-in of eligible creditors. Regarding the latter, the bank resolution case study that was piloted with the European Commission's support in Romania, and the accompanying quantitative tool (the "bail-in simulator") have attracted considerable interest from client countries. FinSAC will use its convening power to bring these new tools to the attention of client countries, and where appropriate integrate them into new projects.

Following previous FinSAC support, several countries have also expressed interest in further operationalizing bank resolution arrangements. One such area is the public interest test. Under the

Further operationalizing bank resolution arrangements

current EU framework for dealing with distressed banks, resolution is seen as an exception to be granted only if liquidation under national insolvency proceedings would not be warranted. This is most notably the case when the bank provides critical functions to the economy, or when its liquidation may have sizeable effects on financial stability. Although intuitively appealing, several client countries including Albania and Romania have approached FinSAC to clarify and operationalize these important concepts.

The entire FinSAC team looks forward to working with our client countries on these many and varied activities in 2019 with a shared common purpose to further strengthen financial stability.

Annex A: Financial stability indicators FinSAC countries

This table presents the status and evolution of financial stability conditions in FinSAC countries, using information as of March 15, 2019.

Economies	Capital			Liquidity			Profitability		Exposures					
	Regulatory capital / RWA	Tier 1 capital / RWA	Capital / total assets	Liquid assets / total assets	Liquid assets / short-term liabilities	Deposits / total noninterbank loans	Return on assets	Return on equity	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
The European Union														
Bulgaria	20.0	19.0	11.1	↓ 26.0	↓ 31.8	138.2	↑ 1.6	↑ 12.7	↓ 28.9	↓ 8.7	↑ 83.6	37.3	39.4	0.2
Croatia	22.2	21.1	↑ 14.6	33.1	45.7	113.4	↑ 1.7	↑ 11.9	13.3	↓ 10.2	52.5	↓ 60.6	64.2	4.6
Poland	18.4	16.4	10.3	↓ 15.8	↓ 27.4	90.5	0.8	8.5	9.8	4.0	-	22.7	↓ 17.6	0.2
Romania	20.0	17.8	9.0	54.2	-	127.1	1.8	16.4	↓ 14.1	5.6	59.6	34.6	30.9	0.9
EU candidate and potential candidate countries														
Albania	↑ 18.2	↑ 17.0	↑ 10.5	↑ 15.3	↑ 20.6	↑ 204.3	↑ 2.3	↑ 20.7	14.9	↓ 11.3	↓ 100.5	↓ 52.9	↓ 50.8	5.5
Bosnia and Herzegovina	15.5	14.6	13.6	↑ 29.7	44.4	108.5	1.5	11.1	13.5	9.4	.	↓ 57.7	53.5	6.2
Kosovo	↓ 17.0	15.5	12.2	29.0	40.0	↓ 122.8	2.3	18.3	1.5	↓ 2.5	65.9	↓ 0.1	↑ 5.0	3.8
Montenegro	16.4	15.0	12.3	25.3	35.6	136.6	↑ 0.9	↑ 7.0	25.9	8.0	108.0	6.5	6.5	↓ 0.9
North Macedonia	↑ 16.3	↑ 14.9	↑ 11.2	22.7	39.8	114.7	↑ 2.2	↑ 19.5	-6.3	↓ 4.9	↑ 247.3	42.7	45.5	8.1
Serbia	22.6	21.6	19.8	36.7	53.1	107.3	↑ 2.1	↑ 10.6	.	↓ 9.8	↓ 69.3	↓ 67.5	69.4	2.9
EU neighbouring regions														
Belarus	18.2	14.1	↑ 14.7	↓ 13.9	-	93.5	↑ 2.0	13.5	↓ 15.8	↓ 4.1	167.6	↓ 51.1	66.6	3.8
Moldova	27.9	27.6	17.4	54.6	-	177.1	2.2	12.7	10.1	↓ 13.4	21.5	38.4	42.4	-7.1
Ukraine	16.2	10.5	10.8	51.1	93.5	81.8	↑ 1.6	↑ 14.6	↓ 60.2	↑ 52.8	↓ 176.2	46.5	↓ 46.9	-
South Caucasus and Central Asia														
Armenia	18.2	15.6	16.0	↓ 27.0	-	105.5	1.5	9.6	13.1	6.3	156.1	60.1	↓ 59.5	0.8
Georgia	↑ 18.8	13.8	13.4	21.7	↓ 27.4	79.7	2.3	17.5	↓ 6.4	3.0	.	57.0	↓ 62.6	3.2
Uzbekistan	15.6	14.3	↑ 12.4	↓ 13.6	41.2	.	2.0	16.2	4.3	1.3	.	.	.	↓ 2.1

Source: IMF Financial Soundness Indicators and national financial stability reports of Montenegro and Serbia.

Note: Significant changes in values are visualized with arrows on the left side, with deep blue indicating improvements and yellow, deteriorations. A change is significant for a country if the latest available value is more than one annual historical standard deviation away from its recent 3-year average. Cross-country quartile standings are visualized with signal bars on the right side. Each additional increment signifies sounder conditions compared to peers, from a statistical point of view. "-" represents censored value and "." represents missing observation. Data vintages are as follows: Albania and Georgia – 2019M1; Kosovo, Ukraine, and Uzbekistan – 2018Q4; Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Moldova, North Macedonia, Poland, and Romania – 2018Q3; Armenia – 2018Q2; Montenegro and Serbia – 2017Q4, from national financial stability reports. Detailed information for Azerbaijan is unavailable.

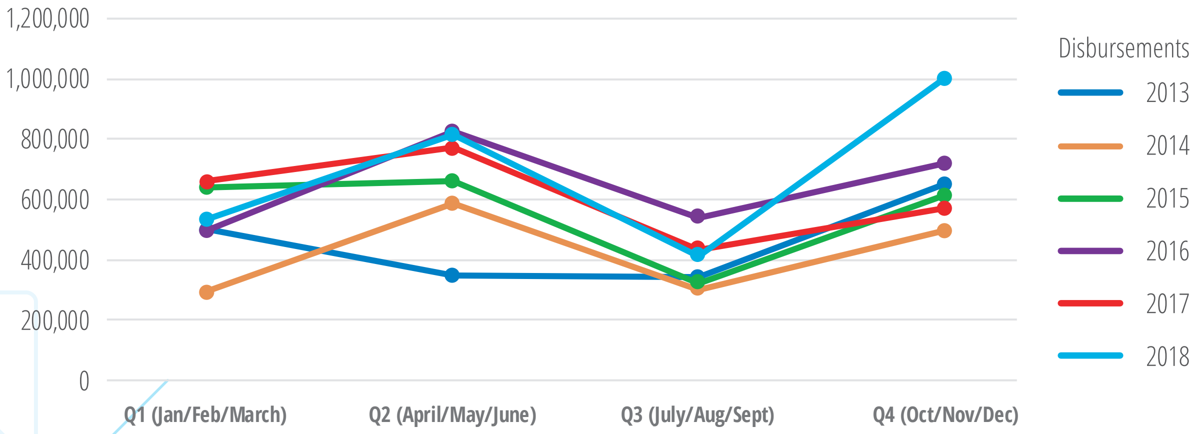
Annex B: Disbursement of Trust Fund by FinSAC

As of January 1, 2018

FinSAC 2 (TF071659 & parallel TF072761)	
Contributions paid-in	€ 15,177,200
Contributions to be paid	€ 0
Investment Income	€ 76,285
Disbursements	€ 14,855,471
Fund Balance incl. commitments	**€ 398,014**

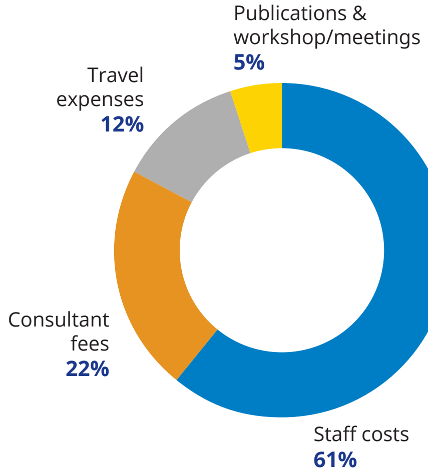
FinSAC 3 (TF072993)	
Contributions paid-in	€ 4,000,000
Contributions to be paid	€ 4,000,000
Disbursements	€ 544,502
Fund Balance incl. commitments	**€ 3,441,118**
Investment Income*	€ (14,380)

	Disbursements					
	2013	2014	2015	2016	2017	2018
Q1	€ 503,296	€ 295,836	€ 638,483	€ 495,853	€ 660,469	€ 533,788
Q2	€ 346,791	€ 585,282	€ 659,242	€ 823,747	€ 775,256	€ 814,793
Q3	€ 343,023	€ 301,968	€ 323,288	€ 540,713	€ 433,911	€ 414,172
Q4	€ 649,640	€ 499,193	€ 613,310	€ 718,554	€ 572,154	€ 1,000,471
Total	**€ 1,842,749**	**€ 1,682,278**	**€ 2,234,323**	**€ 2,578,867**	**€ 2,441,790**	**€ 2,763,224**

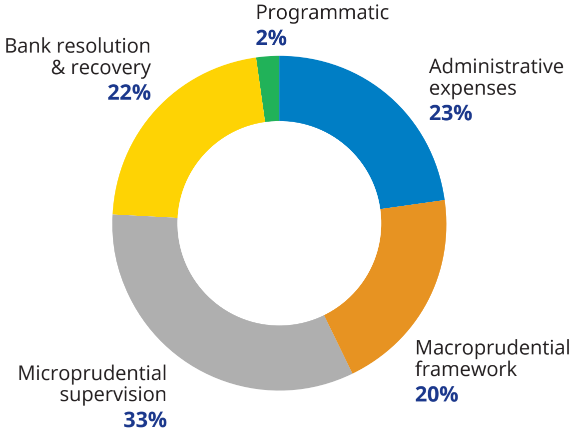


*Due to negative interest rate on savings rate in euro.

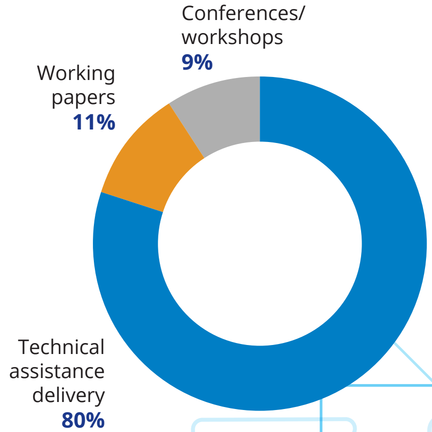
Disbursement by categories (for the period of 1 January 2018 – 31 December 2018)		
Staff costs[1]	€ 1,745,550	61%
Consultant fees[2]	€ 592,405	22%
Travel expenses[3]	€ 287,089	12%
Publications & workshop/ meetings	€ 138,180	5%
Total	**€ 2,763,224**	**100%**



Disbursement by pillars (for the period of 1 January 2018 – 31 December 2018)		
Administrative expenses[4]	€ 637,964	23%
Macroprudential framework	€ 539,090	20%
Microprudential supervision	€ 903,712	33%
Bank resolution & recovery	€ 623,410	22%
Programmatic	€ 59,048	2%
Total	**€ 2,763,224**	**100%**

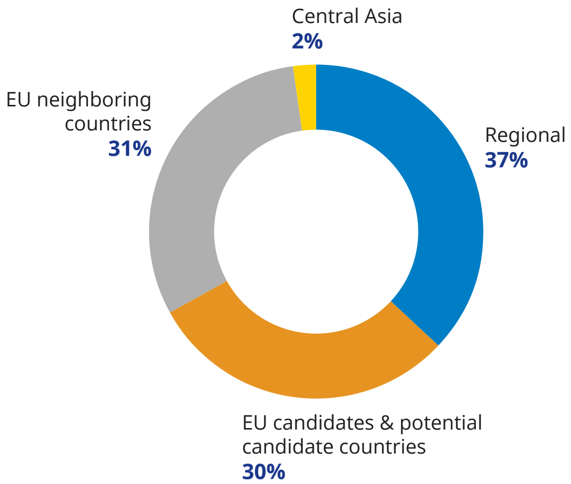


Disbursement by output (for the period of 1 January 2018 – 31 December 2018)		
Technical assistance delivery	€ 1,713,732	80%
Working papers	€ 222,178	11%
Conferences/workshops	€ 189,350	9%



1 Incl. FinSAC Coordinator, one program assistant, one financial sector analyst, one financial sector specialist, four senior financial sector specialists, and one lead financial sector specialist.
2 Incl. short term consultants and consultant firms
3 Incl. travel expenses of staff and consultants/visitors
4 Incl cost of all types of categories not related to the particular TF activities and all general expenses: contracts of designer, corrector, staff cost of program assistant/back up, travel cost for staff for training, general translations services, utilities, office maintenance, office supplies, depreciation, publications and other printing services, representation cost, coordination and some business development activities.

Disbursement by country groups (for the period of 1 January 2018 – 31 December 2018)		
Regional	€ 779,904	37%
EU candidates & potential candidate countries (Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Montenegro, Serbia)	€ 635,075	30%
EU neighboring countries (Armenia, Belarus, Georgia, Moldova, Ukraine)	€ 669,020	31%
Central Asia (Uzbekistan)	€ 41,261	2%



Disbursement by countries (for the period of 1 January 2018 – 31 December 2018)		
Regional	€ 779,904	37%
Albania	€ 136,093	6%
Belarus	€ 127,801	6%
Bosnia and Herzegovina	€ 139,007	7%
Georgia	€ 65,527	3%
Kosovo	€ 13,666	1%
North Macedonia	€ 156,244	7%
Moldova	€ 91,288	4%
Montenegro	€ 97,027	5%
Serbia	€ 93,039	4%
Ukraine	€ 384,405	18%
Uzbekistan	€ 41,260	2%

Annex C: Results framework table

Pillar	Type of product	Country/Project	FinSAC Activities /Inputs (Description of the activity and context)	FinSAC Outputs (Result of technical assistance)	Outcome (Benefit)	Indicators	Baseline	Source
Pillar 1: Financial Stability, Macroprudential Framework and Crisis Preparedness	Technical Assistance	Belarus: Strengthening Deposit Insurance Framework	Technical assistance to the Central Bank and the Deposit Insurance Agency of Belarus to strengthen the deposit insurance scheme, as endorsed by the Financial Stability Council.	Development of regulations to engineer a smooth transition from the permanent blanket guarantee of retail deposits to a limited coverage consistent with international best practice.	* Enhanced incentives for depositors to consider banks' risk profile. This helps to instill greater discipline on banks, discouraging excessive risk-taking. * Alignment with international best practice (IADI core principles).	Permanent blanket guarantee revoked.	Developed a white paper for deposit insurance reform, but not yet implemented.	The Client Feedback Survey and FinSAC assessment.
		Georgia: Introduction and Implementation of Deposit Insurance System	Technical assistance on deposit insurance system implementation.	Development of procedures and capacity building including: (i) the development and finalization of regulations on verification of data provided by banks and the application of sanctions for non-compliance, (ii) technical revisions to the Deposit Insurance Law, (iii) the design and content of the Deposit Insurance Agency's website; and (iv) a road map and discussion of international experience and best practices in building the deposit's payout process together with other issues.	* Alignment with international best practice (IADI Core Principles) and convergence with applicable EU standards.	Deposit Insurance Agency fully operational.	The strategy to create a deposit insurance system was approved in November 2016 and the Deposit Insurance Law was passed in June 2017, but Deposit Insurance Agency still to be established.	The Client Feedback Survey and FinSAC assessment.
		Montenegro: Deposit Insurance Strengthening Project	Technical assistance to strengthen deposit insurance arrangements in line with international and EU best practice	Developed methodology for a risk based premium framework. Drafted amendments to the Deposit Protection Law and bylaws.	* Alignment with international best practice and convergence with applicable EU standards.	Risk-based premiums fully enacted. Amendments to Deposit Protection Law and bylaws in force.	No differentiation in deposit insurance premiums, laws and bylaws not fully aligned with EU standards.	The Client Feedback Survey and FinSAC assessment.
		Ukraine: Analytical Tools for Assessing the Systemic Risk in Consumer Lending	Technical assistance to construct analytical tools to benchmark the consumer loans' growth rate, in order to assess any systemic risk to financial stability.	Developed a quantitative model for assessing the sustainability of consumer credit together with the Financial Stability Department of the National Bank of Ukraine.	*Strengthened analytical capacity to detect or monitor the evolution of financial stability risks.	New analytical methodology in use by the NBU's financial stability department, and part of its systemic risk monitoring toolkit.	Gap in knowledge and analytical skills.	The Client Feedback Survey and FinSAC assessment.

Pillar	Type of product	Country/Project	FinSAC Activities /Inputs (Description of the activity and context)	FinSAC Outputs (Result of technical assistance)	Outcome (Benefit)	Indicators	Baseline	Source
Pillar 2: Strengthening Microprudential Supervision and Regulation	Technical Assistance	Moldova: Bank Resolution & Restructuring	Technical assistance to the National Bank of Moldova to resolve and restructure the banks that have been under special administration since 2016.	Hands-on support in dealing with fraud in the affected banks. New governance regulation.	* Banks affected by raider attacks free from fraud * Strengthening of prudential requirements	New owners that meet fit and proper requirements attracted for the three affected banks. The Regulation on Internal Governance and Risk Management in Banks was approved by the NBM's Executive Board on December 20, 2018.	Banks controlled by owners that do not meet fit and proper requirements. Governance regulation does not meet international standards as per the Basel Core Principles.	The Client Feedback Survey and FinSAC assessment.
		Ukraine: Non-performing Loans Restructuring & Workout Guidelines	Techncial assistance regarding NPL restructuring methodologies/models for working out NPLs of big corporate conglomerates.	FinSAC finalized a set of guidelines this year for non-performing loans resolution and the operation of workout units in banks. A two-day seminar on good practice for NPL resolution in banks in Kiev.	* Strengthening of legal/regulatory framework for prudential oversight. * Enhanced capacity for banks to successfully resolve NPLs. * More resilient financial institutions.	The National Bank of Ukraine transformed a set of guidelines into regulation and submitted for consultation to the banks, which is pending approval/ enactment. Volume of NPLs that is successfully worked out.	Missing or incomplete regulation.	The Client Feedback Survey and FinSAC assessment
	Capacity Building and Knowledge Product	NPL Resolution Conference and Policy Papers	Organized and hosted a "Non-Performing Loans" conference in Vienna to share knowledge on international best practice on this topic with all client countries and other interested countries.	Delivered a conference bringing together experts from FinSAC client countries, EU authorities, and international experts. Generated discussions and shared knowledge in the area of NPL covered in the FinSAC NPL resolution policy notes.	*Enhanced knowledge about NPL resolution that was identified as very important topic during the FinSAC technical assistance program.	Participants' satisfaction (4.9 out of 5) Attendance: Some 100 delegates and experts from 25 countries in ECA and other regions in the world.	Knowledge gaps in client countries with respect to NPLs.	Evaluation forms and FinSAC assessment.

Pillar	Type of product	Country/Project	FinSAC Activities /Inputs (Description of the activity and context)	FinSAC Outputs (Result of technical assistance)	Outcome (Benefit)	Indicators	Baseline	Source
Pillar 3: Addressing Bank Resolution including Bank Liquidation	Technical Assistance	Albania: Bank Resolution Framework	Technical assistance to operationalize the resolution framework.	Development of a resolution plan manual including analysis of good practice examples for resolution authorities' internal decision making. Support to adapt EBA and SRB bank reporting templates to the local framework. Contributed to the development of by-laws, including by providing examples for the most important aspects of resolution process.	* Enhanced operational readiness to respond to banking distress. * Alignment with international best practice and convergence with applicable EU standards (including BRRD). * Introduction of project outcomes in decision making process (procedural changes). * Institutional changes.	Three sublegal acts adopted. It is planned to adopt four more in 2019. It is planned to implement the manual and procedures provided by the technical assistance.	Missing or incomplete regulation. Need to align current regulation with the EU or international best practice. Gap in knowledge and analytical skills. Implementation challenges following the introduction of updated laws and/or regulations.	The Client Feedback Survey and FinSAC assessment.
		Belarus: Improvement of the Bank Resolution Framework	Technical assistance to operationalize the resolution framework.	Supported the working group on bank resolution in establishing the necessary regulatory framework, and assisted the authorities in dealing with specific technical queries.	* Enhanced readiness to face episodes of banking distress. * Institutional changes.	Development of the new draft law. It is planned to implement a new law document on bank resolution with higher legislative power.	In December 2017 the National Bank of the Republic of Belarus and the Financial Stability Council endorsed a framework concept paper for a new bank resolution framework that remained to be operationalized.	The Client Feedback Survey and FinSAC assessment.
		Bosnia and Herzegovina: Bank Resolution Framework	Technical assistance to operationalize the resolution framework.	15 implementing recovery and resolution by-laws were drafted with FinSAC support in accordance with the new banking law, covering resolution planning, reporting templates, valuation, and the bail-in and bridge bank tools. FinSAC shared a recovery and resolution decision-making matrix with the authorities to guide them through the first round of recovery plan submissions in July 2018.	* Enhanced operational readiness to respond to banking distress. * Alignment with international best practice and convergence with applicable EU standards.	Implementation of 15 recovery and resolution by-laws. The Federal Banking Agency has adopted a regulatory framework for resolution. The other internal acts are in adoption process. In Republicka Srpska the regulation prepared with FinSAC assistance was implemented, as well as internal acts.	Missing or incomplete regulation. Need to align current regulation with the EU or international best practice. Implementation challenges following the introduction of updated laws and/or regulations.	The Client Feedback Survey and FinSAC assessment.

Pillar	Type of product	Country/Project	FinSAC Activities /Inputs (Description of the activity and context)	FinSAC Outputs (Result of technical assistance)	Outcome (Benefit)	Indicators	Baseline	Source
Pillar 3: Addressing Bank Resolution including Bank Liquidation	Technical Assistance	Romania: Resolution Simulation Exercise	Technical assistance on resolution framework testing and crisis preparedness.	Delivered i) a crisis simulation exercise in October 2018, financed by the EU via the SRSS, ii) an ex-post report with analysis of the current resolution framework and recommendations for its improvement.	* Convergence with applicable EU standards. * Introduction of project outcomes in decision making process (procedural changes). * Strengthened capacity for mitigating financial stability risk.	Policy recommendations emerging from the exercise endorsed by the Romanian authorities and concrete actions planned to follow up on the outcomes.	Implementation challenges following the introduction of updated laws and/or regulations.	The Client Feedback Survey and FinSAC assessment.
		Ukraine: Strengthening the Resolution Framework	Technical assistance for the development of a new bank resolution framework in light of the EU accession agreement signed in 2017.	Prepared a White Paper on an Enhanced Bank Resolution Framework in alignment with the EU. Prepared a BRRD alignment matrix outlining a set of sequenced and prioritized policy recommendations.	* Strengthening of legal or regulatory framework for prudential oversight. * Alignment with international best practice and convergence with applicable EU standards (including BRRD). * Institutional changes. * Strengthened capacity for mitigating financial stability risk and more resiliant financial institutions.	Implementation should start in 2019.	Need to align current regulation with the EU or international best practice.	The Client Feedback Survey and FinSAC assessment.
	Capacity Building	Bank Recovery & Resolution Conference	Organized a "Bank Recovery and Resolution Planning " workshop in Albania to share knowledge of international best practice on this topic.	Organized a workshop together with Bank of Albania bringing together experts from the EU authorities, banks and central banks, and international experts. Generated discussions and shared knowledge in the area of bank recovery and resolution.	*Enhanced knowledge about bank recovery and resolution (identified from FinSAC technical assistance program as very important).	N/A	N/A	FinSAC assessment.
		Ukraine Workshop on Law Enforcement in the Resolution of Failing Banks	Organized a workshop in Ukraine "Bank Resolution: National Law Enforcement Practice and International Experience" to share knowledge on international best practice on this topic.	Organized a workshop together with the Ukraine National School of Judges bringing together judges, EU authorities, and international experts. Generated discussions and shared knowledge in the area on law enforcement in the resolution of failing banks.	*Reduction in risk that resolution decisions in line with international best practices are reversed by the judiciary (which happened to more than ten banks).	N/A	N/A	FinSAC assessment.

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