

**EFSE Annual Meeting 2011, Tirana**

**Speech Dr. Klaus Glaubitt, Chairman of the EFSE Board of Directors**

**7 June 2011, 11.30-12.00**

Dear Mr. Prime Minister Berisha

Dear Mr. Fullani,

Dear Mrs. Ambassador Müller-Holtkemper,

Dear Mr. Schuman-Hitzler,

Distinguished Central Bank Governors,

Esteemed Delegates and Partners,

Ladies and Gentlemen,

## **A) Introduction & Recapitulation**

It is a great pleasure for me to welcome you to the Annual Meeting 2011 of the European Fund for Southeast Europe, EFSE, here, in the lovely and vibrant city of Tirana.

When I arrived yesterday, passing all the picturesque buildings on the way from the airport to the hotel, I remembered what it was like when I first came to Tirana, in the early nineties.

There were no buildings around the airport. Just small, shabby bunkers scattered in the fields along the road leading to the city. The landscape was surreal, in a way that reminds you of the painter Salvador Dali. The predominant colour at that time was dark grey - a legacy of the old, very rigid political system still in place. The old statue of Josef Stalin, located at the centre of the town near the old Deity Hotel, had been already removed, but there was still the plaque on the

pavement...*“Do not even think of spitting here!”*....It so well captured the distrust of political leaders in the people of a command society and economy.

But at that time, still in the early nineties, there already was the spark of a transition in Albania’s economic and social environment. In view of the tremendous challenge of setting up a sound banking sector from the scratch, I had the privilege of participating in the German-Albanian Working Group of the Bank of Albania led by Mr. Fullani, who at that time was head of the International Department.

The first greenfielding project in Eastern Europe, in fact a Micro Enterprise Bank, was designed and implemented in Albania with the support of KfW, the German Development Bank. This was the start of the ProCredit group in Tirana, eight other micro enterprise banks soon followed in Eastern Europe. The father and promoter of the greenfielding idea was Dr. Neuhoff, and, at a later stage Mr. Kroh – the former speaker of Financial Cooperation in KfW. And I’m doubly pleased to see they are both here today participating in our conference.

In hindsight, I can now say that the Bank of Albania has been, is, and most certainly will continue to be, a sterling incubator for innovative development finance in Eastern Europe.

A thank you is in order, to you, dear Governor Fullani, and to the Bank of Albania, for hosting the EFSE Annual Meeting. (applause)

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The EFSE, to which the Government of Albania is strongly dedicated, has just celebrated its 5<sup>th</sup> Anniversary. Many people are here today who have been with the Fund from the beginning, and even helped to design it and possibly, even more importantly, had the nerves and the stamina to make it happen. I’m sure

Dominik Ziller from the German Ministry for Economic Cooperation and Development knows exactly what I mean.

Since the end of 2005, it has been a long and challenging five years – and, for good reasons a memorable five years. Many things have happened in the history of the Fund, and there has been much change.

But before I delve into this, allow me to highlight what has **not** changed. I wish to highlight **6 stability factors**:

**First: The model has not changed:** the Fund – set up with an unlimited duration – is a true and powerful partnership of public and private investors combining diverse interests and forms of capital for the benefit of economic development in the Fund’s target region... with built-in potential and capacity to grow and expand and constantly innovate itself.

**Second: The Corporate Governance Structure has not changed:** the Board of Directors elected by the General Meeting of the Shareholders serves as the Executive Management of the Fund under Luxembourg law and regulation. Investment decisions are delegated to a dedicated investment committee and supported by a Fund Manager and Fund Advisor.

This structure allows for fast, effective and powerful decision-making and execution. The continuity, professional and development capability and commitment of the Board to the Fund’s mission is a very special asset, an asset that our private investors particularly appreciate. All stakeholders know that each director has fiduciary duties: that he acts with integrity, and in good faith, and in the best interests of the Fund as a whole, - and not in the sole interest of one or several shareholders.

**Third: The strong commitment and support of the European Commission**

**and the German Ministry for Economic Cooperation and Development as well as other governments has not changed:** the European Commission and the BMZ continue to provide significant funding to the Fund [as will be shown again later on today by Mr. Schuman-Hitzler from the EU]. They also provide unequivocal support and commitment to the model as evidenced by replicating the EFSE's setup in many other Funds. We have the support of the Swiss, Austrian and Danish Governments. We are also very pleased about the continued commitment of the Republic of Albania as the first government in Southeast Europe to directly invest in the EFSE. This only underscores the confidence the Albanian Government places in the Fund as an effective agent of sustainable economic development and prosperity in Albania.

**Fourth: The strong commitment and support of the Development Finance Institutions has not changed:** The story of the EFSE is one of continuous innovation in every aspect of what we do and how we do it. The EFSE's ongoing success has been made possible by the strong and steady support of KfW as the Fund's initiator and lead investor, and that of Development Finance Institutions such as the IFC, EBRD, the Austrian Development Bank, the Dutch FMO, the EIB and EIF. The continued commitment of these outstanding Finance institutions provides an extremely sound basis for coping with future challenges.

**Fifth: The concept of the Advisory Group has not changed:** the Governors of the region - as again we have seen in a lively fashion this morning – are committed to the growth and impact of this Fund. And, thanks to their contributions, they have consistently enhanced and advanced it in its learnings and innovations. The Advisory Group consists of 14 Governors of the target region's National Banks. The participation of the Governor of the Central Bank of Armenia, Artur Javadyan in the Annual Conference underscores the commitment

of the Caucasus region which falls under the European Neighbourhood Region.

As you know, at the end of 2009 we continued to expand our operations to Armenia, Georgia, Azerbaijan, Belarus, and Ukraine. Not despite – but because of – the financial crisis. During the crisis, the governors of Southeast Europe sent a strong signal as to how close coordination and the open exchange of information can become a strong asset with a growing Advisory Group, also in embracing the new European Eastern Neighbourhood Region.

**Sixth: The commitment to providing integrated financial services through the Fund together with technical assistance and capacity-building through the EFSE Development Facility has not changed:** It is especially during the financial crisis that providing speedy and targeted technical assistance – complementary to our investment activities – has proved to be highly relevant and effective.

Another key feature of the EFSE Development Facility worth noting is that more than half of its budget is financed out of the profits of the EFSE's investment activities. In other words, EFSE shareholders give away part of their returns to increase the development impact of the Fund and contribute to further stabilising the investment portfolio at the same time.

**These stability factors,**

**Our public-private partnership model;**

**Our Corporate Governance Structure;**

**The strong commitment and support of**

the European Commission;

the German Ministry for Economic Cooperation and Development;

the other governments and of;  
the Development Finance Institutions;

**Our concept of the Advisory Group; and lastly**

**Our commitment to providing integrated financial services together with technical assistance,**

these stability factors were essential to the EFSE becoming the largest development finance Fund worldwide. A Fund that now cooperates with 64 partner lending institutions and has provided close to EUR 1 billion in loan funding over time.

Together with the EFSE Development Facility's high-impact work at the institutional and sectoral levels, and its research activities, this in turn enabled our partners to extend almost 270,000 loans totalling EUR 1.5 billion to micro and small enterprises, as well as to individual lenders for home improvement.

It is to a large extent the Fund's structure that enabled us to expand operations from four countries five years ago to fourteen countries today – with the possibility of further expansion as we will hear later on from the European Commission. In each country, and in cooperation with our partners, the Fund's set up, which includes sound governance, is the key to fast and targeted service. Speed and efficiency have always been a focus for the Fund. But so has quality. - Quality of service and respect for our partners ultimately resulted in outstanding portfolio quality: the Fund has so far had to build less than 1% for impairment allowances.

## **B) Where we stand today**

Now that we've established that the EFSE is an example of stability and flexibility by virtue of the public-private partnership, what's next?

Before we touch on the future, let's take a brief look at where we stand today.

The structural and capital reforms undergone by the EFSE in early 2011 further bolster the Fund's ability to grow with the development finance challenge, and to do so effectively and measurably. Above all, these reforms protect private investment capital against risks to a greater extent than before. A change that was well received within the microfinance industry.

Today, "EFSE" also stands for Responsible Finance. That is because of our comprehensive approach to tackling the issue. Our approach builds on roundtables held in concert with central banks – like the one we held here in Tirana in March of last year, also hosted by the Bank of Albania – to raise awareness and spark change. It also builds on concrete support to partner lending institutions in adopting better governance, in making their products more accessible and their processes more transparent. And it builds on educational measures to increase the financial literacy and risk awareness of those who are ultimately our customers, the many thousands of micro and small enterprises and individual borrowers.

To all of the EFSE's stakeholders it is clear that compliance with the duties and functions of the Board and the supporting Fund Management as well as its Service Providers and Administrator requires dedication to the target group. This means that, especially in times of crisis, we must appreciate the ultimate damage which failures in the banking sector may cause.

It is not a matter that only affects the balance sheet.

There is also the toll in broken lives, lost homes and lost jobs – and worse than that, the loss of prospects, of confidence in the future.

It is against this background that we follow the guidance of our Advisory Group in amplifying the positive effects and the reach of vibrant and innovative Partner Lending Institutions who support small enterprises with long-term loans – so that these partner lending institutions and their customers may thrive, and wobbly institutions become rare exceptions.

Our partners know they can rely on the EFSE as their development finance backbone. When capital is scarce, we can draw on both development finance money and funds from private investors – a key advantage of operating as a public-private partnership. As of today, private capital, in fact, accounts for 67% of total investor commitments. Our partner lending institutions appreciate that we are able and responsible, that we share their experiences, that we speak their language and that we remain accessible. And we are committed to building on these strengths.

### **C) Challenges ahead**

So where do we go from here? What are the challenges ahead? What issues must we face as a Fund operating in a region that was hit hard by the global financial and economic crisis and is now on the road to recovery?

From our perspective, the crisis in our region has provided new insights and opened up new perspectives that may have a lasting impact on economic policy.

As we all know, as the global crisis worsened, the Basel Committee on Banking Supervision proposed far-reaching reforms regarding capital and liquidity

provisions. In November 2010, these rules, known as Basel III, were endorsed at the G 20 Summit in Seoul. Now they need to be transposed into national policies in developed countries to make individual banks more stable and prevent dysfunctions.

We all know that high quality capital provides incentives and limits on bank risk taking. But we also know that a strong capital base and comprehensive risk coverage cannot substitute for deficiencies in risk management. There are a lot of other measures for promoting safer banks. Once implemented in the developed countries, Basel III will probably be also put on the agenda of the emerging and developing countries in Eastern Europe with a certain time lag.

This is the new reality that has dawned on all of us. We must shape it. We must leverage it.

The goal is to make banks safer by higher capital requirements, stricter regulations and limits on risk-taking. It means in fact preparing banks and the banking sector for the next crisis. The banking model will adapt to the new context. It is difficult to say what exactly the adaptation process will look like. But in all probability the lending strategy in Eastern European Banks will become more diversified. And it may focus more on lending to small and medium-sized enterprises and less on consumer loans. There are Partner Countries where the actual equity risk buffer is greater than the equity requirements of the Basel III micro-prudential measures.

On the other hand there are countries where we are facing equity shortcomings. We should also consider strong reliance on foreign currency savings and borrowings in some countries where local currency markets and funding and lending in local currency needs to be developed. The EFSE is taking a long hard

look at the situation with the support and guidance of the Advisory Group. An initiative with the Central Bank of Armenia is in the works and expected to launch this summer, for instance. The EFSE is taking a country by country approach to the local currency issue because the reasons for financial “dollarisation” differ from country to country.

When facing the challenges ahead we should also consider the diversity of the financial and banking sector in each country of our target region. In this context, we must also keep in mind that, within our target region, the crisis impacted microfinance institutions, or MFIs, in particular, which caused them to run into greater trouble in the wake of the global financial crisis.

Getting to grips with these shortcomings is key to shaping and leveraging the new reality.

**The first issue** we need to address is that MFIs need a solid regulatory basis on which to operate from. Ownership or equity stakes for instance, were not clearly defined then and they still aren’t clearly defined now. And where there is no ownership, there is no sense of ownership, no sense of responsibility and accountability – and limited recourse for the owners.

**The second issue** is a corollary of the first: imperfect or disregarded principles of Responsible Finance. Had they been in place, this would have helped to avoid some of the excesses in the consumer finance area and the over-indebtedness of micro credit borrowers. With a minimum of governance, there would have been the necessary checks and balances, but also necessary learnings and innovations that need to drive any institution. Deficiencies in corporate governance endanger the stability of institutions by triggering illegal attempts at

intervention by fishy parties. Good corporate governance is a prerequisite for institutional sustainability and resilience in times of crisis.

**Challenge number three** concerns liquidity. A bridge financing facility, for instance, is crucial in the context of a crisis – here, I might add, the EFSE did its part. We can also all agree that providing local currency financing windows, also by tapping local capital markets, is key to strengthening budding businesses by mitigating currency exchange risks.

**The fourth area that requires attention** is risk management. Having adequate risk management tools, processes and procedures in place would have preserved many financial institutions from the onslaught of loan delinquencies in the aftermath of the crisis. It would also have separated the wheat from the chaff at a much earlier stage, in the pre-crisis years, when credit was so readily available. Here, too, the EFSE, specifically the EFSE Development Facility, takes on a pivotal role in building the capacities of partner lending institutions to properly assess and mitigate credit risks.

**Problem number five** points to the lack of an effective process for selecting advisors to guide reorganisation and restructuring processes, and especially for empowering them in their mission. Although they were the ones who ultimately were made accountable, they didn't have the authority to make the necessary changes. This deficiency has to be seen in the context of the lack of an adequate regulatory framework for preserving creditor interests. Restructuring an MFI must happen under a transparent oversight process that involves owners and creditors. This is a precondition for ensuring the MFI's recovery or – in what should be an extremely rare occurrence – preparing to wind down the institution for liquidation.

More hurdles to overcome, I'm sure, will be identified in the various workshops during our conference here in Tirana.

What these issues – all of which can be solved, let me be clear on that – boil down to is this: people and processes. Get those right and you're half way there. The new reality, which is ours to shape and leverage, clearly puts us before new challenges. But these are challenges we have been preparing for. Here, Responsible Finance is the keystone of our efforts. Responsible Finance, and, consequently, good corporate governance and transparency, is about people and processes, and had it been more strongly ingrained, I would venture to say that the list I just read out would have been much shorter.

Let me conclude by saying that the EFSE, together with the funding and development facility support it provides, continues to send the strong signal that, despite still turbulent times, we believe in our target region and in its small business sector. We also encourage other investors to remain in, or to return to these countries. Our Commitment to our countries of operation, is firm and irrevocable. Our partners know that they can count on us in times of crisis – just as they can count on us in times of prosperity. And I am confident that through it all, the EFSE will always be able to count on guidance from its Advisory Group.

I am sure the workshops will provide ample food for thought. Thank you for your attention.