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LAW IN TRANSITION JOURNAL

Public-private partnerships: the UNECE-EBRD Model Law
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ABOUT THE EBRD

The EBRD is a multilateral bank that promotes the development of the private sector and entrepreneurial initiative in 38 economies across three continents. The Bank is owned by 69 countries as well as the EU and the EIB. EBRD investments are aimed at making the economies in its regions competitive, inclusive, well-governed, environmentally friendly, resilient and integrated.

ABOUT THIS JOURNAL

Legal reform is a unique dimension of the EBRD's work. Legal reform activities focus on the development of the legal rules, institutions and culture on which a vibrant market-oriented economy depends. Published once a year by the Office of the General Counsel, *Law in Transition* journal covers legal developments in the region, and by sharing lessons learned aims to stimulate debate on legal reform in transition economies.

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FOSTERING THE SUSTAINABLE DEVELOPMENT GOALS

Only 10 years remain until 2030, the target date for achieving the Sustainable Development Goals (SDGs), and time is running out to accomplish the shared prosperity and sustainable world the goals envisage. Recent reports show significant progress globally, particularly in reducing poverty. Yet, many areas still call for urgent collective attention, especially those related to climate action.

The EBRD is a strong supporter of, and contributor to, the Sustainable Development Agenda. We are proud to be helping economies in central and eastern Europe, Central Asia and the southern and eastern Mediterranean transition to vibrant market economies. For the past three decades, the Bank has combined its investment programme with technical cooperation projects to bring about change for the better in these regions. The Legal Transition Programme, in particular, which this publication covers, has pride of place at the forefront of this change.

It is widely accepted that "good laws make for good economies". Year after year, our programme has successfully put this theory into practice in the economies where we invest. More recently, however, we have expanded the scope of our work to reflect that the SDGs themselves have a strong legal dimension and that legal and institutional reforms play a crucial role in achieving them.

Indeed, SDG 16 (Peace, Justice and Strong Institutions) is directly linked to law. Its introduction underlined the development contribution of organisations such as ours that work to further the rule of law. Nevertheless, several other SDGs also call for the adoption or improvement of legal frameworks and institutions, such as SDG 5 (Gender Equality); SDG 8 (Decent Work and Economic Growth); SDG 9 (Industry, Innovation and Infrastructure); and SDG 13 (Climate Action). SDG 17 (Partnerships for the Goals) is also very relevant to our reform work, as it calls for proper buy-in from national authorities and coordination among organisations that provide aid.

This issue of the *Law in Transition* journal showcases the EBRD's work in upgrading legal regimes for business and investment in the economies where we invest. In particular, the various stories highlight the strong links between our activities and the SDGs. By sharing our experience of what has worked and what has not, we hope to stimulate debate on current and future reforms. As the United Nations Secretary-General noted in *The Sustainable Development Goals Report 2019*, leaders everywhere now have "an opportunity to get the world back on track and to kick-start a decade of delivery for people and the planet". In that spirit, I hope that our journal enlightens policymakers and supports all those working to create a better legal environment for business and development.

MICHAEL STRAUSS
GENERAL COUNSEL, EBRD

EDITOR'S MESSAGE

Through its Legal Transition Programme, the EBRD promotes the rule of law as a development tool in its regions. The aim of this programme is to help establish the legal rules and institutions on which a vibrant market economy depends. The economies where we invest are at different stages of advancement in this process, as can be seen from the stories in this issue of the *Law in Transition* journal. Most of these economies, however, have been making progress on the path towards well-functioning legal regimes for investment and entrepreneurship, in some cases with EBRD assistance. The articles in this journal illustrate the diversity and richness of our legal reform support activities.

In the first article, **Alexei Zverev** and **Nenad Ilic** present a new standard for public-private partnership (PPP) development: the UNECE-EBRD People-First Model PPP Law. The model legislation will be of use to countries aiming to enact a solid and modern regime for PPPs.

Vesselina Haralampieva advocates the need to step up corporate environmental, social and governance disclosure as a cornerstone for delivering on the Sustainable Development Goals (SDGs). She details the various factors globally that contribute to driving big transformation towards a low-carbon and climate-resilient economy. The article includes a contribution by **Kate Harrington** on the relevance of food loss and waste to the green agenda.

Gian Piero Cigna, **Pavle Djuric** and **Markus Renfert** look at the benefits of corporate governance codes as "soft tools" to improve governance in companies. They detail how the "comply or explain" mechanism plays a decisive role in that context. The article draws on experiences from Croatia and Turkey.

I interviewed the new General Counsel of the EBRD, **Michael Strauss**, who shares his views on legal reform technical assistance by international organisations and the relevance of the SDGs to that process.

The next article is by **Ammar Al-Saleh**, with contributions by **Jacek Kubas** and **Polyxeni Pentidou**. It reveals the difficult balancing act of regulators when trying to address Fintech. As the author points out, too-stringent rules can stifle innovation whereas too relaxed a regime can create systemic risks. In another Fintech-related story, **Jelena Madir** and **Melis Ekmen Tabojer** discuss the concept of open banking and the risks associated with it; they consider in particular the impact of the new EU Payment Services Directive 2 and the situation related thereto in various economies in which the EBRD invests.

Eliza Niewiadomska of the EBRD and **Caroline Nicholas** of the UNCITRAL discuss institutional leapfrogging in transition economies, using public procurement rules and digital processes as an example. **Yulia Shapovalova**, **Jyldyz Galieva** and **Bakai Zhunushov** then examine a new online catalogue system introduced in the Kyrgyz Republic, expected to have a huge impact on access to public procurement markets by small and medium-sized businesses.

Veronica Bradautanu and **Taras Starosselets** reflect on the benefits of mediation as an alternative dispute resolution mechanism. In particular, they draw lessons from the Bank's technical cooperation with Serbia and Moldova in promoting mediation.

Catherine Bridge Zoller and **Alenka Cerne** write about the Bank's work to turn around distressed state-owned enterprises in Croatia, in light of a recently completed project. The article includes suggestions for further revitalising this complex sector of the Croatian economy.

Paul Moffatt and **Rika Ishii** have prepared a piece on the telecommunications sector in Uzbekistan. The article focuses on the challenges for the country to deliver on its broadband goals and suggests approaches based on proven best practices from other countries, with a focus on the positive effect of competition in this process.

I hope you will enjoy this issue of the *Law in Transition* journal. It aims to reflect some of the main achievements and lessons learned of our programme during the past year. We would of course welcome your feedback.

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PUBLIC-PRIVATE PARTNERSHIPS: THE UNECE-EBRD MODEL LAW

"PPPs help to foster economic growth and social development in ways that promote the Sustainable Development Goals of the United Nations, leading to a higher and more sustainable quality of life for everyone and stronger environmental protection."

POTENTIALS OF PUBLIC-PRIVATE PARTNERSHIPS

When properly structured and implemented, public-private partnerships (PPPs) can offer all sorts of advantages for society. They can advance the efficient and cost-effective development, provision and operation of public infrastructure and public services by effectively and sustainably harnessing the skills, resources, know-how and/or finance of the private sector on a long-term basis and structuring projects in ways that allocate the risks and responsibilities involved most appropriately over their life.

Whether it is in design, construction, rehabilitation, operation and/or maintenance, this can stimulate new funding and investment opportunities, raise the quality of public services and improve the public's access to these services.

PPPs therefore help to foster economic growth and social development in ways that promote the Sustainable Development Goals (SDGs) of the United Nations (UN), leading to a higher and more sustainable quality of life for everyone and stronger environmental protection.

UNIFICATION OF APPROACHES

To harmonise the approach to PPP legislation worldwide, the Model Law has been drawn up as part of the wide-ranging corpus of guidance documents, modules and studies on PPPs. The Model Law is currently being produced on behalf

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of the PPP Group within the United Nations Economic Commission for Europe (UNECE) and the EBRD's Legal Transition Programme. It aims to assist governments seeking to create or develop PPP systems of their own, especially in the economies where the EBRD invests and those doing so for the first time.

Governments seeking to launch or expand PPP systems often decide to put a PPP law in place, especially in countries based on civil law systems and/or relatively highly regulated commercial activities where a comprehensive and explicit set of rules applicable to PPPs may be considered helpful or necessary. Many common law countries, however, have done without one altogether, or only have very focused and limited new legislation in this area, since existing legal and contractual principles are often thought to constitute an adequate framework for them.

Many PPP laws have been adopted by different countries around the world in the past few years. Others are now doing so or are planning to do so. However, there is still a considerable disparity in the quality of those laws already in place. Some constitute extremely well-thought-out and structured laws, and others rather less so. Moreover, most of these laws do not yet take into account the challenges that have arisen when attracting private business to infrastructure in connection with the SDGs, and in particular with the Guiding Principles on People-First Public Private Partnerships, set out in the document of that title published by the United Nations in 2019 (the "People-First PPP Principles").[1]

In drawing up the Model Law the authors made extensive use of those existing laws that they believe represent leading precedents and international best practice in this field. On the one hand, the availability of these documents has made the production of a Model Law based on them feasible. On the other, the number of countries still seeking to enact new or revised legislation of this kind provides a clear justification for publishing a model, in terms of offering further guidance.

MODEL LAW FEATURES

The United Nations Commission on International Trade Law (UNCITRAL) team has recently revised and published its own Legislative PPP Guide (with template clauses) on this subject, which has been a leading authoritative text in this field for the past 20 years. The authors of the Model PPP Law have also drawn heavily and fruitfully on those published clauses in structuring and wording its provisions, which cover some of the same ground and are designed to be generally compatible with them.

The Model PPP Law is, however, more comprehensive, therefore representing a standalone complete act compared with the UNCITRAL text which focuses on a few specific aspects of PPPs. The prepared Model Law enshrines and gives effect to the Guiding Principles on People-First Public Private Partnerships. These principles represent a new paradigm for PPPs, designed to achieve a range of sustainable development outcomes, which are critical to the SDGs and build on the PPP attributes described above, including:

- increased access to essential services and decreased social inequality and injustice
- enhanced resilience and adaptability
- proper responsibility for environmental sustainability
- improved socioeconomic effectiveness and sustainability
- vigilance against corruption
- replicability and the development of further similar projects
- full involvement of and consultation with stakeholders.

PPPs structured and implemented in accordance with the provisions of the Model Law can therefore be expected to promote those outcomes. They should represent enhanced "value for people" as well as "value for money" in terms of their long-term net value for consumers, the government and the wider public, considered over their lifecycle in light of all their significant impacts, for the greater good of everyone.

Promoting PPPs in Lebanon

Since October 2019, the EBRD Legal Transition Programme (LTP) has been engaged in providing technical assistance to the High Council for Privatisation and PPP (HCP) focusing on capacity enhancement and enabling framework development related to PPP project identification, preparation and implementation. The HCP is the country's PPP unit charged with appraising potential PPP projects and determining whether to reject or pursue a particular project.

The key objective of the LTP's assistance is to conduct a detailed gap analysis of the current institutional set-up and provide PPP institutional capacity enhancement assistance including, notably, through designing a comprehensive PPP training strategy for the HCP and relevant ministries and the delivery of training. The project team has completed the legal and institutional review of the PPP framework in Lebanon and has presented to HCP a draft set of recommendations for improvement. A set of further PPP guidelines have recently been drafted to provide additional clarification on PPP project implementation.

THE PEOPLE FIRST

The People-First PPP concept can provide invaluable guidance and focus, even if this is just a matter of emphasis. Highlighting the human, social, environmental and ethical aspects of PPPs should contribute to better designed PPPs in ways that are intrinsic to the wider mission of the UN.

The People-First PPP concept has now been formally supported, and its use recommended, by four United Nations Regional Commissions, namely UNECE, ECA, ESCWA and ECLAC, which in May 2019 announced their decision to collaborate and work together to make PPPs fit for purpose for the 2030 Agenda for Sustainable Development. The Model Law has been drawn up specifically with the People-First PPP objectives in mind and contains a number of cross-references to them. The core principles behind it are cited in its preamble.

"The Model Law assumes a fine balance between general regulatory control by the government over the PPPs implemented under its terms and freedom of contract for the parties to the relevant PPP contracts."

Promoting PPPs in Tunisia

The LTP has been supporting Tunisia with PPP/concessions legal advisory since 2015. With the assistance of the EBRD, the country adopted its new PPP law in 2015. The new law brought greater clarity and transparency to the overall regime for private sector participation in infrastructure projects. Adoption of the PPP law was one of the highest priorities on the government's agenda, and it laid the groundwork for further cooperation between the EBRD and the Tunisian authorities in the area of developing PPP/concessions frameworks.

In 2017 the President of the Concessions Monitoring Unit, the main body mandated to coordinate, provide advice on and monitor PPPs and concessions in Tunisia, requested the EBRD's technical assistance with reviewing the old concessions law and enhancing capacity to implement concession projects. Following LTP's successful engagement on reviewing the PPP/concessions framework, in 2019 the government of Tunisia requested LTP's further support in developing a PPP policy that will declare public support for PPPs, define their key characteristics and promote the development and practical implementation of concession projects in the country.

WIDE USE OF THE MODEL LAW

The Model Law is not, of course, a template piece of legislation that can simply be pulled down and enacted by any country. It is designed to offer guidance, not cut-and-paste statutory clauses. Careful consideration will always be needed.

In the end, there are many different ways of approaching laws of this kind and the various provisions they contain. They give rise to questions and issues to which different countries will offer different answers and reach different conclusions.

Furthermore, any PPP law that a country adopts must be fully compatible with its wider legal system, jurisprudence and legislative traditions, as well as with the idiosyncrasies of its PPP system. That may call for extensive modification to the Model Law where it is being used as a helpful precedent.

The Model Law represents the type of PPP law that aims to be relatively comprehensive in scope, setting out a robust framework to govern all the fundamentals of a PPP system, the basic elements of PPP projects and the procedures and regulatory mechanisms that apply to their preparation, award and implementation.

But it may not always be technically necessary at a legal level to do this. Some of the relevant legal concepts and arrangements may already be in place. For example, the country's existing procurement regime may be adequate for PPP purposes and the country may already have a long history of successfully using PPPs. In that case, a shorter, more focused law may be appropriate. That is something each country must decide for itself.

The advantage of the approach reflected in the Model Law and the reason it is often adopted, in particular in civil law countries, is that the new PPP law then becomes a comprehensive enabling statute, offering clarity and certainty as to what is feasible in the PPP context and how individual projects should be approached and implemented. This can work to everyone's advantage.

It should also be noted that the Model Law is not directed primarily at member countries of the European Union (EU) or the accession countries. The EU already has a wide-ranging body of laws and requirements applicable to the procurement of PPPs. Any EU accession countries that seek to

draw on Model Law provisions should therefore carefully consider how to harmonise their PPP laws with the EU *acquis* and how to adapt the clauses from the Model Law accordingly.

The Model Law assumes a fine balance between general regulatory control by the government over the PPPs implemented under its terms and freedom of contract for the parties to the relevant PPP contracts. Some countries may prefer to include additional tiers of approval of and control over a PPP's elements, terms and implementation. The degree of regulatory control that any country seeks to establish is a matter of the country making its own decision in light of its political and jurisprudential traditions and socioeconomic system.

The Model Law and its commentary are the work of a team of distinguished legal, and some non-legal, experts in the field of PPPs, who have been collaborating on this exercise for over 18 months under the aegis of the United Nations and the EBRD.

1 See https://www.unece.org/fileadmin/DAM/ceci/documents/2018/PPP/Forum/Documents/The_8_Guiding_Principles_for_People-first_PPPs_in_support_of_the_UN_SDGs-Part_II.pdf (last accessed 13 February 2020).

RAISING THE BAR: HOW CORPORATE ENVIRONMENTAL, SOCIAL AND GOVERNANCE DISCLOSURE IS HELPING DELIVER THE UN SUSTAINABLE DEVELOPMENT GOALS

"In line with the Green Economy Transition (GET), the EBRD is on track to achieve its objectives to increase green financing to 40 per cent of its annual business volume by 2020."


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Promoting environmentally sound and sustainable development is a core part of the EBRD's mandate. In line with its 2015 Green Economy Transition approach, the EBRD is on track to achieve its ambitious target to increase green financing to 40 per cent of its annual business volume by 2020.[1] In fact, the Bank surpassed this target in 2019. The GET approach is aligned with the 2015 Paris Climate Agreement, and is delivered through the EBRD's unique business model combining investments, concessional financing, policy engagement and technical support. The Bank has also embraced the strategic long-term vision for development, as set out in the United Nations' Sustainable Development Goals (SDGs).

The SDGs are the global blueprint for environmentally sustainable and inclusive economic development. There are just 10 years to go before the 2030 deadline to achieve the Goals, to which members of the international community signed up in 2015.

Pursuing the SDGs is closely linked with delivery of the EBRD's mandate, as encapsulated in the six Transition Qualities by which impact is measured. These define a sustainable, well-functioning market economy as competitive, well governed, green, inclusive, resilient and integrated.[2] In addition, the Bank has a robust and inclusive Environmental and Social Policy ensuring proper safeguards are put in place in every project and benefits for the wider community are maximised.[3]

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Four years after the SDGs were created, progress has been made in some areas, but it is clear that a "much deeper, faster and more ambitious response on a global level is needed to unleash the social and economic transformation needed to achieve our 2030 goals," according to the Secretary-General of the United Nations António Guterres.

The lack of progress is particularly apparent when looking at SDGs related to the environment, such as climate action and biodiversity. The impacts of climate change and increasing inequality across and within countries are factors that are undermining progress on the sustainable development agenda, threatening to reverse many of the gains made over the last decades that have improved people's lives, warns the United Nations' latest report on the Sustainable Development Goals.[4]

CLIMATE ACTION

There are numerous factors in a complex world that contribute to driving big transformation towards a low-carbon and resilient economy. Nonetheless, over the last couple of years, several key interconnected trends have emerged, which influence this transformation on a global and regional level.

First, the impacts of climate change are becoming far more tangible. People and governments increasingly have to deal with the impacts of a warmer world: extreme weather, heatwaves, a rising sea level and ocean acidification are intensifying. Businesses are experiencing financial losses from the unpredictability of the climate. Natural disasters and the collapse of ecosystems are causing increased food insecurity, displacement and widening inequality gaps. Simultaneously, general awareness is growing and many national, city and regional leaders have called for urgent, coherent and transformative climate action.

Second, there has been a strong social movement on a global scale that has been driven by young people who are calling for change. This wave of activism is shaping public opinion and has led to a growing focus on the climate change challenge in the media and in political debate.

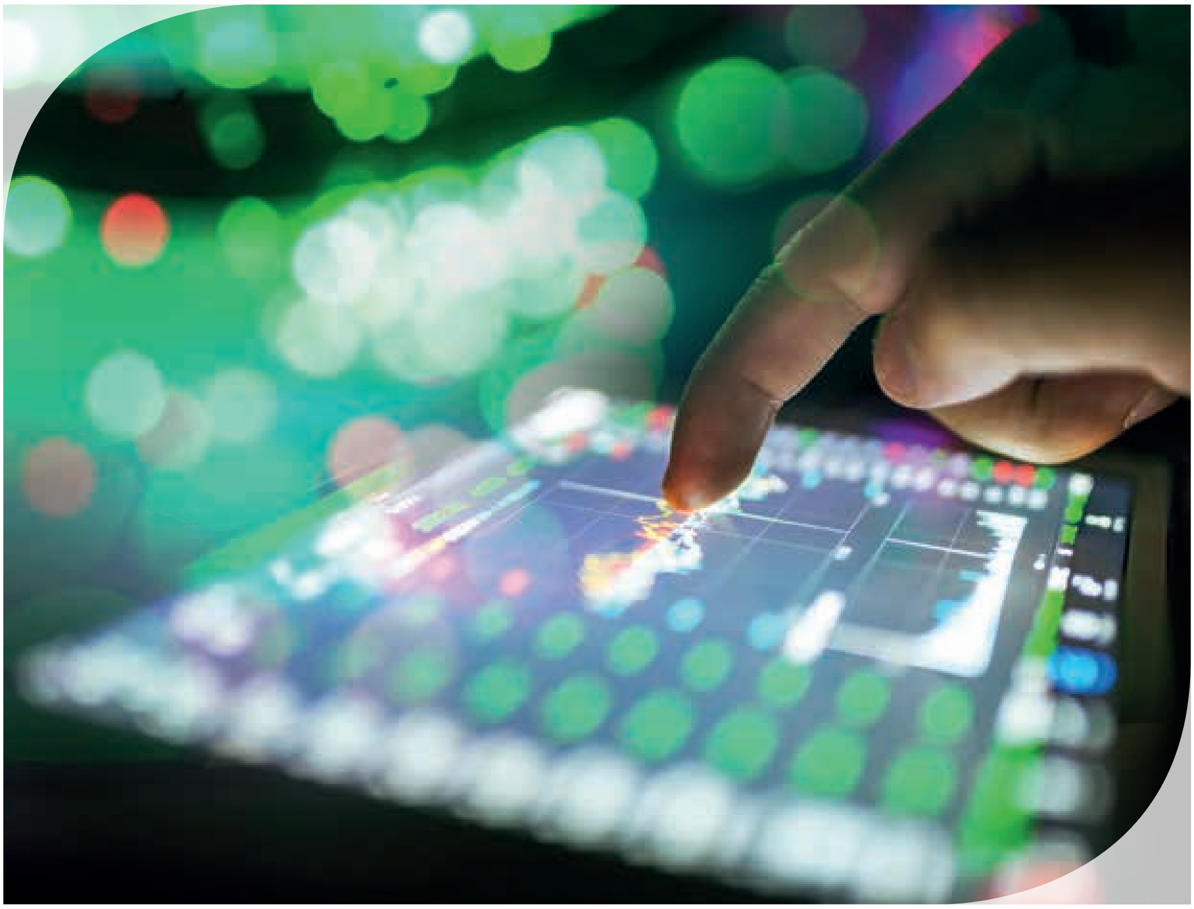
Third, the cost of renewable energy technology is plunging, largely due to ambitious national policies, earlier subsidies and current targets for green energy. Other technologies are becoming increasingly attractive (for example, energy storage) and their deployment will help reduce dependency on fossil fuels. Digital technologies are transforming the energy sector and other industries: for example, the application of data gathering, open access data and smart contracts are increasingly becoming integral to the decarbonisation and decentralisation of energy systems, while artificial intelligence and disruptive technologies are being used for verifying and analysing companies' environmental, social and governance (ESG) data.

INVESTORS SHIFT TO SUSTAINABLE PRODUCTS AND SEEK ESG REPORTS

The fourth factor is closely related to the concerns of corporations and investors about sustainable investment and the impacts of climate change. Investors are taking a sustainable approach to pursue their investment objectives by requesting ESG insights into traditional investment approaches. There is overwhelming research showing that better management of ESG risks leads to better long-term financial performance of firms.[5] The strength of this relationship depends, among other things, on the type of industry in question, the firm's location and the quality of governance in the country where the firm is located.

Reports show that the ESG disclosure rate for top companies has quadrupled since 2011. It has been a significant challenge to decipher this data, which has burgeoned in recent years. In addition, the range of ESG reporting frameworks, standards and voluntary initiatives is expanding, making the reporting landscape complex and challenging

The EBRD is supporting the economies where it invests in developing renewable energy markets and in implementing competitive renewable energy auctions that ensure increased transparency and low prices for end consumers.



for companies, especially for those from emerging markets. Criticism has been directed at a lack of standardisation of data, favouritism of some ESG considerations over others, a lack of historical data and the fact that some sectors report more than others. A growing number of ESG ratings providers are tackling these problems, but challenges in implementation and a lack of consistency and comparability of reports remain. Investors are increasingly enquiring about sustainable investment, including the risks and opportunities emerging from energy transition in a warmer world. Accordingly, market-leading initiatives and standards have been developed which acknowledge that useful corporate information on climate-related risks and opportunities will help mitigate the risk of financial loss and reveal the potential for financial gain.

Some of these reporting frameworks and standards apply to investors, such as the UN Principles for Responsible Investment (UNPRI), which require investors to have appropriate disclosure on ESG issues by the entities in which they invest. While others, such as the OECD

"To achieve the SDGs in Europe, the European Commission developed the Sustainable Finance Action Plan. The Plan aims to redirect capital flows towards a more sustainable economy, mainstream sustainability in risk management and foster transparency and long-termism."

Guidelines for Multinational Enterprises and the Due Diligence Guidance of Responsible Conduct, apply directly to corporates. The market-led recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), for example, apply directly to corporates and aim to ensure that investors, lenders and insurance underwriters have sufficient information about how climate change could affect their actual and proposed investment. Other disclosure bodies join forces to ensure consistency in their standards and requirements and contribute to the emergence of knowledge around the good practices in implementing the TCFD recommendations.[6] Blackrock, a global investment management company, announced that the companies it invests in will be asked to disclose information in line with the guidelines of the Sustainability Accounting Standards Board and the TCFD. This may be a real game changer for the market as it is encouraging its financial institutions to do so too.[7] Nonetheless, providing decision-useful sustainability reporting remains a challenge, especially in emerging economies where reporting is patchy and burdensome. Clearly there is a role for development banks to play.

The EBRD is a signatory to UNPRI and was the first multilateral development bank (MDB) to support the TCFD.

Sharing their ambition for climate action, in 2018 the EBRD and other MDBs signed a joint declaration aligning their activities with the goals of the Paris Agreement. The MDBs stated that: "there is an international consensus on the urgent need to ensure that policy engagements and financial flows are consistent with a pathway towards low greenhouse gas emissions and climate-resilient development."[8] In 2019 the MDBs announced plans to increase the global climate action investments they support each year to US$ 175 billion by 2025.[9]

EMERGING REGULATORY FRAMEWORKS

The fifth central factor driving markets to low carbon and resilient transformation is the move by governments and regulators to standardise and simplify ESG disclosure regimes, which will increase board-level engagement on this topic in the short to medium term.[10] To achieve the SDGs in Europe, the European Commission developed the Sustainable Finance Action Plan. The Plan aims to redirect capital flows towards a more sustainable economy, mainstream sustainability in risk management and foster transparency and long-termism. Accordingly, the European Commission has adopted 10 separate action points, including developing legislative proposals in relation to some of the work streams. Key contributions of the Plan include establishing a European Union (EU) classification system for sustainable activities (so-called taxonomy), strengthening sustainability disclosure and accounting rule-making and fostering sustainable corporate governance. The EU's ambition to mainstream sustainable investment by providing the relevant definitions, tools and regulatory regime will help develop a consistent and comparable assessment and reporting of ESG data. In 2019 the EU incorporated TCFD recommendations in its supplement to the Guidelines on Non-Financial Reporting, which is another positive development towards streamlined reporting requirements.

On a national level, for example, the UK's Financial Reporting Council encourages non-financial reporting and requires companies to report on their principal risk and environmental matters, when material. The UK's Green Finance Strategy (July 2019) aims to align private-sector financial flows with clean, environmentally sustainable and resilient growth. France is among the first countries to require institutional investors to disclose information about their contributions to climate goals, compelling them to provide information on the methodology applied under the "comply or explain" approach. Other countries are also moving to provide guidance for ESG reporting. Meanwhile, the Network for Greening the Financial System, a group of central banks and financial regulators, has put forward recommendations aimed at making climate risk management a standard component of financial supervision across a range of advanced and emerging market economies.

Lastly, another factor is the increasing number of legal claims brought in courts by shareholders against companies and company directors for failing to disclose information related to climate risk, for failing to account for possible risks to carbon-intensive assets or for contributing to extreme weather conditions by burning fossil fuels and raising CO_2 levels in the atmosphere. In some cases, claimants are seeking billions of dollars in damages. Such climate liability risks can be mitigated, if companies develop long-term strategies and disclosure policies for climate-related risks.

The uptake of climate governance for companies, in practice, especially in emerging countries, is still at an early stage. A 2018 EBRD study led by the LTP highlighted the key practices that have emerged for companies to adopt in line with international standards. A senior buy-in at the highest level is essential. Nonetheless, even with the right buy-in, developing a forward-looking strategy incorporating the climate may still take several years, requiring close cooperation of finance, risk management and audit teams, as well as local business units in order to account for local climate-related risk and impacts. Furthermore, companies may also need to establish partnerships with experts and scientific organisations in order to translate scientific data into workable and operational action plans and to improve access to data. More mature companies should carry out climate scenario modelling tests to feed into the analysis of risks and opportunities and to support organisational decision-making processes. Governance of climate risks also needs to be supported by regular meetings of designated governance bodies and training for board members and key managerial staff.

Based on the study the EBRD has launched a pilot project to support an energy-sector client in developing an action plan to identify, assess and manage climate-related risks and enhance its climate governance. This will lead to an open and transparent dialogue with investors, policymakers and stakeholders on managing climate risks and opportunities and will make the company more climate-resilient.

OPPORTUNITIES IN A CHANGING WORLD

Despite market, litigation and emerging regulatory pressure to report on ESG and the climate in particular, there are also valuable incentives that exist to accelerate progress by leveraging the opportunities in tackling climate change. Financial experts have stated that firms that do not adapt "will go bankrupt", while “there will be great fortunes” for those who are working to tackle global warming.[11] Interlinking climate action with the rest of the SDGs will also unveil opportunities. Reducing greenhouse gas emissions, for instance, goes hand in hand with creating jobs, building more liveable cities and improving health and prosperity for all.

It is expected that the emerging frameworks and alignment initiatives will provide a cornerstone for transforming the financial system to reward the most sustainable companies and allow their solutions to achieve the scale that society needs. Delivering on the Paris Agreement and the SDGs requires improved, robust, meaningful ESG and climate disclosure practices.

“It is expected that the emerging frameworks and alignment initiatives will provide a cornerstone for transforming the financial system to reward the most sustainable companies and allow their solutions to achieve the scale that society needs.”

EBRD building partnerships for achieving SDG 12 (Responsible consumption and production), SDG 13 (Climate action) and SDG 17 (Partnerships for the goals)

by Vesselina Haralampieva (Senior Counsel) and Kate Harrington (Chief Counsel, EBRD)

Few things are as interwoven with human existence and culture as food. At the most basic level, we need food to survive. Beyond sustenance, the production and sharing of food is often central to cultures around the world. However global food production is also a major contributor to climate change, and nearly one-third of food produced for human consumption is either lost or wasted. This amounts to 1.3 billion tonnes of food, resulting in US$ 1 trillion in economic costs, around US$ 700 billion in environmental costs and around US$ 900 billion in social costs.[12] Despite this, more than 10 per cent of the global population goes hungry.[13] And the number of people who are undernourished or facing severe food insecurity worldwide is increasing. Reducing food loss and waste (FLW) included in SDG Target 12.3 requires global food waste at the retail and consumer levels to be halved and food losses along production and supply chains to reduce by 2030.[14]

Reducing FLW is an important way to increase the efficiency of the food system, improve food security and nutrition, and contribute towards environmental sustainability. In addition to SDG 12 (responsible consumption and production), reducing FLW contributes directly to SDG 2, which calls for an end to hunger, the achievement of food security and improved nutrition, and the promotion of sustainable agriculture. The positive environmental impacts from reducing FLW support SDG 6 (sustainable water management), SDG 13 (climate change), SDG 14 (marine resources), SDG 15 (terrestrial ecosystems, forestry, biodiversity) and other SDGs. In service of SDG 17 (partnerships for the goals), the EBRD works closely with Food and Agriculture Organization of the United Nations (FAO) and the International Fund for Agricultural Development (IFAD) to address FLW.

The EBRD invests in the private sector to encourage companies to adopt sustainable practices, reduce waste and integrate ESG data into their reporting. Climate change will affect food security, including food production and distribution channels. At the same time FLW negatively affects climate and environmental sustainability. Companies adopting sustainable business roadmaps will generate less waste, fewer greenhouse gas emissions, and more considerate usage of food resources.

In accordance with the objectives of the EBRD's Agribusiness Strategy (2019-23) and the EBRD's Green Economy Transition Approach, the LTP developed FLW Guidelines for Greece and Turkey[15] in 2019 aimed at identifying and promoting policies, regulatory measures and business practices that would have a positive impact on prevention, reduction and management of FLW at supply and retail levels. In addition, the guidelines highlight good sector practices for the integration of the circular economy approach into the relevant stages of the food supply chain.[16] This initiative has been implemented in partnership with FAO.

FLW represents economic losses for all actors along food supply chains, including end-consumers. Investments designed to reduce FLW yield more safe and nutritious food for human consumption than investing only in increasing food production. Engaging the public sector, private sector and civil society is critical to raise awareness and focus efforts for change at the retail and consumer levels. From better matching supply with fluctuating demand for different food types, using "ugly" fruits and vegetables as ingredients for food products such as baby food and spreads to ensuring expiration dates reflect the true shelf life of products, retailers can reduce their food waste. Retailers can also play an important role in ensuring any surplus edible food is redistributed for human consumption, helping divert food waste from landfill and providing high quality nutrition to food-insecure consumers. Interventions that help people avoid overbuying food and letting it spoil can help save money while also creating new business opportunities.

FLW is a significant global challenge for business, policymakers and civil society. The EBRD is committed to work in partnership with all stakeholders to meet the SDG Goals.

1 See https://www.ebrd.com/what-we-do/get.html (last accessed 10 January 2020).

2 See https://2018.ar-ebrd.com/our-transition-qualities/ (last accessed 10 January 2020).

3 See https://www.ebrd.com/environmental-and-social-policy.html (last accessed 20 February 2020).

4 See https://www.un.org/sustainabledevelopment/blog/2019/07/sdg-progress-report-2019/ (last accessed 10 January 2020).

5 Manrique and Martí-Ballester (2017), Xie et al. (2019) and *Transition Report 2019-20*, EBRD.

6 In September, the Sustainability Accounting Standards Board (SASB) and Climate Disclosure Standards Board (CDSB) published the TCFD Good Practice Handbook, which provides examples of good practice from across the G20 countries.

7 See https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter (last accessed 31 January 2020).

8 See https://www.ebrd.com/news/2018/mdbs-make-joint-declaration-on-climate-finance-alignment.html (last accessed 10 January 2020).

9 See https://www.ebrd.com/news/2019/-mdbs-pledge-to-join-forces-to-raise-annual-climate-finance-to-175-bn-by-2025.html (last accessed 10 January 2020).

10 See https://www.wbcsd.org/Programs/Redefining-Value/External-Disclosure/Reporting-matters/News/Reporting-matters-2019-regulators-and-standard-setters-urged-to-simplify-and-align-the-corporate-reporting-landscape (last accessed 10 January 2020).

11 See https://www.theguardian.com/environment/2019/oct/13/firms-ignoring-climate-crisis-bankrupt-mark-carney-bank-england-governor (last accessed 10 January 2020).

12 FAO, *Food loss and food waste*, http://www.fao.org/policy-support/policy-themes/food-loss-food-waste/en/ (last accessed 31 January 2020).

13 Hunger Notes, *How many people are hungry in the world?* (2016), https://www.worldhunger.org/hunger-quiz/how-many-people-are-hungry-in-the-world/ (last accessed 31 January 2020).

14 Food and Agriculture Organization of the United Nations (FAO) describes FLW as the decrease in quantity or quality of food along the food supply chain – with food loss occurring along the food supply chain from harvest/slaughter/catch up to the point of sale, and food waste occurring at the retail and consumption level. This definition aligns with that in SDG Target 12.3.

15 See https://www.ebrd.com/cs/Satellite?c=Content&cid=1395286955709&pagename=EBRD%2FContent%2FContentLayout (last accessed 31 January 2020).

16 The EBRD is a leader among multilateral development banks in circular economy work, engaging with external parties and financing projects that are explicitly aligned with the circular economic model. The Near Zero Waste Programme (NØW), introduced in 2015, supports waste minimisation and resource efficiency investments.

CORPORATE GOVERNANCE CODES AS A TOOL FOR DIALOGUE BETWEEN ISSUERS AND INVESTORS: EXPERIENCE FROM TURKEY AND CROATIA

"The effectiveness of each code's implementation largely depends on how actively the market is monitoring company practices and on the value companies themselves attach to greater transparency and better disclosure."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Corporate governance codes across Europe and, increasingly, the world are implemented mainly according to the principle of "comply or explain".

This approach, first conceived in the United Kingdom in 1992[1] and institutionalised in the European Union (EU) with the adoption of the Accounting Directive,[2] allows listed companies to deviate from the code's recommendations, provided they clearly and publicly disclose the reasons for doing so.

Transparency and external accountability are at the heart of this principle as they encourage companies to reflect on their corporate governance practices and engage in discussions internally and externally with relevant stakeholders about the need for improvement.

While on paper the approach to how companies should implement corporate governance codes seems relatively unified across countries, the actual practice varies greatly. The effectiveness of each code's implementation largely depends on how actively the market is monitoring company practices and on the value companies themselves attach to greater transparency and better disclosure. In other words, pressure, culture and recognition of good corporate governance are crucial for the success of a corporate governance code.

In its determination to raise the quality of listed companies' corporate governance statements and explanations of departures from corporate governance codes, the European Commission (EC) in 2014 issued a Recommendation on the Quality of Corporate Governance Reporting ("comply or explain").

The Recommendation focuses on the quality of information provided in corporate governance statements and elaborates on the elements of an explanation that should be clearly provided for all recommendations of the code that a company has departed from.

Also, because the "comply or explain" approach is essentially a dialogue between companies and the market, it is important to provide feedback on the basis of companies' reporting, which, in turn, requires active monitoring of how a code is applied. The EC Recommendation also supports this by stressing that "efficient monitoring needs to be carried out at a national level, within the framework of the existing monitoring arrangements".

This monitoring role is increasingly undertaken by capital markets regulators (for example, the United Kingdom's Financial Reporting Council, Autorité des Marchés Financiers in France and Comisión Nacional del Mercado de Valores in Spain), which sometimes act as creators or owners of the code. We examine two recent examples from the EBRD's corporate governance work, where projects led by the Legal Transition Programme helped capital markets regulators put in place better monitoring frameworks and introduce new rules for corporate governance codes.

"The EBRD is also promoting good corporate governance when it invests directly in a company. Whether it invests in a listed company or in a private company, the EBRD attaches high value to corporate governance."

MAINTAINING PRESSURE: THE NEW MONITORING FRAMEWORK IN TURKEY

In Turkey, the "comply or explain" approach was introduced in June 2003, when the Capital Markets Board of Turkey (CMB) adopted the Corporate Governance Principles, a set of voluntary recommendations to companies listed on the Istanbul Stock Exchange (ISE). However, the Principles were not effectively implemented and disclosure by listed companies was limited to general descriptions of corporate practices, without specific references to compliance with the Principles or reasons for non-compliance. This approach was revised in 2011, when the CMB identified a number of provisions from the Principles and required companies listed on the ISE to mandatorily comply with them, leaving the remainder of the rules subject to the "comply or explain" mechanism.

In an effort to further improve transparency in Turkey's capital markets, the CMB teamed up with the EBRD to strengthen the implementation of the mandatory Principles and to introduce a more proactive monitoring process with regards to how non-mandatory Principles are applied.

To this end, the Bank helped the CMB to develop a new reporting framework for listed companies: instead of the previous reporting format, which examined compliance with only about 40 per cent of the Principles, the new reporting format covers all Principles and additional information on corporate governance practices that may be significant for the CMB's oversight function. Among the many areas that have been streamlined, there is a focus on the gender diversity of boards, which is part of the EBRD's strategy for the promotion of gender equality.

The framework consists of two reports: the Compliance Report Format (CRF), in which companies report on their compliance status with all non-mandatory Corporate Governance Principles; and the Corporate Governance Information Filings (CGIF), which is used to collect information on current governance practices. The new reporting templates were presented to issuers listed on the ISE in February 2019, along with a manual on how to comply and report compliance with the Principles.

In parallel with the new reports, the Bank is helping the CMB to develop the monitoring framework that will support the CMB's ambitions to start issuing annual monitoring reports. To achieve that, a monitoring manual has been prepared for the CMB, which includes advice on how to:

- review disclosures (including guidance on how to interpret responses from companies and identify red flags)
- transform disclosures into an annual CMB corporate governance monitoring report
- set out its structure and content.

The annual monitoring report shows exactly where the value of a well-developed reporting and monitoring framework lies. The regulator's expectations, coupled with appropriate guidance, can form a solid basis for maintaining pressure on companies to furnish the market with information that goes beyond a box-ticking exercise and provides real meaning and value to stakeholders. The role of the regulator should also make other players more proactive in engaging with companies, all of which should contribute to a more mature governance framework.

The EBRD is also promoting good corporate governance when it invests directly in a company. Whether it invests in a listed company or in a private company, the EBRD attaches high value to corporate governance. In the case of companies on the way to an initial public offering (IPO), corporate governance will be a prominent part of the pre-investment due diligence. Sometimes the EBRD will require a full audit by a reputable corporate governance consultant. In other cases, the audit is performed in-house by the EBRD corporate governance specialists within the Office of the General Counsel. The Corporate Governance Principles will serve as a benchmark when identifying corporate governance deficits of Turkish companies aiming for an IPO. Gaps identified will be part of a roadmap, which the relevant company will implement in the process of raising the IPO. In the case of companies already listed, the EBRD actively engages with the company, so as to maintain good alignment with the Corporate Governance Principles.

ENABLING A SHIFT IN CULTURE: THE NEW CORPORATE GOVERNANCE CODE IN CROATIA

When the collapse of Agrokor Group shook Croatia and some of its neighbouring countries in 2017, the issue of corporate governance quickly came to the fore. Stories of poor management and a lack of oversight within the Group quickly became public knowledge as news platforms reported on one of the biggest corporate scandals in central and eastern Europe.

Yet, even if predicting Agrokor's downfall was difficult, it is not hard to see that the Group did not take corporate governance very seriously. By checking disclosures of the Group's listed subsidiaries from a few years ago, one can easily notice numerous deviations from some of the most important provisions of the Croatian Corporate Governance Code, such as those regarding independent directors, board committees and internal controls. To make matters worse, not only was the Code not being followed, but also the explanations for non-compliance were, in many cases, non-existent or very superficial. However, that did not seem to have raised any flags when the businesses were doing well, so the companies kept repeating the same explanations year after year.

Sadly, many other companies listed on the Zagreb Stock Exchange (ZSE) seemed to follow a similar pattern and, in recent years, the levels of stated compliance with the Code have decreased, while the number of companies providing no or insufficient information to the market has increased.

The Legal Transition Team has been supporting HANFA (the Croatian capital markets regulator) and the ZSE in these revisions since early 2018. Through honest and constructive discussions, we have been able to carry out thorough diagnostic work and benchmark the Code against its latest and most advanced peer European codes. We also took note of the issues related to the old Code's implementation and corporate governance practices raised by both issuers and investors. All of this information was distilled into the final structure and content of the new Code. Once public consultation was completed, the

> "The new Croatian Corporate Governance Code was officially adopted by the presidents of the HANFA and ZSE management boards on 15 October 2019."

initiative reached a major milestone on 15 October 2019, when the new Croatian Corporate Governance Code was officially adopted by the presidents of the HANFA and ZSE management boards.

The new Code reflects developments in Croatian and EU law that have occurred since the previous edition was published in 2010. It is also shorter than the previous version and contains many background explanations, the aim of these being to help companies understand the benefits and importance of certain good practices. Since companies will be required to disclose their compliance with the Code according to the "comply or explain" approach, the Code also provides guidance on how to structure explanations in cases of non-compliance.

There are many novelties in the new Code, but perhaps the most important ones are: the clear strategic role of the supervisory board (Section 1); the provision according to which companies should set targets for improving gender diversity across the board and in management structures (Section 3); much clearer expectations in the area of risk management (Section 7); specific references to rules of conduct and whistleblowing mechanisms (Sections 1 and 7); and a section entirely dedicated to "Stakeholders and Corporate Social Responsibility" (Section 10).

As part of the Code's implementation, which is due to start in 2020, companies will be required to disclose their compliance with the Code's provisions or explain why they have not complied.

Similar to the development of the reporting framework in Turkey, the launch of the Code is just the start of the process and not an end in itself. To ensure that information on compliance with the Code (and any issues companies face in that respect) can be processed and fed back to the market in annual monitoring reports by the authorities, we are now starting work on establishing an effective reporting and monitoring process for the Code's implementation. We are also preparing a set of training events for issuers and investors so that they fully understand the value that good corporate governance can bring. We will develop a standing curriculum on corporate governance courses that will be rolled out by the ZSE Training Academy.

These latest regulatory developments in Croatia and Turkey are certainly important, but perhaps more significant than the new Code and reports is the fact that, by taking a leading role in monitoring corporate governance practices, HANFA and CMB are looking to join the ranks of the most advanced European securities regulators in this area and thereby provide a real impetus for the development of local capital markets. This should be instrumental in raising companies' and investors' awareness of the need for good governance and appropriate transparency.

1. The first corporate governance code that included this approach was the Cadbury Code.
2. Directive 2006/46/EC required all companies listed in the EU to "*include a corporate governance statement in its annual report, which shall include (…) an explanation by the company as to which parts of the corporate governance code it departs from and the reasons for doing so*". Also, the revised version of the Accounting Directive (Directive 2013/34/EU) stays true to this approach.

INTERVIEW: EBRD GENERAL COUNSEL MICHAEL STRAUSS

Michael Strauss took up his post as EBRD General Counsel at the start of 2020. Before coming to the EBRD, Mr Strauss was a partner with the Washington DC law firm Harris, Wiltshire & Grannis and had previously practised law at Cleary, Gottlieb, Steen & Hamilton in London and Paris. He has also worked in the legal departments of the International Monetary Fund (IMF) and the World Bank Group's Multilateral Investment Guarantee Agency (MIGA), served as a Senior Advisor at the US Treasury and represented the United States of America on the Board of the Asian Development Bank (ADB). Mr Strauss is a graduate of Stanford Law School, The Fletcher School of Law & Diplomacy and Williams College.

As the EBRD General Counsel, Mr Strauss oversees the Bank's Legal Transition Programme (LTP). Michel Nussbaumer, Director of the LTP, interviewed Mr Strauss about his career, his previous exposure to legal reform and his views on the EBRD's role in the sector.

Michel Nussbaumer: What motivated you to become a lawyer?

Michael Strauss: Thinking back, I recall three motivations. First, like so many others, I felt that lawyers were on the frontlines of social change and the delivery of justice, so I felt I would be best prepared to make a difference in the world as a lawyer. Second, I have always felt a profound need to know how things work – how the cogs fit together and what rules make systems function. In particular, I sought to understand how different societies organise people's claims and rights when those bump up against each other, overlap or even conflict. I guess this also explains my foray – academic and professional – into the field of economics. Finally, in the United States of America, where I grew up, if you hope to be a leader, you often start as a lawyer. I think each of these motivations partially explain what led me to the EBRD.

MN: Is there a moment you are particularly proud of in your career?

MS: Yes, but it is not at all what you would expect. It happened in my first year as a lawyer, while I was still studying for the New York Bar. A young Somali man had been denied asylum in the USA for misidentifying the name of his clan in his initial interview. My firm had taken the case pro bono and appealed on the basis that he had been treated as an adult even though he had fled Somalia as a child. As a new lawyer on an old case, I scoured the transcripts and it became clear that there was a translation mistake. I think it took someone having a fresh look at the case to identify this hidden defence. Eventually, this is how he won his appeal and gained asylum – something that possibly saved his life.

MN: How can lawyers change the world? Who are your legal heroes?

MS: See above! Everywhere you look, lawyers are making a difference in the world. Lawyers I know are fighting for the right to free speech, prosecuting war crimes, combating discrimination in the use of the death penalty, promoting desperately needed investment into developing countries and establishing best practices for legal reform for countries in transition.

No list of lawyer heroes would be complete without Abraham Lincoln and Gandhi. And most Americans also revere a famous fictional lawyer from the American South, Atticus Finch (from Harper Lee's novel, *To Kill a Mockingbird*), who fought for the rights of the unjustly accused. There are echoes of Atticus Finch in the highly successful Innocence Project in the USA, which has worked to exonerate the innocent and the wrongly convicted. Consider each hero a deeply principled lawyer who faced enormous pressure to cut corners or make political accommodations. Each lawyer found a way to achieve important outcomes without compromising integrity. Finally, I would include the legal heroes of the movements for civil rights: Thurgood Marshall and Ruth Bader Ginsburg, who so brilliantly, creatively and valiantly fought for civil rights for women and racial minorities through the courts.

MN: What contribution can lawyers working in international financial institutions (IFIs) make to achieving the Sustainable Development Goals (SDGs)?

MS: I am glad you asked that question because I think it is a crucial subject. Achieving the SDGs should guide our work here – with the LTP to the fore. The EBRD's most direct contribution will naturally fall in SDGs 6 to 13, which speak to sustainable economic growth, energy, infrastructure and reduced inequality. But lawyers in particular have an additional opportunity to contribute to SDG 16 (Peace, Justice and Strong Institutions). The work of the IFIs in that regard is best showcased at the annual Law, Justice and Development Week, hosted by the legal department of the World Bank in Washington DC each year. Needless to say, it should be a source of pride at the EBRD that the LTP is a key player among the IFIs in effecting change in the legal regimes of economies where we invest, as this work advances so many components of the SDGs.

MN: In your previous jobs, did you have any exposure to, or involvement in, technical cooperation with governments regarding law reform? If so, do you have any advice on what works or what does not?

MS: I had exposure, though not expertise, ranging from the IMF's banking and central bank technical assistance to the US Treasury's Office of Technical Assistance, and then in oversight of technical assistance generally on the Board of ADB. One of the most effective (if among the smallest) programmes I witnessed was an ADB-funded moveable property registry in the Pacific island nation of Samoa, which simplified the process for pledging security over moveable assets. The most important lesson I have gleaned from what I have seen is uncontroversial: legal reform programmes succeed when there is domestic ownership and they are less likely to succeed if they are "top down" or "one size fits all". As an adjunct professor at Fletcher last year, I had the privilege of teaching some of the achievements and pitfalls of land tenure registries as a driver of development and transition, including extracting some lessons I learned from observing ADB's experience with mortgage registration in Samoa.

MN: In your opinion, what role can the EBRD play when it comes to policy dialogue and technical cooperation in the legal sector?

MS: The EBRD – specifically, the LTP – is a key player in this field. The EBRD's recent conference on debt enforcement was a case in point, as the Bank's LTP attracted top scholars and practitioners in this field for a highly successful event that advanced learning and best practices on the subject. Given the EBRD's unique transition mandate, it should be no surprise that the Bank can play a crucial role in promoting the development and reform of legal rules, institutions and culture in its regions.

MN: You have served on the Board of ADB. Does ADB's approach to legal reform differ meaningfully from the EBRD's?

MS: It does in some ways; perhaps reflecting differences in the institutions' core mandates, ADB does not have a full team devoted to legal reform like the EBRD does. ADB generally advises on legal and regulatory reform through grant-based or fee-based technical assistance, but also provides legal reform advice to governments as a core component of its financed projects. A classic example is that ADB has advised many borrowing member countries on the establishment of a legal framework of best practices for the use of public-private partnerships (PPPs) for the development of infrastructure. Alongside the reforms, ADB then helps its borrowers develop PPPs to provide needed infrastructure in areas such as power, water, energy and transportation.

MN: Your answer leads me to another question. As an institution investing mostly in the private sector, the EBRD does not have the benefit of incentivising government reform through loan conditionality. Do you have any thoughts on addressing this dilemma in the economies where we invest?

MS: It is one of the most salient differences compared with institutions like the World Bank and ADB and thus presents a challenge for the EBRD. But the LTP's success itself demonstrates that governments have a high demand for legal reform support, even when the reforms are not backed by funds and the associated conditionality. The US Treasury's technical assistance programme has had similar success. Cross-country assessment tools like the World Bank's *Doing Business* reports also drive beneficial changes all over the world without concomitant investment. The LTP can follow the example of such highly successful change-driving programmes. This calls for creativity and cooperation among the IFIs and across the UN system.

MN: How well do you know the economies where the EBRD invests?

MS: I am most familiar with Central Asia and the Caucasus, which include borrowing member countries for ADB. I have had the privilege of visiting every country in these regions except Tajikistan and Turkmenistan. In fact, ADB held annual meetings in Astana (now Nur-Sultan) and Baku during my time on the Board there. And while at the World Bank and in private practice, I worked on transactions in Morocco and Tunisia. Lastly, I participated in an official visit to Egypt while at the US Treasury.

MN: You mentioned cooperation among IFIs. There can be an element of competition among aid-providing institutions, as each one wants to be seen as the key player in advising governments on their reforms. Do you have any thoughts on this phenomenon?

MS: Indeed, as I am now working at my fourth IFI, I have seen this competitiveness from multiple angles. Some competitive spirit can be beneficial if it improves the service and opportunities offered to clients; I saw this firsthand with the advent of the Asian Infrastructure Investment Bank in Beijing, and ADB's healthily competitive response to the founding of a new institution on its doorstep. But there is perhaps a larger benefit to be had from effective and efficient cooperation among IFIs. As noted above, the institutions' specialisations are more than simply geographic – the EBRD has a transition mandate; ADB focuses on infrastructure and development; and the IMF leads on balance of payments issues and financial stability. We are all stronger when each institution leads with its area of strength and when we coordinate to ensure we can be trusted partners who recognise each institution's particular value proposition as a development partner.

MN: The EBRD's advisory services such as the LTP are largely funded by donors, funds that could become more scarce and constrained. Do you have any suggestions as to how we can overcome this problem?

MS: Here is another place where cooperation is key. I mentioned my own *pro bono* work and I do think that there is a sense of eagerness at top law

> "What the EBRD Legal Transition Programme does is essential for the economies where the EBRD invests, but also fundamental to the institution's mission."

firms to help with an area of work that is so important, creative and enriching (not strictly in the remunerative sense). Great organisations like the International Development Law Organization in Rome provide another path for cooperation to expand capacity. And as a former member of the Board of an IFI, I have an almost reflexive response that some technical and reform advice can be provided on a fee-paying basis to cover costs when the government can afford it. Where it cannot, developing multi-donor funds could help. You are right, though, that we will likely face increasingly straitened funding circumstances and must be as creative as possible in the face of this.

MN: Any advice to the EBRD Legal Transition Programme on its future activities?

MS: Would it be trite to say, "Keep up the good work"? What you do is essential for the economies where the EBRD invests, but also fundamental to the institution's mission. Perhaps now more than ever, the potential economic dividend achieved from strong institutions and dependable rule of law are especially apparent. And the specialised expertise that the LTP provides in achieving both is invaluable.

FINTECH REGULATION: A BALANCING ACT

"Only time will tell if Fintech could lead to new types of systemic risk. However, uniformity in regulations is key to managing this risk."


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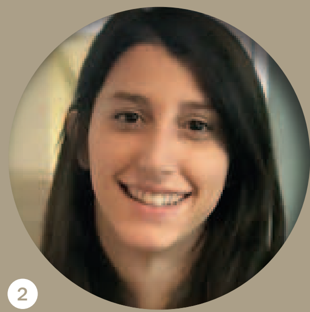
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Fintech, the marrying of financial services and technology, has only recently made its way into the dictionary, although apparently the term was first known to be used in 1971.[1]

So Fintech is far from a new concept, being defined as "products and companies that employ newly developed digital and online technologies in the banking and financial services industries".[2] The definition does not specify the size of the company or the type of technology used.

It is therefore no surprise that Fintech products exist today across the entire spectrum of the financial service sector. Chart 1, which is not intended to be exhaustive, highlights the various Fintech products available.

CHALLENGES OF REGULATION

There is no doubt that Fintech plays a role in efficiently providing new investment opportunities for consumers and investors, which increases access to finance and promotes competition across the economies where the EBRD invests.

However, Fintech is not without its challenges. In the last couple of years we have seen regulators across the globe attempt a cautious balancing act of permitting Fintechs some freedom with the eventual goal of bringing uniformity between them and traditional financial service providers.

Regulators recognise the need for innovation and are working to support and encourage Fintech

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activity through regulatory changes and the creation of innovation hubs or regulatory sandboxes. At the same time, regulators are becoming more cautious about Fintech, specifically with regards to data privacy, customer protection and systemic risk.

ONE SIZE FITS ALL?

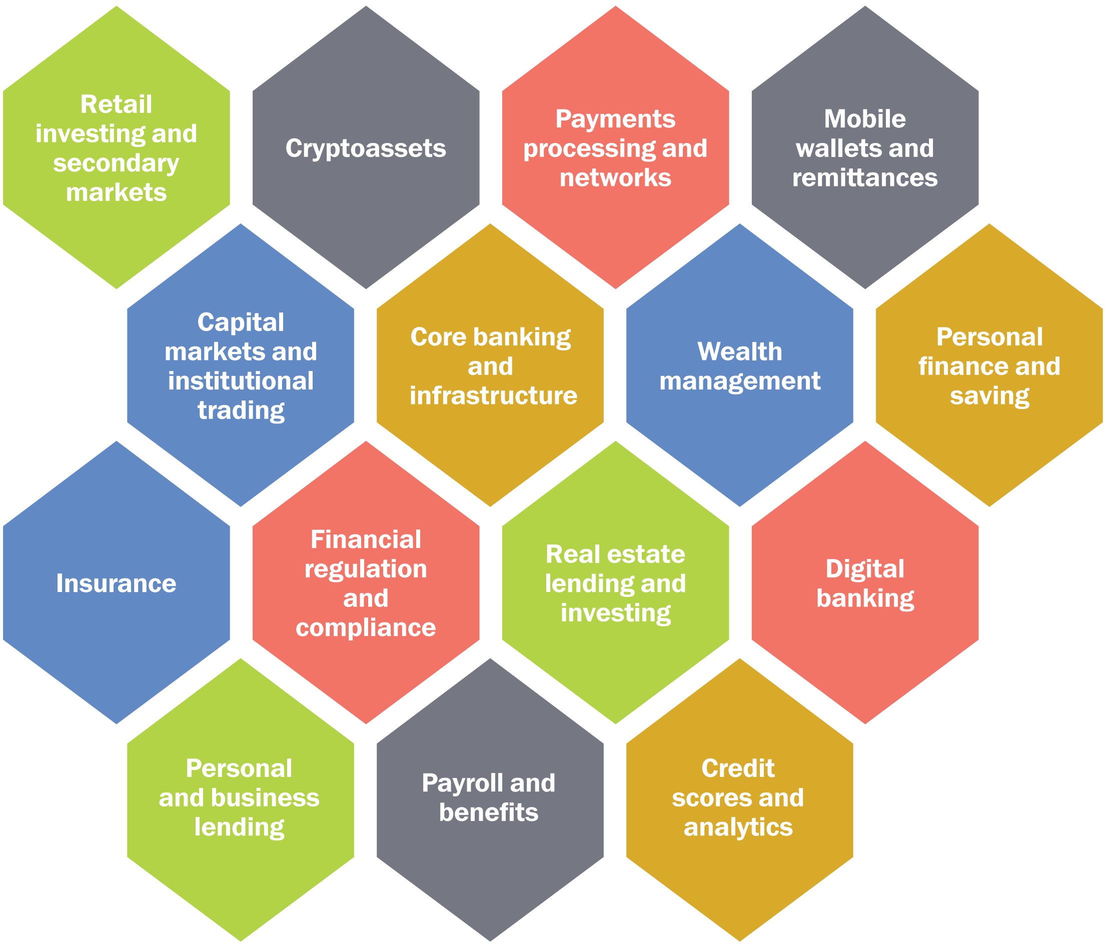
There is no legislation dedicated to Fintech in the EBRD regions. In fact, no dedicated legislation exists within the European Union (EU). So how do regulators go about regulating Fintech? It is important to note that while regulating a Fintech entity depends on the actual activity performed by the entity in question, the technology that the particular entity uses is not regulated.

Nevertheless, regulators need to be flexible in order to create uniformity in regulations between Fintechs and traditional players without stifling innovation. Regulators must shift their approach, moving from a rule-based approach to regulation to a principle-based methodology.[3]

As well as ensuring that their approach does not suppress innovation, regulators are expected to adjust their methodology in order to exhibit focus, dexterity and completeness in their regulatory outlooks and mission. On the one hand, if stringent regulatory control is applied too early, innovation can be stifled, while on the other hand, delays in regulatory intervention can result in serious systemic risk.

Brummer and Gorfine contrast the two approaches and note that with respect to Fintech, in "circumstances where innovation is offering potential benefits to markets and customers, but is not yet well understood, erring on the side of "principle-based" regulation would seem to

Chart 1: Available Fintech products



Source: EBRD.

maximise the benefits and minimise applicable negative trade-offs as the new innovation develops. Once the innovation matures, thereby allowing for learning and analysis, it may become increasingly appropriate to promulgate a larger set of detailed rules that prohibit negative behaviour and encourage observed best practices. The key here, however, is to not stunt the development of innovation with non-indicated rules and regulations".[4]

Regulations have traditionally been set up in a way that is specific to a product. Regulators must move to broader principle-based frameworks to ensure unbiased regulations that allow less scope for entities to manoeuvre in a crowded playing field. In order to generate a uniform approach to regulations, regulators must broaden their scope to non-financial service providers depending on the activities they undertake.

This, perhaps, is the fundamental challenge faced by regulators. They would need to blend the supervision of different regulated entities under their purview into one regulatory framework. Regulators would also play an important role in fostering collaboration between Fintechs and traditional banks through the guidelines they set, including any restrictions on activities. To allow for innovation within financial markets, regulators must also create an environment in which this can be fostered.

Only time will tell if Fintech could lead to new types of systemic risk. However, uniformity in regulations is key to managing this risk. Regulators will have to allow for principle-based regulation as long as the risks are low, and once Fintechs have a broader scope, regulators must align regulatory expectations with those applicable to traditional players.

THE IMPORTANCE OF INTERNATIONAL COOPERATION

It is important to note that, to a certain extent, regulators across the globe are attempting to deal with the challenges identified. However, creating a level playing field does not necessarily mean that regulation must be uniform.

There are commonalities in the global dimension of many Fintech activities; there are therefore many benefits to increased international cooperation. Increased cooperation will be particularly important to soften the risk of disintegration in regulatory frameworks, which could obstruct innovation in the financial industry.

Through its Legal Transition Programme, the EBRD has been working with governments across the economies where it invests to help them create an investor-friendly, transparent and predictable legal environment. To that end, we have been looking at different types of Fintech solutions and the issues that merit the attention of supervisors and regulators.

Box 1: **Innovation hubs and regulatory sandboxes**

by Polyxeni Pentidou, Analyst, LC2, EBRD; Jacek Kubas, Associate Director, LC2, EBRD and Ammar Al-Saleh, Senior Counsel, EBRD

Certain countries have arrangements in place that aim to promote an orderly application of new technologies in the financial industry through innovation facilitators, which take the form of regulatory sandboxes or innovation hubs.

Through sandboxes, regulators allow entities to test new ideas in a "controlled" regulatory environment for a specified period with actual customers pursuant to a strict testing plan agreed and monitored by them. This also offers an opportunity for collaboration between incumbent financial institutions and Fintechs. Innovation hubs, more widespread than sandboxes, are a form of community to provide support and non-binding guidance to innovative firms, as well as to provide an understanding of regulatory requirements.

Such arrangements are generally considered a forward-thinking approach for Fintech adoption.

The EBRD's work in this sector includes several technical cooperation projects led by the Local Currency and Local Capital Markets Development (LC2) Team. For instance, in Poland, Fintech was identified in the EBRD's Capital Market Development Strategy as one of the strategic sectors with the potential to become a driving force for the Polish economy.

Because of this, with the support of the European Commission's Structural Reform Support Service (EU SRSS), we are currently working with the Ministry of Finance and the Regulator (KNF) in Poland to conduct a feasibility study and Fintech roadmap and, in parallel, to establish a regulatory sandbox. With the support of the EU SRSS, we are also conducting a similar project in Estonia, where we are exploring the possibility of establishing a thematic sandbox focused on Regtech. Similar projects are also in the pipeline together with other regulators.

Lastly, we are actively engaged in policy dialogue and engagement on innovation facilitators. To this end, it is worth noting that the EBRD is an observer to the Global Financial Innovation Network (GFIN), which was launched in early 2019 by the UK Financial Conduct Authority, together with others. GFIN is now a network of 50 financial regulators and related organisations with a commitment to supporting financial innovation in the interests of consumers. In parallel, we have an open dialogue with the European Commission, the European Banking Authority (EBA), market participants pioneering in Fintech and other stakeholders.

> "It is important that regulators are agile in responding to rapid changes in the sphere of Fintech and should review the regulatory perimeters regularly."

We sometimes find that it is more difficult for regulators to supervise alternative finance than it is to supervise traditional sectors. Reasons for this can include limited technical expertise, limited funding and resources, difficulties in coordinating multiple supervisory bodies and a lack of reliable data. Therefore, working jointly with other departments within the EBRD, we have developed regulatory innovation initiatives, for instance, exploring the use of regulatory sandboxes (see Box 1).

One way to help regulators is through benchmarking. In 2018 we worked with Clifford Chance to prepare a report on the best practices for regulating lending-based and equity-based crowdfunding platforms, based on the existing regulation of several jurisdictions (see Box 2). This report could serve as a toolkit for lawmakers and regulators who are looking to foster the crowdfunding industry while protecting consumers. Against this background, several countries across the EBRD regions have been very keen to promote crowdfunding with help from the EBRD and are looking to enact, or have already enacted, crowdfunding legislation (for example, Armenia, Egypt, Kazakhstan, Morocco and Turkey). We have also published a study, Smart contracts: Legal framework and proposed guidelines for lawmakers.

Box 2: **Crowdfunding**

The availability and provision of financial credit is a key driver of economic growth. Financial credit can be used to bridge cash flow gaps and make investments. This is particularly important for small and medium-sized enterprises (SMEs). The 2008 financial crisis has, however, led to an increased systematic risk and therefore a tightened credit market for SMEs.

As a result, new financing methods offered by Fintech firms have appeared, with two central models emerging.

1. Peer to peer (P2P) lending: money is lent to individuals or businesses through an online platform, with a view to a financial return in the form of interest payments and repayment of capital over time.
2. Equity crowdfunding: money is invested in unlisted shares issued by businesses, allowing SMEs to raise capital from a large pool of investors through an online platform.

Crowdfunding has the potential to mitigate some of the issues faced by SMEs in obtaining credit, while allowing investors to access new products that are normally out of reach in traditional markets. Nevertheless, providers of these platforms face significant barriers that may be inhibiting their market entry and growth.

Several of our economies have been very keen to promote crowdfunding and are looking to enact (or have already enacted) crowdfunding legislation. Kazakhstan, Latvia, Lithuania, Morocco and Turkey are a few of the countries leading the charge at the digital frontier.

Because the process of crowdfunding is still being established, no consensus exists as to what constitutes best practice in this area, which makes it difficult to advise lawmakers.

It is in this context that the EBRD prepared a best practice report on the regulation of investment-based and lending-based crowdfunding, based on an analysis of six jurisdictions: Austria, the Dubai International Financial Centre, France, Germany, the United Kingdom and the United States of America. The report makes recommendations in a number of areas, including: (i) types of authorisations required for the operation of platforms; (ii) capital and liquidity requirements; (iii) know-your-customer (KYC) rules and anti-money laundering (AML) checks; (iv) consumer protection measures, such as investor disclosures; (v) conflicts of interest inherent in the crowdfunding platform's role; and (vi) platforms' governance requirements.

We have already begun putting these recommendations into practice with our ongoing technical cooperation projects. It is motivating to read in the recently published report, *Regulating Alternative Finance – Results from a Global Regulator Survey*,[5] that as industries mature, many policymakers are considering changes to their regulatory frameworks for alternative finance sectors. The study showed that half of the regulators surveyed (of about 110 regulators across the globe) are planning to review their regulatory frameworks for equity crowdfunding by early 2021.

CONCLUSION

It is important that regulators are agile in responding to rapid changes in the sphere of Fintech and should review the regulatory perimeters regularly. This is particularly important as many innovations have not yet been tested through a full financial cycle and decisions taken in this early stage may set important precedents.

Over time, the regulation of Fintech firms will inevitably increase. This is both necessary and important to providing stability and protection to both financial markets and users. International financial institutions can play an important role in in this.

1. See https://www.merriam-webster.com/dictionary/fintech (last accessed 19 December 2019).
2. *Ibid.*
3. C. Brummer and D. Gorfine (2014), *Fintech: building a 21st century regulator's toolkit*, Centre for Financial Markets, Milken Institute.
4. *Ibid.*
5. The report was prepared by the World Bank and the Cambridge Centre for Alternative Finance (CCAF) at the University of Cambridge Judge Business School.

OPEN BANKING CREATES OPPORTUNITIES IN EBRD REGIONS

"Open banking generally refers to the ability of banking customers to authorise third parties to access their bank account data to either collect information and/or to initiate payments."

The global payments landscape has completely changed in the past decade and many countries are reviewing their regulatory approach towards payments to ensure that it serves the changing needs of customers and providers. This is happening against the backdrop of a growing e-commerce sector, the increased adoption of innovative technologies and expanding global cooperation.[1] In an attempt to accelerate the diversification of payments and offer greater choice and lower costs for consumers, countries around the world are opening up customer data and spearheading "open banking" initiatives.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WHAT IS OPEN BANKING?

Open banking generally refers to the ability of banking customers to authorise third parties to access their bank account data to either collect information and/or to initiate payments.[2] In its 2019 *Future of Finance* report, the Bank of England describes open banking as "a powerful idea to give customers more control over their finances in the next decade".[3]

The United Kingdom (UK) was one of the first countries in the world to launch open banking in response to a report issued by the Competition and Markets Authority in 2016. The report highlighted a lack of competition among established, larger banks for customers' business, as well as difficulties for smaller and newer banks to compete.[4]

The open banking rules in the UK require the nine largest banks[5] to share their current account holder data through an integration technology called application programming interfaces (APIs). These APIs can then be used – with the customer's consent – by third parties, including challenger banks, Fintech companies, technology companies and credit information bureaus, to open up the financial services industry and provide consumers with products better suited to their individual needs.[6] For example, small and medium-sized enterprises could benefit from being able to compile their data from different vendors to build a comprehensive, digital business profile. They could then use their data to seek the most appropriate forms of finance at the best possible prices.[7]

Incumbent banks in the UK have been slowly but surely working on new digital services for customers. For example, HSBC was one of the first banks to release an open banking app, Connected Money, which groups customers' total spending across 30 categories, including grocery shopping and utilities.[8] Santander has partnered with the Moneybox app to offer its customers a chance to connect their accounts and round up their spare change from banking transactions into a savings account.[9] Barclays customers can also view all of their bank accounts – even the ones held with rival banks – in one app.[10]

Clearly, with greater transparency as to their customers' financial position and behaviour, traditional banks are forced to reposition their services and product offerings to match the increasing competition from multiple third-party providers and to improve the quality of customer experience. Keeping up with the fast-advancing technologies and continuous innovation, the reduction in revenues from traditional services and the increased need for cybersecurity come at a cost. And on top of it all, banks will need to convince their customers to share their financial information.

How Open Banking changes customers' relationships with banks

AISP- account information service provider | **API**- application programming interface | **FCA**- Financial Conduct Authority | **PISP**- payment initiation service provider

Source: FCA.

BALANCING THE RISKS

With open banking comes the need for increased security and structure surrounding the transfer of data between partners. This is where regulations come in, the most pertinent one being the European Union's Payment Services Directive 2 (PSD2).[11] Aiming to improve consumer protection and to make payments safer and more secure, among other things, the PSD2 introduces the requirement for strong (two-factor) customer authentication (SCA) on the majority of electronic payments and for common and secure communication. The European Banking Authority (EBA) has subsequently issued the Regulatory Technical Standards (RTS) for the SCA.[12]

One area that has been quite challenging to navigate is the interplay between the PSD2, which calls for banks to open access to customer account and transaction data, and the General Data Protection Regulation (GDPR), which requires companies, including (but not limited to) banks, to protect and handle more carefully what personal data they have, with the particular aim of giving more control to individuals over their personal information.[13]

While the European Data Protection Board has provided helpful guidance on this intersection,[14] some questions still remain. For example, the PSD2 prohibits a payment services provider (PSP) from using the personal data it has obtained for purposes other than performing the specified service. However, it is not clear how robust this prohibition may be in practice. For instance, a clever PSP may circumvent this limitation by simply broadly defining the service it offers: for example, not only account aggregation, *but also* personalised offers for other products and services. If customers were to sign up for that package and consent to such purposes, the PSP would, as a practical matter, have broadened grounds for the lawful processing of their personal data.[15]

Another challenge is the allocation of liability in case of a data breach or an unauthorised transaction. The *Future of Finance* report notes that, at least in the UK, it would be a bank, not a payment company, that may have to compensate the client for any errors or cyber-breaches before counter-suing the payment company. Obviously, this is not an optimal design.[16]

> "In 2019 the EBRD, through its Legal Transition Programme, advised the National Bank of Belarus on the implementation of the new Payment Services Act."

ECONOMIES WHERE THE EBRD INVESTS

While the PSD2 has set the baseline for open banking standards, every European country can put its own flavour on it.[17] Thus, for example, in Poland, the Act of 10 May 2018, Amending the Act on Payment Services and Certain Other Acts, integrated into national law the provisions of the PSD2 and introduced a small payment institution as a new entity authorised to provide payment services.[18] The Ministry of Finance has indicated that this type of institution "may be an attractive form of running business by entities just starting to operate in the payment services market, in particular from the so-called Fintech sector".[19]

The Latvian Baltic International Bank launched an APIs sandbox solution for open banking, touted as a "safe […] environment where third-party service providers are able to test their ideas and innovations in the financial sector in general and in asset management in particular".[20]

Across the rest of the world, open banking means different things to different organisations. Still, financial industry participants around the globe are keeping a close eye on developments in the UK and Europe.[21] Whether open banking develops through UK and European-style changes or simply by the adoption of greater interoperability of APIs at the industry level, it is uniquely evolving in different parts of the world, although a common denominator is the need for security and value for the banking customer.[22]

For example, in anticipation of the rise of Fintech in Jordan, the Central Bank of Jordan has issued regulations and guidance to regulate third-party payment processors. These include the protection of e-payment users' data and personal information, the introduction of a minimum share capital for e-payment service providers and the authority for foreign companies to exercise e-payment transactions in Jordan.[23]

Turkey's largest bank, Isbank, has launched its APIs portal as it looks to work with third-party developers and Fintech companies.[24]

THE EBRD'S WORK IN BELARUS

In 2019 the EBRD, through its Legal Transition Programme, advised the National Bank of Belarus on the implementation of the new Payment Services Act, which aimed to modernise the payment services sector by transposing significant parts of the PSD2. Our recommendations focused on implementing the SCA requirements and procedures for obtaining customer consent, making payments secure, protecting customer data and using methodology to supervise PSPs by the National Bank.

In many instances the recommendations required finding a balance between being too specific and too general. With technology-related provisions in particular, specificity can encourage a standardised approach, but it can also stifle innovation and can mean that PSPs are only working with the rules to tick boxes and complete a "compliance exercise". However, where rules are too high-level, PSPs may struggle to comply with them because there is little guidance to suggest what they need to do.[25]

For example, when the EBA issued the above-described RTS, it had intentionally not specified what would be required to satisfy the elements of the SCA in order to remain technologically neutral. However, this approach led to a lot of uncertainty in the industry as to the practical implementation of systems dealing with the SCA and which methods would satisfy the authentication requirements. This confusion ultimately led the EBA to provide further guidance on each of the SCA authentication requirements.[26]

There are also further issues that have not yet been resolved by the EBA. For instance, there is some uncertainty as to whether a biometric-enabled payment card and fingerprint can authorise a contactless mobile payment, in cases where that fingerprint is also used to activate the device.[27]

To avoid this type of confusion, we recommended that the National Bank include more guidance on non-exhaustive examples on how to satisfy customer authentication. This could include setting out guidelines as to which factors are acceptable for the different authentication requirements of the SCA.

CONCLUSION

New payment services and new types of market participants are changing the way the payments and retail banking sector operate. Encouraging these new entrants is intentionally disruptive – it affects the business models, profitability, market share and consumer relationships of incumbent players – but is necessary to achieve greater innovation for the benefit of customers.[28]

However, regulators will need to take great care to balance these new disrupting forces with the need to maintain consumer protection and stability in the financial system. This will require, among other things, a well-coordinated dance with data protection regulation, which should specify how liability will be allocated in the event of a data breach and unauthorised transactions and synchronise the consent requirements with those in the regulations regarding open banking and payments. Central banks, on their end, will have to evaluate the potential risks of opening access to their services and infrastructure (such as the operation of reserve or settlement accounts) to non-bank payment providers.

1. EBRD and Hogan Lovells (2019), *Regulating Payment Services in Belarus*.
2. KPMG (2019), *Open banking opens opportunities for greater customer value*.
3. Bank of England (2019), *Future of Finance*, p. 13.
4. *Ibid.*, p. 105.
5. Barclays PLC, Lloyds Banking Group PLC, Santander, Danske, HSBC, RBS, Bank of Ireland, Nationwide and AIBG (2017). Competition and Markets Authority Retail Banking Market Investigation Order 2017.
6. Lucy Warwick-Ching (2019), *Open banking: the quiet digital revolution one year on*.
7. Bank of England (2019), *Future of Finance*, p. 61.
8. See https://www.hsbc.co.uk/connected-money/ (last accessed 13 February 2020); see also Lucy Warwick-Ching (2019), Open banking: the quiet digital revolution one year on; and https://on.ft.com/38rY23E (last accessed 13 February 2020).
9. See https://www.moneyboxapp.com/santander-launch/ (last accessed 9 January 2020); see also Lucy Warwick-Ching (January 2019), *Open banking: the quiet digital revolution one year on*.
10. See https://www.barclays.co.uk/ways-to-bank/account-aggregation/ (last accessed 9 January 2020); see also Lucy Warwick-Ching (January 2019), Open banking: the quiet digital revolution one year on.
11. Nick Ismail (2017), *Open Banking: a friend or foe to traditional banks?*
12. For a more detailed description of the SCA and the RTS, see Ben Rengard-Weinrabe and Jane Finlayson-Brown (2019), *Adapting to a Changing Payments Landscape*, in Jelena Madir (ed.), *FinTech: Law and Regulation*, Edward Elgar Publishing Ltd, UK.
13. Ross Leckow and Jess Cheng (2019), *Data laws for the digital age: How modernized legal frameworks can accelerate data-driven innovation: Challenges and opportunities*.
14. Letter from the European Data Protection Board to Sophie in't Veld (July 2018).
15. Ross Leckow and Jess Cheng (2019), *Data laws for the digital age: How modernized legal frameworks can accelerate data-driven innovation: Challenges and opportunities*.
16. Bank of England (2019), *Future of Finance*, p. 114.
17. Chris Thompson (2018), *Understanding the Global Evolution of Open Banking*.
18. Polish Ministry of Finance (2018), *Legal framework on payments and open banking – PSD2 implementation.2020)*.
19. *Ibid*.
20. The Paypers (2019), *Baltic International Bank implements open banking and sandbox*.
21. Chris Thompson (2018), *Understanding the Global Evolution of Open Banking*.
22. *Ibid*.
23. Clifford Chance (2019), *Fintech in the Middle East - Developments across MENA*.
24. See https://developer.isbank.com.tr/Pages/home.aspx (last accessed 9 January 2020); see also Finextra (2018), Isbank opens API portal.
25. EBRD and Hogan Lovells (2019), *Regulating Payment Services in Belarus*.
26. *Ibid*.
27. *Ibid*.
28. *Ibid*.

TRANSFORMATIONAL CHANGE:
EBRD-UNCITRAL PUBLIC PROCUREMENT INITIATIVE REVOLUTIONISES ELECTRONIC PUBLIC PROCUREMENT

"There are public procurement champions who see the digitalisation of public procurement as a chance to allow procurement officials to move beyond the complex regulations and to focus on expanding their market knowledge and improving performance."


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The public procurement market operates on a huge scale throughout the world: its total size may exceed US$ 10 trillion annually. Governments all over the world wield enormous purchasing power and could use that to promote the Sustainable Development Goals (SDGs) of environmental protection, social impact and economic development.

However, governments tend to focus on more immediate issues, and this potential power remains under-utilised. The immediate issues include, rightly, ensuring that they are equipped with whatever they need to deliver services to their citizens, in as efficient a way as possible and without the ever-present risk of corruption materialising. Indeed, as many governments do not know at a detailed level what they are buying and selling, and for how much, (with long and non-transparent supply chains) nor where in the globalised world their public funds may end up. Reforming public procurement to improve the immediate outcomes, let alone to pursue a coherent set of sustainability objectives, is challenging because the procurement process is horizontal and cuts across the whole of government. Inertia and vested interests can also prevent change.

The digital government agenda offers the transformational opportunity of a world shifting from documents and paperwork to smarter, online digital services, and is the subject of many political aspirations and declarations. Applying it to the reform of public procurement is highly complex and may meet inner resistance as noted above. Many reform programmes have not been entirely successful so far, in that they have not harnessed the potential of digitisation – in particular, through the effective use of digital data. However, there are public procurement champions who see the digitalisation of public procurement as a chance to allow procurement officials to move beyond the complex and sometimes unclear regulations, to be relieved from clerical tasks and to focus on expanding their market knowledge and improving performance.

Learning from the best

To learn from these champions and to gain an insight into the future of public procurement systems in the digital economy, the EBRD-UNCITRAL Public Procurement Initiative – a collaboration between the EBRD's Legal Transition Programme and the United Nations Committee on International Trade Law (UNCITRAL) – began a research project with global leaders in the field, including Chile, Brazil, Cyprus, the Republic of Korea and Portugal. Research demonstrated that those profiled opted for transparent automated evaluation procedures and "planning to payment" eProcurement systems. This way, the electronic system with all-digital data manages compliance with procurement regulations (all mandatory pass/fail rules and policy requirements are in the automated online workflows), as well as offering massive transactional efficiency gains for the government and business community alike through automation and robotics. What we found most enlightening was that all of these countries embraced open data policies. They applied the Open Government principles of transparency, accountability and engagement with stakeholders in practice, through the effective use of data and created open public access to information about public procurement that sustained their digital transformation reforms through difficult times of institutional change.

> "The procurement process is not an end in itself, but serves the delivery of public services and should be designed to drive fiscal performance in government, which should result in a high-quality public service for citizens."

Testing our hypothesis

Research tells us that to succeed in digital transformation in public procurement, policymakers and reformers should embrace the following outlook:

- Public procurement is a means to achieving quality and efficient public services while promoting sustainable development objectives.
- Clear processes in legal instruments and standards for data are positive contributors towards this end.
- Public procurement policy as expressed in national systems reflects international standards, and is user- and performance-driven.
- Public procurement regulatory frameworks should be re-engineered for the digital economy.
- In digital markets, embracing stakeholder feedback and openness to collaboration with the business community is a necessity, not a privilege.
- Digital government solutions should be innovative to enable public procurement to create online marketplaces that serve public-sector and private-sector buyers alike.

PUBLIC PROCUREMENT POLICY THAT IS USER-DRIVEN AND PERFORMANCE-DRIVEN

The procurement process is not an end in itself, but serves the delivery of public services and should be designed to drive fiscal performance in government, which should result in a high-quality public service for citizens. Regulatory reforms should strive to make public procurement legal frameworks compliant with international policy standards but optimised for the digital economy. Public procurement policy should be transparent, clear and accessible, promoting sound governance, competition and objectivity. Public procurement regulation (from planning to tender to award and throughout public contract implementation) should aim to secure the transparency, accountability and integrity of procurement decisions and maximise the participation of the business community in public tenders, since the level of competition is a recognised driver of value for money in public spending. All these elements of good practice allow procurement systems to develop the capacity to allow the pursuit of the Sustainable Development Goals.

A call for "principle-based" and "technology neutral" public procurement laws

Technological progress is beneficial, but it brings a challenge for legislators: markets and policies are driven by technology, therefore are often subject to change. This challenge was recognised by the 2011 UNCITRAL Model Law on Public Procurement (the "UNCITRAL Model Law") and the idea of a ""principle-based", practice-oriented and "technology neutral" public procurement law was brought forward. To be responsive to a changing market and to evolving technology, primary public procurement laws should prescribe principles to be followed and introduce the key economic concepts of public procurement and general rules for procurement procedures. In this respect, transparency safeguards, value for money through fair competition and fiscal efficiency of procurement for governments are key procurement principles promoted by the UNCITRAL Model Law. At the same time, primary laws should avoid excessively prescribing formats of procurement proceedings – technical detail

that is prone to becoming outdated but that implements the principles in the primary law can quickly be introduced in the secondary legislation on public procurement. Secondary legislation with technical requirements for procurement procedures can be revised more easily, to enable national legislators and policymakers to match technological progress or market developments and not jeopardise the efficiency of procurement by a lengthy process of amending primary laws.

A need for a standardised "policy toolbox" for governments

The UNCITRAL Model Law provides a description of procurement best practice from around the world in a standardised manner and describes various procurement methods and techniques, as may be needed by governments for different types and values of public procurement contracts. It details best practices methodologies for execution of each stage of the public procurement process (advertising, solicitation, evaluation, award and contract implementation), with a key emphasis on transparency. This standardisation of steps and stages of procurement procedures helps to understand how to select the correct approach to award specific public contracts. The UNCITRAL Model Law methodologies also explain how procedural steps are combined into a sequence to create procurement methods suitable for various types of procurement. Clarity of procedural steps and rules for procurement methodologies facilitate the flexibility of procurement regulation, but at the same time maintain certainty for procurement officers and predictability of the procurement process for participating suppliers.

NATIONAL PUBLIC PROCUREMENT SYSTEMS DESIGNED FOR STAKEHOLDER FEEDBACK AND OPEN TO COLLABORATION

Public procurement systems should foster and solicit feedback to drive further improvements and innovation. Any stakeholder who might be affected by a procurement decision of the government should be able to provide feedback and participate at the right time. Feedback by buyers and sellers on each other will improve their interactions. Feedback from citizens and users of public services helps improve delivery and builds public trust. Feedback from procurement officials in a transparent and structured way (such as debriefing) allows sellers to understand buyers' needs. It takes time and care to build trust, responding and adapting to changing needs and demands. Still, once civil society and business stakeholders are satisfied that the public procurement system takes account of their perspectives, incentives change and coalitions for reform can be created to overcome vested interests.

While working on the EBRD-UNCITRAL Public Procurement Initiative technical cooperation projects, we learned to appreciate the capacity of civil society to create feedback and engagement loops across government with business and civic actors, and to institutionalise their interactions.

Our initial interest in the Open Government agenda was driven by problems with enforcing transparency safeguards in public procurement. Most public procurement laws around the world declare that procurement should be transparent, including the laws of the most corrupt countries, and where transparency rules are sometimes simply not respected. We considered that the effective digitalisation of the procurement process, matched with the use of open data that executes transparency rules by default, should improve the enforcement of the relevant transparency safeguards. This turned out to be correct, as demonstrated, for example, by the success of the combined forces of Open Government and digitalisation of public procurement in Georgia in 2010 and in Ukraine in 2015. What we learned along the way is that when it comes to the quality of public services information truly empowers. The more citizens act on accurate information about public spending on public services and make themselves heard, the more successful public procurement reforms and systemic improvement in the government tend to be. As the Open Government features of open access to information, civic monitoring and feedback are embedded in the public procurement policies, ordinary people and businesses, who benefit from changes, start to have an interest in defending public procurement reforms. This incentivises governments to continue their reforms and to bring further improvements when they can see the benefits. New constituencies emerge—such as small businesses previously shut out of the public procurement market. Reforms in countries such as Ukraine and Moldova have already saved billions of euros, increased efficiency and competition, exposed cartels on the public procurement market and improved both the quality of public services and the accountability of public procurement officials.

"The UNCITRAL Model Law provides a description of procurement best practice from around the world in a standardised manner."

DIGITAL GOVERNMENT SOLUTIONS THAT ARE CREATING ONLINE MARKETPLACES

Existing paper-based procurement procedures should not be taken online, but the entire process should be redesigned as a user-friendly digital service, delivered in collaboration with the private sector. Open data and open source tools operated by the government and networking with commercial operators of e-commerce platforms that are suitably robust in terms of transparency and accountability, can become a standard for digital procurement services.

A new model for digital government in public procurement

The digital procurement model promoted by the EBRD-UNCITRAL Initiative technical cooperation projects uses an open source and open data distributed architecture for multi-platform networking. This is similar to blockchain, but without a blockchain price tag. Instead of blockchain technology, it uses open data in the format of the open contracting data standard (OCDS) to guarantee data standardisation and ensure user trust in accuracy of data exchange. The digital procurement systems built on this model form a collaborative online network between government-operated e-government systems and commercial e-commerce platforms. Each system consists of a government-owned open source central unit, a web portal and networking e-commerce platforms. The network central unit serves as an interoperable online OCDS data exchange and a transaction repository for linked networking commercial electronic platforms (that can be open source or proprietary), which provide digital procurement services to buyers and suppliers. Data collected by a network central unit is displayed in real time on an open, accessible, searchable, government-run and open source web portal. The web portal creates a single point of access to all procurement information, including online electronic bidding because it is automatically synchronised in real time between all network members – the government central unit and the web portal, the networked commercial platforms and (if available) other eGovernment services and digital registers.

Results of the pilots: Ukraine and Moldova

Working with this hypothesis, the EBRD-UNCITRAL Initiative engaged in collaboration with Open Contracting Partnership[1] and Transparency International.[2] This co-working created a forum for dialogue between public procurement policy experts and civil society organisations and resulted in the EBRD becoming an early supporter of the Open Government civic technology lab at Transparency International Ukraine.

Spurred on in 2014 by the Maidan Revolution in Ukraine that ousted the corrupt Yanukovych regime, Transparency International Ukraine became a champion of public procurement reforms and paved the way to innovative thinking about digital government solutions for public procurement. Software prototyped by civic activists became the pilot of ProZorro in February 2015 and led to the creation of a national-level eProcurement system for Ukraine in August 2016, which implemented the transparency standards of the UNCITRAL Model and EBRD-UNCITRAL policy approach. In autumn 2016, DoZorro– a watchdog for ProZorro – was launched to create a civil society network monitoring public procurement conducted on the ProZorro platform.

> “Reforms in countries such as Ukraine and Moldova have already saved billions of euros and increased efficiency and competition.”

In five years, ProZorro has progressed from a civic start-up to a mandatory system for all public sector entities, with over 200,000 suppliers registered. ProZorro has made savings of UAH 100 billion (3.8 billion euros equivalent) in its four years of existence (savings are calculated as the difference between the initial value of the purchase and the amount of the signed contract after the auction). The total number of electronic reverse auctions since the launch of the system in 2015 has reached more than UAH 4 million (150,375 euros equivalent) and the savings exceeded UAH 100 billion (3.8 billion euros equivalent). The system has accumulated 100 terabytes of procurement data. Each citizen can see how their taxes are spent. About 90 per cent of registered businesses on ProZorro are small and medium-sized enterprises (SMEs). Monthly, 3,000 to 5,000 new suppliers register in ProZorro. Over 50,000 suppliers registered in the system in 2019. ProZorro is trusted – it is significant that suppliers from more than 40 countries (mainly from the European Union) are registered in ProZorro and participate in Ukrainian public tenders.

MOLDOVA

Building on the global success of ProZorro and Dozorro, work on the use of the UNCITRAL Model Law with Open Government concepts continues in Moldova, where an end-to-end digital online marketplace for public and commercial buyers has been piloted since 2017.

In Moldova, UNCITRAL Model Law standards were used to develop MTender – an electronic procurement system that complies with the World Trade Organization Agreement on Government Procurement mandatory requirements and the requirements of the 2014 EU public procurement directives. The MTender is deliberately geared towards minimising corruption and collusion risks and increasing value for money and the fiscal efficiency of public procurement for the government. Although developed in stages, the MTender digital procurement service is now about 60 per cent complete in terms of functionality, covers almost 97 per cent of public entities funded from the state budget and has enrolled 4,700 suppliers. The results are as follows:

- estimated state budget savings of €29,966,095 from public procurement awarded in electronic competitive procedures within 15 months of operation
- six times more contracting authorities using eProcurement and using more advanced eProcurement functionalities
- six times more procurement advertised online and subject to competition
- 20 times more public procurement procedures recorded online on the web portal
- a 30 per cent increase in participation of new suppliers in MTender electronic tenders (1,396 new suppliers)
- Moldovan state budget investment in MTender pilot: in-kind MCloud hosting/€0
- estimated investment of commercial partners – local e-commerce platform operators: €200,000.

Transformational change

Learning from examples in Ukraine and Moldova, the regulatory standards of the UNCITRAL Model Law matched with Open Government principles for digital tools have the proven potential to change fundamentally how public procurement works, with huge implications for efficiency, fairness and innovation.

Gearing public procurement laws towards Open Government concepts means emphasising in the regulatory framework transparency safeguards, high levels of integrity and accountability of public officials and introducing instruments for a genuine dialogue with civil society and the business community about public procurement performance and outcomes for public services.

Application of Open Government principles to digital government tools for public procurement means using open source technologies, open data standards – Open Data for Government Standards (ODGS), Open Contracting Data Standard (OCDS) – and real-time online communication and data exchange. When implemented together, eProcurement tools make it possible for governments to conduct public procurement in a digital and transparent manner, secured by real-time publishing of the OCDS open data about public procurement transactions. Reliable and complete information about procurement and public contracts is easily accessible online for all stakeholders – public buyers, suppliers and contractors – and civil society is expected to generate trust in government and encourage civic participation. It can improve the accountability of public officials, enable the management of the data-driven public procurement process by relevant governmental agencies and create favourable market conditions for competitiveness as well as the public procurement market participation of SMEs.

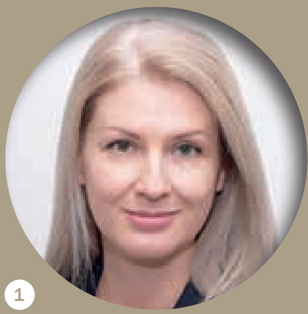
CONCLUSION

The case of Ukraine and ProZorro/DoZorro and Moldova and MTender projects demonstrates that modern policy thinking and Open Government values embedded into digital transformation of public procurement can accelerate the historic shift from documents to data in public procurement, and operate as a significant tool to allow states to implement the legal standards of the UNCITRAL Model Law and policy approach of the EBRD-UNCITRAL Initiative in practice. It can catalyse systemic reforms, help innovations have a global impact and foster a culture of openness about procurement policies, tools, data and reform results in governments that lack the trust of their citizens. It can allow governments that face political and market challenges to leapfrog to a better future and establish new leaders in the digital transformation of public procurement.

1 https://www.open-contracting.org
2 https://www.transparency.org/

TANDOO: NEW OPPORTUNITIES FOR LOCAL SMALL BUSINESSES IN PUBLIC PROCUREMENT IN THE KYRGYZ REPUBLIC

"Several governments across the world have adopted new public procurement policies to ensure proportional participation from local small businesses."



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INTRODUCTION

Technological progress is creating a global digital economy that is driven by innovation. Such an economy is highly competitive and, perhaps surprisingly, the most dynamic part of it is made up of small businesses. Globally, it is estimated that a tax-paying small business contributes up to 45 per cent to employment rates and up to 33 per cent of gross domestic product (GDP) in developing economies and nearly 64 per cent of GDP and 62 per cent to employment in developed countries.[1] With such a great contribution, small businesses should enjoy a substantial share of the economy and participate in equal measure in business-to-business and business-to-government transactions. But this is not the case. All over the world, public contracts funded with money from taxpayers are principally awarded to large companies. The share of business-to-government transactions involving small businesses is typically well below half of the value of their general market standing.

With this disproportion in mind, several governments across the world have adopted new public procurement policies to ensure proportional participation from local small businesses. In some countries, these procurement policies result in the reappearance of traditional regulatory solutions: domestic preferences, subsidies or procurement quotas for small business suppliers and contractors. In others, governments abandoned populist quotas-and-preferences approaches and have implemented reforms targeting market failures of public procurement regulation, complexity of procedures, insufficient access to business opportunities and excessive red tape. This article presents the case of Tandoo, an online shopping system in the Kyrgyz Republic, which is testing the waters for new public procurement policies through the use of disruptive technologies and modern policy thinking that focuses on promoting competitiveness among local small businesses.

> "The Kyrgyz Republic made some advances in the area of public procurement by adopting a new Law On Public Procurement in April 2015."

SMALL AND MEDIUM-SIZED ENTERPRISES AND THE PUBLIC PROCUREMENT MARKET IN THE KYRGYZ REPUBLIC

The Kyrgyz Republic made some advances in the area of public procurement by adopting a new Law On Public Procurement in April 2015, Number 72, based on the 2011 UNCITRAL Model Law on Public Procurement and by introducing an electronic procurement system in June 2014. Since May 2015, all public tenders have been conducted electronically through the national electronic procurement portal www.zakupki.gov.kg. The exception is direct contracting, which remains offline.

In terms of market impact, in 2017 public procurement accounted for 26 per cent of state budget spending and has significant purchasing power in the domestic economy. At the same time, local small businesses are heavily under-represented in the area of public procurement. Despite the introduction of mandatory electronic bidding in 2015, the majority of small businesses did not win a public tender. In the survey among small businesses conducted in 2018, in collaboration with the Chamber of Commerce and the National Alliance of Business Associations

(NABA), three issues were emphasised by almost all participants: complex and time consuming procedures, no bidding opportunities and exceedingly high financial capacity requirements in public tenders.

Indeed, small value public contracts that hold the biggest appeal to local small businesses range in the Kyrgyz Republic from KGS 1 million (12,920 euro equivalent) to KGS 3 million (€38,762)[2] but do not have to be conducted online or subject to competition. In fact, in 2017, public procurement in the Kyrgyz Republic consisted of 49 per cent of public contracts being directly awarded offline, 34 per cent of contracts awarded in electronic simplified tendering, 16 per cent awarded in electronic open tenders and 1 per cent awarded in other offline procedures. In addition to a high proportion of direct awards, simplified tendering is not as simple as the name may suggest. It differs from standard open tender for high value procurement only by shorter bidding deadlines. It requires contracting entities and suppliers to prepare a procurement notice and documentation for each tender and to submit technical and financial proposals as well as qualification documents for each tender they wish to participate in. As this process involves time, skills and trained staff that small and medium-sized enterprises (SMEs) that many economies in our regions cannot afford, they simply do not participate in public tenders.

To remedy the situation, new procurement procedures and online eProcurement tools were called for to simplify and speed up the procurement of small value goods, works and services and make direct awarding online, transparent and accessible for local small businesses.

NEW LEGAL FRAMEWORK

Facilitated by the EBRD, technical cooperation amendments to the Law of the Kyrgyz Republic On Public Procurement introducing new provisions on the electronic catalogue were adopted in January 2019.[3] A new government regulation on the public procurement of goods, services and works through an electronic catalogue was adopted in May 2019 and came into force in June 2019.[4] It envisages the development of an online shopping system, Tandoo, which is based on eCatalogues, initially for four categories of products, aiming for 29 categories on completion of the system pilot.

> “Online shopping is not commonly used in public procurement, especially not in the Kyrgyz Republic and other Central Asian countries. Tandoo is a welcome innovation for public bodies and suppliers alike.”

HOW TANDOO WORKS

Online shopping is not a new phenomenon in the commercial world, as demonstrated by the global reach of companies such as Amazon, but it is not commonly used in public procurement, especially not in the Kyrgyz Republic and other Central Asian countries.

Tandoo is a welcome innovation for public bodies and suppliers alike as it:

- supports the purchase of standardised products from the eCatalogue, according to standard technical specifications
- offers simple qualification for suppliers once a year and there is no paperwork needed to submit an offer
- keeps prices up to date by recording purchases in all categories
- reduces the time taken to request a quote from a supplier
- is competitive and transparent, as invitations are published online and received by suppliers through the system for all goods they have an offer for
- offers automated identification of the best price when several suppliers are offering the same product in the eCatalogue
- works through a mobile application.

One of the many benefits of the online system is the fact that suppliers and their products only need to be registered once a year and there is no need to prepare tender documentation for each procurement.

Tandoo is run by the Public Procurement Department of the Ministry of Finance, which is responsible for the administration of the eCatalogue in terms of identifying categories of products and developing standard technical specifications for products in each category of the eCatalogue. The Tandoo administration team also undertakes the registration and qualification of suppliers and the verification of products to ensure they are placed correctly by qualified suppliers in the eCatalogue.

With Tandoo, registration of supplier, placing a product in the eCatalogue and purchasing from eCatalogue can be simplified to three steps, as explained in the chart below.

TANDOO TRAINING PROGRAMME FOR SMEs AND GOVERNMENT BUYERS

In order to bring Tandoo to the market, a training programme for SMEs, which will be available in every region in the Kyrgyz Republic, will begin in January 2020. It will be delivered in collaboration with the local chamber of commerce and NABA and aims to reach 1,400 active SME suppliers within six months. The total number of trained suppliers and public contracting entities will be over 2,500. Each region will get a Tandoo ambassador – 30 members of the Chamber of Commerce volunteered for the programme to be trained– and, on completion, the ambassador will be available to support and train their local business communities. Online tutorials have been developed for the eCatalogue to assist SMEs and contracting entities in using Tandoo effectively. Online shopping by government bodies is a radical change for business in the Kyrgyz Republic and problems are to be expected. For this reason, dedicated SME help desks at the Ministry of Finance will provide support to purchasing entities and suppliers.

The Tandoo process

Registration and qualification

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- eCatalogue offers a **simple registration and qualification** process for suppliers that needs to be **confirmed every six months** with **no additional paperwork required to submit an offer**.

Placing the products in the eCatalogue

2

- Registered and qualified suppliers **place their products with prices** in the eCatalogue under the relevant category.
- They can update the **data, including prices and discounts** offered, at **any time**. The system requires the supplier to **confirm their prices every sixty days**.

Procurement from the eCatalogue

3

- The contracting entity **requests a price quotation** through the eCatalogue, including the quantity of products, delivery conditions, contract and payment conditions. **A procurement notice is published automatically online** on the eProcurement portal.
- The system **automatically sends a request to all suppliers** offering relevant products to quote their prices.
- **Suppliers submit their offers through the system with confirmed or updated prices and delivery conditions.** Requesting a quote from a supplier takes just minutes for contracting entities and for suppliers to respond.
- If several suppliers offer the same product in the eCatalogue, the system **automatically identifies the best price**.
- The procurement contract is generated electronically by the system and is signed by the contracting entity and the supplier offering the best price.
- The payments in the contract are automatically recorded in the eCatalogue.

Source: Kyrgyz Public Procurement Department of the Ministry of Finance.

The help desks can assist, online and over the phone, any local business that is interested in eCatalogues or experiencing issues in terms of getting paid in time for public contracts that have been signed through Tandoo.

REMOVING BARRIERS TO MARKET PARTICIPATION

Tandoo is an example of the way in which the government may correct bias towards or remove barriers to SMEs being able to participate in the public procurement market. As SMEs have fewer resources, anything that makes the procurement process easier and lowers the cost of involvement will have a greater relative result for them. With user-friendly technology, public procurement reform can go a long way towards creating a business environment where local small businesses can operate and compete openly.

Tandoo eCatalogue is a new modern electronic tool that simplifies, speeds up and adds transparency to the process of purchasing small value goods, services and works. It significantly improves the process of purchasing small value goods by reducing the time and costs for such procurement for both the contracting entities and the suppliers. It is expected to encourage the participation of local SMEs in bidding for public contracts and the transparency of the Tandoo online procedures should reduce corruption risks as well. It offers new rules and new tools to give local SMEs access to procurement opportunities that were previously unavailable online and not open to competition. It also helps to ensure that payments for public contracts delivered by SMEs will be more timely due to regular monitoring by the Tandoo administrators.

If piloting is successful, by December 2020 Tandoo may become the main online platform for government buyers and SMEs in the Kyrgyz Republic creating reliable revenue for local small businesses across the country and reducing the cost and time of procurement for government buyers.

> "The visual presentation of a list of goods, services and works in the eCatalogue will greatly facilitate the public procurement process. Knowing the approximate prices for certain standardised goods and services, we can better estimate the cost of public contracts. An electronic catalogue is a great help for both suppliers and procuring organisations. Here you can see the difference in price and quality – a good incentive for developing competition."
>
> **Mukhammedkalyi Abylgaziev**,
> Prime Minister of the Kyrgyz Republic
> October 2019

1. International Finance Corporation (2010), *Scaling-Up SME Access to Financial Services in the Developing World.*
2. Regulation of the Government of the Kyrgyz Republic (January 2016), 'On approval of threshold amounts for the procurement of goods, works and services', Number 10 (as amended by Government Regulation in April 2017, No. 225).
3. See http://cbd.minjust.gov.kg/act/view/ru-ru/111831 (last accessed 9 January 2020).
4. See http://cbd.minjust.gov.kg/act/view/ru-ru/14125 (last accessed 9 January 2020).

COMMERCIAL MEDIATION: EXPERIENCE FROM MOLDOVA AND SERBIA

"Increasing the use of mediation is an aspiration for EU countries and for the economies where the EBRD invests."


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The idea of parties in a dispute coming to a mutually acceptable solution is very appealing, particularly when the solution is quick and affordable. Mediation is believed to offer such a solution and is one of the alternative dispute resolution (ADR) mechanisms.

WHY USE AND PROMOTE MEDIATION?

In some disputes, the use of mediation is accepted more easily, for example, in family or labour cases. This is due to the fact that mediation is, in many respects, about preserving relationships.

In commercial disputes, the main reasons for using mediation are similar: preserving business relationships and saving time and costs. On a different level, parties involved in a mediation do not need to follow a point of law or resolve the dispute according to the law. This means that parties may find a business solution based on their priorities. For instance, shareholders may find it less damaging to find a solution through mediation rather than to take each other to court in order to agree to change the shareholders' agreement. Furthermore, restructuring a debt does not need to be raised in court as it can be resolved between the parties, however they may need the assistance of a mediator to come to an agreement.

The government may be interested in promoting mediation in order to lower the costs of maintaining the state court system, as well as to reduce litigation and to unclog the court system.

In addition, it is in the public interest to improve the investment climate by offering another dispute resolution tool for investors.

Despite mediation being a soft dispute resolution tool, there is some scepticism and criticism surrounding it. In particular, when mediation is made compulsory in law or practice. The main arguments against mediation concern its misuse as a tool to delay proceedings and add to the expense of litigation. Preservation of the status quo is another culprit, as is quite often the opposition from the legal profession, which jokingly describe "*ADR*" as an "*Alarming Drop in Revenue*".

The response to such criticism is finding a balance: identifying the most suitable cases; limiting the timeframe for mediation to avoid delay; and offering enforceability tools and incentives. For many jurisdictions, finding this balance is a process of trial and error.

INTERNATIONAL SUPPORT FOR MEDIATION

To promote mediation, the European Union issued the EU Directive in 2008,[1] setting an aspirational target of 10 per cent of commercial cases to be resolved through mediation. Similarly, the World Bank Doing Business Report includes the availability of mediation and its practice is one of the main indicators of a good investment climate.[2]

In December 2018, the United Nations General Assembly adopted the United Nations Convention on International Settlement Agreements Resulting from Mediation, also known as the "Singapore Convention on Mediation". The signing ceremony was in Singapore on 7 August 2019, and involved 46 countries, including China, India, Singapore and the United States of America. The objective of the Convention is to promote widespread international enforceability of settlement agreements, similar to arbitration.[3]

EBRD PROJECTS IN MOLDOVA AND SERBIA

Increasing the use of mediation is an aspiration for EU countries and for the economies where the EBRD invests. The Bank, through its Legal Transition Programme, initiated and implemented a number of projects to assist jurisdictions in their endeavour to establish a functioning mediation framework and practice. The most notable projects are taking place in Moldova and Serbia.

The project in Moldova began in 2013. Its first phase involved supporting the Moldovan government in implementing Moldova's Justice Reform Strategy (2011-2015), which specifically aimed to strengthen the ADR system in Moldova and promote its use in the business community. The project piloted court-annexed mediation in a number of courts and trained mediators, contributed to the drafting of a new Law on mediation, hosted public awareness events. Many of the activities were kindly supported by the United Kingdom's Good Governance Fund. In 2018 the EBRD launched the fourth phase of the project,

"The Bank, through its Legal Transition Programme, initiated and implemented a number of projects to assist jurisdictions in their endeavour to establish a functioning mediation framework and practice."

with funds from the United States Agency for International Development (USAID), to attempt a final push to establish viable mediation in Moldova. The project envisages an array of public awareness activities, amendments to the legislative and regulatory framework and institutional capacity-building that are implemented in partnership with the International Development Law Organization (IDLO).

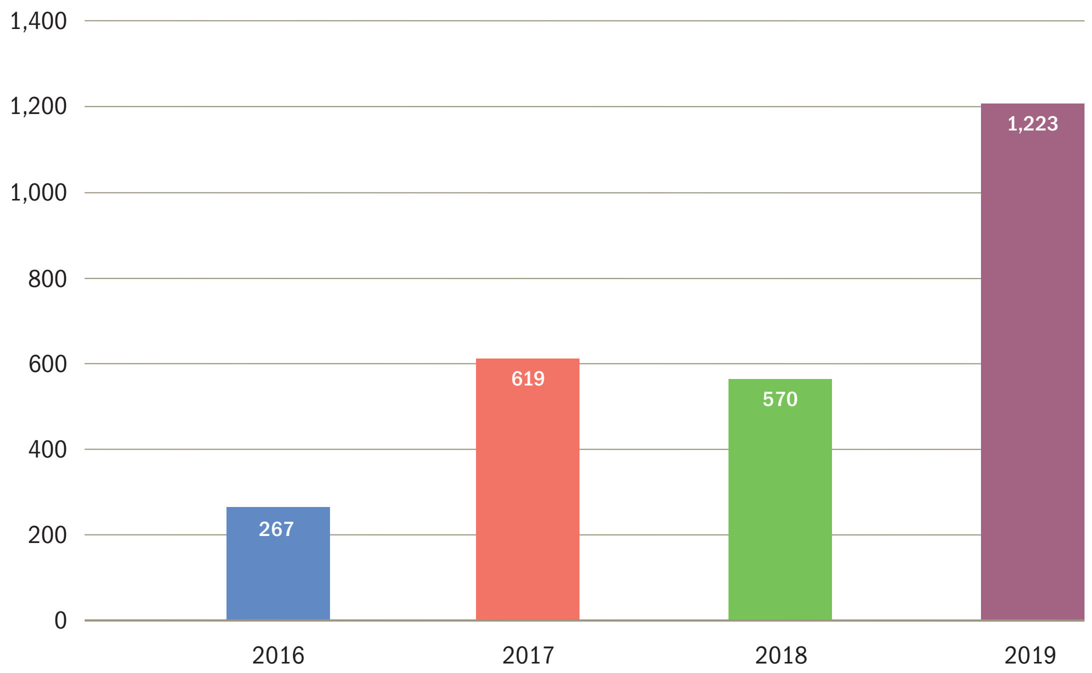
In Serbia, the project was launched in 2016 and was supported by the United Kingdom's Good Governance Fund. It assisted the government and judiciary in raising awareness about commercial mediation and provided training on commercial mediation to judges and mediators. The second phase of the project, funded by the Grand Duchy of Luxembourg, began in 2019 and aimed to carry out a comparative study of the mediation frameworks in other relevant jurisdictions. It also aimed to provide recommendations for revamping Serbia's ADR strategy, with a focus on commercial mediation.

MEDIATION PROGRESS AND MOTIVES FOR REFORM IN SERBIA AND MOLDOVA

The motives for establishing effective mediation in Moldova and Serbia are slightly different. This is reflected in the level of government involvement in each country. In Serbia, the courts are tremendously overwhelmed. More specifically, the Supreme Court of Cassation in its Annual Report for 2018 indicated that the inflow of cases in all courts in 2018 amounted to a staggering 2,089,237 cases.[4] To put this into perspective, the population of Serbia in the same year was 7,022,000 – that is, one case for every third person in the country. Hence, the government is keen to unburden the courts by actively promoting mediation.

Despite all the government and donor community efforts in Serbia, the uptake of cases was relatively slow. At the same time, 2019 appeared to be more promising, with 1,200 cases of mediations before the end of the year (see Chart 1).

Chart 1: Serbia mediation cases, 2016-19



Source: Ministry of Justice, Serbia.

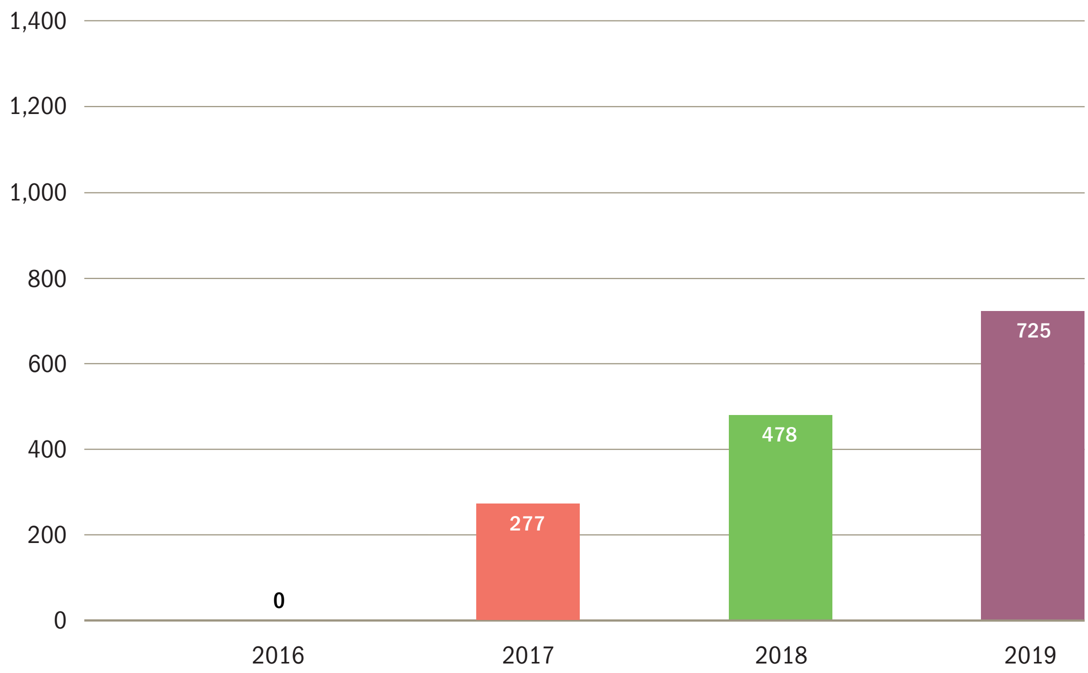
The reasons for reform in Moldova involve the fact that the courts are incredibly weak and lack independence. Accordingly, mediation is potentially an alternative to courts. However, although the government is supportive of various activities by the project, it is slow to lead any initiatives. The uptake of cases is growing from year to year, although not as fast as expected. In 2017 there were about 277 mediated cases, which grew to 725 in 2019 (see Chart 2).

MEDIATION REFORM JOURNEY IN SERBIA AND MOLDOVA

Both Serbia and Moldova, until recently, were primarily attempting to establish mediation through voluntary routes, relying on market forces to create the supply and demand for mediation services. Unfortunately, in countries where litigation is not expensive, there is less reason to identify alternatives to courts. Hence, the state is burdened with the expense of maintaining busy courts instead.

"Another common feature in both countries is an attempt to introduce judicial mediation in addition to private mediation. This is when the judges act as mediators."

Chart 2: Moldova mediation cases, 2016-19



Source: Mediation Council, (Ministry of Justice), Moldova.

Another common feature in both countries is an attempt to introduce judicial mediation in addition to private mediation. This is when the judges act as mediators. In Moldova this initiative went the furthest: the civil procedure code was amended and judicial mediation became mandatory for many categories of civil cases. Judges strongly opposed this initiative as it is perceived to add to the judges' workloads. Accordingly, there is a strong demand from the judiciary that this type of mediation be abolished.

In Serbia and Moldova there were initiatives to introduce court-annexed mediation. In Moldova, with assistance from the EBRD, a number of courts in the country piloted court-annexed mediation, offering space for private mediators to carry out mediations and redirecting parties to attempt mediation. The pilot revealed that the courts were not prepared and could not be relied on to continue this initiative, due to a lack of resources and increased administrative demand. Therefore, the idea was abandoned and now a completely out-of-court service is considered.

In Serbia, many courts set up information desks, where parties are able to find out more about mediation and court staff encourage parties to attempt mediation before litigation. This initiative continues, however, opinions about the use and impact of information desks is split. It works very well in some courts (for example, in Nis) and not so well in others.

"ITALIAN MODEL" AND ITS POTENTIAL USE IN VARIOUS JURISDICTIONS

More recently, Italy has appeared to be successful in using mediation to resolve disputes and many countries are considering adopting its model for promoting mediation, the so-called Italian model. The main feature of the Italian model is that in a number of categories of disputes, including most banking and finance-related disputes, parties must attend a meeting with the mediator (the "first meeting"). During the meeting the mediator explains the mediation process and benefits for this particular case, based on which parties may decide to mediate the case, but it is not mandatory to go through with the mediation.

The Italian model has shown excellent results. Despite mediation not being mandatory, the number of cases where parties agreed to mediate and concluded a mediation agreement increased dramatically after the introduction of this model. The data for 2018 show that there were 258,786 new cases of commercial mediation registered, which is in line with the data from 2017 (263,263 cases). A settlement agreement was reached in 44.8 per cent of cases (all data is in line with previous surveys).[5]

Currently, both Moldova and Serbia are considering the Italian model for domestic commercial disputes. The Ministry of Justice created a multi-stakeholder ADR working group in June 2019. However, the progress of the reform

Table 1: Comparing commercial mediation in Serbia and Moldova

	Serbia	Moldova
Mediation laws	2005, various amendments	2008, 2015
Commercial mediation (private)	Voluntary	Voluntary
Commercial mediation (judicial)	Under consideration	Mandatory (for certain types of cases)
Court-annexed mediation	Some courts have information desks, most successful in Nis	Attempted in 2014-15, failed
Reform	Planned for 2020, considering the Italian model	Started in 2019-20, considering the Italian model
Singapore Convention on Mediation	Signed on 7 August 2019, not yet ratified	Not signed

"The outlook for 2020 is very promising for both Serbia and Moldova, with regard to advancing mediation."

stalled after the legal community opposed the proposal of mandatory first meeting. The government hopes to push for reform in 2020, after the parliament elections in April. As mentioned above, the EBRD is helping the Serbian Ministry of Justice and Commercial Courts decide on the course of action for commercial disputes.

In Moldova, due to frequent changes in governments and consequently the composition of the Ministry of Justice, the pace of reform is slow. However, the draft Strategy for Justice Sector Reform for 2019-20 includes an entire section on alternative dispute resolution, focusing on the promotion of mediation. The EBRD, with the help of funding from USAID, is undertaking an extensive reform programme to help the Ministry implement this part of the Justice Sector reform.

CONCLUSION

The road to establishing a new dispute resolution mechanism is long. The approach that works in one jurisdiction is not always suitable for another. As a result, jurisdictions must experiment with different rules until they identify the right mechanism and rules and build the necessary capacity. The outlook for 2020 is very promising for both Serbia and Moldova, with regard to advancing mediation.

1. Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters.
2. So far, the advance of mediation in Europe is slow. A study in 2016 revealed that since the issuance of the Mediation Directive, mediation was used in less than 1 per cent of civil and commercial cases in EU parties. The study comprises the views of up to 816 experts from all over Europe, showing that "this disappointing performance results from weak pro-mediation policies, whether legislative or promotional, in almost all of the 28 Member States". See The Implementation of the EU Mediation Directive (November 2016), http://www.europarl.europa.eu/RegData/etudes/IDAN/2016/571395/IPOL_IDA%282016%29571395_EN.pdf (last accessed 9 January 2020).
3. Singapore Convention on Mediation (December 2019), see https://www.singaporeconvention.org/ (last accessed 9 January 2020) and https://uncitral.un.org/en/texts/mediation/conventions/international_settlement_agreements (last accessed 9 January 2020).
4. "Annual Report on the Work of the Courts in the Republic of Serbia for 2018" (Belgrade, 2019), see https://www.vk.sud.rs/sites/default/files/attachments/Annual%20Report%20on%20the%20Work%20Of%20Courts%202018_1.pdf.
5. See https://www.lexology.com/library/detail.aspx?g=d0faf894-e442-46f9-9fee-dfb1f78ddd4a (last accessed 9 January 2020).

TURNING AROUND STATE-OWNED ENTERPRISES IN CROATIA

"With approximately 260 state-owned enterprises per 1 million inhabitants, Croatia and Slovenia are, according to a recent IMF survey, and after Belarus, the countries with the highest number of state-owned enterprises in central and south-eastern Europe."

In this article we discuss the continued importance of state-owned enterprises (SOEs) to the Croatian economy and the challenges of the state ownership structure.

We also present some of the EBRD's activities in the Croatian SOE sector through the lens of the achievements and lessons learned from a recently completed project – the SOE Restructuring Project –which aims to improve operational and financial restructuring processes in distressed SOEs and introduce an internal early warning system.

We conclude with suggestions on how to further strengthen the financial performance and corporate governance of SOEs.

THE ROLE OF STATE-OWNED ENTERPRISES IN THE CROATIAN ECONOMY AND RELEVANCE FOR THE EBRD

In Croatia SOEs play an important role in the economy. They are prominent in transport (air, road, railway and maritime transport, as well as airports and ports), energy (generation, distribution and storage), construction, post and communication, forestry and utilities (where public participation may be explained by public interest or market failure), and in agribusiness.

The state is heavily present in public utilities and transport where, between 2012 and 2013, the share of employees working for SOEs in these sectors reached 79 per cent and 45 per cent,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respectively. Croatian SOEs employ 73,000 people (5 per cent of the country's total workforce) and costs of employees in total revenues are higher than in neighbouring central and eastern European (CEE) countries across all sectors. Nevertheless, SOEs are present in many sectors beyond natural monopolies, including manufacturing for retail markets, construction and hotels. This, together with the lack of a clear state ownership policy, results in state ownership being, in many respects, fragmented and heterogeneous.

With approximately 260 SOEs per 1 million inhabitants, Croatia and Slovenia are, according to a recent IMF survey, and after Belarus, the countries with the highest number of SOEs in central and south-eastern Europe.[1] Although the value of SOE assets in Croatia is much higher than in CEE countries, their revenues stand only at 15 per cent of gross domestic product (GDP) and they are less profitable, or more loss making than CEE peers in the same sector.[2] Due to this financial underperformance, SOEs place a considerable burden on the state coffers. Despite some decline over the past decade, subsidies to SOEs (at 2 per cent) remain significantly above the European Union (EU) average (at 1.3 per cent) and payments of SOEs to the state budget remain around 1 per cent of GDP.

In recent years, Croatia's national reform programme has recognised the importance of reducing state ownership in companies of no strategic or special interest for the state by means of privatisation. It has also acknowledged the need to improve corporate governance in those that remain under state ownership.

Nevertheless, many reform commitments remain unfulfilled. The 2019 EU country report for Croatia states that "limited progress has been made in improving corporate governance and divestment in SOEs" and that there have been substantial delays to the introduction of measures aimed at speeding up the activation of assets and the disposal of minority shares in SOEs.[3]

In this context, it is useful to recall the EBRD's mandate. Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development states that the purpose of the Bank shall be "to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the central and eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics".

The EBRD focuses its SOE-related activities on promoting SOEs' transition to private ownership and control. The Bank has therefore become proactive in many initiatives related to the restructuring, privatisation and commercialisation of SOEs. The EBRD's five-year country strategy for Croatia adopted in June 2017 refers to supporting corporate governance and the privatisation of some SOEs. This support has broad foundations and is not limited to direct privatisation. Recent EBRD activities have included a €40 million loan for the Croatian railway reform agenda and major efforts to improve the financial and operational performance of water utilities. The EBRD is also providing restructuring financing to national power company HEP and motorways company HAC, the two largest Croatian SOEs.

EBRD-SRSS STATE-OWNED ENTERPRISE RESTRUCTURING PROJECT

As discussed, many SOEs in Croatia are unprofitable and in need of financial and/or operational restructuring. Yet there is a clear lack of skills and experience at both the state and SOE-management level to effectively tackle financial difficulties and/or operational underperformance.

In response, the EBRD and the European Commission's Strategic Reform Support Service (SRSS) launched, at the beginning of 2019, an EU-funded project for the Ministry for State Assets, and the Restructuring and Sale Centre (CERP) as beneficiaries. The purpose of the SOE Restructuring Project, as it is known, is to support the Ministry and CERP, as well as SOE management, in dealing with financially distressed SOEs. The Ministry manages, together with relevant line ministries, SOEs that are considered to be of special interest to the state and it is responsible for 39 of these companies. All other 374 SOEs (of which 25 are majority owned by the government) fall within the domain of CERP.

The SOE Restructuring Project, which concluded at the beginning of February 2020 with a workshop for government official and SOE management officials, has developed a comprehensive framework for preparing and implementing so-called financial and operational improvement plans (FOPIPs), as well as restructuring plans by the Croatian state bodies and the SOEs.

A FOPIP looks at what issues a business is facing, and the operational and financial impact of addressing those issues, and sets out how to transition to the business's required future state, including the costs of achieving this transition.

In contrast, a restructuring plan is a more elaborate exercise and covers the following four elements:

- an independent business review
- cash forecasting and management, since the business is usually facing a short-term cash shortfall
- financial restructuring to address liquidity issues
- turnaround or operational improvements to ensure business sustainability.

The first step of the SOE Restructuring Project was to review existing processes relating to the FOPIP and restructuring plans based on two pilot companies, one from the manufacturing sector and the other from the transport sector. Each had followed one of these processes.

The next step was to draft two manuals – one for the Ministry and CERP and the other for SOE management – on preparing and implementing restructuring and FOPIPs, reflecting each stakeholder's different role and responsibilities. Workshops were organised in 2019 with key stakeholders in the Ministry, CERP and the SOEs to gather feedback and test the proposed guidelines.

Regular reporting and monitoring of the liquidity of SOEs falls within the competence of SOE management, because management should be the first to know about any financial difficulties. The cornerstone of the SOE Restructuring Project Guidelines is an early warning system (EWS) for managing financially distressed SOEs.

Early action in relation to a distressed business is critical to minimise further financial losses and to give the company a real chance of successful restructuring and turnaround. Policymakers are increasingly emphasising the importance of early warning mechanisms to signal financial difficulties. The new Directive (EU) 2019/1023 requires member states to develop early warning tools to notify businesses in financial difficulty of the need to take prompt action.[4]

The EWS introduced by the Project uses a combination of internal and external indicators consisting of both qualitative and quantitative data to generate an EWS summary report. Internal indicators, such as the company's debt ratio or liquidity ratio, are sourced from the new annual and mid-term reporting templates for SOEs, developed as part of a 2018 EU-funded project led by the EBRD and the SRSS. External indicators are split into local and global indicators for SOEs, including the general economic and political situation in Croatia and the global environment (Europe and the world). The EWS also incorporates a flagging system which identifies any changes in key performance indicators between different reporting periods.

If the report detects an early warning event, a process of closer monitoring by SOE management and the state bodies should begin. The Guidelines recommend the convocation of a so-called Early Action Committee, chaired and coordinated by either the Ministry or CERP as applicable and including persons from the relevant line ministries to oversee a particular SOE. The Early Action Committee may, depending on the financial condition of the relevant SOE, elect to start either a FOPIP or a restructuring plan. This triggers the beginning of a process illustrated in Chart 1. The Guidelines set out the basis on which SOEs nominated for either FOPIP or restructuring processes should prepare the FOPIP and/or restructuring plans and include examples of FOPIP and restructuring plan dashboards.

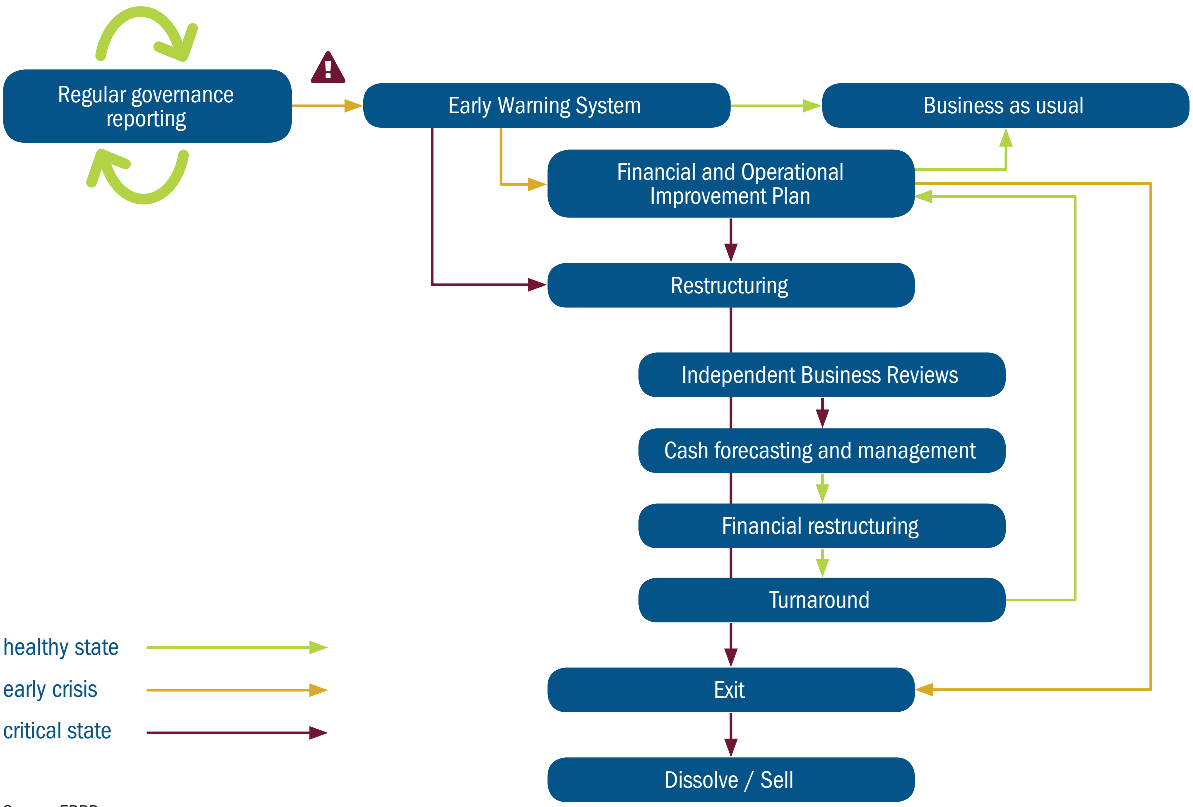
Good corporate governance is critical to ensure timely and effective action. The Guidelines therefore emphasise corporate governance and proper management of the state ownership function in accordance with the Organisation of Economic Co-operation and Development (OECD) Guidelines on Corporate Governance of SOEs 2015.

Despite a move towards greater centralisation with the establishment of CERP and the Ministry, ownership of SOEs in Croatia is not fully centralised, as recommended by the OECD Guidelines. While the new 2018 Law on the Management of State Assets clarifies the overarching responsibilities of different state players, the Law does not address the granular split of specific tasks that each state body performs and how coordination between state bodies is to be achieved. The Ministry, for example, is responsible, in cooperation with other ministries and other state administration bodies and public entities, for proposing to the government a strategy for the management and disposal of state assets.

However, in practice the line ministries have greater influence over strategic decisions (such as approving SOE strategic plans and SOE restructuring plans and appointing SOE board members) than the Ministry and CERP. There is, furthermore, no existing, clearly defined state rationale or policy for its ownership of SOEs.

The SOE Restructuring Project Guidelines recommend that the Ministry or CERP (as applicable) play a driving role in any FOPIP or restructuring process. At the same time, the Guidelines stress, on the SOE management side, the responsibility of the supervisory board in leading the process and ensuring that SOEs deliver timely and comprehensive reports to the Ministry or CERP.

Chart 1: Dealing with financially distressed state-owned enterprises



Source: EBRD.

The Guidelines introduce a corporate red flag system to identify potential weaknesses that may reduce management accountability and the capacity of SOE boards to fulfil their responsibilities. They suggest that corporate governance red flags should be reviewed by the Early Action Committee following an EWS event, but state that red flags can also be used during normal times of operation.

One example of a corporate governance red flag is if the SOE supervisory board does not have a clearly defined and documented mandate and clear responsibility for overseeing management and guiding the enterprise's performance.

Another example in relation to commercially oriented SOEs is any circumstance in which the relations of these SOEs with other SOEs (including state-owned financial institutions) or state agencies are not based on commercial grounds, potentially giving rise to a conflict of interest or connected transaction. Such transactions may reduce the profitability of SOEs and therefore contribute to their financial distress.

Where SOE management lacks skills, the Guidelines recommend considering the employment of a Chief Restructuring Officer to bring in valuable turnaround experience and skills and/or external advisers to guide SOE management.

PROJECT ACHIEVEMENTS AND LESSONS LEARNED

Interestingly, while many SOEs are underperforming, there has been relatively little emphasis to date on improving internal early warning mechanisms and turnaround skills for SOEs, despite the fact that this could be an important interim step to any successful privatisation project.

In this article we suggest that SOEs should be more aware of available restructuring tools and of how to improve corporate governance management and processes to ensure that these are sufficiently rigorous to manage businesses going through financial difficulty. The Guidelines introduced as part of the Croatian SOE Restructuring Project may be useful for other economies where the EBRD invests and where SOEs continue to play a significant role in the economy.

In Croatia the Guidelines have laid the foundations for a more robust and coherent corporate governance structure for the state management of SOEs in financial distress. Workshops organised around the Project recommendations and the Guidelines have equipped the Ministry and CERP with the necessary knowledge and awareness to play more active roles as stakeholders. Nevertheless, key challenges will be to ensure the necessary level of internal cooperation given the existing decentralised management of SOEs through the Ministry of State Assets, CERP and the line ministries and bringing on board the necessary external specialist skills to implement a significant turnaround of underperforming SOEs.

Furthermore, at the state level there needs to be a comprehensive rationale for SOE ownership in order to improve operational efficiency and fiscal sustainability. Today, a number of SOEs in Croatia have a significant portfolio of non-operating assets, such as construction sites that have been out of use for decades despite potential interest for commercial use by the private sector. Such assets are no longer required in the day-to-day operations and do not currently generate general cash flow for the business. The EBRD is therefore planning to launch a new project in the first quarter of 2020 – in partnership with the SRSS – that would develop a framework for the Ministry to credibly record and categorise the non-operating assets in SOEs.

1 International Monetary Fund (2019), *Reassessing the Role of State-Owned Enterprises in Central, Eastern, and Southeastern Europe*, page 6

2 EBRD (2019), *Croatia: Background study on state-owned enterprises - Economic and financial performance of SOEs: Significant room for efficiency gains.*

3 See https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-croatia_en.pdf (last accessed 8 January 2020).

4 Directive (EU) 2019/1023 of the EU Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency on preventive restructuring frameworks.

WHOLESALE REFORM IN UZBEKISTAN: THE KEY TO ENABLING DIGITAL CONNECTIVITY

"Beyond the economy, high-speed broadband connectivity is also increasingly becoming a key conduit of modern society, in terms of enterprise, entertainment, learning, public services, civic and social cohesion and more."

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BACKGROUND

Following the appointment of a new president, Shavkat Mirziyoyev, in 2016, Uzbekistan embarked on a course of wide-ranging economic reforms aimed at modernising the country's economy and social fabric and transforming its competitiveness. More than three years later those reforms continue, some having borne fruit, while other more structurally focused changes will take longer to come to fruition.

Among the sectors targeted for reform in Uzbekistan is the telecommunications sector, given its increasing role as an engine of broader economic development. While always important, the role of telecommunications has come to the fore in recent times, with its importance of broadband connectivity linked to the digitisation of economies and societies across the globe.

In line with other economies, Uzbekistan seeks affordable access to quality internet services for its government, enterprises and citizens, as a critical tool of economic and social development. The country does this in recognition of the fact that, as well as its ability to boost a country's competitiveness at a global level, access to the internet has become an essential tool in modern society, in terms of commerce, entertainment, learning, public services, civic participation, social inclusion and more.

Similar to broader reform in the country, while the telecommunications sector requires some structural change that will take time to deliver, effective results can, nonetheless, be delivered in the shorter term through applying tried-and-tested approaches and methodologies.

In this article we look at some of the background to the telecommunications sector in Uzbekistan; we emphasise the importance of affordable access to quality internet services; we highlight how affordable access has been achieved in more developed markets; we look at some of the challenges facing the sector in delivering on Uzbekistan's broadband goals; and, drawing on both the EBRD's own experience and some proven best practice, we identify some of the steps that could deliver widespread broadband connectivity at an affordable cost.

In particular, we look at the importance of competition to delivering affordable, high-quality broadband and the central role that and effective wholesale market for telecommunications infrastructure and services plays in enabling competition.

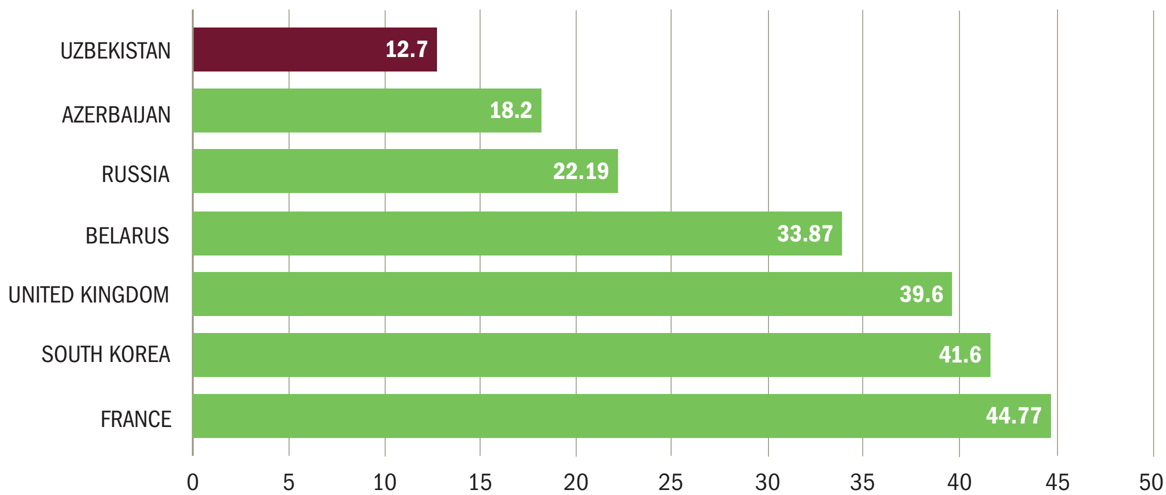
UZBEKISTAN'S TELECOMMUNICATIONS MARKET

The major player in Uzbekistan's market remains Uzbektelecom (UT), a state-owned, vertically integrated operator. UT holds a dominant position in the fixed-line voice market, while also being the biggest internet service provider and the owner of most physical telecommunications infrastructure in the country. Most other operators depend on infrastructure leased from UT to provide service.

While in large cities (for example, in Tashkent or Samarkand) customers usually have the opportunity to choose among several providers for fixed internet services, in towns and rural areas either no internet service is available or UT is the only provider.

While fixed broadband penetration in Uzbekistan reached 12.7 customers per 100 inhabitants in 2018,[1] this remains relatively low compared with regional neighbours such as Russia,[2] Belarus[3] and Azerbaijan[4] and significantly less than advanced markets such as South Korea[5] and some countries in the European Union (EU). Connection speeds are also reportedly low[6] while prices can be high.

Chart 1: Fixed broadband penetration (% of population), end of 2018



Source: International Telecommunication Union.

Against this background, in 2018 the government of Uzbekistan announced ambitious development goals for the telecommunications sector, including increasing liberalisation and actively seeking private investment.[7] The government has also committed to improving access to digital government services[8] as a means of improving public service delivery and advancing digital development. In this context, the government has also committed to resolve longer-term challenges by providing high-productivity, well-paid employment opportunities, especially for young people, while reducing the high disparity in living standards between rural and urban areas.

THE SOCIOECONOMIC IMPACT OF BROADBAND INTERNET CONNECTIVITY

Broadband internet is a driver and enabler of virtually all of today's commercial enterprises that are critical to underpinning the digital economy. It enables new business models, new processes, new inventions and new and improved goods and services to emerge. While investments into infrastructure deployment are direct contributors to gross domestic product (GDP) growth, the deployment of broadband networks can also have an indirect impact on GDP, through positive externalities that will enhance the overall productivity of the economy.[9]

Beyond the economy, high-speed broadband connectivity is also increasingly becoming a key conduit of modern society, in terms of enterprise, entertainment, learning, public services, civic and social cohesion and more. Essential to such connectivity is investment in the high-speed, high-capacity infrastructure that underpins fast broadband services. Therefore, investment in telecommunications infrastructure for the expansion of broadband services is fundamental to ensure that the demand of residential customers, businesses and the government is met, thus widely contributing to the overall benefit of the national economy and society.

LIBERALISATION OF TELECOMMUNICATIONS NETWORKS

The engine that drives broadband services is connectivity, through the "interconnected networks" (in other words, the internet), and underpinning that connectivity is the physical infrastructure. In many economies around the world, liberalisation that actively promotes competition in the provision of services to end-users has deepened the broadband market – in terms of network reach, capacity, cost to consumers, choice and quality. Liberalisation of the telecommunications markets has been achieved by policymakers and regulatory bodies using three key enablers:

- the removal of exclusive monopoly rights historically given to incumbent national telecommunications operators
- allowing the entry of new market players under fair and competitive market conditions
- the passage of national incumbents from state ownership to private ownership, so that effective policymaking and operational control are separated.

While de-monopolisation has been achieved to a certain extent in Uzbekistan, the remaining significant market power of UT in the fixed network appears to be preventing the emergence of a truly competitive marketplace. Therefore, establishing an effective framework that will allow for the entry of new market players under fair and competitive market conditions should be a priority for the government, if its broadband and digitisation goals are to be within reach.

Although there are many dimensions to an effective framework for a competitive marketplace, such as licensing rules, institutional structures and efficient spectrum allocation, the most critical part of the framework is the development of a robust wholesale market, allowing cost-based, non-discriminatory access to dominant operator infrastructure and service delivery.

> "In 2018 the government of Uzbekistan announced ambitious development goals for the telecommunications sector, including increasing liberalisation and actively seeking private investment."

THE DEVELOPMENT OF WHOLESALE MARKETS

In modern telecommunications markets, effective wholesale markets have become essential to the development of information and communications technology (ICT) services that are fully competitive and attractive to investors. The most important wholesale element of the market consists in an existing network operator offering to allow another operator or service provider to use its network. By having this wholesale offer, other operators – particularly new entrants – can choose to use existing infrastructure or to invest in their own infrastructure. A new entrant can therefore enter the retail market by offering services to end-users over an existing network, without the significant cost of establishing a new network to reach the same end-users. Existing network operators can also make interconnections through wholesale agreements to allow their end-users to connect with the end-users of other networks. This is the case for calls or internet connections, where the caller or internet user needs to establish a connection to another user or an internet service provider served by another network operator.

Regulators worldwide have recognised the importance of wholesale services because there is the potential for one party – a network provider – to obstruct the development of a competitor by refusing interconnection, or by making the wholesale offer at the price needed to ensure that the competitor has an economic path to its retail market. Under best practice regulation, competitive markets have now developed efficiently, with regulators focusing entirely on wholesale markets, leaving retail markets unregulated. This balance has proved attractive to market players because it allows them to compete freely at the retail level, while having favourable conditions to make economic decisions about infrastructure growth.

Effective wholesale markets have enabled network infrastructure to be separated from the service provided to the end-user. Many competitive services can be provided over a single network infrastructure. Under best practice regulatory conditions, telecommunications businesses can now choose, at any point in their business development, to invest in infrastructure to serve any chosen location or to use another pre-existing network through a wholesale agreement.

It is best practice for the regulator to oblige an operator's wholesale access offer to use cost-related wholesale charges, using set cost-calculation methodologies.

PRACTICES IN UZBEKISTAN

While aspects of best practice illustrated above are clearly present in the laws and regulations covering the telecommunications sector in Uzbekistan, the effective implementation of those laws and regulations is less clear. In particular, the apparent absence of an effective wholesale market appears to be preventing the emergence of a market that is meaningfully competitive.

Thus, although wholesale infrastructure access is legally required in Uzbekistan, its practical implementation lags behind that mandate. Despite UT's recognised monopolistic position and official significant market power status, the price for wholesale services provided by the company appears to lack a basis on reported cost or a transparent system for its approval. Additional mandatory wholesale services (for example, access to last-mile fibre and copper networks) appear to be provided based on

commercial agreements, similarly without transparency in pricing, clear guidelines and requirements or non-discriminatory service level agreements.

Overall, the price-setting mechanism is not transparent, as UT develops price proposals without clear guidelines or detailed requirements normally set by the regulator. The best-practice approach would see the regulator developing cost-reporting requirements for operators and performing price control usually based on developed pricing models.

HOW CAN UZBEKISTAN TRANSFORM ITS TELECOMMUNICATIONS SECTOR?

Uzbekistan appears to be following the classic trajectory seen in many other countries at a similar stage of their market development. While a competitive marketplace is largely provided for in the laws and regulations of the sector, either those instruments lack sufficient detail to make their provisions effective or the sector's institutional structure or regulatory capacity is ill-suited to delivering on government targets.

To fully deliver on these targets and build on the results of the country's initial liberalising steps, a clear programme of sector reform needs to be implemented, ranging from an overhaul of licensing and spectrum allocation rules to the separation of the policymaking and regulatory functions, privatisation and establishment of provision for universal service. While some of these activities require longer-term structural changes, improvements to the wholesale market could be implemented relatively quickly, largely within the current legal and regulatory framework, potentially creating a more competitive environment in the shorter term.

These improvements could be achieved by applying tried-and-tested regulatory rules and methodologies, including those related to accounting separation, data gathering, analysis, cost recovery and tariff regulation. Tariff regulation should require cost-based prices and accounting systems that provide detailed costing data for

specific types of access and/or interconnection services. Best practice shows that where such obligations are effectively applied to a dominant incumbent – UT, in the case of Uzbekistan – they will enable fair, clear and precise determination of the use, efficiency and level of competition regarding existing infrastructure, allowing the imposition of set remedies and more efficient access to and maximisation of the use of existing infrastructure.

CONCLUSION

In line with global trends, Uzbekistan evidences a clear desire to use digitisation and broadband to transform its economy. To date, however, efforts to achieve this have fallen short. The country still lags behind most regional comparators in terms of the coverage, speed, quality and price of fixed broadband.

While current laws and regulations have opened up the market and introduced some competition to the retail markets, in order to truly harness the power of the internet and digitisation to transform its economy, further steps to enable the effective functioning of wholesale market in telecommunications infrastructure (currently dominated by the incumbent UT) should and can be quickly taken. Time and again, international experience has shown that establishing an effective wholesale market will increase competition, attract private investment, improve quality and decrease prices.

Drawing on existing sector laws, regulations and institutions, a fully functioning wholesale market can be made operational in Uzbekistan relatively quickly (within 12 to 18 months) by ensuring all relevant provisions of those laws and regulations are effectively implemented, and the existing regulatory body under the Ministry of Information, Technologies and Communication is provided with a modest increase in capacity (for example, through increases in resources and being provided with temporary external expertise).

Although the current sector laws and regulations will need to be revised and supplemented – and institutions enhanced – to take full advantage of the benefits digitisation has to offer, the current legal and regulatory environment affords a sufficient basis to jumpstart sector reform through enforcing an effective wholesale market for broadband infrastructure and services.

1. Latest available figure for Uzbekistan (2018) – ITU.
2. At the end of 2018, the fixed broadband penetration rate for Russia was 22.19 per cent (ITU).
3. At the end of 2018, the fixed broadband penetration rate for Belarus was 33.87 per cent (ITU).
4. At the end of 2018, the fixed broadband penetration rate for Azerbaijan was 18.2 per cent (ITU).
5. At the end of 2018, the fixed broadband penetration rate for South Korea was 41.6 per cent (ITU).
6. Average fixed download speed for Uzbekistan in October 2019 was 18.9 Mbps, placing the country 119th out of 176 countries. Average mobile download speed in the same month was 9.4 Mbps, placing the country 136th out of 141 countries (Ookla Speedtest Global index – www.speedtest.net).
7. Presidential Decree 5349, 19 February 2018.
8. Via "e-Government Development Program 2013–2020".
9. Research has shown that investment in broadband networks can deliver the greatest benefits in terms of the GDP growth compared with traditional fixed and mobile networks. For example, a 10 per cent increase in fixed and mobile teledensity has been shown to have an impact of a 0.5 per cent and 0.7 per cent increase in GDP, respectively. Whereas a 10 per cent increase in broadband penetration can have almost double the effect of fixed teledensity and almost threefold of the mobile teledensity and can boost GDP by 1.3 per cent. Other research indicates similar impact of investments in broadband networks, ranging between 0.9 and 1.4 per cent (such as studies carried out by the World Bank and the Organisation for Economic Co-operation and Development).

GLOSSARY

CEE
central and eastern Europe

EBA
European Banking Authority

EBRD
European Bank for Reconstruction and Development

EC
European Commission

EU
European Union

FINTECH
financial technology

FOPIP
financial and operational improvement plan

IBR
independent bank review

ICT
information and communications technology

IDLO
International Development Law Organization

IFI
international financial institution

IMF
International Monetary Fund

IPO
initial public offering

LTP
Legal Transition Programme

MDB
multilateral development bank

OECD
Organisation for Economic Co-operation and Development

PPP
public-private partnership

SDGs
Sustainable Development Goals

SEMED
southern and eastern Mediterranean

SMEs
small and medium-sized enterprises

SOE
state-owned enterprise

TC
technical cooperation

UN
United Nations

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