

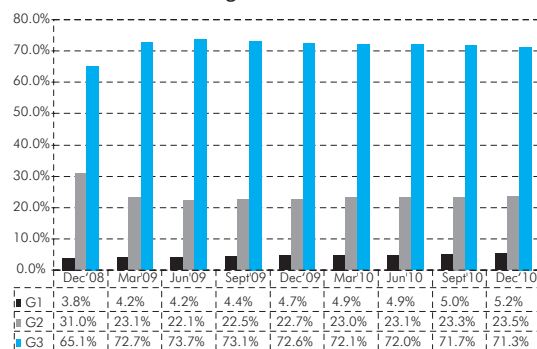
## CHAPTER VI BANKING SUPERVISION

## VI.1. BANKING SYSTEM AND NON-BANK FINANCIAL INSTITUTIONS

## VI.1.1. BANKING SYSTEM ASSETS AND FINANCIAL INTERMEDIATION

The banking system remains the main financial intermediary in Albania. At end-2010, its assets accounted for about 81% of the Gross Domestic Product (GDP). During 2010, the banking system total assets doubled in annual terms. The banks' asset structure continued to be financed mainly by household deposits and was focused on lending, primarily to the private sector. At end-2010, the loan portfolio accounted for about 49% of the banking system total assets.

Chart 1 Shares of peer bank groups\* according to total of assets



\*Size of activity is the criteria used for dividing the banks into peer groups: G1 is the group of small banks (the share of assets of each bank in this peer group is below 2% of the total system assets); G2 is the group of medium banks (the share of assets of each bank in this peer group ranges 2% - 7% of the total system assets); and G3 is the group of large banks (the share of assets of each bank in this peer group is above 7% of the total system assets).

Source: Bank of Albania

In 2010, the banking system's total assets were up by about ALL 104.3 billion or about 12%, indicating accelerated growth rates in 2010 compared to 7% in 2009.

Table 1 Banking system total assets

| Indicators                    | 2003  | 2004  | 2005  | 2006  | 2007  | 2008  | 2009  | 2010  |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total assets (in ALL billion) | 373.6 | 426.4 | 496.6 | 624.3 | 742.9 | 834.1 | 886.3 | 990.6 |
| Total assets /GDP (in %)      | 53.8  | 56.8  | 60.9  | 70.8  | 76.8  | 76.7  | 77.5  | 81.0  |

Source: Bank of Albania

Consequently, in 2010, banking activity continued to deepen its intermediation in the economy. This intermediation, banking system total assets to the GDP, increased by 3.5 percentage points in 2010 vis-à-vis 0.8 percentage points in 2009.

Concentration indicators during 2010, presented in the Herfindahl index, are shown in levels almost equal to those in the last three years, remaining far from optimum levels.

| Indicators         | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|--------------------|------|------|------|------|------|------|
| H Index (assets)   | 0.21 | 0.18 | 0.15 | 0.15 | 0.14 | 0.14 |
| H Index (deposits) | 0.24 | 0.2  | 0.17 | 0.17 | 0.16 | 0.15 |
| H Index (credit)   | 0.1  | 0.11 | 0.12 | 0.11 | 0.11 | 0.11 |

Source: Bank of Albania

Table 2 H (Herfindahl) Index of asset, deposit and credit concentration

- *BANKING SYSTEM CREDIT HIGHLIGHTS*

Banking system investments, creditwise, despite recording a slower growth compared to previous periods, follow an upward trend year-on-year. However, this growth was slower regardless of high growth rates of the banking sector lending to total asset ratio, over the last two years. Perception of a higher lending risk was followed by bank's tendency to increase their placements at other, mainly foreign, financial institutions. Nevertheless, the decelerated lending growth is deemed to have been temporary. More specifically, lending to the economy grew by 9.07%, with the highest growth concentrating more during the last quarter.

Table 3 Quarterly credit growth in 2010

| Quarterly credit growth | Q I      | Q II      | Q III    | Q IV      |
|-------------------------|----------|-----------|----------|-----------|
| In ALL million          | 8,639.68 | 11,115.79 | 3,125.76 | 18,097.27 |
| In percentage           | 1.90     | 2.40      | 0.70     | 3.80      |

Source: Bank of Albania

This development has affected the loan portfolio quality. At end-2010, non-performing loans rose to ALL 68.5 billion, increasing by ALL 21.4 billion year-on-year. However, in 2010 Q4, non-performing loans increased by ALL 3.4 billion, the lowest record over the last two years. Non-performing loans dropped by ALL 1.1 billion in December 2010 compared to November 2010. Consequently, the monthly non-performing loan indicator declined for the first time in the last two years, from 14.4% in November to 14.0% in December 2010<sup>1</sup>.

Furthermore, it is worth noting that non-performing loan growth was lower in 2010 than in 2009. Loan portfolio quality dropped for both businesses and households. Non-performing loans to total outstanding business and household loan was respectively 15.5% and 11.7%. Moreover, loan portfolio quality deteriorated both in lek and in foreign currency loan. Quality indicators, "non-performing loan/outstanding loan in lek" and "non-performing loan/outstanding loan in foreign currency" were 14.4% and 13.7%, respectively.

The second most significant item was the "Treasury and inter-bank transactions"<sup>2</sup>. At end-2010, this item reached about ALL 296 billion, accounting for 30% of total assets. This increase was due to the increase in transactions with commercial banks, credit institutions and other financial institutions, from 6.3% of assets at end-2009 to 9.3% at end-2010.

- *NET PROFIT AND BANKING SYSTEM PROFITABILITY INDICATORS*

During 2010, the banking system net profit posted higher growth compared to 2009. Net profit in 2010 was around 90% higher, with banking activity growth playing a determinant role.

<sup>1</sup> At end-2009, non-performing loan to total loan was 10.48%.

<sup>2</sup> This item includes banks' transactions with the central bank (deposits, required reserve, and open market operations); transactions with T-bonds, and commercial inter-bank transactions - deposits, current accounts, loans; etc.

| Indicators             | December '07 | December '08 | December '09 | December '10 |
|------------------------|--------------|--------------|--------------|--------------|
| Net profit (after tax) | 9.98         | 7.33         | 3.54         | 6.72         |

Source: Bank of Albania

Table 4 Net profit in ALL billion

Net Interest Margin (NIM) surged compared to 2009 year-end, primarily due to increased operational income and decreased financing costs of interest-bearing assets.

Table 5 Core activity profitability indicators, in percentage (cumulative)

| Indicators  | December '07 | December '08 | December '09 | December '10 |
|---|--------------|--------------|--------------|--------------|
| Interest income/average income-bearing-assets (1)   | 7.72         | 8.06         | 8.10         | 8.11         |
| Interest expenses/average income-bearing assets (2) | 3.37         | 3.94         | 4.06         | 3.78         |
| Net interest margin (NIM) {(1)-(2)}                 | 4.35         | 4.13         | 4.04         | 4.32         |

Source: Bank of Albania

Profitability indicators, return on assets (RoA) and return on equity (RoE) at end-2010 increased y-o-y, owing to the banking system net profit growth.

| Indicators | December '07 | December '07 | December '07 | December '07 |
|------------|--------------|--------------|--------------|--------------|
| ROA        | 1.48         | 0.91         | 0.42         | 0.72         |
| ROE        | 20.32        | 11.35        | 4.58         | 7.58         |

Source: Bank of Albania

Table 6 Banking system profitability indicators (in percentage)

Efficiency indicator hiked compared to the previous year due to almost similar levels in operating expenses and substantial rise in income.

- **BANKING SYSTEM CAPITAL ADEQUACY RATIO**

Capital adequacy ratio remains at satisfactory levels. System's shareholder equity increased by ALL 8.29 billion, to ALL 93.1 billion as at December 2010. The shareholder equity to liabilities was 9.4%, down by 0.2% year-on-year. Financial leverage ratio increased only by 0.2%, to 10.6%, indicating sustainable reliance on same debt levels for two consecutive years.

Table 7 Banking system capital adequacy ratio

| Indicators                            | December '06 | December '07 | December '08 | December '09 | December '10 |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Capital adequacy ratio, in percentage | 18           | 17.1         | 17.2         | 16.2         | 15.4         |

Source: Bank of Albania

At end-2010, the Albanian banking system was considered well capitalised in terms of solvency. Capital adequacy ratio was 15.4%, about 0.8 percentage points lower than figures of June 2009. The minimum regulatory capital requirement is 12%. In spite of banks' good capitalisation levels, capital requirements for individual banks need to be monitored prudentially.

Stress-test analyses show that the banking system, overall, remains resilient to various shocks. However, individual banks' sensitivity to these shocks increased. For that reason, banks should assess their resilience to similar scenarios and should be encouraged to constantly strengthen their capital stock and control operational risks at best.

Credit risk remains the banking sector's primary risk. In response to the credit risk situation, the banking system has established its provisions to cover potential losses. At end-2010, provisions for covering residents credit risk surged to ALL 36.1 billion, about 33% higher than at end-2009. Provision to non-performing loan ratio was 52.7%, above from the 49.9% three-year average. Provision to total outstanding loan ratio rose to 7.4%, from 5.4% a year earlier. In addition, the non-performing loan portfolio collateral coverage was 79.3% of the loan portfolio, from 78% six months earlier.

#### VI.1.2. NON-BANK FINANCIAL SYSTEM HIGHLIGHTS

- *NON-BANK FINANCIAL INSTITUTIONS*<sup>3</sup>

Seventeen non-bank financial institutions currently operate in Albania, compared to twelve registered a year earlier. According to their activities licensed by the Bank of Albania, these institutions are classified as follows:

- Lending financial institutions;
- Leasing financial institutions;
- Payments services and money transfer financial institutions;
- Microcredit financial institutions;
- Factoring financial institutions.

Non-bank financial institutions performed positively in terms of growth of assets, loan portfolio and financial profit. In September 2010, these institutions accounted for ALL 30.8 billion or 3.1% to the banking system total assets. Compared to December 2009, these institutions recorded a growth of 23.2%, leading to increase of their specific share to the banking system total assets by 0.3 percentage points.

During 2010 Q3, non-bank financial institutions loan portfolio's gross value was ALL 18.5 billion, accounting for 3.8% of the total loan portfolio of the system. Compared to 2009, the portfolio increased to 29.9%. Lending institutions (60.0%), followed by leasing institutions (38.8%) are the largest contributors to their share to the total loan portfolio. During 2010, these institutions' loan portfolio highlighted increased non-performing loans to total loans, to 5.6% against 3.4% as at December 2009.

Non-bank financial institutions' net profit was positive, albeit lower than in 2009. A determining factor to this slowdown was the reduction in income from non-bank financial institutions and increase in their provision expenses.

<sup>3</sup> Non-bank financial institutions data refer to the period up to 2010 Q3.

- SAVINGS AND LOAN ASSOCIATIONS AND THEIR UNIONS

Savings and Loan Associations (SLAs) are grouped in two unions, namely: The Albanian Savings and Loan Union (ASLU) and Jehona Union. The unions account for about 0.5% of the system's total assets. In December 2010, the unions' total assets were ALL 4,614 million with an annual growth rate of 16.8%. The network of SLAs<sup>4</sup> posted a total volume of assets of ALL 5,091 million, up 5.8% compared to 2009. At system level, the SLAs network accounts for 0.5% of total assets. Most of the unions and the SLAs network is lending-oriented.

Loan portfolio of the unions and SLAs network accounted for 0.5% and 0.9%, respectively, to total banking system loans. The loan portfolio quality is assessed as positive for both the unions and the SLAs network. The majority of the loan portfolio consists of "standard" loans, 98.8% for the unions and 95.8% for the SLAs portfolio. The unions' net profit improved during 2010, whereas SLAs network, albeit a positive financial position, had a downward performance compared to end-2009.

### VI.1.3. CREDIT REGISTER

Year 2010 may be considered an eventful year for the Credit Register's performance and functioning. At end-2010, which marked the Register's third anniversary, data were reported for almost all the borrowers in the Republic of Albania. The latest records show about 540.000 reported loans in total, of which 260.000 are active loans.

During 2010, the aim was to include non-bank lending institutions as data reporters to the Credit Register. Since November 2010, five new entities have been added as reporters to the Credit Register to the existing banks and branches of foreign banks. More specifically, they were:

- Fondi Besa sh.a.;
- Opportunity Albania sh.a;
- Vision Fund Albania sh.p.k;
- SLAs Union Jehona;
- Albanian Union of SLAs Unioni Shqiptar i Kursim-Kreditit.

This inclusion was coupled with the revision of the relevant regulatory framework. Furthermore, five regional branches of the Bank of Albania were also included in this process, as a new development to assist persons residing in remote areas outside Tirana. The information generated by the Credit Register serves also to the Bank of Albania for its on-site and off-site examination, contributing to a risk-oriented supervision.

<sup>4</sup> SLAs network refers to the total SLAs of both unions: Jehona Union and ASLU Union.

VI.1.4. NON-CREDIT RISK CONDITION AND SUPERVISION

Upon entry into force of the BoA’s organisational changes, supervision focus and strategy were re-conceptualised in accordance with the banking and financial system risks.

Besides the credit risk that deserves due attention during supervision, a series of other risks, followed and supervised equally strictly by the Bank of Albania, are present in the system.

• SUPERVISION OF LIQUIDITY AND MARKET RISKS

The end-2008 events in international financial markets, manifested in the Albanian financial system in the loss of public confidence in the banking

system and subsequent deposits outflow, led to the need for intensified monitoring of the situation and a timely reaction by the Bank of Albania. In this regard, frequent and detailed analysis were conducted daily, weekly, or monthly, based on a new information packet. This periodic information provides for an assessment of banks liquidity situation both on individual and system basis.

During 2010, the system’s liquidity seemed improved, especially with regard to foreign currency liquidity, which had been a problem for most of the banks during 2009. As of April 2009<sup>5</sup>, deposits have continued to show even higher growth rates in 2010.

Credit to deposit ratio is an important indicator, which may be used to assess banking system liquidity.

At end-2010, this indicator was at 60%, down by 5 percentage points year-on-year. The improvement in the indicator was due to lower credit growth rate (9%) compared to deposit growth rate (18%). Credit to deposit ratio in foreign currency was at 86%, down by about 13 percentage points year-on-year. Credit to deposit ratio in lek was 35%, generally stable throughout the year.

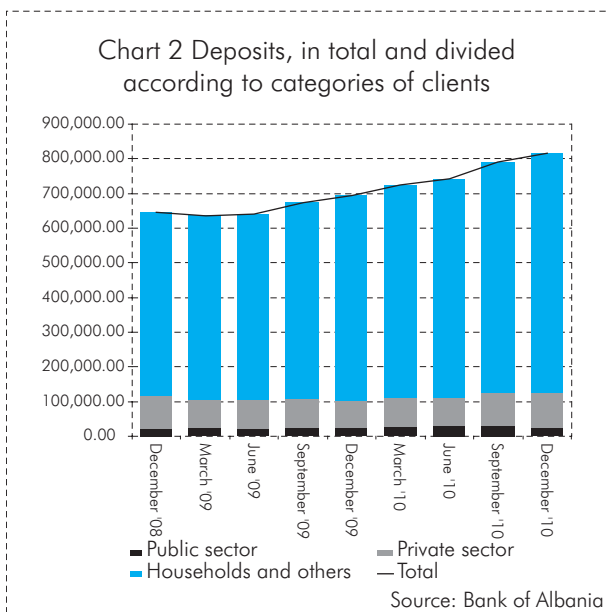


Table 8 Credit to deposit ratio, over the years, in percentage

| Year | Lek | Foreign Currency | All currencies |
|------|-----|------------------|----------------|
| 2006 | 17  | 70               | 38             |
| 2007 | 22  | 79               | 46             |
| 2008 | 30  | 104              | 62             |
| 2009 | 36  | 99               | 65             |
| 2010 | 35  | 86               | 60             |

Source: Bank of Albania

Entry into force of the new Regulation “On liquidity risk management”, in December 2009 changed the definition of liquid assets, making them more

<sup>5</sup> At this time, deposits began to return to the system.

conservative. This Regulation led to the entry into force of a 20% regulatory limit (for all currencies) for liquid assets to short-term liabilities, up to a year. During 2010, this ratio was relatively stable. In December 2010, it was at 30.6%, of which 42.9% in lek, 15.6% in euro and 23.9% in US dollars.

Concerning the foreign exchange risk, at the end of December 2010, the system's net open position in buying and in relative terms accounted for 5% of the banks regulatory capital. With the entry into force of the Regulation "On open foreign exchange positions", in August 2010, the calculation methodology for foreign exchange open positions also changed<sup>6</sup>.

The required capital to cover market risks was, in relative terms, 2.1% of the regulatory capital at end-2010. The overall rate for covering the systemic, markets and credit risks with capital was 126.5% compared to the regulatory rate of 100%.

Operational risk assessment through a stress-test analysis shows a moderate influence of the direct foreign exchange risk, due to low levels of banking system open foreign exchange position. As regards the interest rate risk, the difference between assets and liabilities sensitive to interest rate indicates a low risk to interest rate fluctuations for a three-month maturity term. The risk is more eminent for longer-term maturity. Nevertheless, stress-test analyses show that the influence of this risk on banking system adequacy is moderate.

In relation to the liquidity risk, liquid assets to short-term liabilities (maturity term up to a year) resulted 30.6%, against 32.6% a year earlier. The minimum value of this ratio as stipulated in the regulatory framework is 20%. The differences between assets and liabilities according to time maturity structures<sup>7</sup>, both for balance items and off-balance items, result in negative values. However, these values are covered in multiple times by the liquid asset value, demonstrating a full capacity for liability payment as they fall due. Nonetheless, credit to deposit ratio is expected to increase again during the resurgence of banks' lending. Another form of administration of short-term liquidity needs is borrowing in the interbank market or from the Bank of Albania. This is generally a collateralised borrowing and the type and adequacy of assets that may serve as collateral in this case are other elements that need to be monitored for assessing banks capacity to satisfy their needs for short-term liquidity.

#### VI.1.5. COMPLIANCE, TRANSPARENCY AND ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM (AML/CFT)

Anti-money laundering, transparency and compliance with supervision norms were an important part of supervision during 2010. In this regard,

<sup>6</sup> Some of the off-balance items are not taken into account for the calculation of open foreign exchange position, while the total position is calculated as the absolute maximum value of positions in various currencies, in order to avoid neutralisation of opposite positions in various currencies.

<sup>7</sup> Supposing keeping assets and liabilities to their maturity date.

general examinations were conducted in two banks and four non-bank institutions as well as two targeted examinations.

In view of cooperating with the Directorate General of Anti-money Laundering, it was quarterly reported in accordance with the implementation plan of the strategy document "On financial crime investigation" approved by the Decision of the Council of Ministers, No. 1077, dated 27.10.2009 as well as an annual report on the enforcement of this document.

- *COMPLIANCE WITH SUPERVISORY NORMS*

During 2010, banks' capital requirement, exposure to significant risks, liquidity risk, etc., were at the core of the periodic analysis on compliance of banks and non-bank institutions with regulatory supervisory standards. The analysis revealed that the banking sector continued to be well capitalised, despite a few cases of a decline in banks' regulatory capital levels.

Overall, non-bank institutions complied with regulatory indicators. All these institutions had adequate capital. Some non-bank financial institutions failed to comply with the regulatory permissible norms on open foreign currency positions.

- *ANTI-MONEY LAUNDERING*

In 2010 on-site examinations and off-site periodic examinations on AML/CFT at banks and non-bank financial institutions revealed that institutions took measures for improvement, mainly, to:

- Establish necessary structures and infrastructure on anti-money laundering and combating the financing of terrorism;
- Draft internal regulations, which take into account the risk of money laundering and financing of terrorism by compiling a "Know Your Client" policy, with issues related to the implementation of "Expanded due diligence";
- Develop systems, which daily generate all cash transactions of over ALL 1.5 mln and non-cash transactions of over ALL 6 mln in addition to specific modules that function according to risk definition variables or a centralised data collection system.

During 2010, recommendations in accordance with problems identified by the Bank of Albania examinations generally consisted in implementing programmes that enable risk perception by business activity, turnover, etc.; strengthening the due diligence to client; reporting the suspicious activity in quantitative indicators (low number of Suspicious Activity Reports (SARs)) and qualitative ones (typology analysis), etc.

The Bank of Albania, with regard to increasing the number of SARs, has suggested the establishment of a broader structure of communication between the Responsible Authority and the Supervisory Authority. This should

be intensified in the future with concrete joint examinations on categorisation, identification of suspicious transactions and activities, as well as on training institutions' staff to enhance their awareness and professionalism for identifying suspicious activities.

- *TRANSPARENCY TO THE PUBLIC*

Transparency and publication of information on banking and financial products, accurately and timely, by banks and non-bank institutions were at the core of supervision for 2010. This was reflected through off-site periodic analyses and on-site examinations. The dynamics was guided by the financial system developments and problems evidenced during the reporting period.

Overall, institutions reacted to the Bank of Albania's recommendations or requirements to establish a transparent and more efficient banking market. These recommendations, related also to transparency assessment, are a consequence of on-site examinations findings and client complaints during 2010. The issues mainly refer to information disclosure at bank premises, calculation methodology for the effective interest rate (EIR), changes to the calculation interest rates methodology by banks, the language used in the content of loan contracts, etc.

High commission fees applied for banking products and services were a sensitive issue in the past year, which will also be primary for the upcoming periods. This phenomenon was the subject of an open discussion of the Bank of Albania, which addressed the banks and the Albanian Association of Banks on this topic, mainly concerning the methodology for setting commission fees and their comparison with the countries in the region. Such communications originate from thorough analyses by the Bank of Albania on the matter.

Regarding non-bank financial institutions, satisfactory efforts are observed for compliance with relevant Bank of Albania's regulatory requirements. Improvements are also noticed in the framework of public information disclosure. The number of banks without a web page is reduced and the quality of published information has increased.

#### VI.1.6. SUPERVISION OF OPERATIONAL RISK

Materialisation of this risk category in the supervision carried out by the Bank of Albania was a necessity arising from recommendations of the New Basel Capital Accord (BASEL II) and best international practices.

In 2010, regulatory foundations were laid through drafting a regulation "On minimum standards for operational risk management" and a periodic reporting framework with banks data on this risk category.

Furthermore, in mid 2010, a number of targeted examinations were carried out to see more concretely and closer the status of the main banks in

the system as regards operational risk management. The results demonstrate that the majority of banks have well-defined organisational structures and approved policies at senior management level concerning operational risk management. Most of the banks use also quantitative self-assessment, as an important tool in the context of operational risk. Many banks have started to identify data on operational loss, although some of them are still at the formatting stage.

- *INFORMATION AND COMMUNICATIONS TECHNOLOGY*

As regards the banking system information and communications technology, during 2010, the banks upgraded their basic banking softwares. During this time, four banks changed and applied new banking software. At system level, there are improvements or developments of the banking software in use.

## VI.2. ON-SITE EXAMINATION

In 2010, the Supervision Department of the Bank of Albania was reorganised aiming at integrating the horizontal perspective of the banking system (credit – non-credit sectors) with the vertical perspective for each bank (portfolio managers).

During 2010, 3 full and 3 partial examinations on commercial banks and 4 full examinations on non-bank institutions were carried out.

### VI.2.1. BANK EXAMINATIONS

The banking system continued, in 2010, to demonstrate the effects of crediting expansion from previous years, also influenced by the economic growth slowdown in the past two years. During full and partial examinations, special attention was paid first to the loan portfolio quality and practices pursued by the banks to monitor and follow-up overdue loans, as well as measures for their re-payment. Special importance is given to the bank transparency to clients in the lending process, for a complete disclosure of information on loan terms and conditions. Main shortcomings were identified on a correct classification of loans and bank provisioning inadequacy. Main breaches of the regulatory and legal framework were identified on:

- Regulation “On large exposures.” An excess of maximum permissible limit of 10% to the regulatory capital for shareholders and the limit of 20% of the regulatory capital for a beneficiary was identified;
- Regulation “On credit risk management” about the correct classification of credits and inadequacy of reserve funds. Examinations requested the establishment of additional funds for provisions in amounts that vary according to banks;
- Regulation “On capital adequacy”. Increase of required provisions by

examination teams affected a recalculation of the capital adequacy ratio, leading to lower-value indicators. In addition, a lower influence was also exercised from other elements such as categorisation of assets according to risk classes;

- Regulation "On transparency for banking and financial products and services." The identified cases relate to the absence of some elements in the credit and deposit contracts envisaged in the regulation, lack of information clarity in promotional materials, calculation of the effective interest rate, changes to the credit interest rates, etc;
- Regulation "On foreign exchange", regarding transfers and the relevant supporting documentation;
- Regulation "On liquidity risk management" regarding compliance with liquidity indicator limits and design of stress-test scenarios;
- Regulation "On use of information and communications technology in subjects licensed by the Bank of Albania". Identified cases refer to the method of creating user profiles, not always based on the job description for that position and, in some cases, circumvents the four-eyes principle. In addition, deficiencies are noted on risk and its documentation, ICT service assessment, plan for work continuation and back-up in case of a disaster, etc. Some banks, during the year, were in the process of improving/changing their banking software. In these cases, it was recommended that, during implementation, measures be taken to observe all requirements of the relevant Regulation.
- Regulation "On functioning of the Credit Register at the Bank of Albania" about the provision of prior consent that needs to be signed by the client, accuracy of the information reported by files, etc.;
- Law "On Anti-Money Laundering" on the physical presence of clients at a bank.

#### VI.2.2. NON-BANK INSTITUTIONS EXAMINATIONS

Examinations conducted in 2010 on non-bank institutions focused on the assessment of their crediting and their action on credit risk management. Other areas of importance included compliance, money laundering, transparency and ICT. Among the main problems identified, we may list the following:

- Worsening the loan portfolio situation for lending institutions. In this context, strengthening of structures responsible for follow-up and collection of credits was recommended;
- Non-complying with the internal regulatory framework. Problems appear mainly with regard to compliance with the set limit and approval of transactions by the Steering Council, their ongoing monitoring, restructuring process, portfolio classification, relevant provision levels and blocking of collateral. Moreover, institutions need to review and update lending manuals, in compliance with regulatory requirements of the Bank of Albania;
- Breaching the regulatory limitations on open foreign exchange positions. Institutions were required to present their methodologies

and suitable solutions for compliance with the regulatory norms on open foreign exchange positions.

- Incomplete transparency on preliminary information on credit terms and conditions, including, among other things, the nominal annual interest rate; incomplete information on foreign currency borrowing risk, calculation conditions and changes to the interest rate as well as methodologies used for their calculation. Deficiencies were identified also during calculation, disclosure and reporting of the effective interest rate and drafting contracts content with the requirement components as defined in the Regulation “On transparency for banking and financial products and services” of the Bank of Albania;
- Exceeding the permissible limits on large exposures. For the identified cases, measures were required to bring the exposure within the norms;
- Failure to comply with Regulation “On supervisory standards of non-bank financial institutions”;
- Deficiencies in the implementation of the law “On accounting and financial statements”;
- Expanding the scope of control of the Internal Audit with verification of compliance with requirements laid down in the legal and sub-legal acts of the Bank of Albania;
- Using the ICT; Institutions were requested to draft policies, procedures and technological standards in line with regulatory requirements of the Bank of Albania.

### VI.3. LICENCING AND REGULATORY FRAMEWORK

#### VI.3.1. LICENCING

In 2010, as part of banking supervision, a considerable number of practices were handled for new licences, revocation of licences, preliminary approvals, notifications, etc. This process consisted mainly in:

- Preliminary approvals for additional activities in the bank licence annex. Banks, in view of implementation of their strategies to expand activities, besides new branches and agencies, request additional activities not included in the licences annex as well as new banking products. In 2010, the Bank of Albania granted its approval for additional activities to seven banks. These activities consist in the following activities:
  - a) Factoring and financing of commercial transactions;
  - b) Trading of transferable securities, other negotiable instruments and financial assets, including transactions in gold;
  - c) Issuing all types of securities, including signing, establishment as an agent (both public and private) and conduct of services related to these issuances;
  - d) Intermediation for monetary transactions for compensation and administration of assets such as money and portfolio management,

- funds administration, custody, deposit and trust services;
- e) Services for compensation and settlement of payments of financial assets, including securities, derivative and other negotiable products, etc.

Table 9 Bank network at end-2009

| No. | Banks   | No. of branches in country | No. of agencies | No. of branches abroad | No. of branches and agencies |
|-----|---|----------------------------|-----------------|------------------------|------------------------------|
| 1   | Raiffeisen Bank                               | 102                        |                 |                        | 102                          |
| 2   | National Commercial Bank (BKT)                | 27                         | 29              | 2                      | 58                           |
| 3   | United Bank of Albania                        | 4                          | 2               |                        | 6                            |
| 4   | Veneto Bank (former Italian Development Bank) | 8                          |                 |                        | 8                            |
| 5   | Tirana Bank                                   | 43                         | 4               |                        | 47                           |
| 6   | National Bank of Greece Branch (NBG)          | 5                          | 25              |                        | 30                           |
| 7   | International Commercial Bank                 | 8                          |                 |                        | 8                            |
| 8   | Alfa Bank Branch                              | 48                         |                 |                        | 48                           |
| 9   | Intesa Sanpaolo Bank, Albania                 | 19                         | 14              | 4                      | 37                           |
| 10  | ProCredit Bank                                | 30                         | 15              |                        | 45                           |
| 11  | Emporiki Bank                                 | 13                         | 10              |                        | 23                           |
| 12  | Credit Bank of Albania                        | 1                          | 2               |                        | 3                            |
| 13  | Credins Bank                                  | 27                         | 6               |                        | 33                           |
| 14  | Banka Popullore                               | 42                         |                 |                        | 42                           |
| 15  | Union Bank                                    | 15                         | 16              |                        | 31                           |
| 16  | First Investment Bank                         | 5                          | 4               |                        | 9                            |
|     | T O T A L                                     | 398                        | 126             | 6                      | 530                          |

Source: Bank of Albania

- Approval of the request of three banks to use their e-banking products, such as internet banking, sms banking, electronic bank cards, ATMs and POSs services.
- Approval for changes in the shareholders structure for banks and non-bank financial institutions.

Table 10 Bank network at end-2010

| No. | Banks  | No. of branches in country | No. of agencies | No. of branches abroad | No. of branches and agencies |
|-----|--|----------------------------|-----------------|------------------------|------------------------------|
| 1   | Raiffeisen Bank  | 103                        |                 |                        | 103                          |
| 2   | National Commercial Bank (BKT)                         | 27                         | 31              | 1*                     | 59                           |
| 3   | United Bank of Albania                                 | 4                          | 2               |                        | 6                            |
| 4   | Veneto Bank (former Italian Development Bank)          | 8                          |                 |                        | 8                            |
| 5   | Tirana Bank  | 49                         | 3               |                        | 52                           |
| 6   | National Bank of Greece Branch (NBG)                   | 5                          | 25              |                        | 30                           |
| 7   | International Commercial Bank                          | 9                          |                 |                        | 9                            |
| 8   | Alfa Bank Branch                                       | 48                         |                 |                        | 48                           |
| 9   | Intesa Sanpaolo Bank, Albania                          | 17                         | 14              | 1                      | 32                           |
| 10  | ProCredit Bank   | 25                         | 17              |                        | 42                           |
| 11  | Emporiki Bank  | 13                         | 11              |                        | 24                           |
| 12  | Credit Bank of Albania                                 | 1                          | 2               |                        | 3                            |
| 13  | Credins Bank   | 28                         | 6               |                        | 34                           |
| 14  | Societe Generale Albania Bank (former Banka Popullore) | 42                         |                 |                        | 42                           |
| 15  | Union Bank   | 15                         | 15              |                        | 30                           |
| 16  | First Investment Bank                                  | 5                          | 4               |                        | 9                            |
|     | T O T A L  | 399                        | 130             | 2                      | 531                          |

\*) Number of National Commercial Bank branches was verified and revised. Namely, the National Commercial Bank has one branch in the Republic of Kosovo, which operates through 15 units all over the territory of Kosovo.

Source: Bank of Albania

- Preliminary approvals for the expansion of the banks network. Network expansion of the banks' branches and agencies continued in 2010. More specifically, 23 bank branches and agencies opened and started their activity while during this year banks reported the closure of 21 branches, following their network reorganisation. At the end of the year, the total number of branches and agencies in country and abroad was 531<sup>8</sup> from 530 at end-2009.
- Approval of 53 requests for the approval of administrators appointed by the banks and non-bank financial institutions, pursuant to the Law "On Banks in the Republic of Albania". These preliminary approvals of administrators consist in:
  - Appointment of administrators due to developments in the organisational structures of banks, parallel reassignment or new appointments;
  - New posts as a result of the establishment of new structures in the bank;
  - New appointments as a result of appointment of shareholders representatives in managing positions.

These cases of approvals of bank administrators include 12 approvals for bank steering council members, 5 for control committee members, 6 for general/executive directors, 2 for deputy general directors, 28 for head of department/division/directorate.

At end-2010, there were 16 banks operating in the Republic of Albania, two of which are branches of foreign banks. During the past year, there were no applications for new bank licences.

- Establishment and licensing of non-bank financial institutions. The Bank of Albania granted four new licences to non-bank financial institutions in response to their application for financial activities (such as crediting, leasing, microcrediting, and factoring) as well as in compliance with regulatory provisions. In the meanwhile, there is a tendency to establish financial institutions that provide payments and money transfer services through mobile telephony.
- Granting and revoking licences for foreign exchange bureaux. In 2010, 66 new licences for foreign exchange bureaux were granted and three were revoked. Furthermore, pursuant to the Regulation "On licensing, organisation, activity and supervision of foreign exchange bureaux" additional activities were approved for 52 foreign exchange bureaux that operate as money transfer agents on behalf of a non-bank financial institution. At end-2010, there were 284 bureaux operating in the foreign exchange market.
- Granting and revocation of licences for savings and loan associations.

<sup>8</sup> After verification and revision of the number of branches abroad, going down from 2 to 1 branch of the National Commercial Bank for 2010, the total number of bank branches and agencies operating in Albania and abroad at the end of 2010 is 531.

During 2010, four new savings and loan associations were licensed and 13 licences were revoked, following merger with an existing association, totalling 126 savings and loan association and two savings and loan associations unions.

- Pursuant to the Regulation “On licensing and activity of non-bank financial institutions”, approved by Decision No 11, dated 25.02.2009 of the Supervisory Council of the Bank of Albania, the process continued for the approval of agents that operate on behalf of a non-bank financial institution, licensed by the Bank of Albania. Namely, 102 agents were approved to transfer money on behalf of non-bank financial institutions.

Table 11 Subjects licensed by the Bank of Albania.

| No | Subjects                                | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|----|---|------|------|------|------|------|------|------|------|------|
| 1  | Banks and branches of foreign banks     | 14   | 15   | 16   | 17   | 17   | 18   | 16   | 16   | 16   |
| 2  | Non-bank financial institutions         | 5    | 7    | 7    | 7    | 6    | 6    | 7    | 13   | 17   |
| 3  | Foreign Exchange Bureaux                | 58   | 58   | 54   | 58   | 60   | 112  | 189  | 221  | 284  |
| 4  | Savings and Loan Associations           | 113  | 131  | 130  | 131  | 125  | 130  | 133  | 135  | 126  |
| 5  | Unions of Savings and Loan Associations | 2    | 2    | 2    | 2    | 2    | 2    | 2    | 2    | 2    |

Source: Bank of Albania

### VI.3.2. REGULATORY FRAMEWORK

Year 2010 witnessed the finalisation of a number of new regulations and amendments to some existing regulations on banking supervision. This process has continually focused on approximation with Basel Committee standards and European Union directives, taking into consideration best practices in the field of regulation and development of the Albanian banking system.

New regulatory acts and significant amendments to existing acts on banking supervision approved during this year are:

- Regulation “On risk management in the activity of non-bank financial institutions”, which sets out risk management rules in the activity of non-bank financial institutions, particularly on risk management in the activity of microcrediting and leasing financial institutions.
- Regulation “On defining the decision-making level in the supervision of banking and financial activities”, which lays down the level of competencies by managing bodies of the Bank of Albania in the decision-making process as regards its supervisory functions.
- Regulation “On management of risk from open foreign currency positions”, which sets out the rules and criteria for calculating, supervising and reporting open foreign currency positions of a bank, for foreign exchange risk management.
- Guidelines “On conservatorship and liquidation of banks”, which sets out the procedures and actions for the realisation of conservatorship and insolvency, in the framework of the actions of the authority in the cases of putting in conservatorship/liquidation of a bank or branch of

- a foreign bank.
- Additions and amendments were made respectively to the following:
  - Regulation “On supervision of savings and loan associations and their unions”, waiving the limit on a credit granted for over three years and limit the credit of over five years in relation to given amounts of capital, deposits or liabilities, while providing space for long-term crediting, in order to encourage investment crediting;
  - Regulation “On administration of risk from large exposures of banks”, to ease the measures taken by the authority during the global financial crisis on concentration risk management;
  - Regulation “On capital adequacy ratio” and an amendment to the Regulation “On risk management in the activity of non-bank financial institutions”, referring to the list of OECD countries applicable in counterparties against which banks and non-bank financial institutions are exposed.



