



**BANK OF ALBANIA'S MONETARY POLICY
INSTRUMENTS AND PROCEDURES FOR THEIR
EXECUTION**



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I. THE OPERATIONAL FRAMEWORK OF BANK OF ALBANIA

1.1. MONETARY POLICY OF BANK OF ALBANIA

The objective of monetary policy carried out by Bank of Albania is to attain and maintain price stability. In order to achieve this objective, which is presently defined as an annual inflation rate of 2 to 4 percent, Bank of Albania attempts to control the money supply. The latter is thought to have a stable relationship with the final objective of inflation.

Since Bank of Albania does not have full control over the money supply, it tries to influence the money supply components through manipulating the market interest rates. The market interest rates, among other things, influence commercial banks' loan and deposit interest rates.

1.2. MONETARY POLICY INSTRUMENTS

Bank of Albania has available a set of instruments that allow it to influence the market interest rate. These instruments include: open market operations, standing facilities and minimum reserves that commercial banks hold in their accounts with Bank of Albania.

1.2.1. OPEN MARKET OPERATIONS

Open market operations, which are initiated by Bank of Albania, consist of treasury bills transactions between Bank of Albania and commercial banks. These operations aim at changing the liquidity situation in the market and, as a consequence, changing the short term interest rates. The following are the open market operations employed

by Bank of Albania: repurchase agreements (known as REPO) and reverse repurchase agreements (known as collateralised loans), as well as outright transactions. With regard to their aim, regularity and procedures, repurchase agreements and reverse repurchase agreements are considered as transactions with a temporary effect, while outright transactions are considered as transactions with a permanent effect.

Outright transactions take the simplest form of open market operations. These operations consist of selling or buying treasury bills. The purchase of treasury bills by Bank of Albania injects liquidity in the market, while their selling absorbs liquidity.

Repurchase agreements (REPOs) and reverse repurchase agreements are the most frequent open market operations employed by central banks. Repurchase agreements imply the selling of treasury bills by Bank of Albania to the commercial banks, accompanied by Bank of Albania's obligation to repurchase the treasury bills on a pre-specified date and with a pre-specified price. The central bank's sale of

treasury bills is equivalent to a commercial bank's deposit placement with the central bank. On the other hand, reverse repurchase agreements imply Bank of Albania's purchase of treasury bills from a commercial bank, accompanied by the latter's obligation to repurchase the treasury bills on a pre-specified date and with a pre-specified price. Central bank's purchase of treasury bills is equivalent to a collateralised loan that it grants to the commercial banks.

Open market operations are executed on the basis of three procedures: standard auctions, quick auctions and bilateral procedures. Repurchase agreements and reverse repurchase agreements are carried out by auctions that have weekly frequency and a maturity of one week. These operations are executed by Bank of Albania on the basis of standard auctions. Repurchase agreements and reverse repurchase agreements play a pivotal role in pursuing the purposes of open money markets by withdrawing or injecting liquidity in the market. Reverse repurchase agreements are also known as collateralised loans.

The repurchase agreement fixed interest rate is determined by the Supervisory Council of Bank of Albania and is subject to periodical revisions. REPO rates serve as a reference to all money market instrument rates.

Repurchase agreements and reverse repurchase agreements with a maturity of one day, one month, and three months are executed through quick auctions. These operations are part of Bank of Albania's fine-tuning operations and help in managing the liquidity situation in the market, as well as interest rates.

In addition, Bank of Albania carries out structural operations through outright transactions. These transactions are initiated by Bank of Albania and are executed through quick auctions and bilateral procedures. The effect of these transactions on liquidity is permanent.

1.2.2. STANDING FACILITIES

Standing facilities aim at, temporarily, providing and absorbing liquidity for a

period of one day up to three months. These instruments signal the monetary policy stance and steer money market interest rates. Standing facilities include overnight deposits, overnight loans and Lombard loan, and are initiated by commercial banks in order to fulfil their liquidity needs (see Table 1).

Commercial banks use overnight deposit in order to place their excessive liquidity in an overnight deposit with Bank of Albania. Under normal circumstances, there are no deposit limits or other restrictions to the commercial banks' access to this facility. The interest rate on the deposit facility is currently 2.5 percent lower than the REPO rate and serves as a floor to the overnight market interest rates.

Commercial banks use the overnight loan in order to obtain overnight liquidity from Bank of Albania against eligible assets. Under normal circumstances, there are no credit limits or other restrictions on commercial banks' access to the facility, apart from the requirement to present sufficient

Table 1. Bank of Albania's monetary policy operations' framework

Monetary Policy instruments	Types of transactions		Maturity	Frequency	Procedure
	Provision of liquidity	Absorption of liquidity			
Open market operations					
Repurchase agreement and reverse repurchase agreements auction	Reverse Repo	Repo	Seven days	Weekly	Standard auction
Repurchase agreement and reverse repurchase agreements auction	Reverse Repo	Repo	One day	Daily	Quick auction
Repurchase agreement and reverse repurchase agreements auction	Reverse Repo	Repo	One month	Monthly	Quick auction
Repurchase agreement and reverse repurchase agreements auction	Reverse Repo	Repo	Three months	Quarterly	Quick auction
5. Treasury bills outright transactions	Outright transaction	Outright transaction		Non-regular	Bilateral procedure Quick auction
Standing facilities					
Lombard loan	Collateralised loan		Up to three months	Non-regular	Bilateral procedure
Overnight loan	Collateralised loan		One day	Access at the discretion of commercial banks	
Overnight deposit		Deposit	One day	Access at the discretion of commercial banks	

underlying assets. The interest rate on the overnight loan facility is currently 2.5 percent higher than the fixed REPO rate and serves as a ceiling for the overnight market interest rates.

Commercial banks use Lombard loan in order to obtain excess liquidity for a period up to three months against eligible assets. The interest rate on Lombard loan uses REPO rate as a reference and serves as the highest interest rate in the market.

1.2.3. MINIMUM RESERVES

The minimum reserve requirement consists of the lek or foreign currency funds that commercial banks should keep in their accounts with Bank of Albania. The minimum reserve system pursues the aims of stabilizing money market interest rates and creating liquidity shortages. The reserve requirement of each commercial bank is determined in relation to the elements of its balance sheet. In order to pursue the aim of stabilising interest rates, the minimum reserve system enables institutions to make use of averaging provisions. Compliance

with the reserve requirement is checked on a daily basis in order to assure that it is within the determined levels. Bank of Albania pays interest on the minimum reserves that commercial banks hold with Bank of Albania.

1.3. COUNTERPARTIES

Based on the regulation framework of the functioning of indirect monetary policy instruments, counterparties to the open market operations, standing facilities and minimum reserves, are only commercial banks that hold a minimum reserve with Bank of Albania.

1.4. UNDERLYING ASSETS

Bank of Albania's credit operations (i.e. liquidity-providing operations) have to be based on adequate collateral. Bank of Albania accepts marketable government treasury bills and easily convertible deposits as assets underlying its loans. In the case of reverse repurchase agreements only treasury bills are used as underlying assets.

1.5. MODIFICATION OF THE INSTRUMENTS

The Supervisory Council of Bank of Albania may, at any time, in accordance with the latest developments in the money market, change the instruments, conditions, criteria

and procedures for the execution of the monetary policy operations.

The following is a more detailed description of each of the instruments that Bank of Albania employs in order to execute its monetary policy.

II. OPEN MARKET OPERATIONS

Open market operations involve the selling and buying of treasury bills in the market by Bank of Albania. They play the most important role in transmitting the monetary policy stance to the banking system. They aim at steering interest rates, managing the liquidity situation in the market and signalling the banking system as to Bank of Albania's stance on the monetary policy. With regard to open market operation, Bank of Albania exclusively determines the type of instrument to be used, as well as the respective conditions of their execution.

According to their purpose, open market operations are divided into the following categories: *primary market operations*, *fine-tuning operations* and *structural operations*. As for the instruments used, repurchase agreements are the main open market instrument and can be employed in all three aforementioned operations, whereas outright transactions

are used for structural and fine-tuning purposes only.

2.1. REPURCHASE AGREEMENTS

a. *Type of instrument*

Repurchase agreements are open market operations where Bank of Albania sells treasury bills to the commercial banks and repurchases them on a pre-specified date following the terms of the agreement. Reverse repurchase agreements are open market operations where Bank of Albania buys treasury bills and sells them back on a pre-specified date following the terms of the agreement.

b. *Legal nature of the instrument*

Treasury bills that are traded during (reverse) repurchase agreements have, initially, been bought by Bank of Albania

and the commercial banks in the primary or secondary treasury bill market.

Reverse repurchase agreements are considered collateralised loans, where the value of the underlying asset must be 115% of the auction bid amount. The latter should be, at least, 5 million leks and it can be increased only in multiples of 100 thousand leks. Treasury bills, with a maturity of one year and no less than 14 days left to maturity, serve as underlying assets.

2.1.1. PRIMARY MARKET OPERATION

The primary market operation is the (reverse) repurchase agreement with a maturity of one week, which is also Bank of Albania's most important instrument for the application of monetary policy. The purpose of its employment is to steer market interest rates, manage the liquidity situation and signal the stance of monetary policy. The main features of the (reverse) repurchase agreements can be summarized as follows:

- They are auctions with a fixed offered amount and variable prices or fixed price auctions with no pre-specified offered amount.
- The fixed interest rate of the (reverse) repurchase agreements is determined by the Board of Directors of Bank of Albania. This interest rate acts as a floor or ceiling rate for variable price auctions.
- The repurchase agreements are employed to withdraw liquidity from the banking system, while the reverse repurchase agreements are employed to inject liquidity in the system.
- The auctions for these types of agreements are executed every week and are of the standard type.
- This instrument has a maturity of seven days.
- Commercial banks that have an account with Bank of Albania have the right to submit auction bids.

2.1.2. STRUCTURAL OPERATIONS

The instruments employed in open market structural operations are (reverse) repurchase agreements with a maturity of one month and three months, as well as outright transactions¹. The purpose of their employment is to adjust structural positions and manage the liquidity situation (temporary augmentation or decrease). The features of the (reverse) repurchase agreements with a maturity of one month and three months can be summarised as follows:

- They are executed through quick auctions with no pre-specified auction date.
- The interest rate for these agreements employs the market interest rate at the time of the auction as a reference.
- Bank of Albania reserves the right to decline bids whose rates differ substantially from the actual rates in the money market.

- Commercial banks that have an account with Bank of Albania have the right to submit auction bids.

2.1.3. FINE-TUNING OPERATIONS

Open market fine-tuning operations use (reverse) repurchase agreements with a maturity of one day, one month and three months, as well as outright transactions. The purpose of their execution is the adjustment of market's unexpected fluctuations. The operational features of the (reverse) repurchase agreements with a maturity of one day can be summarized as follows:

- They are quick auctions with a non-standardized maturity.
- Their interest rate uses as a reference the fixed (reverse) repurchase agreement rate, which is determined by the Board of Directors of Bank of Albania.
- Commercial banks that have an

¹ The information on outright transactions is summarized in section 2.2.

account with Bank of Albania have the right to submit auction bids.

2.2. OUTRIGHT TRANSACTIONS

a. *Type of instrument*

Outright transactions refer to operations where Bank of Albania buys or sells treasury bills outright on the market. These operations are not reversible and have a permanent effect on the market. Outright transactions are executed for structural purposes only.

b. *Legal nature of the instrument*

An outright transaction implies a full transfer of ownership from the seller to the buyer with no reverse transfer of ownership.

c. *Instrument's operational features*

The operational features of outright transactions can be summarised as follows:

- They can take the form of liquidity-providing operations in the case of outright purchases or liquidity-absorbing operations in the case of outright sales.
- Their frequency is not standardized.
- Their execution through quick auctions or bilateral procedures has to be previously approved by the Governor of Bank of Albania.
- Outright transactions are executed through outright buying or selling of treasury bills with a maturity of three, six, or twelve months, and with a period left to maturity of no less than seven days, as well as other securities with high liquidity and credibility, of the book-entry type, that are accepted as such by the Board of the Directors of Bank of Albania.
- Only commercial banks that have an account with Bank of Albania have the right to be counterparties in outright transactions.

III. STANDING FACILITIES

The main purpose of standing facilities is to absorb or inject liquidity and impede serious interest rate fluctuation. Their employment is always and exclusively initiated by the commercial banks.

3.1. OVERNIGHT DEPOSIT

a. *Type of instrument*

The overnight deposit is a short-term investment instrument available to commercial banks. Its primary purpose is the withdrawal of liquidity from the banking system and the mitigation of large short-term interest rate fluctuations. The overnight deposit interest rate represents the lowest interest rate in the market.

b. *The legal nature of the instrument*

Commercial banks preserve the right to place overnight deposits of undetermined

amounts with Bank of Albania. On the other hand, Bank of Albania, in accordance with its targets, maintains the right to decline the request of commercial banks for overnight deposits without having the obligation to give explanations regarding the rejection. In addition, Bank of Albania does not use underlying assets as collateral for the overnight deposits it accepts.

c. *Access conditions*

Overnight deposits with Bank of Albania may be placed by all commercial banks and their branches that exercise their activities in Albania and have an account with Bank of Albania.

In order for the overnight deposit to be accepted, commercial banks have to submit their requests with the respective amount and agree with the interest and maturity of the overnight deposit placed.

d. *Maturity and interest term*

The maturity of credit extended under the facility is overnight. The interest and the full amount are paid to the bank on the next working day. The maturity date may be postponed when the next day is a holiday.

The interest on the overnight deposit is pre-specified and is calculated on a 365-day basis. The interest paid to the commercial banks is 2.5 percentage points lower than the annualized interest rate of the repurchase agreements with a maturity of seven days, which is determined by the Supervisory Council of Bank of Albania.

3.2. *OVERNIGHT LOAN*

a. *Type of instrument*

The overnight loan is a short-term debt instrument available to the commercial banks. It is a collateralised loan, which is used to satisfy commercial banks' liquidity needs and oversee interest rates. The interest on the overnight loan provides a ceiling for the short-term interest rates.

b. *Legal nature of the instrument*

Bank of Albania provides overnight collateralised loans upon the request of commercial banks or automatically.

c. *Access conditions*

The overnight loan facility may be used by all commercial banks and their branches that exercise their activities in Albania and have an account with Bank of Albania. All commercial banks that at end-of-day notice a liquidity shortage can make a request for an overnight loan. On the other hand, if at end-of-day, Bank of Albania realizes that a commercial bank's checking accounts are below the allowed level of 95%, it automatically grants the overnight loan and notifies the commercial bank on the loan grant.

d. *Maturity and interest terms*

The overnight loan has a maturity of one day. Bank of Albania receives the interest payment and the initial amount on the first working day following the loan grant.

The interest on the overnight loan is pre-specified and is calculated on a 365-day basis. The interest rate is 2.5 percentage points higher than the rate of (reverse) repurchase agreement with a maturity of seven days.

3.3. LOMBARD LOAN

a. *Type of instrument*

The Lombard loan is a debt instrument, whose purpose is to help commercial banks to, temporarily, overcome liquidity problems. It represents the last crediting instrument and it bears the highest interest rate of all instruments.

b. *Legal nature of the instrument*

The Lombard loan is of the collateralised type and is granted after the approval of the commercial bank's official request. Lombard loan is approved by the Governor of Bank of Albania following the proposal of the Monetary Operation Department and the Research and Monetary Policy Department.

c. *Access conditions*

A commercial bank employs the Lombard loan, only once every three months, after it has exhausted all other possibilities to obtain liquidity from the interbank market or repurchase agreements. The largest amount that can be obtained through the Lombard loan stands between 20 percent of the paid capital and 2 percent of the lek deposits as presented in the last balance sheet that the commercial bank has submitted to Bank of Albania. If approved, the loan is granted the same day that the commercial bank makes its request. In the event the commercial bank does not pay back the loan on the pre-specified date, the commercial bank is not allowed to obtain any type of loan for the three following months.

d. *Maturity and interest terms*

The Lombard loan has a maturity of up to three months. The loan and its interest are paid back to Bank of Albania on the pre-specified maturity date.

The interest rate on the Lombard loan is 6 percentage points (on an annualized basis) higher than the (reverse) repurchase

agreements rate with a maturity of seven days. The commercial banks are previously notified on any interest rate change.

IV. PROCEDURES

4.1. AUCTION PROCEDURES

Bank of Albania's open market operations are executed in the form of

auctions. Bank of Albania's auction procedures are performed as described by the steps in Box 1.

Box 1: Operational steps for auction procedures

Step 1. Auction announcement

Bank of Albania notifies all commercial banks regarding auction's form and conditions through one of the following information systems: SWIFT, telex, REUTERS, fax or official note.

Step 2. Submission of auction bids

Commercial banks send their auction bids, through telex, REUTERS, fax, or official note, to the Monetary Operation Department of Bank of Albania.

Step 3. Processing of auction bids

Commercial banks' auction bids are evaluated by a committee of permanent members, who are substituted when absent and work for the Monetary Operation Department and Research and Monetary Policy Department.

Step 4. Auction allotment and announcement of auction results

- a) *The committee decides upon auction allotment*
- b) *Once the auction is over, the commercial banks, that participated in the auction, receive their respective announcements on the auction allotment results*

Step 5. Auction results announcement for all commercial banks

Step 6. Settlement of the transactions

Bank of Albania operates with two types of auctions: standard auctions and quick auctions. The procedures for the standard and quick auctions are identical except for the timeframe.

a. *Standard auction*

Standard auctions are executed within 24 hours of Bank of Albania's Monetary Operation Department's announcement. These auctions take place every Wednesday, or in the previous working day when Wednesday is an official holiday. Chart 1 gives a timeframe of the operational steps of standard auctions. The primary open market operation auctions, i.e. (reverse) repurchase agreements with a maturity of one week, are the only standard auctions.

b. *Quick auction*

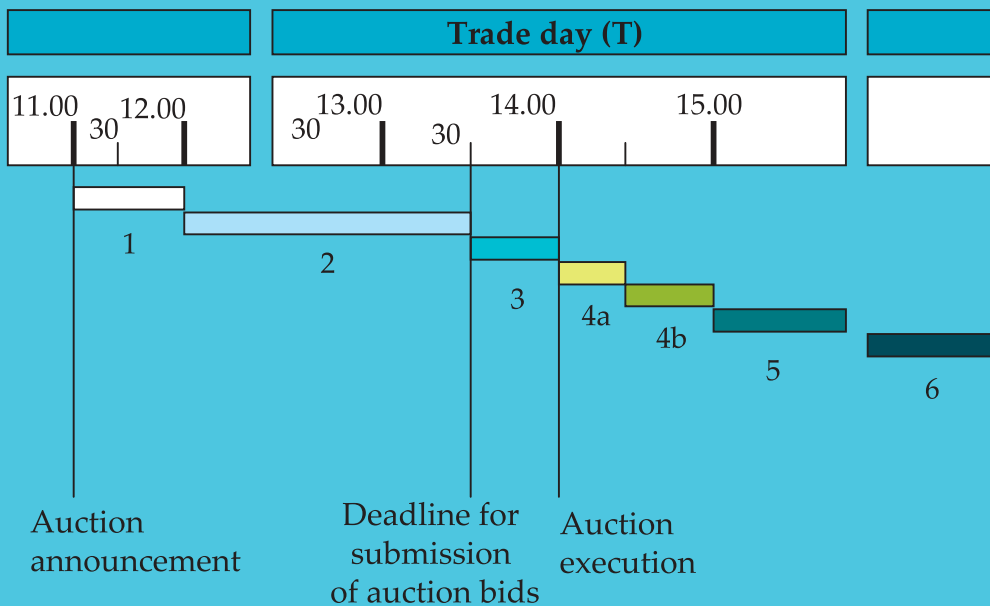
Quick auctions are employed in the case of (reverse) repurchase agreements with a maturity of one day, one month and three months. They are executed whenever Bank of Albania deems it

necessary. In the case of (reverse) repurchase agreements with a maturity of one day, the quick auction is executed within two hours of the Monetary Operation Department's announcement. Likewise, for the (reverse) repurchase agreements with a maturity of one month and three months, the auction is executed within four hours of the announcement.

c. *Fixed price and variable price auctions*

Bank of Albania has the option of conducting either fixed or variable price auctions. In a fixed price auction Bank of Albania satisfies the auction bids following the (reverse) repurchase agreement rate, which, in turn, is determined by Bank of Albania. On the other hand, the variable price auction consists of satisfying commercial banks' auction bids following their own interest rate offers, which should not be higher/lower than the (reverse) repurchase agreements rate as specified by Bank of Albania.

Chart 1: Timeframe for the operational steps for standard auctions



Note: The time frame refers to the operational steps as defined in Box 1

4.1.1. AUCTION ANNOUNCEMENT

The (reverse) repurchase agreement auction announcement for the commercial banks contains the following information:

- Auction reference number.
- Auction category (selling vs. buying from the viewpoint of Bank of Albania).
- Auction type (fixed price vs. variable price).
- The required/offered auction bid.
- The minimum/maximum or fixed interest rate.
- Auction date and time.
- Reversal date.
- Account clearing and settlement date.

The procedures for the announcement of the standard and quick auctions are identical.

4.1.2. SUBMISSION OF AUCTION BIDS

The commercial banks' auction bids for (reverse) repurchase agreements should

contain the following information:

- Auction date.
- Auction reference number.
- Auction category (selling vs. buying).
- Reversal date.
- The name of and information on the participating commercial bank.
- Auction bid in leks (the amount should be presented as a number and in words).
- The amount of treasury bills used as collateral (when collateral is used).
- The repurchase agreement rate, rounded in two decimals only in the case of variable price auctions.
- The name and signature of the authorized person.

Auction bids which are submitted after the deadline or whose information is incomplete are discarded.

4.1.3. AUCTION ALLOTMENT PROCEDURES

a. Fixed price auctions

In fixed price (reverse) repurchase agreement auctions, commercial banks specify only the amount they demand from the auction. The committee that organizes the auction calculates the commercial banks' aggregate amount bid and it pays them or receives from them (depending on the auction category, selling vs. buying) the fixed interest rate, which is approved by the Supervisory Council of Bank of Albania. In the case of fixed price auctions, the entire requested amount is satisfied

b. Variable price auction

In variable price (reverse) repurchase agreement auctions, commercial banks specify in their auction bids the amount and the interest rate they demand. Commercial banks, whose auction bids offer interest rates that are higher/lower than the maximum/minimum interest rates approved by Bank of Albania are automatically discarded.

The bids are listed in ascending/descending order according to the REPO rate that they demand. If the aggregate amount bid is less

than or equal to the amount offered by Bank of Albania, all bids are automatically satisfied. When the aggregate amount bid exceeds the amount offered by Bank of Albania, the bids with the highest/lowest REPO rate are accepted until their aggregate amount is equal to the amount offered by Bank of Albania.

4.1.4. ANNOUNCEMENT OF AUCTION RESULTS

Once the auction is over, Bank of Albania notifies all participating commercial banks on the results. The result information contains the following:

- Auction reference number.
- Auction category (selling vs. buying).
- Auction type.
- Auction date.
- Reversal date.
- Account clearing and settlement date.
- The amount and interest rate that the commercial banks bid on.
- The amount and interest rate offered by Bank of Albania.

- The amount allotted to the participating commercial bank.

Bank of Albania informs the commercial banks that did not participate in the auction on the total amount offered, total amount requested by the participating commercial banks and the total amount allotted by Bank of Albania, while the specific information on the auction bids of each commercial bank and their results is sent to the respective commercial bank only.

4.2. PROCEDURES FOR OUTRIGHT TRANSACTIONS

Outright transactions can be executed through quick auctions or bilateral procedures. The procedures for quick auctions for these types of transactions are identical with those of (reverse) repurchase agreement quick auctions. When outright transactions are executed through bilateral procedures, Bank of Albania notifies the commercial bank that it aims at operating with, through wire services. If the commercial bank agrees to transact with Bank of Albania, it notifies Bank of Albania

immediately. Subsequently, both parties work on the respective transaction terms.

4.3. SETTLEMENT PROCEDURES

The settlement of (reverse) repurchase agreements, which were executed through standard auctions, is done on the day following the auction (T+1), while (reverse) repurchase agreement, which were executed through quick auctions, are settled the same day the auction was executed. Treasury bills are frozen in the register only after the funds are transferred to Bank of Albania's accounts.

On the day of the agreement's maturity, the interest payment and the funds are transferred from the treasury bills' register to the commercial banks' accounts.

Outright transactions are settled on the auction's or bilateral agreement's trade day. The settlement procedures imply the transfer of treasury bills ownership and that of the respective funds to Bank of Albania's and participant commercial banks' accounts.

V. MINIMUM RESERVES

5.1. GENERAL CONSIDERATIONS

The minimum reserve system aims at fulfilling the following monetary functions:

- Banking system safety.
- Creating demand for liquidity and stabilizing the liquidity situation in the market.

Bank of Albania requires that commercial banks hold minimum reserves on accounts with Bank of Albania within the legal framework laid down in the Law No. 8269 “For the Bank of Albania” and in the regulation of Bank of Albania “On commercial banks’ minimum reserves withheld in Bank of Albania”.

The amount of minimum reserves to be held by each commercial bank is determined in relation to its reserve base. The minimum reserve system enables

commercial banks to make use of up to 5 percent of the monthly average of the minimum reserve. This implies that compliance with reserve requirements is determined on the basis of average of the end-of-calendar-day balances on the commercial banks’ reserve accounts over a one-month maintenance period. Commercial banks’ minimum reserves held in lek are remunerated at a rate, which uses the repurchase agreements’ rate as a reference.

The minimum reserve rate for reserves held in lek and in other currencies is the same.

5.2. INSTITUTIONS SUBJECT TO MINIMUM RESERVES

All commercial banks and the branches of the foreign banks that operate within the territory of the Republic of Albania are subject to the minimum reserve requirement. All other branches of the

commercial banks that operate outside the Republic of Albania are not subject to minimum reserves.

The following are excluded from the minimum reserve requirements:

- Commercial banks which have filed for bankruptcy or are in the liquidation process.
- Commercial banks whose license and registration have been revoked.
- Commercial banks that are exercising their activity only temporarily.

5.3. DETERMINATION OF MINIMUM RESERVES

a. Reserve base and reserve ratios

The reserve base of an institution is defined in relation to elements of its balance sheet. The balance sheet data are reported to Bank of Albania following the frequency, format and deadlines as determined within the framework of statistical reporting.

For commercial banks subject to minimum reserve requirements, the balance sheet data referring to the end of a given calendar month are used to determine the reserve base for the maintenance period starting during the following calendar month. Based on the regulation “On commercial banks’ minimum reserves withheld in Bank of Albania”, the reserve base on which the minimum reserve is calculated includes deposits and debt securities issued by the commercial bank.

Liabilities vis-à-vis commercial banks, repurchase agreements, frozen accounts that serve as collateral, deposits with agreed maturity over 2 years, escrow accounts, debt securities issued by the commercial banks with agreed maturity over 2 years, are all deducted from the minimum reserve base. (see Box 2)

b. Reserve rate

The reserve rate is defined as a percentage of the minimum reserve base. Bank of Albania’s Supervisory Council may, at all times, change the minimum reserve rate.

BOX 2. Required reserve base

A.Liabilities included in the reserve base

Deposits

- *Deposits with agreed maturity up to 2 years*
- *Certificates of deposit*
- *Agent transactions/ Social Security deposits with commercial banks*

B.Liabilities excluded from the reserve base

- *Deposits with a maturity of over 2 years*
- *Liabilities vis-à-vis commercial banks*
- *Repurchase agreements*
- *Debt securities issued by the commercial banks with agreed maturity over 2 years*
- *Escrow accounts*
- *Liabilities created in order to cover letter credits*
- *Frozen accounts that serve as collateral*

Changes in the reserve rate are announced by Bank of Albania prior to the first maintenance period for which the change is effective.

c. Calculation of reserve requirements

The reserve requirement of each commercial bank is calculated by

multiplying the reserve base during the base period with the minimum reserve rate.

The settlement of the accounts for the required reserve in lek or other currencies is done on the 24th day of each month. If the 24th happens to be a holiday, the accounts are settled on the next working day.

Commercial banks are allowed to use up to 5% of the minimum reserve amount on a daily basis, with the only condition of not having the minimum reserve monthly average fall below the required minimum reserve.

d. Minimum reserve management

Commercial banks oversee their minimum reserves during the maintenance period in compliance with the requirements of the regulation “On commercial banks’ minimum reserves withheld in Bank of Albania”.

Each commercial bank holds its minimum reserve with Bank of Albania in unified accounts in lek and foreign currency.

Euro and USD are the foreign currencies in which Bank of Albania holds the minimum reserves against the commercial banks’ foreign currency liabilities.

Commercial banks’ liabilities held in other foreign currencies are converted to

euros based on the official exchange rate, that Bank of Albania releases everyday, of the last day of the base period.

5.4. MAINTENANCE OF THE RESERVE HOLDING

a. Maintenance period

The period during which the reserve base is observed in order to calculate the minimum reserve is known as the base period and it corresponds to a calendar month.

The maintenance period for commercial banks’ minimum reserves is one month.

It starts on the 24th calendar day, when the base period is reported, and ends on the 23rd calendar day of the following month.

b. Remuneration of reserve holdings

Bank of Albania pays interest, for the period during which commercial banks’ minimum reserves, in lek or in foreign

currency, are held, according to their reserve accounts with Bank of Albania. (see Box 3).

minimum reserve is done on the following working day.

BOX 3: Calculation of the remuneration of holdings of required reserves

The holdings of required reserves is remunerated according to the following formula:

In lek $R_t/lek = (H_t * n_t * 1/2MR)/365,$

In usd $R_t/usd = (H_t * n_t * 1/2Lib)/360,$

In euro $R_t/euro = (H_t * n_t * 1/2Eur)/360,$

Where:

R_t = remuneration to be paid on holdings of required reserves for the maintenance period *t*

H_t = holdings of required reserves for the maintenance period *t*

n_t = number of calendar days in the maintenance period *t*

MR = Repo's fixed interest rate as released by Bank of Albania.

Lib. = LIBOR rate for one-month dollar deposits

Eur. = EURIBOR rate for one-month euro deposits

The interest payment on the minimum reserve, in lek or foreign currency, is made at the end of the maintenance period or on the 24th day of each month and it is made in the corresponding currency. If the 24th day of the month happens to be a holiday, the remuneration of the

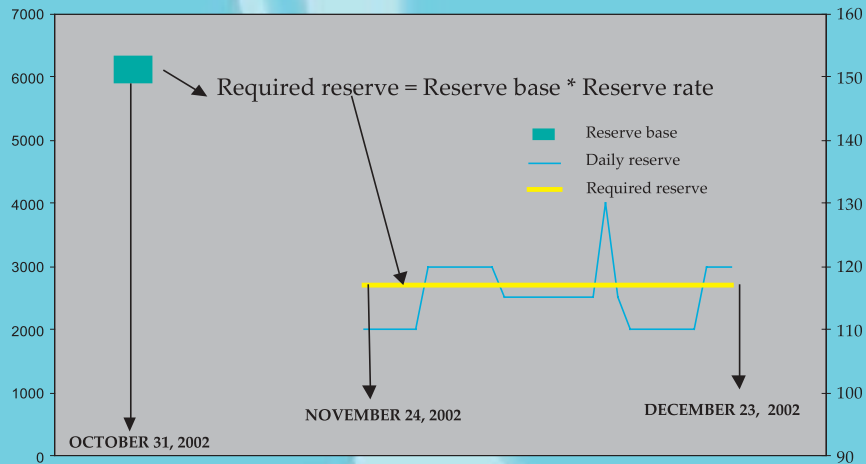
5.5. REPORTING OF THE RESERVE BASE

The reserve base is calculated by the commercial banks subject to minimum reserves themselves and is reported to Bank of Albania within the general

framework of statistical reporting. The data is reported following the specified format, frequency and deadlines. The last day for reporting the required reserve is the 20th calendar day of each month. (see Graph 1). In the event of delayed reports Bank of Albania acts

according to the regulation “On commercial banks’ minimum reserves withheld in Bank of Albania” and the Law No. 8269 “For the Bank of Albania”, as well as with other available policies, in order to take corrective actions.

Graph 1: Minimum reserve functioning



5.6. SANCTIONS UPON NON-COMPLIANCE WITH MINIMUM RESERVE OBLIGATION

Non-compliance with the minimum reserve obligation arises if a commercial bank's average balance on its reserve account over the maintenance period is less than its reserve requirement for the corresponding maintenance period.

When a commercial bank fails to comply with the reserve requirement, Bank of Albania may, in accordance with the regulation "On commercial banks' minimum reserves withheld in Bank of Albania", impose one of the following sanctions:

In the event of Lek non-compliance:

- A payment of 5 percentage points more than the Lombard loan applied on the entire monthly amount of the required reserve in lek which the commercial bank failed to provide.

- Asks the commercial bank to place lek non-remunerated deposits with Bank of Albania, in an amount up to three times that of the reserve requirement that the commercial bank failed to provide. In such cases the maturity of the deposit should not exceed the time period during which the commercial bank failed to provide the entire amount of the required reserve.

In the event of USD non-compliance:

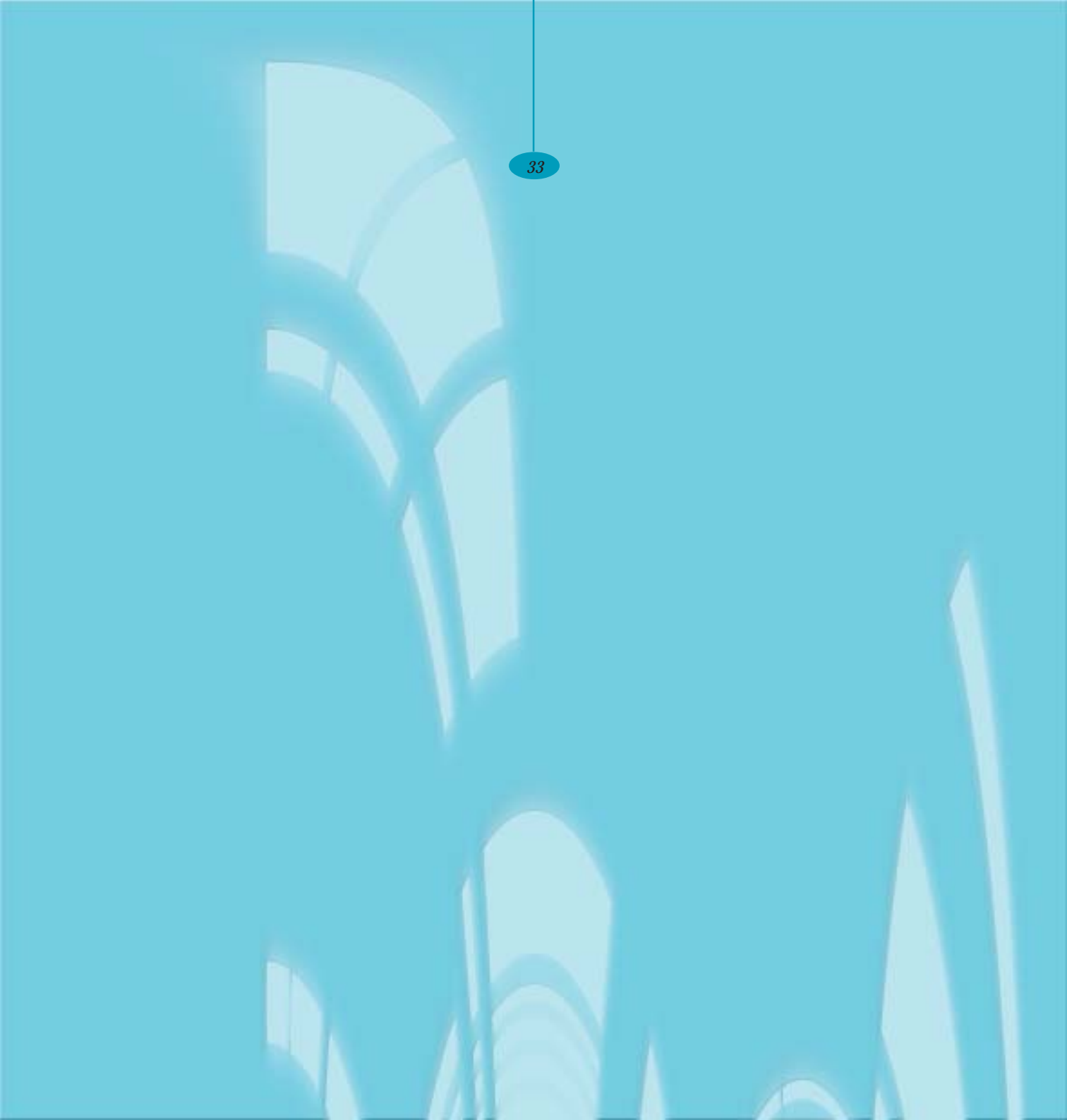
- A payment of 5 percentage points more than the LIBOR rate for USD deposits with a maturity of three months applied on the amount of the commercial bank's required reserve for every non-compliance day.

In the event of Euro non-compliance:

- A payment of 5 percentage points more than the EURIBOR rate for Euro deposits with a

maturity of three months applied on the amount of the commercial

bank's required reserve for every non-compliance day.



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