

E. ON-SITE SUPERVISION

1. EXAMINATIONS AND RELATED MATTERS

The new organizational structure, effective since January 2010, has aimed at integrating the horizontal supervisory line of the banking system with the vertical one, for each individual bank. On-site supervision function is regarded as a responsibility of the Portfolio Management Office, which is responsible for evaluating the portfolio risk profile of the supervisory entities in cooperation with other risk-profiled sectors.

During 2010, the licensed entities were subject to examinations which evaluated all types of risks an entity is exposed to. A special focus was given to evaluating the loan portfolio quality and the adequacy of loan loss provisions and reserves. Following the identified concerns, meetings were held with banks' senior managers, their shareholders or with third parties, such as banks' external auditors.

1.1. EXAMINATIONS CONDUCTED IN 2010

On-site examinations have been conducted by coordinating human resources of risk-profiled sectors, taking into consideration the significance of problems or phenomena detected at individual banks. During 2010, 3 full-scope examinations and 6 thematic examinations were carried out on banks, as well as 4 full-scope examinations on non-bank financial institutions.

Table 38 Examinations conducted in 2010

Type of financial institution	Examinations performed
Banks	3 full-scope examinations 6 thematic examinations
Non-bank financial institutions	4 full-scope examinations

1.2. ISSUES RELATED TO EXAMINATIONS ON BANKS

During 2010, the past-years' loan portfolio's rapid growth effects continued to emerge on the banking system, being also influenced by the economic growth slowdown over the past two years. During the full-scope examinations

and targeted ones, attention was paid especially to:

- Loan portfolio quality and bank practices for monitoring non-performing loans, as well as measures taken for their re-payment;
- Banks' transparency to customers concerning the lending process, complete disclosure of information on loan terms and conditions; prevention of money laundering and operational risk assessment;
- Incorrect loan classification, non-adherence to prudential regulations and inadequate bank provisioning.

Concerns related to adherence to regulations. The banking system has generally operated in accordance with the legal and regulatory supervisory framework. However, shortcomings have been pointed out in terms of credit risk management, exposure to significant risk, liquidity risk, transparency to customers, etc.

More specifically, cases have been identified in which the following acts have not been complied with:

- Regulation "On the management of risk arising from large exposure of banks". An excess of the 10% maximum permissible limit to the regulatory capital for persons related to the bank and of the 20% limit of the regulatory capital to a person or persons related to the bank was detected.
- Regulation "On credit risk management" about the correct loan classification and inadequacy of provisions. Examination teams requested additional provisioning funds, at amounts varying according to specific banks; they also recommended the improvement of the financial analysis on borrowers, and of the practices followed for monitoring the loan performance. In addition, constant improvements in internal policies and procedures that regulate the activity of lending have been requested.
- Regulation "On capital adequacy". The increase in provisioning funds required by examination teams has affected the recalculation of capital adequacy ratio, leading to lower indicators. Moreover, irregularities, though of immaterial significance, were found with regard to the implementation of requirements for risk-weighted asset classification.
- Regulation "On liquidity risk management". Recommendations related to the meeting of requirements in this regulation relate to the observance of the regulatory liquidity limits and the construction of stress-test scenarios for evaluating liquidity risk under unusual situations of banking activity.
- Regulation "On transparency for banking and financial products and services". The identified cases relate to the absence of some elements in loan and deposit contracts envisaged in the regulation, lack of

information clarity in promotional materials, calculation of effective interest rate, changes to loan interest rates, etc.

- Regulation "On foreign exchange activities" related to the definition of the purpose of transfers and relevant supporting documentation.
- Regulation "On the use of information and communication technology in the entities licensed by the Bank of Albania". The identified cases relate to the method of creating the user profiles, not always based on the job description for that position. Moreover, deficiencies were detected in terms of risk assessment and its documentation, ICT service assessment, business continuity plan and disaster recovery plan, etc. During the year, some banks were in the process of improving their banking software. Examination teams recommended measures in this regard, so as to observe all the requirements of the relevant Regulation while implementing it.
- Regulation "On information content and functioning of the Credit Registry at the Bank of Albania" about the preliminary consent clause, which must be signed by the customer, and about the accuracy of information reported by files, etc.

1.3. ISSUES RELATED TO EXAMINATIONS ON NON-BANK INSTITUTIONS

Examinations on non-bank institutions in 2010 focused on assessing their lending activity and their actions on credit risk management. Other areas of significance included compliance, anti-money laundering, transparency and information and communication technology.

Examinations identified the following main concerns:

- Non-compliance with the internal regulatory framework. The concerns appear mainly related to the compliance with the loan limit and approval, their ongoing monitoring, restructuring process, portfolio classification, relevant provision levels and blocking of guarantee-pledged collaterals. Moreover, the entities should review and update their lending manuals in line with the regulatory requirements of the Bank of Albania.
- Non-compliance with the Regulation "On supervisory ratios of non-bank financial institutions carrying out financial activities" related to open foreign currency positions and large exposure limits. Concerning the evidenced cases, measures were required, so as to bring exposure back to limit.
- Incomplete transparency related to preliminary information on credit terms and conditions, including, *inter alia*, the nominal annual interest rate, incomplete information on foreign currency credit risk, conditions

for the calculation and interest rate changes; and the methodologies used for their calculation. Deficiencies were also identified as regards the calculation, disclosure and reporting of the effective interest rate and completion of contracts with elements required under the relevant Bank of Albania's Regulation "On transparency for banking and financial products and services".

- Deficiencies in implementing the Law "On accounting and financial statements".
- Expansion of Internal Audit's scope with the verification of adherence to Bank of Albania's laws and by-laws.
- Improvement of policies, procedures and technological standards related to Information Technology and Communication.

1.4. EXAMINATIONS ON ANTI-MONEY LAUNDERING (AML), COMBATTING THE FINANCING OF TERRORISM (CFT), TRANSPARENCY AND DISCLOSURE OF INFORMATION

In 2010, the scope of on-site examinations on 5 banks and 4 non-bank financial institutions was anti-money laundering and combating the financing of terrorism, as well as the transparency and disclosure of information.

With regard to these aspects, the banking system has generally adhered to the regulatory framework of the Bank of Albania.

In 2010, on-site examinations and off-site periodic surveillance on banks and non-bank financial institutions found that institutions have established the necessary structures and infrastructures for anti-money laundering (AML) and combating the financing of terrorism (CFT), and have also completed the necessary internal regulatory framework in this area. On the other hand, they have managed to generate daily cash transactions of over ALL 1.5 million and non-cash transactions of over ALL 6 million. They have also conducted necessary staff training on anti-money laundering and combating the financing of terrorism.

However, the on-site examinations have pointed out deficiencies, mainly related to the implementation of software that would enable clear risk-perception parameters according to the nature of business, customer position, turnover volume, social and financial status, etc.; functioning of the centralised system responsible for data collection and analysis; and increase in the frequency and quality of internal audits. On the other hand, examination teams have recommended further increase in the number of staff training courses and their focus on specific issues of the banking system. The reporting of suspicious activity in terms of quantitative (their low number) and qualitative indicators (analysis of typology) and the insufficient definition of transaction

categories to which due diligence is exercised, require ongoing monitoring by responsible bank structures.

In terms of transparency and disclosure of information, during 2010, banks individually adjusted both the regulatory infrastructure and the operational one in line with Bank of Albania's regulations. More specifically, they have generally acted in accordance with the Regulations "On transparency about banking and financial products and services", "On consumer and mortgage lending to households" and "On meeting the minimum requirements for disclosure of information by banks". In this regard, the quality of reporting the effective interest rate (EIR) to the Bank of Albania and of the pre-contractual loan information formats has improved, although there are still deficiencies in disclosing preliminary information to customers during the lending process and in the publication of the EIR. Banks have cooperated in terms of loan contract improvement; however, they should be more cautious to notify customers of any changes to product supply conditions.

The disclosure of information has also improved. The number of banks having no official website has decreased, whereas the quality of their publications has increased. 14 out of 16 banks in the system have constructed their official website, most of which have a contemporary level, covering comprehensive information about their activities.

Also, the efforts made by non-bank financial institutions to achieve compliance with the relevant regulatory requirements of the Bank of Albania have been satisfactory.

1.5. EXAMINATIONS TO VERIFY OPERATING CONDITIONS OF ENTITIES

Throughout 2010, on-site examinations were conducted to verify the operating conditions of entities that request to conduct their activity in new premises or that apply for a licence to the Bank of Albania, in accordance with the requirements provided under Article 14, paragraph 7 of the Regulation "On granting a licence to and conduct of activity by banks and branches of foreign banks in the Republic of Albania" and Article 18, paragraph 1 of the Regulation "On minimum technical and security conditions of work premises at entities licensed by the Bank of Albania".

During 2010, examinations were conducted in accordance with the above-mentioned regulatory requirements, on:

- 66 foreign exchange bureaus;
- 19 new branches of banks; and
- 4 new non-bank financial institutions.

2. COOPERATION WITH FOREIGN AUTHORITIES

2.1. COOPERATION WITH FOREIGN AUTHORITIES

Cooperation with foreign authorities continued during 2010. Pursuant to cooperation agreements with several foreign supervisory authorities, information on certain foreign banks that conduct banking business in our country has been prepared. Also, following the initiative of the European Central Bank on the operation of colleges of supervisors of large European banking groups and financial institutions, during 2010, we participated in panels organized by the Bank of Greece. These colleges served as an opportunity to meet supervisory authority representatives of countries that have a large presence of Greek banking groups and senior management representatives of these banking groups in Greece. They discussed issues related to specific concerns found in subsidiaries and branches of banks, identified during the supervisory process by relevant authorities, measures taken to address them, and the challenges ahead. Meanwhile, in terms of anti-money laundering, we have cooperated with foreign central banks.

2.2. COOPERATION WITH OTHER AUTHORITIES IN THE COUNTRY

During 2010, the Bank of Albania continued the efficient cooperation with various institutions monitoring specific activities of the financial market in the country. More specifically, information-sharing and joint examinations with the Financial Supervisory Authority (FSA) have taken place, with the subject insurance companies in the banking system.

There has been close collaboration with the General Directorate for the Prevention of Money Laundering (GDPML). This cooperation has not been limited only to quarterly reporting to the GDPML on the implementation of the national financial crime investigation strategy, but it has also included a frequent exchange of correspondence throughout the year between the Bank of Albania and the GDPML. The Supervision Department has participated in periodic meetings of the Group of Experts for reporting on the implementation of the National Financial Crime Investigation Strategy, an important part of which is the institutional work for preventing money laundering and terrorism financing. This document, approved by the Council of Ministers' Decision No. 1077 of 27/10/2009, aims to establish a long-term platform for action and a balance between effective prevention and investigation of crimes in the economic and financial area. State institutions involved in its implementation, the Bank of Albania being a part thereof, will set out standards, based on the observance of values such as: integrity, commitment and professionalism.

The cooperation for anti-money laundering, because of its importance to other law protection institutions, has not been limited only to GDPML, but it has also included a frequent exchange of correspondence throughout the year between the Bank of Albania and other institutions, such as the Ministry of Finance, the Albanian Association of Banks, etc.