

## 7. FINANCIAL SYSTEM

(41) The share of the activity of the financial system in the Gross Domestic Product (GDP) is estimated downward during the period, but the main financial indicators overall improved. The decrease of the share of banking activity contributed most to the decline in the share of the financial system. The non-banking sector maintained its share to GDP, and non-bank financial institutions, private pension funds and investment funds made positive contributions to its performance. The direct exposure of the banking sector in the non-banking sector is assessed as low, whereas the performance of the banking sector remains a critical factor for the activity and stability of the non-banking sector. In the structure of the non-banking sector assets, investments in debt securities of the Albanian Government remain relevant and marked an increase in 2017 H1. Particularly for the banking sector, the indicators of capitalisation, profitability and liquidity remain at adequate levels.

(42) Developments in the activity of banks, savings and loan associations and insurance companies provided the main contribution to the decline of the share of the financial system activity in GDP. Total share of banking sector assets decreased at 91.9% of GDP, against 94.9% at the end of 2016. Banks continue to dominate the structure of the financial system assets, accounting for 89.7% of it, down during the period. As a result of the dominance of the banking sector in the financial system, the ratio of the financial system asset<sup>28</sup> against GDP declined at 101.9%, around 3 p.p. lower than at the end of 2016. In annual terms, the activities of the banking sector, non-banking financial institutions and private supplementary pension funds increased.

Table 7.1 Share of financial system segments in GDP, over years

Licencing and supervising authority	Financial system	2011	2012	2013	2014	2015	2016	2017 H1
Bank of Albania	Banking sector	84.7	89.6	90.5	91.7	91.3	94.9	91.9
	NBFIs	2.5	2.7	2.5	2.7	2.7	2.9	2.8
	SLAs and Unions	0.7	0.8	0.8	0.8	0.7	0.6	0.5
Financial Supervision Authority	Insurance companies	1.5	1.6	1.6	1.7	1.9	2.1	1.9
	Pension funds	0.01	0.02	0.03	0.04	0.1	0.1	0.1
	Investment funds		1.21	3.7	4.5	4.7	4.4	4.7
Financial intermediation	89.41	95.93	99.13	101.44	101.3	105.1	101.9	

<sup>28</sup> The financial system consists of banks, non-bank financial institutions, savings and loan associations (SLAs), insurance companies, private supplementary pension funds and investment funds. In this chapter's analysis, consider that only the data for the banking sector are from 2017 H1. The data from the other segments of the financial system are from 2017 Q1.

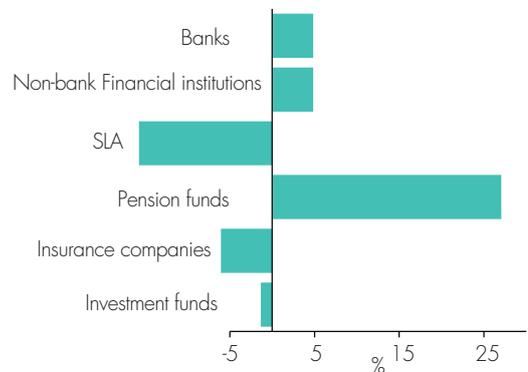


## 7.1 BANKING SECTOR DEVELOPMENTS

### INSTITUTIONS SUPERVISED BY THE BANK OF ALBANIA

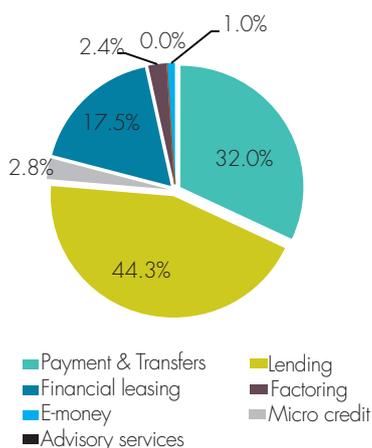
(43) During the period, non-banking financial institutions (NBFIs) expanded their activity and showed good financial indicators. Namely, assets' increase was supported by the expansion of lending and investment in securities. The NBFIs' financial result was positive; capitalisation was adequate although asset's quality has declined. In 2017 H1, the financial system had 28 NBFIs engaged mainly in microcredit, lending, leasing, factoring, electronic money etc. Lending NBFIs had the main share, followed by those that provide payment and transfer services. NBFIs' assets registered ALL 42.2 billion, up by 1.28% against the end of 2016 and by 6.5% against a year earlier. The main share in the structure of assets was from "customer transactions", which represent the lending activity, followed by investments in banks in the form of deposits and current accounts, which have given the main contribution to the expansion of the assets. Enterprises account for around 86% of the credit portfolio of NBFIs, mainly operating in the trade (23.3%) and agriculture (13.9%) sectors. The financial result of NBFIs resulted positive, around ALL 0.14 billion, but downward from a year earlier (ALL 0.34 billion).

Chart 7.1 Annual growth of financial system components



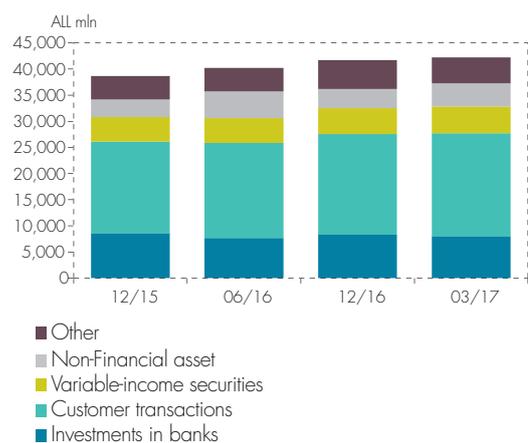
Source: Bank of Albania, Albanian Financial Supervisory Authority.

Chart 7.2 Structure of NBFIs by type of activity



Source: Bank of Albania, Financial Stability Department.

Chart 7.3 Structure of the assets of NBFIs

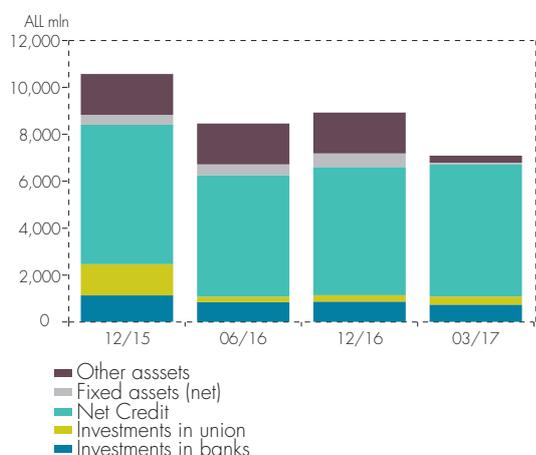


Source: Bank of Albania, Financial Stability Department.

(44) The activity of savings and loan associations (SLAs) was positive during the period; but it contracted from a year earlier. The SLAs assets performance was determined by the decline in both investments in the banking sector and in



Chart 7.4 Structure of savings and loan associations



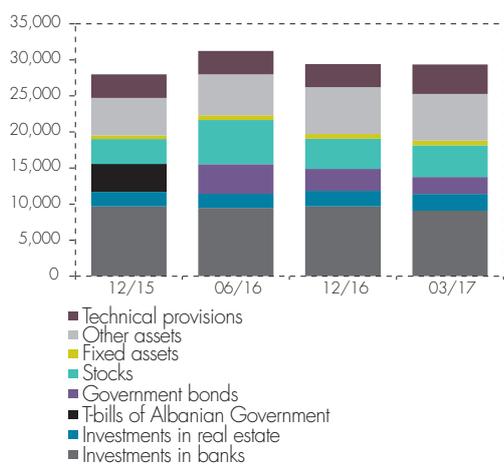
Source: Bank of Albania, Financial Stability Department.

shares. The main activity of these institutions registered an increase despite the overall performance of the activity. The financial result of SLAs returned to positive terms (around ALL 17 million) compared with the financial loss of a year earlier (around ALL 40.6 million). Loans to customers, investments in banks and other assets (mainly investments in shares) represent the main items of the assets of these institutions. In 2017 H1, thirteen active savings and loan associations operated in the market.

### INSTITUTIONS SUPERVISED BY THE ALBANIAN FINANCIAL SUPERVISION AUTHORITY

(45) The activity of insurance companies was overall stable during the period.<sup>29</sup> In 2017 H1, there were 12 licensed insurance companies.<sup>30</sup> The assets of these institutions remain very close to the levels of end-2016, at around ALL 29.3 billion. Their activity is mainly concentrated in investments in the form of time deposits, government debt securities and shares. Overall, insurance companies maintained capital levels supported by a positive financial result.

Chart 7.5 Structure of assets in insurance companies



Source: Bank of Albania, Financial Stability Department.

In the insurance activity, gross written premiums and paid claims were upward. Premium income (which is paid in advance) is used for paying liabilities and covering costs that may arise when an insurance event occurs. Gross written premiums<sup>31</sup>, which represent the main financing source for the insurance companies activity, expanded by 12.0% in annual terms. The insurance market penetration indicator, measured as the ratio of premiums against GDP was

at 0.5%, unchanged from a year earlier. The loss indicator, or the ratio of paid claims against gross written premiums, increased at 36.5% from 28.4% of a year earlier. This development reflects the faster growth in paid claims compared to the growth in gross premiums income. The value of gross paid claims increased by 44.0%, in annual terms, to ALL 2.7 billion.

<sup>29</sup> Data are from 2017 Q1.

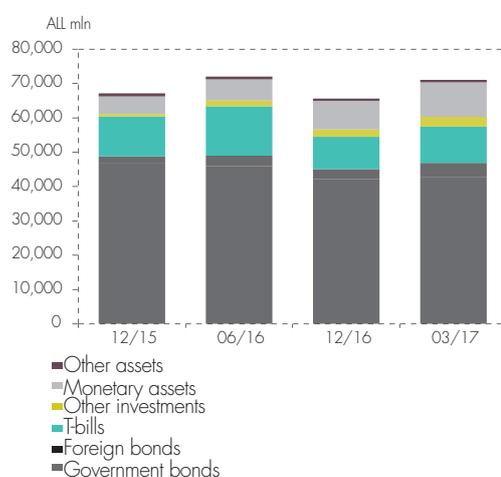
<sup>30</sup> 8 non-life insurance companies, 3 life insurance companies and 1 reinsurance company.

<sup>31</sup> AFSA, "Insurance Market Statistical Report: January-June 2017", published on 25 July 2017.



(46) The activity of investment funds<sup>32</sup> expanded, as a result of the increase of investments in banks and government debt securities. The investment fund is an entity with open participation, created on the basis of a contract, through public supply of quotas<sup>33</sup> that represent the rights and the interest of the investors. The return rates by the participation of investors in investment funds is usually higher than that of deposits in banks, reflecting the higher risk profile<sup>34</sup> of investment funds. Currently, three investment funds operate in the Albanian financial system. Funds' assets are mainly invested in T-bills and bonds issued by the Government of the Republic of Albania in lek and euro. In 2012, investment funds had 7,149 members, while during the period, this number was around four times higher (31,235 members). The value of net assets in September 2012 stood at ALL 16.9 billion, whereas in 2017 the value of net assets was ALL 70.8 billion (4.7% of the GDP of Albania).

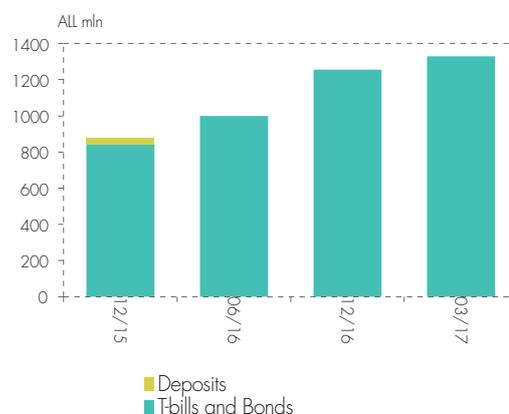
Chart 7.6 Asset structure of investment funds



Source: Bank of Albania, Financial Stability Department.

(47) Supplementary Private Pension Funds<sup>35</sup> have expanded their activity during the period. In Albania, 3 supplementary private pension funds operate in the financial market. At the end of 2017 Q1, the assets of these funds registered ALL 1.4 billion or 27% higher than a year earlier. The activity of pension funds is dominated by investments in government debt securities. The value of these investments was around ALL 1.3 billion or 5.8% higher than the end of 2016. According to the latest reports, the number of members of pension funds was 18,487.

Chart 7.7 Structure of investments in supplementary private pension funds



Source: Albanian Financial Supervisory Authority.

<sup>32</sup> AFSA, "General data on Investment Funds, 31 March 2017"

<sup>33</sup> Law, No. 10198, dated 10/12/2009 "On Collective Investment Enterprises", AFSA.

<sup>34</sup> In an extreme case related to unfavourable movements of the market and/or mismanagement of a fund, the entire value invested in a fund may be lost. In similar cases in banks, depositors' savings are protected at least up to ALL 2.5 million (in accordance with the provisions of the Law "On deposits insurance"). In any case, both investment funds and banks are subject to the regulatory requirements for their activity's financial indicators, in order to minimize the possibility of their failure.

<sup>35</sup> AFSA, Statistical Report "Developments in the private supplementary pensions", 31 March 2017, published on 11 May 2017.

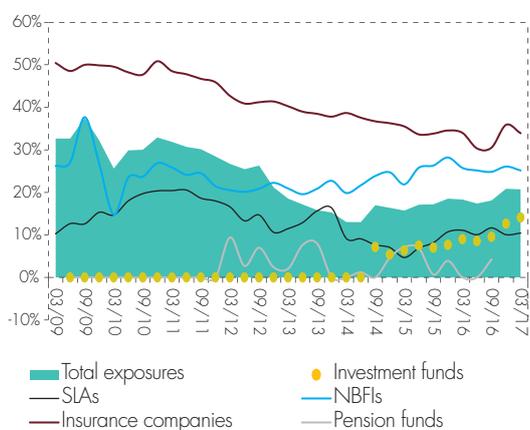


## 7.2 ASSESSMENT OF RISKS AND EXPOSURES IN THE NON-BANKING SECTOR

(48) The banking sector’s exposure to the non-banking sector in Albania remained low. This exposure on the side of banks’ assets is represented by loans and participation in the capital of non-bank financial institutions; meanwhile, on the side of liabilities it is represented in the form of funds collected by them (various accounts). In total, this exposure accounts for only 2.3% of the values of assets of the banking sector.

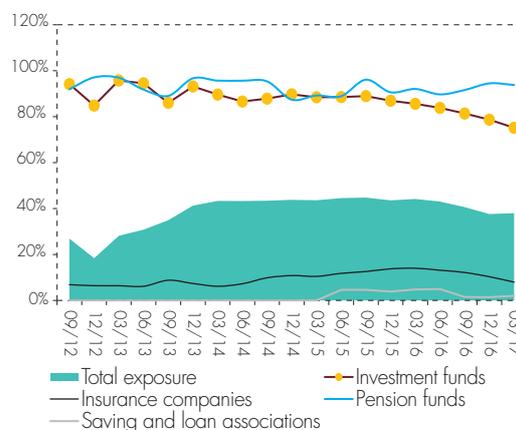
(49) On the other hand, the sensitivity of the non-banking sector to the activity of the banking sector remains high. In total this exposure constitutes 20.7% of the assets of the non-banking sector, up by 2.4 p.p. against a year earlier.<sup>36</sup> Insurance companies and non-bank financial institutions (NBFIs) show the highest exposure to the banking sector, as their placements in banks in the form of deposits and equity instruments constitute 33.9% and 25.2%, respectively, of the relevant assets. Investment funds and savings and loan associations also show upward exposures.

Chart 7.8 Exposure of main NBFIs to the banking sector, in relation to their total assets



Source: Albanian Financial Supervision Authority, data processed by the Bank of Albania.

Chart 7.9 Investments of NBFIs in government securities, against their total assets



Source: Albanian Financial Supervision Authority, processed data, by the Bank of Albania.

(50) Non-bank financial institutions and saving and loans associations, while active in lending, are exposed mainly to credit risk. In March 2017, the ratio of non-performing loans against total NBFIs loans increased at 12.6% from 11.9% a year earlier, while for SLAs the quality indicator registered a decrease at 5.4% from 8.2% a year earlier.

(51) Market risk affects most significantly the activity of life insurance companies, investment funds and private supplementary pension funds. The manner of impact is explained in the previous Financial Stability Report, and

<sup>36</sup> The data refer to 2017 Q1.



is related mostly with the impact that the level or the movements of the interest rate and the exchange rate may have on the financial performance of the enterprise because of the duration gap, the type of currency or interest payment profile, amongst the liabilities and assets items in the balance sheet of these enterprises. During the period, interest rates remained at similar levels with the previous period and overall have shown low volatility. After operating for a relatively long time in an environment with low interest rates, the potential of their increase may be accompanied with negative effects in the balance sheets of these institutions. It is therefore necessary that they evidence and assess this impact regularly.

