

1. INTRODUCTION

Based on the law “On the Bank of Albania” and “On banks in the Republic of Albania”, the Bank of Albania shall have the right to carry out the function of banking supervision. Banking Supervision Department was established in 1992 to accomplish banking supervision.

The publication of this Annual Report for 1998 regarding banking supervision activities of the Bank of Albania aims at presenting the mission, objectives as well as the activities of the banking supervision of the Bank of Albania, exercised through 1998.

Since this Annual Report is published for the first time, a brief history of the development of the supervision and entire banking system for the period 1992 -1998 is included.

2. MISSION OF BANKING SUPERVISION

MISSION

To encourage safe and sound banking activities as well as their transparency through an effective supervision with the final aim depositor's protection.

OBJECTIVES

Objectives of the Banking Supervision are the following:

- * To help the stability of financial system
- * To help establishing a safe, sound and competitive banking system
- * To ensure the cooperation of the financial institutions and the economy

ROLE

- * Make the public have confidence on the banking system.
- * Ensure the implementation of the bank laws as well as by-laws.
- * Help establishing an effective and competitive banking system that could serve to public needs with high quality and at reasonable cost.
- * Ensure depositors and shareholders for a safe and sound management of their assets.

3. DEVELOPMENTS OF THE BANKING SUPERVISION

3.1 Brief history on Banking Supervision

The approval in 1992 of the law “On the Bank of Albania” and “On banks in the Republic of Albania” acknowledged the Bank of Albania the performance of the Banking Supervision function.

According to the above mentioned laws, Banking Supervision Department was established to perform supervision functions on second tier banks oriented to the market economy, and preparing regulatory framework of the Banking Supervision.

Since 1992, considered as the year when Banking Supervision started its activity, both the functions and activities of the Banking Supervision Department have undergone the process of organization and creation of the regulatory framework pursuant to the law. At the same time recruiting and training of the staff was a priority in order to upgrade their skills in Banking Supervision area.

Year 1993 and 1994 are years in which the first regulations on Banking Supervision were drafted and Banking Supervision norms were set for the state-owned banks.

Based on the requirements of the law “On the banking system in the Republic of Albania”, Basle Committee Principles on Banking Supervision, and the experience of other countries, the regulation “On the requirements for granting a license to act as a bank in Republic of Albania” was drafted and approved.

During 1994, banking Supervision Department was organized in the following units:

- Methodology and Licensing Unit
- Off-site Examination Unit
- On-site Examination Unit

With the above restructuring changed the concept and the completion of the functions of the Department in accordance with the international standards.

During 1995, the objective of the Department was mainly to check out the way of implementing the issued regulations, the completion and review of the existing regulatory framework with the aim of meeting international standards on Banking Supervision defined by Basle Committee.

During the years 1995-1996, the banking system changed its composition. New joint ventures, branches of foreign banks and private banks incorporated in Albania were introduced. The expansion of the banking system with private banks brought several changes on the bank operation and services.

Failure of the state-owned banks to perform their role in a market economy made indispensable their privatization, a process that has started since 1997 and is still going on. This period was accompanied with the crises of 1997 that had its negative effect on the entire banking system and especially on the state-owned banks. Notwithstanding, during the above period some positive events were observed in the area of the banking activities and supervision.

It is worth mentioning that despite of the situation all over the country, banking system continued to attract the interest of foreign investors. The above interest became evident in the establishment of two new banks that started their operations and another one got preliminary license.

In 1997, the Rural Commercial Bank, a state-owned bank was closed down due to a failure in its privatization process in the framework of restructuring the state-owned banks. The closing of this Bank was made by the Ministry of Finance and was supervised carefully by the Bank of Albania in order to avoid as much as possible problems that might have arisen with its depositors and clients.

The year 1998 should be considered as the year where qualitative steps have been taken in improving either regulatory framework of the Banking Supervision and the examination of the banks and branches of foreign banks. The above steps were dictated by the changes in the banking system, that consisted in entering of new banks and branches of foreign banks in the Albanian banking market with special features with respect to their ownership and the activities they conduct and particularly by the Core Principles for an effective Banking Supervision of the Basle Committee, published in September 1997.

For the time being, the Bank of Albania operates based on the law no. 8269, dated 23.12.1997 "On the Bank of Albania" and law no. 8365, dated 02.07.1998 "On banks in the Republic of Albania", where the Bank of Albania is the sole authority that issues license and supervises all the banks in the Republic of Albania.

Both laws regulate banking system in the following directions:

1. Defining terms and conditions for the establishment of banks and branches of foreign banks in order to have an effective banking system;
2. Defining of the banking operations;
3. Supervising of the banking system;
4. Defining regulations with respect to bank custody and liquidation.

The composition of the banking system during 1998 was more complex from the point of view of ownership, activities, services they offer, and size of their network, etc. 10 banks operated in 1998, out of which 2 state-owned, 2 joint-ventures, 4 private and 2 branches of foreign banks. Notwithstanding these changes the influence of the state-owned banks still remained considerable.

Restructuring and privatization process of the two state-owned banks is still going on and according to the schedule the privatization will finish within 1999 for National Commercial Bank and within 2000 for the Savings Bank. In order to maintain the assets value of both banks and improve their activities and being prepared for the privatization process both banks have been under the management of foreign advisors.

The Bank of Albania is acting as an advisor and supervisor of the privatization and liquidation of the state-owned banks, by implementing a tight lending policy. In the meantime, Bank of Albania through the strict implementation of the licensing requirements for establishing new banks aims at establishing a banking system based on sound private banks.

Second tier banks at end of 1998 were as follows:

1. National Commercial Bank (state-owned)
2. Savings Bank (state-owned)
3. Italian-Albanian Bank (joint-venture)
4. Arab Albanian Islamic Bank (joint-venture)
5. Dardania Bank (private bank)
6. Branch of National Bank of Greece (branch of foreign bank)
7. Tirana Bank (private bank)
8. International Commercial Bank (private bank)
9. Branch of Alpha Credit Bank (branch of foreign bank)
10. American Bank of Albania (private bank)

3.2 Core Principles for Effective Banking Supervision

Principles of Basle Committee

The twenty-five Core Principles for Effective Banking Supervision, or the so-called Basle Core Principles published on September 1997 by the Basle Committee on Banking Supervision, define the minimum standards for an effective banking supervision. Their aim is the performance of an effective supervision.

These principles relate to the following:

Preconditions for Effective Banking Supervision

1. An effective system of banking supervision will clear responsibilities and objectives for each agency involved in the supervision of banking organizations. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking organizations and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.

Licensing and Structure

2. The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.
3. The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.
4. Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.
5. Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

Prudential Regulations and Requirements

6. Banking supervisors must set prudent and appropriate minimum capital adequacy requirements for all banks. Such requirements should reflect the risks that the banks undertake, and must define the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, these **requirements must not be less those** established in the Basle capital Accord and its amendments.

7. An essential part of any supervisory system is the evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.
8. Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss and provisions and loan loss reserves.
9. Banking supervisors must be satisfied that the banks have management information systems that enable management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.
10. In order to prevent abuses from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.
11. Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.
12. Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.
13. Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and, where appropriate, to hold capital against these risks.
14. Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
15. Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.

Methods of Ongoing Banking Supervision

16. An effective banking supervisory system should consist of some from of both on-site and off-site supervision.

17. Banking supervisors must have regular contact with bank management and thorough understanding of the institution's operations.
18. Banking supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.
19. Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.
20. An essential element of banking supervision is the ability of the supervisors to supervise the banking group on consolidated basis.

Information Requirements

21. Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.

Formal Powers of Supervisors

22. Banking supervisors must have at their disposal adequate supervisory measures to bring timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios) when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.

Cross-border Banking

23. Banking supervisors must practice global consolidated supervision over their internationally-active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.
24. A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved primarily host country supervisory authorities.
25. Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have power to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.

3.3 Bank of Albania Supervisory Role

Bank of Albania in conformity with its main objective shall maintain the liquidity, solvency and normal functioning of the banking system based on market principles.

Bank of Albania has sole responsibility for the issuance of licenses to banks and supervision of all the banks in the Republic of Albania.

Related to this responsibility Bank of Albania:

- Issues the statutory and non-statutory acts in order to secure the banking system stability;
- Supervises any bank office or foreign exchange bureau, bank account and banking documents as well as the other subjects which have the license for conducting banking activity.

Bank of Albania cooperates with respective foreign authorities of banking supervision, based on the reciprocity principle, to supervise and inspect the banks, which operate under their direct respective jurisdiction. (A cooperation agreement has been signed on January 18, 1999 between the Bank of Albania and Bank of Greece).

- * Pursuant to the Law no.8365, dated 02/07/1999 "On the Banking System in the Republic of Albania", Bank of Albania shall have the right to enforce the other subjects which perform the banking activity to comply with the provisions of this law as prescribed under article 26 of this law;
- * Under the Bank of Albania supervision authority, the second tier banks shall submit to Bank of Albania monthly and periodic reports on the evaluation of the financial statement as well as other data related to bank administration;
- * Bank of Albania, according to the Law and by respecting the legal, operational, financial and administrative independence of the banks, considers banks' requests and gives preliminary approval or refuses these requests for: signing of twining agreements, permission of additional financial activities, increasing of capital by non-liquid instruments, decreasing of capital, repurchasing of shares by the bank, nomination of one or some bank administrators, merging, dividing or selling of bank assets, etc.

3.4 Strategic Plan for an Effective Banking Supervision

Strategic objective of the banking supervision is the creation of a sound and secure banking system. Accomplishment of this strategic objective is a very dynamic process requiring the compliance with some short and medium term objectives.

Banking supervision shall be oriented by the following objectives:

- * to create the legal and regulatory framework in compliance with EU directives and international standards of Basle Committee on banking supervision;
- * to ensure the rigorous implementation of the legal and regulatory framework;
- * to limit the banks from undertaking significant risks that may lead to risky situations for the depositors

These objectives can be reached through:

- a. supervision of the newly established banks (licensing);
- b. regulating the commercial banks activity and continuous supervision of the implementation of the regulations (banking regulations, on-site and off-site examination);
- c. supervision of the financial bank performance (analysis on the banks and banking system);
- d. Supervision of problem banks (from taking corrective measures to license revocation).

3.5 Organizational Chart of the Banking Supervision Department

Banking Supervision Department acts as a part of organizational structure of the Bank of Albania with an executive and administrative power.

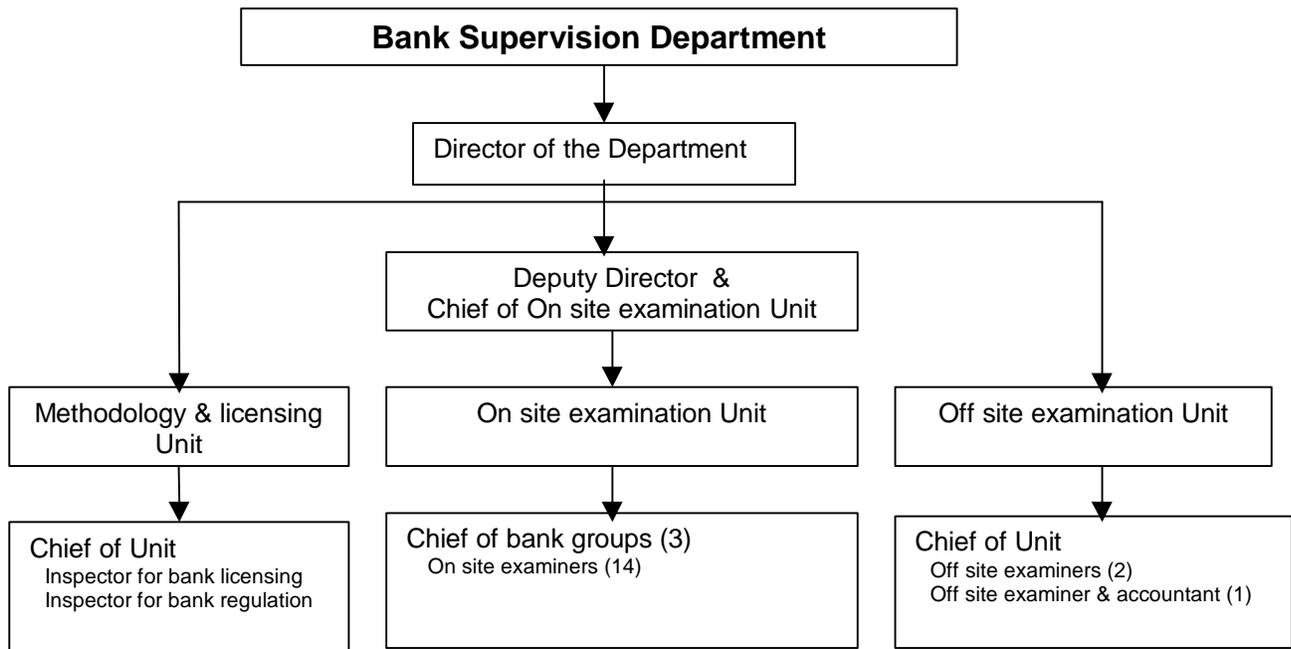
Banking Supervision Department organizes, administers and conducts its activity under well-defined goals and in compliance with the role and functions based on the internal regulation approved by the Supervisory Council of the Bank of Albania.

An executive director heads the Department.

Department is made up of three units:

1. Licensing and banking regulations unit;
2. Off-site Examination Unit;
3. On-site Examination Unit.

*Find attached the organizational chart. (See Chart.1).



3.6 Duties and Responsibilities of the Banking Supervision Department

Banking supervision department accomplishes one of the main functions of the Bank of Albania defined under the Law “ On the Bank of Albania “ which is related to granting the license or license revocation, banking activity supervision in order to secure the stability of the banking system.

To accomplish this function, banking supervision department supervises the second tier banks to effect the reduction of risk and not to oppose depositors and other creditors unnecessarily to risky situations and ensure public confidence in the banking system.

A. Licensing

The main function of the Licensing and Regulation unit is to formulate, publish and follow up the implementation of the procedures for granting the license on banking activity, to review the submitted documentation for obtaining the license to conduct activity as a bank or foreign exchange bureau. It also organizes the work for the drafting of new regulations in order to establish a regulatory framework of banking supervision according to the international standards and the European Union directives considering the fact that the Republic of Albania looks forward to joining it in the near future.

- * Strict implementation of the criteria for granting the licenses to banks, branches of foreign banks, foreign exchange bureaus and other subjects for conducting the banking business;
- * Preparing the recommendations for the Supervisory Council of the Bank of Albania related to the preliminary approval for granting the licenses, issuing of licenses or their revocation;
- * Submission to the Supervisory Council of the proposal to repeal the preliminary approval, in cases when the bank does not complete within one year the requirements for starting its activity or proposes for the extension out of this term up to six months;
- * Objection to the extension of the number of branches and new banks affiliates within the territory of the Republic of Albania;
- * Reviewing of the banks requests for opening of new branches, affiliates, agencies and representative offices out of the Republic of Albania;
- * Evaluation of the banks proposals for changing the ownership on shares or significant interests (over 10% of the capital);
- * Reviewing of the banks requests for direct investments and transferring of their paid-up capital abroad;
- * Presentation of the recommendations related to the banks requests for decreasing the capital through the repurchasing of shares or distribution of the reserve assets, purchasing of shares or partnership to over 10% of capital, etc.;
- * Approval or non approval of the Certified Public Accountant proposed by the second tier banks;
- * Presentation of the recommendations to the Supervisory Council of the Bank of Albania for increasing the number of permitted financial activities to be conducted by the second tier banks;
- * Publication of the Supervisory Council decisions for granting the licenses and their revocation in the Official Bulletin of the Bank of Albania as well as in the newspapers with the widest circulation.

B. Banking regulations

The Supervision Department is responsible for drafting the supervision regulatory framework for the second tier banks, for a prudential activity of these banks with respect to the control of risks undertaken and liquidity management during their activity in order to meet the needs of the clients.

This framework consists of banking supervision norms and procedures materialized in drafting, approval and publication of the rules and regulations of the Bank of Albania related to:

- * Licensing;
- * Minimum initial paid-up capital size;

- * Accomplishment of prudential banking activity by the banks through the implementation of prudential regulations approved by the Bank of Albania on: credit, reserve funds to cover credit losses, open foreign exchange positions, regulatory capital and capital adequacy ratio, bank liquidity, etc.;
- * Regulations to be implemented by the second tier banks on lending and depositing operations with the clients.

C. Off-site analysis

The Supervision Department, in order to secure banking system stability, requires periodical reporting and provision of information by the second tier banks for financial analysis purposes. The main objective of this department is the data collection and financial analysis as well as the supervision through these analyses of the second tier banks and foreign banks branches activity.

The Supervision Department gathers monthly and periodic data from the second tier banks and processes them by focusing on the bank activity indicators and evaluates the financial progress and considers whether these banks comply with supervision regulations.

The Supervision Department in order to accomplish this function, evaluates, the data provided by the second tier banks, verifies their correctness and identifies the negative indicators of their performance that may lead to future problems.

Prior to initiating the financial analysis, it is important to check the accuracy of the reports and whether they are prepared in accordance with the rules and regulations approved by the Supervisory Council of the Bank of Albania. In addition, it is important the verification of compliance with all the norms limits defined by the Bank of Albania. The financial analysis process was made through calculation of some indicators and coefficients for the present and the past period in order to illustrate the overall performance of the banking activity and to notice the problems that may arise in the future.

The Supervision Department issues concise materials on the banking system situation in general and for some or several banks respectively. In this regard, the information processed and analysis of the indicators is made depending on the preliminary warning on the bank progress.

D. On-site examination

The Supervision Department is responsible for banking supervision that it realized through the on-site examinations of the second tier banks, branches of the foreign banks, foreign exchange bureaus and other subjects licensed to conduct banking business.

On-site examinations are carried out as full scope or partial examinations. The first ones are carried out usually every two years and the second ones depend on the bank performance and are numerous. Some other on-site examinations are carried out between two full scope examinations interval.

On-site examinations are focused on full control (full-scope examinations) and partial control (partial examinations) of the bank activities as follows:

- * Control on compliance with the law, implementation of the rules and regulations issued by the Bank of Albania, prudential activities performed according to the procedures and politics approved by managing board of the bank, performance of the bank management bodies, auditing of the financial bank activity by the

authorized Certified Public Accountant, correctness of the second tier bank reports provided to the Bank of Albania, etc.; and

- * In the full-scope examinations carried out by the Supervision Department the examiners evaluate the overall financial situation of the bank, evidence the violation of law and prudential regulations of the Bank of Albania give respective proposals for the application of penalties and punishments on the second tier banks and their administrators pursuant to the law “ On the banking System in the Republic of Albania”.

4. FUNCTIONS OF BANKING SUPERVISION

The Supervision Department aware of role and importance in the progress of the banking system in the Republic of Albania has carried out its function in the course of 1998 though:

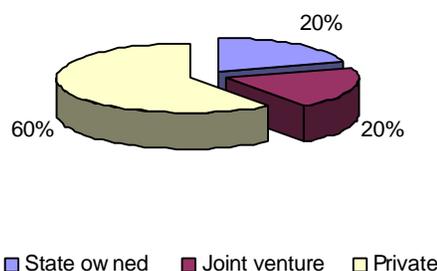
- * continuous contacts with the second tier banks,
- * complete and partial inspections,
- * analysis of monthly and quarterly indicators of these banks,
- * constant review of banking supervision regulation in order that the latter fit the developments of the banking system and implement the basic principles of banking supervision defined by the BIS Basle Committee,
- * careful and accountable analysis of any request to exercise banking activity in the Republic of Albania and to give authorization with respect to opening an account or make a transfer across the Republic of Albania.

4.1. Information and analysis of the banking system.

4.1.1. Structure of the Banking Sector.

By the end of 1998, the structure of the banking system presented changes in the favor of private banks. Therefore the number of banks with a hundred percent private capital reached to 5 at year-end.

Chart 1. Structure of the banking system¹ as of 31 December 1998, by number of banks



The banking system in the Republic of Albania from 1992 through 1998 underwent the following changes:

- In 1992, the following 3 state owned banks carried out banking activity:
 - * National Commercial Bank;
 - * Saving Bank;
 - * Rural Commercial Bank.
- In 1993 started its activity the Italian - Albania Bank, a bank with joint venture capital,
- In 1994 began its activity two other banks, Dardania Bank, a private bank, and Arab Albanian Islamic Bank, with a joint venture capital,
- In 1996, two other new private banks joined the banking system namely Tirana Bank and National Bank of Greece, Tirana Branch,

¹ The second - tier banks are categorized in the following groups :

- Group I - state - owned banks
- Group II - joint - venture banks
- Group III - the rest of the banks

- In 1997 began its activity another private bank, the International Commercial Bank,

- In 1998 began the operation two other private banks, the branch of Alpha Credit Bank and the American Bank of Albania. In the same year, the Bank of Albania revoked the license of the Rural Commercial Bank.

After these changes, on 31 December 1998 the banking system was presented with the following structure: 2 state owned banks, 2 joint venture banks and 6 private banks.

4.1.2 Total assets

Changes in the banking structure affected all indicators of the banking system. These changes are evident not only in the total amount of these indicators related to the whole banking system, but also in the significant increase of number of the third group banks.

The total assets of the banking system increased by about 26.9% compared to the end of 1997. This increase was the result of the increasing number of private banks. Therefore the third group of banks accounted for 9% of the total assets of the whole banking system at 31 December 1998 versus 3.6% recorded in the same period in 1997. Nevertheless group-I of banks, i.e. state owned banks, where the Savings Bank is outstanding, dominate the banking system.

On 31 December 1997, the total assets of the banking system recorded 167.3 billion leke and on 31 December 1998 this indicator reached to 212.3 billion leke.

Table 1. Total assets of the banking system by group of banks

(in billions of leke)

Year	Banks			Banking System
	Group I	Group II	Grupi III	
1997	150.3	10.9	6.1	167.3
1998	181.1	12.0	19.2	212.3

Table 2. Total assets of each bank in % to the banking system

	Banks					
	National Commercial Bank	Savings Bank	Rural Commercial Bank	Italian Albanian Bank	Arab Albanian Islamic Bank	Dardania Bank
31.12.1997	22.7	62.7	4.5	4.4	2.1	0.5
31.12.1998	13.7	71.7		4.2	1.5	3.1

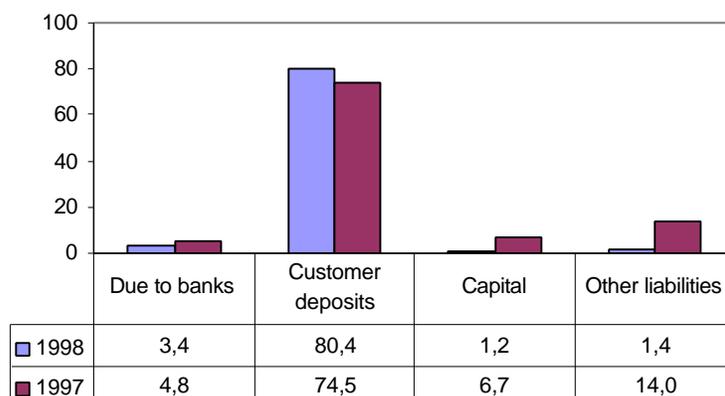
	Banks					Banking System
	Tirana Bank	National Bank of Greece (Tirana Branch)	International Commercial Bank	Alpha Credit Bank (Tirana Branch)	American Bank of Albania	
31.12.1997	1.4	1.4	0.3			100.0
31.12.1998	1.9	1.9	0.3	1.1	0.6	100.0

The banking system accounts for a staff of 2857 persons. Therefore to each employee belongs an average of 74.3 million leke of these assets.

4.1.3 Balance Sheet structure of the banking system

The structure of the balance sheet of the banking system accounts for insignificant changes at end 1998 if compared to end 1997. Therefore current accounts and time deposits constituted 80.4% of the total assets in 1998 from 70.5% in 1997.

Chart 2. Structure of liabilities of the banking system in %



Deposits increased in general. It was group-I of banks that absorbed the majority of these deposits. In 1998 this indicator for the first group of banks was 91.4% compared to 92.3% at end 1997.

Group-II of banks absorbed 3.5% of deposits against 4.5% at end 1997.

Group-III of banks absorbed 5.1% of the total deposits against 3.2 % at end 1997. This was due to the increase of the number of the new banks classified in this group (1% of the total deposits).

The structure of deposits by type of currency shows that deposits in leke constituted 76 % of the total deposits on 31.12.1998, whereas in 1997 they accounted for 71.7%. The banks of group-I, are the ones that dominated with 74.6% of the total deposits.

Table 3. Structure of deposits by type of currency for group of banks:

(in % to total deposits)

Banks	1997		1998	
	Leke	Foreign Currency	Leke	Foreign Currency
Group I	71.0	21.3	74.6	16.8
Group II	0.2	4.3	0.4	3.1
Group III	0.5	2.7	1.0	4.1
Banking System	71.7	28.3	76.0	24.0

Banks of group-I and group-II, have mainly clients that hold their deposits in foreign currency.

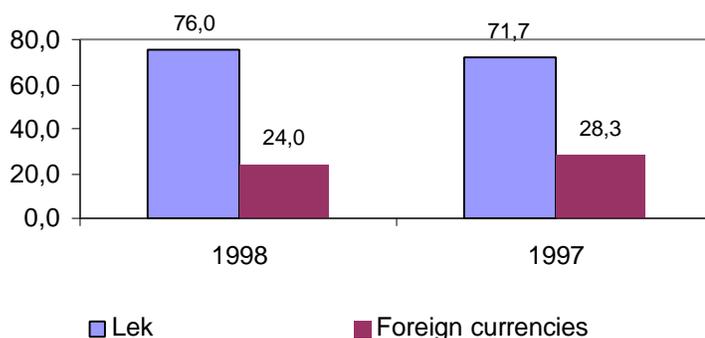
Therefore, by end 1998 the structure of deposits for the group-II of banks was 0.4% of the total held in leke and 3.1% in foreign currency.

As concerns group-III, the deposits in leke constituted 1% of the total deposits whereas those in foreign currency 4.1%.

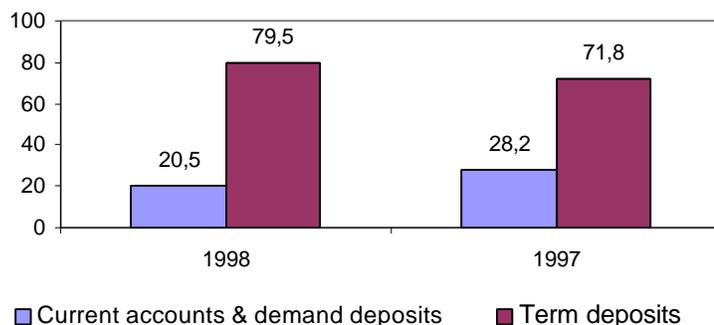
The structure of deposits by maturity shows that 79.5% of the total deposits of the banking system are time deposits and 96% of them is concentrated in the group-I banks and mainly in the Savings Bank.

Chart 3. Structure of deposits of the banking system

a) Structure of deposits by type of currency



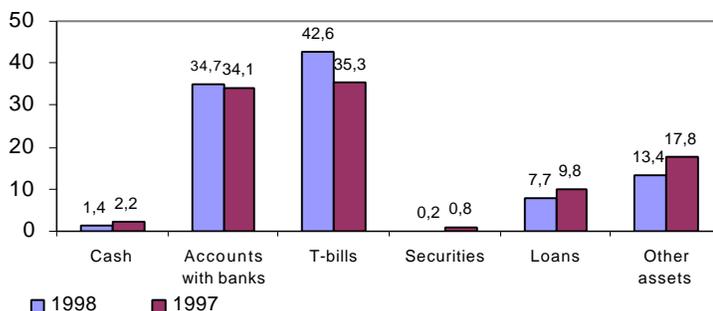
b) Structure of deposits by maturity



c) Structure of deposits by sector

The structure of assets of the banking system changed as well in 1998 compared to the previous year. Significant changes are observed in the investments of the banks in Treasury Bills.

Chart 4. Structure of banking system assets



Almost all the banks of group-II and group-III, invested in 1998 in Treasury Bills, different from 1997 when only banks of group one invested.

4.1.4 Structure of incomes and expenditures of the banking system

In 1998 the incomes of the banking system figured 104.7% higher than in 1997. This increase is observed almost in all the items of incomes but mostly in interest incomes.

As concerns expenditures, they increased 54.2%, mainly interest expenditures. Nevertheless, mention should be made of the fact that the banking system recorded some problems in this aspect.

Chart 5. Structure of incomes

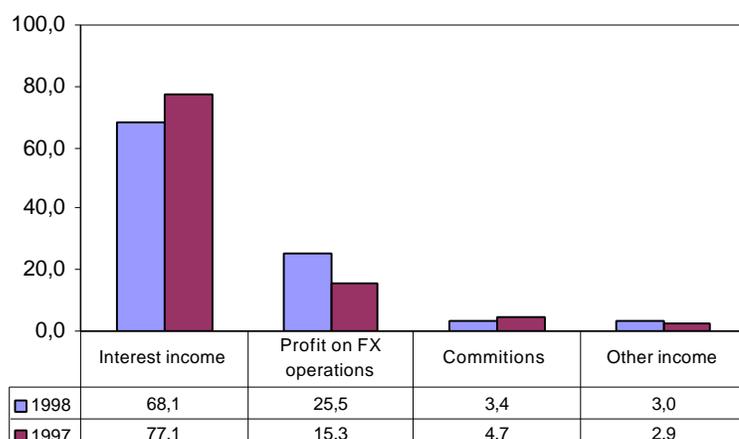
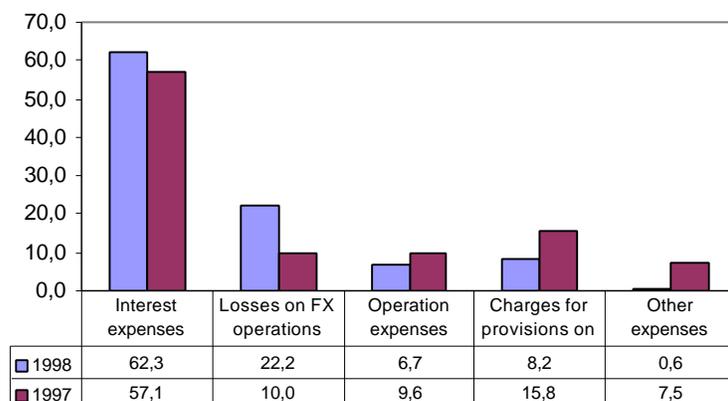


Chart 6. Structure of expenses



4.1.5 Profitability and Capital Adequacy

Table 4. Banking System Profitability

Indicators (in %)	1996	1997	1998
Return on assets	-0.5	-5.9	-1.7
Return on equity	-14.9	-84.9	-77.6
Administration expenses/ Gross administration incomes	106.0	-14.1	-437.7

Table 5. Capital Adequacy

Indicators (in %)	1996	1997	1998
Total of adjusted own funds (in millions of leke)	3,024.0	1,448.4	-2,410.3
Total of risk-weighted assets (in millions of leke)	31,319.6	26,393.3	27,231.4
Risk-based capital ratio (in %)	9.7	5.5	-8.9

With reference to the two above indicators, there are the banks of group-I that brought about their worsening.

Concerning capital adequacy it is observed that the group-II and group-III banks are enough capitalized, whereas group-I of banks showed many problems in this aspect.

4.1.6 Credit risk, classification of loans and creation of provisions.

Because of the bad experience in 1990 through 1997, the banking system was very prudent in extending loans. Although the total of credit surplus as of 31.12.1998 is almost the same as one year ago, the analysis shows that it is the group-I of banks that negatively affected this indicator.

Credit surplus of group-I of banks decreased by 16.8%. This was due to the measures taken by the Bank of Albania for this group of banks that restricted the extension of credits by those banks that had in their portfolio loans outstanding more than 30 days. Therefore these banks were not allowed to exceed the threshold of 20% of their loan portfolio. This measure affected two state-owned banks and a private bank with a bad loan portfolio. Most of these bad loans were taken by the Agency of Credit Recovery. In 1997 these loans were accounted for the credit surplus of the banking system amounting to 1.4 billion leke.

Quite the contrary happened with the other 2 groups of banks. Credit surplus of these banks increased respectively 45.8% and 246.7% compared to the previous year. Two other banks that had not extended loans through 1998, joined the third group of banks.

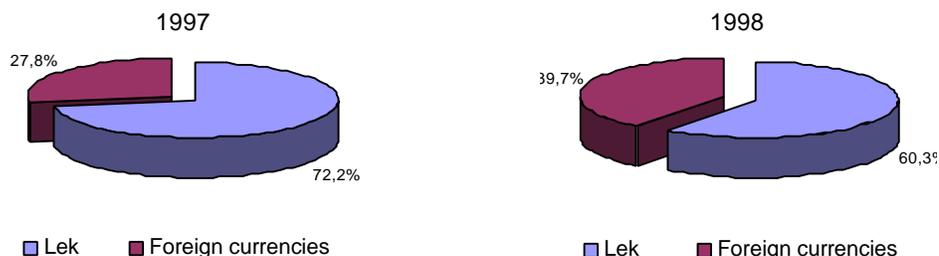
The structure of credit portfolio by type of currency of the banking system shows that 60.3% of the loans are extended in domestic currency. It is characteristic that group-I of banks were inclined to extend loans in domestic currency. This phenomenon is occurring with group-III of banks that through 1998 recorded an increase of these loans.

The structure of loans by maturity brings out such phenomenon as: whereas group-I banks have a long-term loan structure, group-II and group-III banks have extended more short –term loans, by implementing a prudent credit policy

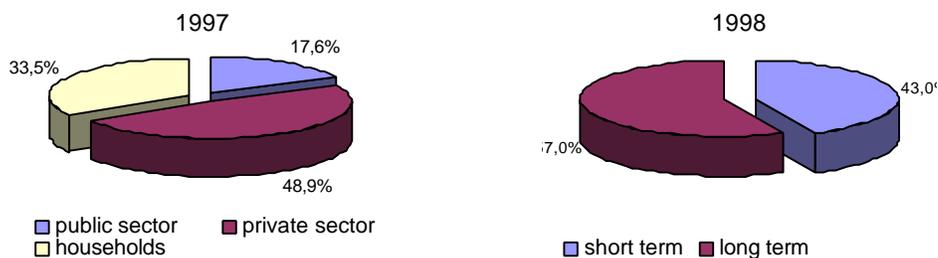
The structure of loans by sector shows a tendency of the banks to credit private sector. These banks consider the development of this sector as imperative.

Chart 7. Structure of banking system credit portfolio

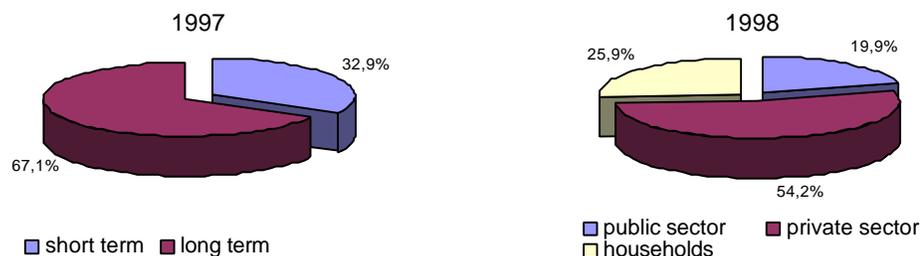
a) Structure of loans by type of currency



b) Structure of loans by maturity



c) Structure of loans by sector



As lending is a risky activity, Bank of Albania has issued and approved time after time the respective regulations for minimizing and protecting the banks from the risk. To be mentioned is the regulation "Classification of loans and creation of reserve fund to cover credit losses".

On 31/12/1998 the banks classified the loans by creating the respective provisions of about 7,5 million of Leke.

Table 6. Classification of loans and reserve fund
(in % to total)

Classification of loans	Classification of loans		Provisions coverage	
	1997	1998	1997	1998
Standard loans		42.0		0.9
Special mention loans		2.5		0.3
Substandard loans	15.0	7.6	3.8	3.3
Doubtful loans	20.6	6.3	13.3	7.0
Lost loans	64.4	41.6	82.9	88.5
Total	100.0	100.0	100.0	100.0

4.2. On-site examinations and corrective measures

Bank supervision is an ongoing process. This process is completed by systematically implementing and complying with the regulations and standards set to control the risk taken by the bank. This is achieved by analyzing the reporting systems of the banks and by carrying out on-site examinations.

On-site examinations are realized:

As full scope examinations that are related to the examinations of all banks or foreign banks branches activity once in two years. The group of examiners makes a general evaluation of the statement of bank on:

- * the implementation of the legal and regulatory system;

- * the implementation of policies and procedures defined by the bank itself;
- * management ability to manage the bank;
- * identification;
- * recording of all accounting operations and retaining of the necessary documentation on every transaction, etc.

As partial examination. These examinations are made for verification purposes and for special problems and are usually planned or made spontaneously depending on the problems that arise. After each examination a report containing findings, analyses and evaluations of the examined problems is prepared as well as conclusions, recommendations and the respective measures to be taken according to the article 44 of the law “ On the banks in the Republic of Albania”. The examinations unit supported by the Supervision Department carried out complete and partial examinations almost on the second tier banks and foreign exchange bureaus. With the complete examinations performed in 1998 and those scheduled to occur 1999, the Bank of Albania aims at examining every bank or foreign bank branch not less than once in two years tending to reduce this period in 18 months.

In the course of 1999, complete examinations are made in three banks whereas incomplete ones in 8 banks and branches of foreign banks.

From the examinations performed it is observed a tendency on the part of the banks to enhance their banking activity pursuant to the policies and procedures approved by them and in compliance with the rules and regulations of the Bank of Albania to identify, measure, monitor and control risk.

Other banking operations are being developed as well.

In the framework of a careful examination performed by the examinations sector on the second tier banks and branches of foreign banks, the inspections have made evident special cases of violations of the Bank of Albania rules and regulations. These violations are made with respect to: classification of loans and creation of reserve funds to cover credit losses, open positions in foreign currencies, foreign exchange market, bank liquidity, the activity in these banks of certified public accountants that are not approved by the Bank of Albania, etc.

As concerns the above violations the Bank of Albania has taken special measures towards these banks and the responsible managers by applying penalties as well.

The Bank of Albania has enhanced the co-operation with of the second tier banks to get them acquainted and make them comply with the Laws “On the Bank of Albania” and “On the Banking System in the Republic of Albania”, as well as with its rules and regulations, by respecting their legal, operational, financial and administrative independence.

4.3 Licensing and Banking Regulations

Licensing: The requirements to be met by the banks and defined by the Bank of Albania aim at allowing the entrance in the market of the new banks and other subjects that promise to be sound banking institutions and not threaten the stability and security of the banking system.

Regarding the above, besides the limitation of bureaucratic procedures the work is concentrated on strengthening the following:

- increase from 2 million USD in 1994 to 5 million USD of the minimum required capital to establish a bank.

- formulation and improvement of bank supervision regulations in compliance with the core principles of Basle Committee and the international standards for an effective supervision.
- cooperation with supervision authorities of the countries from where the applications to open banks, branches of foreign banks or representative offices derive and the perfection of our requirements with respect to this cooperation.

In 1998 were licensed to exercise banking activity in the Republic of Albania:

1. Branch of "ALPHA CREDIT" Bank, in Tirana

License No. 10, dated 07.01.1998

2. AMERICAN BANK OF ALBANIA

License No.11, dated 10.08.1998

Pursuant to the Law No.8075, dated 22.02.1996 "On the banking system in the Republic of Albania" it was licensed with License No. 1/1996, dated 17.07.1998 to continue banking activity, the **Italian Albanian Bank**.

The Law No.8365, dated 02.07.1998, "On the banking system in the Republic of Albania", Article 69 provided for the subjects that acted as banks in the Republic of Albania and were not licensed pursuant to the requirements of the Law No.8075, dated 22.02.1996 "On the banking system in the Republic of Albania", to apply for granting the license to continue banking activity.

As such were licensed:

NATIONAL COMMERCIAL BANK

SAVINGS BANK

DARDANIA BANK

ARAB ALBANIAN ISLAMIC BANK

Through 1998, the Supervisory Council of the Bank of Albania took the following decisions according to the recommendations of the Supervision Department:

1. Decision no. 107, dated 10.08.1998, "**For granting preliminary approval to FEFAD-Bank**"
2. Decision no. 106, dated 10.08.1998, "**For granting preliminary approval to INTERNATIONAL COMMERCIAL BLACK SEA BANK**"
3. Decision no. 142, dated 26.10.1998, "**For granting preliminary approval to THE BRANCH OF FIRST INVESTMENT BANK**"²

In order to have an effective supervision it is imperative the existence of a regulatory framework in the drafting of which it is aimed at:

1- Bringing it closer to the respective standards. This is dynamic process because the standards always undergo changes. Therefore we have maintained some requirements at more conservatory positions than the standards considering the risk of the Albanian economic environment.

2- Completion of the regulatory framework with new international requirements or with such requirements that were not applied before because of the non-existence of certain products.

Regulations: After the approval of the Law No. 8269, dated 23.12.1997, the Licensing and Bank Regulation Unit began to adopt banking supervision regulations to the requirements of the Law.

² have started operation

The Supervisory Council of the Bank of Albania, pursuant to Article 60, item 3 of this Law approved to keep in power the limitations provided for in the regulation "On the Foreign Exchange Market" except for Article 18, to allow the use of foreign currency as a means of payment in the Republic of Albania.

Other new regulations were approved as well:

-Regulation "On banking liquidity"

-Regulation "On the open positions in foreign currency" that replaced an order delivered by the Bank of Albania

-Some changes were made in the Regulation "On granting the license to act as banks in the Republic of Albania". These changes consisted mainly in increasing from 350 million leke to 700 million leke of the minimum amount of the required capital as well as other additional requirements with respect to the business plan and the administrators of the proposed bank.

-The Regulation "On the classification of the loans and the creation of reserve funds to cover credit losses" was reviewed with respect to a better classification of the loans pursuant to the core principles of banking supervision of the Basle Committee.

-In the regulation "On the prevention of money laundering" is made changes with respect to the increasing of the maximum amount of withdrawals of funds by the clients from the banks within the day. Any transaction above the threshold of 10 million leke per day had to be considered by the bank itself.

- The regulation for granting the license on new banks. The regulation "On granting the license to exercise banking activity in the Republic of Albania" was published in December 1998. Different from the first regulation, the new one defines clearly the requirements to be met by the subjects that apply to exercise banking activity such as banks, branches of foreign banks or representative offices of foreign banks in the Republic of Albania"

The core principles of cooperation with the central banks of the other countries in the area of bank supervision were defined according to the Basle Committee principles. These principles shall constitute the basis for the signing of cooperation agreements with other central banks on banking supervision, for a consolidated supervision and the exchange of information and experience in this area.

Pursuant to these principles was drafted and signed the Cooperation Agreement between the Bank of Albania and the Bank of Greece on Banking Supervision. This agreement defines the duties of both parties in the exchange of information and other cooperation forms for a sound and effective supervision of the branches and affiliates of foreign banks. There are attempts to sign similar agreements with the National Bank of Bulgaria, Turkey and Poland.

5. LIST OF APPROVED REGULATIONS (till July 1999)

- * Regulation **“On granting the license to perform banking activity in the Republic of Albania”** – approved with Decision of the Supervisory Council of the Bank of Albania, No.173, date 02.12.1998.
- * **Reporting System of the second tier banks** was approved in 1998 reflecting the changes pursuant to the Bank Accounting Manual. It entered into force on January 1999 together with the Bank Accounting Manual.
- * Regulation **“On granting the license non- to perform financial activity in the Republic of Albania”**- approved with Decision of the Supervisory Council of the Bank of Albania, No.26, date 18.03.1999.
- * Regulation “On the amount and make up of minimum initial capital for allowed activities of banks and branches of foreign licensed banks” approved with Decision of the Supervisory Council of the Bank of Albania, No.51, date 22.04.1999.
- * Regulation **“On the classification of loans and creation of reserve fund to cover credit losses”** approved with Decision of the Supervisory Council of the Bank of Albania, No.50, date 22.04.1999.
- * Regulation **“On the requirements to be met by the administrators of the banks and branches of foreign banks”** approved with Decision of the Supervisory Council of the Bank of Albania, No.13, date 17.02.1999.
- * Guidelines **“On the regulatory capital of the bank”** approved with Decision of the Supervisory Council of the Bank of Albania, No.57, date 05.05.1999.
- * Regulation **“On the open position in foreign currency”** approved with Decision of the Supervisory Council of the Bank of Albania, No.59, date 05.05.1999. According to this regulation the methodological guidelines **“On foreign exchange risks”** were issued.
- * Regulation **“On capital adequacy”** approved with Decision of the Supervisory Council of the Bank of Albania, No.58, date 05.05.1999.
- * Regulation **“On foreign exchange”** approved with Decision of the Supervisory Council of the Bank of Albania, No.63, date 05.05.1999.
- * Regulation **“On market risks”** approved with Decision of the Supervisory Council of the Bank of Albania, No.72, date 02.06.1999.
- * Regulation **“On bank liquidity”** approved with Decision of the Supervisory Council of the Bank of Albania, No.71, date 02.06.1999.
- * Regulation **“On significant risks”** approved with Decision of the Supervisory Council of the Bank of Albania, No.87, date 07.07.1999.