

4. REGULATORY FRAMEWORK

The methodological and regulatory supervisory framework is subject of review and continuous process of completion, aimed at implementing the applicable legal requirements and alignment with the directives of the European Union, a comprehensive implementation of Basel Principles, and the addressing of problems and suggestions of supervised entities, obtained through an on-going communication with them.

Banks and other financial institutions, subject to supervision by the Bank of Albania, have played an active role in the drafting and reviewing process of the bylaws. They have contributed with ideas and opinions about the regulatory amendments.

The Guideline "On the Internal Capital Adequacy Assessment Process (ICAAP)³ is a qualitative step forward in completing the supervisory process and improving the internal risk assessment and management processes at banks, and the start of the work to draft supervisory procedures related with the Supervisory Review and Evaluation Process (SREP)⁴. Also, various new regulatory acts were finalized. They are very important for banking supervision and the institutions entities subject to these acts. Furthermore, existing regulations were amended as follows:

- **Comprehensive review of the Regulation "On consolidated supervision" (approved by Decision No. 4, dated 1.2.2017 of the Supervisory Council of the Bank of Albania).**

This Regulation lays down the conditions, rules and regulatory requirements for conducting consolidated supervision, for the purposes of risk management deriving from a banking group and a financial group. The complete review of this Regulation was accomplished in compliance with the requirements and principles on consolidated supervision laid down in the directives and the regulations of the European Union (EU), and the standards of the Basel Committee. The reviewed Regulation sets out the rules for the supervisory authority, mainly on qualitative and quantitative supervision, the methodology to calculate regulatory capital and capital requirements for the main risks to banking and/or financial groups: credit risk; market and operational risk, including the important effect (material) that the dependant entities/institution might have. The regulation deals also with some qualitative supervisory requirements that address certain problems in the banking system in the framework of risks that

³ ICAAP – Internal Capital Adequacy Assessment Process.

⁴ SREP- Supervisory Review and Evaluation Process.



may derive from important transactions within the group, which are determined also in the European Union Regulation⁵ and the document of Basel Committee⁶.

- **Amendments to the Regulation "On capital adequacy ratio" (approved by Decision No. 5, dated 1.2.2017 of the Supervisory Council of the Bank of Albania).**

The purpose of these amendments is to re-introduce the measure that penalises (in terms of capital requirement) the placements of the banking sector with non-residents, while a part of measures have ended at the end of 2016. The change of the measure was considered to combine the need to maintain a higher capital requirement for banks that are active in placements with non-residents, and the need to place a limit on the measure to increase the capital requirement.

- **Amendments to the Regulation "On Prevention of Money Laundering and Terrorism Financing" (approved by Decision No. 22, dated 5.4.2017 of the Supervisory Council of the Bank of Albania).**

The purpose of these regulatory amendments was to fulfil the recommendations of the Moneyval Committee of Experts, provided in the last evaluation for Albania, and to resolve some issues concluded in the on-site supervision of the institutions that are subject to this Regulation.

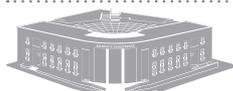
The amendments set out the requirements for the institutions, subject to the regulation, to compile and have in place internal rules and procedures regarding the implementation of the requirements against terrorism financing and the integrity of employees involved in the process of the prevention of money laundering and terrorism financing. Also, the amendments determine the obligation of institutions to inform the Bank of Albania, on the transactions related with persons declared as financiers of terrorism, and some additional requirements on reporting quantitative and qualitative data on money laundering and terrorism financing, according to a standardised form on annual basis.

- **Amendments to the Regulation "On transparency of banking and financial products and services" (approved by Decision No. 25, dated 3.5.2017 of the Supervisory Council of the Bank of Albania).**

The Regulation was amended with a view to completing and improving the regulatory framework of the supervisory authority on transparency of banking and financial products and services provided by the institutions subject to this Regulation, and the particular addressing of some problems at banks, regarding

⁵ "Regulation (EU) 2015/2303 of 28 July 2015 supplementing Directive 2002/87/EC of the European Parliament and of the Council with regard to regulatory technical standards specifying the definitions and coordinating the supplementary supervision of risk concentration and intra-group transactions".

⁶ "Intra-Group Transactions and Exposures Principles".



transparency with clients, by considering also the relevant recommendations of the Competition Authority. These amendments also aim at further aligning it with the European Directive on consumer protection, in the framework of continuous increase of requirements for the consumer protection.

The increase of transparency by the institutions subject to this Regulation improves the effectiveness of market discipline and the supervision by the Bank of Albania.

- **Approval of the new Guideline “On the Internal Capital Adequacy Assessment Process (ICAAP)”, (approved by Decision No 26, dated 3.5.2017 of the Supervisory Council of the Bank of Albania).**

The guideline sets out the requirements for the compilation and implementation of this process by banks, and the supervisory expectations, regarding the structure and content of the report that banks will submit to the Bank of Albania, on annual basis. This process is considered of particular importance to the bank and is realised by the bank independently, as it aims at assessing the adequacy of current and future capital levels, by considering also the bank’s risk profile and strategy (the following Box shows more detailed information on this guideline).

BOX 1. GUIDELINE “ON THE INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS”

The Supervisory Council of the Bank of Albania approved the Guideline “On the Internal Capital Adequacy Assessment Process (ICAAP)”, with the Decision No 26, dated 3.5.2017.

ICAAP is a process fully based on the internal processes and systems of the banks that helps to manage and effectively control the risk profile and consequently determines the necessary capital level. This process is oriented toward the quantitative elements of the risk management process - the assessment of internal capital requirements and risk hedging capital, as well as its qualitative elements, created to strengthen the internal rules of management and control of the bank, which allow for an effective management and mitigation of this risk.

Banks, for the realisation of this process, will follow two steps: first, they will determine the level of a specific risk they can undertake, in order to define their risk-bearing capacity and ensure adequate capital to cover this risk; and second, they will make a critical analysis of the risk level that is rational to undertake, taking into account all the possibilities and threats that correspond to this risk.

Banks, in drafting ICAAP, will consider, at least the implementation of the following basic principles:

- Responsibility.** *The bank shall be responsible for the implementation and development of ICAAP.*
- Proportionality.** *Banks will implement ICAAP, regardless of their size and complexity. Each bank shall use appropriate tools and processes in its ICAAP, while it shall prove/argument for the Bank of Albania that ICAAP is complete and appropriate for the risks arising from the activity and the environment in which this activity is conducted.*



- c) **Materiality of risks.** ICAAP must be focused on risks that may have a material impact on the current or future capital adequacy situation of the bank.
- d) **Forward-looking.** ICAAP shall focus on ensuring the bank's capital adequacy, taking into account future developments and its activity's performance.

The bank, in calculating its capital requirements, shall consider all the important risks and the other internal and external factors that define its risk profile.

- a) **Risks that are subject of the minimal capital requirement.** The bank, in calculating the internal capital requirement on credit risk, market risk and operational risk, shall use the methods defined in the Regulation of the Bank of Albania "On capital adequacy ratio".
- b) **Risks that are not entirely covered by the minimal capital requirement.** The bank, in calculating the internal capital requirements, shall also consider risks that are not entirely covered by the minimal capital, calculated according the standard methods defined by the Bank of Albania (standard methods for credit risk, market risk or the simple indicator method and the operational risk standard one), which overall do not consider some particular factors in capital calculation to fully hedge a certain risk.
- c) **Risks that are not subject of minimum capital requirement.** The bank, in calculating the internal capital requirement, in addition to the risks that are subject of minimal capital requirement, shall also consider the calculation of the internal needs for capital for the interest rate risk in the banking books, concentration risk, reputational risk, profitability risk, strategic risk, etc. The bank, depending on the complexity and particularity of its activity, may consider also other risks of this category and use its internal qualitative and quantitative methods for their assessment.
- d) **External environment factors.** The bank, in calculating the internal capital requirement, shall also consider the risks that may materialise in extreme, but not impossible, situations with a considerable impact on bank's capital adequacy. These risks may derive from the macroeconomic environment or market factors, or from the regulatory framework, for the assessments of which the bank shall use stress-testing.

Bank of Albania, based on the internal capital adequacy assessment process carried out by the bank, will establish the Supervisory Review and Evaluation Process with the purpose to establish an overall opinion on the risk profile of the bank and of its needs for capital.

- Amendments to the Regulation "On establishing the level of decision-making in the supervision of banking and financial activities" (approved by Decision No 29, dated 7.6.2017 of the Supervisory Council of the Bank of Albania).

The amendments aimed at completing the regulatory framework of the Bank of Albania, regarding the decision-making process and its delegation, set out in the appendices, integral part of this Regulation. The amendments provide compliance with the processes and decision making set out in other supervisory acts, in particular: a) the processes laid down in the new law and new supervisory regulations on savings and loan associations and their unions, and b) reflection of some repeals in the law regarding conservatorship on



banks and consequently the approval of the new law "On the recovery and resolution of banks in the Republic of Albania".

- **Amendments in the Regulation "On risk management in the activity of non-bank financial institutions" and some amendments in the Regulation "On the granting of license to non-bank financial institutions" (approved with the Decision No. 46 and 47, dated 6.9.2017, respectively, of the Supervisory Council of the Bank of Albania).**

The simultaneous and interconnected reviewing of these two regulations aimed, first, at addressing some problems identified during the examination in non-bank financial institutions, and second, to provide some facilities for these institutions in carrying out their financial activity. An important amendment in the Regulation "On risk management in the activity of non-bank financial institutions", regards the stipulation in case of breaches and the supervisory measures and escalated sanctions on these entities, previously referred to in the law "On banks in the Republic of Albania and the Regulation "On licensing and activity of non-bank financial institutions", for the cases of licence suspension/revocation.

- **The comprehensive review of the guideline "On recovery plans of banks" (approved with the Decisions No. 72, dated 6.12.2017 of the Supervisory Council of the Bank of Albania).**

The comprehensive review of the existing guideline "On the recovery plans", by replacing it with a new Regulation "On the recovery plans of banks" completes the regulatory framework on recovery plans, in compliance with the requirements set out in the new Law 133/2016 "On the recovery and resolution of banks in the Republic of Albania". The Regulation sets out supervisory requirements on the recovery plans of banks and banking groups, mainly regarding: the content, the way and term of presenting and updating the recovery plans and the simplified recovery plans, the minimum framework of qualitative and quantitative indicators, which are included in the recovery plans, the scenarios banks may include in these plans, as well as the minimum criteria that Bank of Albania takes into account for assessing the recovery plans of banks (The following box provides a detailed information on this Regulation).



BOX 2. REGULATION "ON RECOVERY PLANS OF BANKS"

In compliance with Law No 133/2016 "On the recovery and resolution of banks in the Republic of Albania"* , the Bank of Albania adopted the Regulation "On recovery plans of banks", by Decision No.72, dated 6.12.2017 of the Supervisory Council.

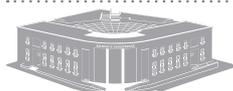
Recovery plans are an important part of risk management of banks, and of the assessment process of risk -based supervision from the Bank of Albania.

A qualitative recovery plan shall at minimum include information on the following issues:

- a) **A summary of all elements of the recovery plan.**
- b) **Bank's governance.** To ensure the plan is effectively compiled and in due time, the plan is crucial to be drafted on sound governance basis.
- c) **Recovery indicators.** The bank shall compile the framework of recovery qualitative and quantitative indicators, as an important part of recovery plan, which includes indicators of capital, liquidity, profitability, assets' quality, as well as market and macroeconomic indicators.
- d) **Strategic analysis of recovery plan.** Through the strategic analysis, the bank identifies the main activities (core business lines) and its critical functions, and determines the main steps to include them in the recovery scenarios.
- e) **Recovery measures.** Through the strategic analysis the bank identifies and assesses the recovery measures and the possible effects of their implementation.
- f) **Scenarios.** The bank, as part of the recovery plan, shall draft, at least, three scenarios: i. a systemic event, ii. a specific event, and iii. a combination of the two.
- g) **Plan of communicating and informing the group of interest.** The internal communication of recovery plan to the bank's employees and the external communication with all groups of interest is a crucial aspect of its effective implementation and avoidance of negative impacts on the financial system.
- h) **An analysis of preparatory measures.** The recovery plan may need organisational changes to facilitate the updating of the plan and its implementation in the future, to monitor the indicators, or because the process has identified some difficulties to implement the recovery measures. These preparatory actions to be undertaken by the bank or group should be included and described in the recovery plan, to assess if their implementation is possible and to facilitate the monitoring of their implementation by the bank and the supervisory authority.

The assessment of recovery plans by the Bank of Albania aims at ensuring the necessary information to the resolution structures, with the purpose the compilation of resolution plans, by considering the adequacy of capital and structure of bank's funds as a ratio to the complexity its organisational structure and risk profile.

* This Law is partially aligned with the EU Directive 2014/59 (Banking Recovery and Resolution Directive).



- **Amendments to the Regulation "On core management principles of banks and branches of foreign banks and the criteria for approving their administrators", approved with the Decision No. 73, dated 6.12.2017 of the Supervisory Council of the Bank of Albania.**

The reviewed Regulation aims the alignment with the recent requirements of the European Union regulatory acts on good governance and the compliance with the European Bank for Reconstruction and Development recommendations provided in the project on the assessment of the relevant legal and regulatory frameworks and supervisory practices of the Bank of Albania in place.

The amendments mainly consist in: definition of concepts: "risk appetite/tolerance" and "risk capacity"; and the requirements for the publication of special statement on the bank's risk appetite/tolerance; requirements to draft a special policy for appointing members of the bank's steering council; additional requirements for the risk management structure/unit and compliance unit; requirements for additional requirements on the credit status of the administrator proposed for approval; requirements to the bank to realise an analysis/assessment on the adequacy of professional knowledge of the administrator that is proposed to be approved; and requirements that banks conduct a regular re-assessment process of the administrators whenever deemed necessary, depending on the circumstances, during the discharge of their functions at the bank; etc.

- **Amendments to the Regulation "On internal audit system" (approved with Decision No. 74, dated 6.12.2017 of the Supervisory Council of the Bank of Albania).**

The regulatory amendments aimed at the approximation with best practices on internal audit and alignment with the amendments in the Regulation "On the core management principles in banks and branches of foreign banks and the criteria for the approval of their managers". In particular, the amendments set out the requirement to banks that the Head of Audit Committee be at the same time member of the Steering Council of the Bank, aiming at aligning it with the best practices that ensure the inclusion of the Audit Committee in the decision-taking process of the Steering Council and the limitation of risk for the expertise of the audit committee to remain only within the Committee.

- **Other legal acts**

The Supervision Department contributed also to the working group to compile the draft-law "On payment services", in the framework of the Bank of Albania's engagement to align the legal framework with the European Directive on Payment Services (PSD2)⁷.

⁷ *Payment Services Directive.*

