

### 3 PRIORITIES FOR 2017

By defining the priorities, the Supervision Department aims to address the main risks identified for the supervised entities as well as the challenges faced during the year.

The priorities of the Supervision Department for 2017 are expected to be the following:

#### 3.1 CREDIT RISK

Despite developments and progress in non-performing loans (NPLs), their stock or respective indicators remain high. The process launched in the third quarter of the previous year to increase the communication with banks for addressing NPLs will continue throughout 2017. The required periodic reporting consists in drafting strategies for reducing NPLs in accordance with the annual budgets drafted by banks as well. Similarly, the Recovery and Resolution Plans for large borrowers has been required to be drafted in accordance with regulatory provisions. These two elements will be monitored continuously to assess the steps taken by each institution along with the achieved results. The communication will continue so as to bring attention to the issues that may be identified and the need to address them.

At the same time, work will be done to build a framework scheme for cooperation between banks to find a solution for a common borrower. This scheme aims at encouraging banks to coordinate and join efforts to address more efficiently borrowers by identifying the real space for restructuring as well as providing sufficient space for businesses to function within their capacity and to pay their obligations. This scheme foresees some core principles for coordination between banks and cooperation with the borrowers, defining framework agreements for cooperation among banks as well as between banks and borrowers and also establishing mitigating and coercive supervision instruments to promote this process. This scheme is being drafted in cooperation and with the assistance of World Bank's FinSAC project, referring to the best practices and similar experiences of other countries.

In the framework of the national plan for the reduction of non-performing loans, the Bank of Albania stands ready to cooperate with other stakeholders and contribute not only to the acceleration of the procedures for out-of-court debt settlement but also in other issues, such as increasing banks' access to collaterals used for securing loans or clarifying tax treatment of non-performing loans in cooperation with other state institutions or the Albanian Association of Banks.



### 3.2 REGULATION AND SUPERVISION OF BANK'S GOVERNANCE

In 2016, a project started focused on good governance of banks with adequate assistance in this field, in order to calibrate the regulatory framework and supervision methods regarding bank management with those of European Union countries. During the first phase of the project, a comparative analysis was carried out on the current regulatory and supervisory requirements of the Bank of Albania, vis-a-vis those of the European Union. During 2017, key recommendations and findings are planned, in addition to their implementation, the development of relevant methodologies as well as the training of the Supervision Department staff. The project targets the following:

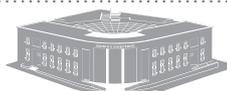
- Structure of banks' governance, steering council and its committees, their composition, responsibilities and role in promoting a more efficient and transparent control environment;
- Governance focused on risk management, particularly credit risk, to which the banking system is most exposed;
- Governance focused on assessment and regulation of remuneration policies;
- Governance focused on assessment and regulation of the compliance and internal audit functions.

### 3.3 COMBINATION OF THE SUPERVISION AND RESOLUTION FUNCTIONS

The approval of the Law "On Recovery and Resolution of Banks" by the Parliament of Albania in December 2016, provided the Bank of Albania, as the Resolution Authority, with a set of legal instruments to intervene early and promptly enough in unsound or collapsing banking institutions. In this framework, the Supervision Department together with the Resolution Department will define the forms, conditions and method of mutual collaboration.

At the same time, this law provides greater support for setting out regulatory requirements for drafting recovery plans<sup>2</sup> in case of significant deterioration of banks' financial standing. Consequently, it is necessary to revise the current requirements for preparing recovery plans presented by some banks since 2012 (banks assessed as having a high systemic impact). During 2017, the revision of the regulatory framework in force for recovery plans is foreseen. This framework will, inter alia, be complemented with the qualitative and quantitative indicators to be included in these plans. Unlike the insofar practice,

<sup>2</sup> Recovery plans are drafted by the bank itself, which define the actions and the instruments that will be used to restore the indicators and the financial situation of the bank in case of their significant deterioration. These plans should not foresee interventions with unconventional instruments by certain authorities and obliges the banks to conduct a detailed self-assessment and identify the instruments available to withstand difficult situations.



recovery plans will be required by all the banks of the system, but for banks that are not systemically important, a simplified representation will be allowed proportionate to their size and activity. Upon the drafting and adoption of new bylaws pursuant to the new law, banks will present their recovery plans, which will undergo another assessment by the Supervision Department.

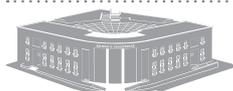
### 3.4 IMPROVEMENTS OF THE SUPERVISION REGULATORY FRAMEWORK

1. Drafting the new regulatory framework for liquidity risk management as required by the European Directive and Regulation on the activity of credit institutions and Basel III for the liquidity indicators. The new framework will aim to present the indicators of Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) initially in the form of reporting requirements for these indicators and then, in the medium-term period, continuing with the implementation of the respective prudential limits;
2. Finalization of the regulatory framework according to the requirements of Basel Capital Accord II and of the European Directive and Regulation on the requirements for the Internal Capital Adequacy Assessment Process (ICAAP) and on consolidated supervision;
3. The review of the regulatory framework for capital adequacy aims to further align the capital adequacy requirements in force primarily with the purpose of presenting the requirements for the implementation of internal models and/or advanced methods for Pillar I risks or standard methods reviewed by the Basel Committee.

### 3.5 COLLABORATION WITH THE EUROPEAN CENTRAL BANK

With the creation of a Single Supervisory Mechanism (SSM) at the European Central Bank in November 2014 and considering the active presence in Albania of subsidiaries of large European banking groups, the Bank of Albania and the European Central Bank are in the process of drafting a comprehensive agreement that will regulate all the fields and aspects of this cooperation.

During 2017, the Supervision Department aims to take part in some of the Supervisory Colleges for European banking groups present in Albania, as an observer, through the signing of a specific agreement for this purpose. This is considered as an important step, not only in the framework of strengthening cooperation with EU supervision authorities and the alignment with the most advanced supervision practices, but also in the framework of a more comprehensive supervision assessment of banks originating in European countries that carry out their activity in Albania.



### 3.6 PREPARATION OF ROUND FIVE OF THE ASSESSMENT BY THE MONEYVAL COMMITTEE

The Moneyval Committee assessment consists in giving an opinion on Albania's anti-money laundering standards. The next assessment by Moneyval will be based on the compliance of the measures taken in the field of AML/CFT with the recommendations of FATF, revised in 2012, as well as with the new FATF methodology of 2013.

In addition to the other institutions involved in this process, the Bank of Albania plays a very important role in preparing the necessary information for this assessment, as the supervisory authority of the financial system and vested with the authority given to it by the relevant AML/CFT legislation.

### 3.7 STRENGTHENING SUPERVISION CAPACITIES

Capacity building remains a priority issue, dictated by markets developments as well as the change of supervision methodologies. In accordance with the implementation of the supervision policy and in line with developments in the market, this year's focus will be on the concentration of resources in high-risk activities as well as on systemically important institutions. This will be based on the careful design of strategies and proper planning of the supervision steps, aiming to increase the efficiency of human resources and timeframe, with a view to improving the quality of the produced materials.

Another instrument that helps the supervision this year is the Internal Assessment Process of Capital Needs, a document drafted in the light of Pillar II of Basel II Accord. This document helps defining the orientation of capital needs assessment for each risk taken by banks and is an instrument that helps supervision for the right quantitative and qualitative capital allocation. In order to implement it fully, the staff should be properly trained to assess efficiently the work of banks, which requires maintaining the existing human resources and attracting new ones. These latter elements are valuable and will be taken into consideration for all the other supervision processes as well.

The full efficiency of the Early Warning System will also be an important instrument of off-site supervision for the timely identification of issues and focusing the attention on the right issues. Its further improvements through the cooperation with the Bank of Italy will increase the qualitative value of the analysis and its harmonization with the methods of counterpart institutions of the European Union.

The building of internal criteria for assessing the quality of financial analysis in banks' lending is a new process that will help supervision. Regarding the criteria, we have also benefited from the experience of the Bank of Italy based



on its work practices, and we will refer to the relevant manuals of the European Central Bank and international accounting standards as well.

Table 1 Supervision priorities for 2016 - 2017 and foreseen activities

Priorities 2016		Priorities 2017	Planned actions	Extension for a further period
Credit risk/ NPLs performance	→	Credit risk/ NPLs performance	- NPLs strategy - Resolution and Recovery plan for large borrowers - Platform for addressing common loans of banks	
		Capitalisation of business strategy	- Consultaion with banks for ICAAP-implementation - Assessment of Recovery Plans	
Regulatory framework development	→	Approximation of regulatory supervisory framework with European standards	- Liquidity risk - BAZEL III - PVBKM - BAZEL II - Capital adequacy - BAZEL II  - Assesemnt of regulatory framework alignemnet with EBA  - Regulatory framework for Recovery Plans - Interconnection of supervision with resolution plan	
Draft of the Law On banks resolution and recovery				
Regulation and supervision of banks' governance	→	Review of regulatory framework and of supervisory methodics on banks' governance	- Consultations with EBRD and assistance from Deloitte Albania and Deloitte England - Methodological developments - Staff training	
		Collaboration with ECB	- Formalisation of the relationship with ECB and for Supervisory Colleges	
		Risk-based supervision	- Early warning system - Determination of assessing criteria for lending	
Consolidation of internal supervisory processes	→	Increase of internal capacities	- Preparation for the implementation of ICAAP - Preparation for the Process of Supervisory Assessment - Implementation of consolidated supervision	
		MoneyVAL Committee	- Preparation of questionnaires for the assessment	

