

## **Gent Sejko: Bank of Albania – strengthening governance and recent other challenges**

Introductory statement by Mr Gent Sejko, Governor of the Bank of Albania, presenting the Annual Report 2015 to the Parliamentary Committee on Economy and Finance, Tirana, 29 March 2016.

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***Honourable Chair of the Parliamentary Committee on Economy and Finance,  
Honourable Members of the Committee,***

It is my special pleasure to present, in this hearing session with the Parliamentary Committee on Economy and Finance, the Annual Report of the Bank of Albania for 2015.

In 2015, the Bank of Albania has worked to successfully fulfil its objectives stemming from the Law “On the Bank of Albania”, as well as all the other obligations arising from relevant sublegal acts and relations with our international partners.

I would like to start my presentation, focusing on the activity of the Supervisory Council of the Bank of Albania.

### **1. Decisions of the Supervisory Council**

At the beginning of 2015, the management team of the Bank of Albania was rendered complete. Thus, thanks to the support of the Assembly of the Republic of Albania, the vacant positions in the Supervisory Council were completed, the Governor, the Second Deputy Governor and Inspector General of the Bank of Albania were appointed.

During 2015, the Council met 15 times and approved 98 decisions. Of them, 63 consisted in acts approved for the first time, and 35 in amendments to existing acts. Eight meetings focused on the monetary policy decision, whereas four meetings focused on decisions about issues pertaining to supervision and financial stability.

The decisions have been communicated to the public through press conferences, full publication of relevant reports and explanation, on a case by case basis, in accordance with requests by various media outlets. All the reports compiled by the Bank of Albania on the monetary policy and financial stability have been fully submitted, within the envisaged legal time frame, to the Assembly of the Republic of Albania and its Committee on Economy and Finance.

In line with the above said, and in accordance with earlier public statements, the strengthening of governance has assumed a key place in the Supervisory Council decision-making process. From this perspective, I will now briefly focus on:

#### ***Establishment of the Audit Committee***

The establishment of the Audit Committee is an important development with regard to strengthening the internal control at the Bank of Albania, especially the supervisory capacities of the Supervisory Council. The meetings held in 2015 discussed the organisation and functioning of the Control [Internal Audit] Department, the audit universe and annual plan, main findings, risk assessment and effectiveness of the internal control system at the Bank of Albania. Another important aspect of the activity was to monitor the work for the preparation of financial statements in accordance with the International Financial Reporting Standards.

### ***Approval of the internal audit policy***

The approved internal audit policy, followed by the revision of the Regulation on the Functioning of the Control Department, defines clearly the position of the activity of the internal audit within the organisational structure of the Bank of Albania. This document provides for the implementation of the Standards for the Professional Practice of Internal Auditing and the Code of Ethics, and specifies the line of reporting of the Inspector General to the Audit Committee, Supervisory Council and Assembly of the Republic of Albania.

### ***Approval of the new Statute of the Bank of Albania***

The new Statute provides for the compliance of many of the provisions for the organisation and functioning of the Bank of Albania with the best practices of the European System of Central Banks. Among others, I would like to mention:

- specification of duties and responsibilities of the Administrators of the Bank of Albania;
- specification of procedures for the replacement of the administrators, during their absence or when they are unable to act;
- reformulation of provisions that stipulate the administrative and financial independence of the Bank of Albania by approximating them to the provisions stipulated in the Statute of the European Central Bank.

### ***Approval of the Medium-Term Development Strategy and Budget for 2016–18***

The medium-term strategy summarises key objectives and major ambitions of the Bank of Albania for the next three years. Following are some of the strategic objectives of the Bank of Albania:

- maintaining price stability around 3%;
- strengthening financial stability;
- strengthening banking supervision;
- enhancing financial market security and efficiency;
- enhancing and approximating institutional capacities to the European model.

To materialise the strategy, the medium-term budget has been prepared for the financial management of the institution in the upcoming three years.

### ***Approval of the new organisational structure of the Bank of Albania***

The new structure of the Bank of Albania adapts the activity of its units to the needs and new process imposed by economic developments and changes in the banking legislation. Moreover, it aims at improving the institution's management and strengthening the internal control. The establishment of the specialised unit to monitor and manage the operational risk is a crucial step in this regard. Also, the new structure aims to strengthen the vertical and horizontal control in compliance with international best practices, models and standards.

### ***Strengthening cash security and management systems***

The Supervisory Council and other administrative structures have reviewed the entire regulatory framework for the security and protection of physical values and information at the Bank of Albania, enhancing both human and technology-related elements. A series of decisions have been made to strengthen the security measures and physical monitoring of the premises where cash is stored and processed, in the form of banknotes and coins. Significant improvements have been made to procedures related to the inventory, processing

and storage of banknotes, including those for destruction. Particular attention has been paid to setting clear criteria to guarantee high integrity of the employees designated in charge of values or assigned in other units engaged in control, supervision or other similar activities.

## **2. Economic developments and monetary policy**

The Albanian economy continued to improve in 2015. The growth rate accelerated compared to the previous year, and the main indicators of economic and financial equilibriums have been overall improving. Thus:

- current account deficit reduced;
- budget deficit fell 1.6 percentage points against the GDP;
- firms' balance sheet appear more liquid;
- banking system non-performing loans and profitability indicators have been improving.

However, aggregate demand remains insufficient to fully utilise production capacities. Subsequently, the internal economic environment has exercised low pressures for rising inflation, which have been further strengthened by the disinflationary trend noted in international markets. While upward, inflation continued to range below our 3.0% target, during the past year.

Following, I will present a summary of the macroeconomic backdrop underlying Bank of Albania's monetary policy decisions and their results.

According to INSTAT data, the Gross Domestic Product rose 2.7% during the first three quarters of 2015. Available data suggest that the economy continued to grow at a similar pace even in the fourth quarter.

From the sectorial perspective, the sources of growth are broader than in the previous year. With a few exceptions, all the sectors have contributed positively to the expansion of economic activity.

From the demand perspective, economic growth was driven mainly by the expansion of private investments and improvement of the balance of trade exchanges with partner countries. Private consumption showed volatility, but its contribution was positive during the third quarter. Fiscal policy continued the consolidating stance. In line with previous statements, fiscal consolidation is the right approach for preserving the macroeconomic foundations. Consolidation creates more space for the expansion of the private sector and produces long-term benefits for the Albanian economy, for its capacity to withstand various shocks.

However, while associated with higher employment and utilisation of production capacities, the growth of aggregate demand has not been adequate to absorb all the spare capacities in the economy. Unemployment averaged 17.5% in 2015, reflecting the unused capacities in the labour market. Thus, pressures on the rise of wages, productions costs and profit margins were weak. Annual inflation averaged 1.9% for 2015, up 0.3 percentage point from a year earlier.

To address low inflationary pressures, the Bank of Albania continued to implement an accommodative monetary policy. It lowered the key interest rate, increased the liquidity injection in the banking system and engaged publicly in maintaining the accommodative monetary policy stance in the medium-term period. The key interest rate fell to the new historic level of 1.75% at the end of 2015.

These decisions have aimed at creating the appropriate conditions for boosting domestic demand, and for the return of inflation to target in the medium term. Moreover, our monetary

policy has been transmitted in lower interest rates across all financial instruments in the domestic currency.

During the fourth quarter, the transmission was also helped by the shift of the budget deficit financing, from domestic to foreign resources. The shift has increased the liquidity in domestic financial markets significantly and has reinforced the downward trend of their interest rates.

Consequently, the average interest rate on loans dropped further during 2015. Combined with the measures taken for reducing non-performing loans, monetary stimuli were reflected in the easing of credit standards. Excluding the effect of write offs from the balance sheets, credit to the private sector grew by ALL 12 billion, or 2.2% in the past year. The monetary policy pass through was reflected also in the reduction of the euroisation in the Albanian economy. At the end of 2015, lek credit to the private sector amounted to 41% of total loans, from 32% at the end of 2010.

The Bank of Albania expects credit to perform better in the medium term, but this projection remains largely dictated by the further improvement of the crediting climate in Albania. Against this backdrop, I take the opportunity to reiterate that the national plan for addressing non-performing loans should be considered as a non-negotiable prerequisite for the growth of credit in the future.

In parallel, pressing ahead with structural reforms agenda will provide for faster and more sustainable development of the Albanian economy.

### **3. Banking system highlights**

For 2015, indicators of banking sector soundness were evidently better than the regulatory requirements for solvency, liquidity and specific-risks provisioning levels. These indicators show a satisfactory level of resilience even when adverse macroeconomic scenarios are assumed.

The number of banks operating in the Republic of Albania remained unchanged, at 16 banks. The major part of the banking sector is owned by subsidiaries of EU-based banking groups that exercise their activity in accordance with the Albanian legislation and in accordance with Bank of Albania's regulatory framework in force.

During 2015, the American Bank of Investments entered the Albanian banking market, the first investor since 2009. This development is considered as a very positive one for promoting competition within the banking system.

At the end of 2015, banking sector assets expanded by 2%, reaching 91.3% of the Gross Domestic Product. The activity continued to be financed by the growth of public deposits by 2.6%, accounting for 83% of the total banking sector balance.

Average profitability indicators improved during 2015. The Return on Assets (RoA) stood at 1.2% and the Return on Equity (RoE) stood at 13.2%. This financial result forms a good basis for the stability of the banking system.

The capital adequacy ratio stood at 15.7%, notably higher than the 12% minimum required in the regulatory framework. Good capitalisation remains a feature of our banking system. It was maintained due to the continuation of positive values in net financial result.

Addressing the non-performing loans issue has been one of the major engagements of the Bank of Albania throughout 2015. For the first time, after a four-year period, the level of non-performing loans fell below 20%. Decisions taken by the Bank of Albania have constantly increased the pressure on the banking system, which, in turn, has added the efforts for managing non-performing loans through restructuring, execution, provisioning and their write off from the balance sheet, accordingly.

The inter-institutional initiative materialised in the Plan of Measures for Reducing Non-Performing Loans, which consists in a multidimensional action of legal, fiscal and regulatory improvements, contributed to lowering the stock of non-performing loans to 18.2 % at the end of 2015. This plan includes other steps over the course of 2016, which will render the positive result even more visible in the system.

Moreover, in 2015 the banking system was tested by the psychological pressure arising from the Greek crisis; however, it passed the test successfully. On the other hand, the situation served to test the effectiveness of prudential measures that the Bank of Albania had taken in due time.

#### **4. Banking supervision**

During 2015, we have worked on further bolstering banking supervision. In concrete terms, we have worked on the following:

- Implementation of the risk-based supervisory policy;
- Implementation of the risk assessment manual and of the new bank assessment system;
- Implementation of the new regulation for calculating the capital adequacy ratio in compliance with Pillar I of Basel II.

The implementation of these contemporary methodologies guarantees a high degree of compliance with international best standards, rendering our approach able to identify the risks in due time and dictate taking corrective measures for preventing the occurrence.

Another achievement in terms of the approximation with the standards of EU homologous institutions was the positive assessment of the confidentiality regime of the Bank of Albania by the European Banking Authority (EBA). In October 2015, through a Memorandum of Cooperation, this Authority certified this regime as in full compliance with the relevant EU standard, including the Bank of Albania in the list of non-EU supervisory authorities that may take part in the work of EU colleges of supervisors.

In the framework of the system's supervision, during 2015, a considerable number of on-site examinations were carried out. Upon completion, the examined institutions were left relevant recommendations to make the necessary improvements and to draft a plan of measures, whose implementation will be rigorously monitored. In the past year, the process of licencing continued for new financial institutions such as microcredit and electronic money institutions and a considerable number of foreign exchange bureaus.

#### **5. Other activities of the Bank of Albania**

##### ***i. Payment systems***

In 2015, the Bank of Albania undertook a series of measures to improve the regulatory framework and oversight procedures for the payment systems. The approval of the Regulation "On licencing, regulation, and oversight of payment systems and clearing houses" is one of the main steps that will promote private initiatives for the clearing and settlement of payments.

In October 2015, the National Committee of Payment Systems met for the first time. The Committee will serve as a forum for discussing issues related to payment systems and instruments, to support the decision-making process by the relevant institutions. Another development in the area of payments is related to the methodology "On the reporting of electronic money instruments by electronic money institutions", which preceded the licencing of two electronic money institutions in 2015.

## **ii. Currency issue**

In the framework of its unique function as the issuer of the national currency, the Bank of Albania continued to fulfil the needs of the economy for banknotes and coins, in accordance with contemporary standards for their quality and security features. Compared to 2014, the structure of the currency in circulation has changed. Thus, the number of higher denominations, ALL 2000 and ALL 5000 increased. Also the use of coins increased, as their value rose by 8.2%.

## **iii. Foreign-exchange reserve management**

The reserve management continued to be conducted in accordance with the regulatory framework in force. The primary objective of the reserve management is the principle of liquidity and security. In line with our policy and international standards on adequacy, we continued in this year to ensure that the reserves are at adequate levels and in conformity with our goal.

Year 2015 was characterised by a further decline in negative territory of interest rates for treasury issues in the euro area. Thus, for the euro portfolio, the possibilities of investment with a positive rate of return, compared to the previous year, are reduced significantly. Regardless of this fact, the result created by the management of the reserve portfolio for 2015 was positive.

## **iv. Legal service**

The improvement of the legal and regulatory framework has been a constant priority for the Bank of Albania. During the year, the Law “On Savings and Loans Associations” was drafted, consulted and submitted to the Assembly of the Republic of Albania for review. The law regulates the SLAs licencing, supervision and activity in accordance with the best standards. In close cooperation with the Albanian Deposit Insurance Agency, amendments have been drafted to the Law “On deposit insurance”, which improve the implementation of the Law on SLAs and include certain categories of legal persons in the deposit insurance scheme. The law on the treatment of banks facing financial difficulties, also known as the Resolution Law is another important project we have been working on during 2015 and are still working in cooperation with the World Bank. Significant work has been carried out also with regard to the regulatory framework.

## **v. Monetary and financial statistics**

Last year was a successful one for the Bank of Albania in its role as one of the three national agencies producing statistics. Expanding statistical information, and perfecting some of the methodologies underlying the statistical product of the Bank of Albania have been evaluated positively by international institutions, making thus significant progress towards the approximation with Eurostat and IMF standards.

In 2015, the Bank of Albania published, for the first time, the annual information on the flow of foreign direct investments by country, flow of foreign direct investments by economic activity and situation of foreign direct investments by country and economic activity.

## **vi. Research**

During 2015, the Bank of Albania completed over 20 empirical studies and analyses dedicated to problems and potential solutions for issues related monetary policy effectiveness and safeguarding financial stability. During 2015, the revaluation of the Macroeconometric Model of the Albanian Economy was completed. The process improved the identification and interpretation of cause-effect macroeconomic correlations.

Research work has been presented in various events and conferences, including those organised by the Bank of Albania, notably, the 9th Workshop of Economic Research in

Southeastern Europe “Rethinking Economic Policies and Central Banks’ Methodologies”, where 20 research papers were presented by central banks, academic institutions and the Bank of Albania.

#### **vii. Communication**

Enhancing the transparency is a constant priority of the Bank of Albania. During 2015, we have aimed at establishing permanent channels of communication with the public. They reflect Supervisory Council’s monetary policy decisions, the underlying factors and expected results. The periodic reports of the Bank of Albania publish comprehensive analysis on economic and financial developments, the outlook for the short and long term, and the performance of the banking sector along with the risks facing the financial stability of Albania. Events organised with representatives of the banking system, business community, specialised international institutions are another aspect of our communication with the public. Examples include the Forum on “Promoting credit growth” in April 2015, “Albania Financial Forum III” organised with the International Monetary Fund in June 2015, and a meeting with the banking system discussing on “The economy and banks: present and future challenges” in September 2015.

#### **viii. Public education**

The launching of the Museum of the Bank of Albania was the main highlight in the area of public education. Designed as an inter-disciplinary museum, it integrates numismatic, historic and educational functions, which contribute to enhancing the financial literacy of the public in general and of the younger generation in particular.

#### **ix. European integration**

Another important aspect of our work has been the contribution of the Bank of Albania in the context of approximation to the European Union. The Bank of Albania has intensified its cooperation with the European Central Bank, central banks of the European System, and European structures that regulate financial aspects in the EU. At the same intensity, we strengthened the cooperation with the International Monetary Fund, the World Bank and the Bank for International Settlements, as well as regional central banks.

The Bank of Albania has continued its contribution to the reporting for the Progress Report and the National Plan for European Integration, leading Chapter 4 “Free movement of capital” and Chapter 17 “Economic and monetary policies” and contributing in 6 other chapters of the Acquis.

#### **x. Human resources**

Improvement to the organisational structure of the institution has constantly been at the focus of human resources policies, with the main aim to enhance the efficiency of the activity of the Bank of Albania. It seeks to provide a better coordination and communication between the units, especially the successful implementation of engagements arising from strategic objectives and the approximation with the model of the European System central banks or the European Central Bank.

The policies in the area of human resources have aimed at promoting the most experienced and proficient employees, through a professional competition. Staff motivation policies have aimed at preserving the stability and continuity of staff. Particular attention has been paid to observing gender equality.

The professional development of the staff is realised, among others, through participation in specialised training organised by central banks or international financial institutions. In addition to enhancing professional capacities, there are also possibilities for the exchange of professional experiences and familiarisation with the most contemporary central bank theories and practices.

***xi. Information technology***

In 2015, the aspect of Information Technology saw several achievements. The AFISaR system started to operate. It is a central electronic register for the documentation of each element involved in the issue and transactions with securities by the Albanian state. Other achievements include:

- automation of the reporting system for banking activity indicators;
- integration and optimisation of the IT network utilisation, reducing therefore operational costs of the Bank of Albania;
- automation of accounting transactions in Bank of Albania branches and improving information processing and storing capacities.

***xii. Internal audit***

In 2015, in addition to planned audits, auditing and non-auditing commitments were carried out, upon the request of the Supervisory Council, Audit Committee, Administrators and Inspector General.

Another important development in this regard was the Quality Assessment for the Control [Internal Audit] Department at the Bank of Albania by the De Nederlandsche Bank (DNB). Conducted for the first time, the assessment serves as an important development plan for strengthening the audit activity in the future.

During 2015, nine full-scope audits were conducted. In addition, three full-scope audits started in 2015, but were completed in the first months of 2016, bringing the total number to 12. The findings and recommendations of each audit have been addressed to the heads of the respective units, the Administrators of the Bank of Albania, the Audit Committee and the Supervisory Council, as part of the periodic reporting by the Inspector General.

***xiii. Financial activities of the Bank of Albania***

After intensive efforts by our staff members with the assistance by foreign experts, and in close communication with the external auditor, for the first time in 2015 the financial statements were compiled in accordance with International Financial Reporting Standards (IFRS). This is a qualitative development for enhancing the financial transparency at the Bank of Albania.

The Bank of Albania's financial statements in accordance with the IFRS are expected to be finally approved on 30 March 2016, at the Supervisory Council meeting. It will also include the opinion of our external auditor, KPMG Albania. Following the Supervisory Council's approval, the statements will be sent to the Assembly of the Republic of Albania for information.

***Honourable Chairman,***

***Honourable Committee Members,***

The presentation of the activity of the Bank of Albania is a key moment for its annual activity. In my brief presentation, I tried to speak about all the aspects of our activity, and shared our expectations and objectives for the period ahead. In the full version, we have tried to include more data, analyses and informative sections. I hope that the Annual Report 2015 is in line with the expectations of the Assembly, and take this opportunity to assure you that the Bank of Albania will continue its endeavours to improve its performance towards perfection in the future.



Price stability, banking system solidity, credit recovery, market supply with liquidity, reducing non-performing loans, implementation of best practices of supervision, strengthening of governance and enhancing communication with the Assembly, the state institutions and our strategic partners will be major objectives for our work in 2016 and beyond.

***Thank you for your attention!***