

Ardian Fullani: The link between the legal system and financial markets

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the Banking Law Workshop, Tirana, 17 November 2008.

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Dear everyone,

The conviction that two monologues do not make a dialogue not only pushed me to study law after my economics studies but also to listen to and toss ideas with colleagues from different professions. I find it especially pleasing when I do this with lawyers, given that there is one particular person I talk to the most – my spouse.

The dialogue between the banking market and the legal system has always been important to any country. Nowadays, it has become extremely vital. For our country to continue sailing towards safe shores of economic development, financial stability and prosperity, I believe these two oars are required: judicial order and the financial market.

Dwelling briefly on the legislation issues, I would highlight that the economic activity is mutually dependent on the legal system at home. As one of the distinguished economists and academics, Mr. Mishkin, says – "The legal system, which as you know, is not only composed of legislation and rule books, but also of the infrastructure of the civil courts and the market regulators, represents a fundamental determinant of economic growth, especially in connection to financial development".

The link between law and finance is inextricable. The financial instruments do not operate in a vacuum. As long as they serve to people, they are based on legal relationships. A financial asset is ultimately a claim in the form of paper (contract) or electronic form (account entry). In any credit relationship, the possibility of default is always looming and this inherent complication cannot be solved without a precise system of norms that protects both the creditors and the debtors.

As Shakespeare's Merchant of Venice reminds us, the legal system has to ensure that the debtor does not walk away from his obligation. At the same time, the lender cannot be too taxing for the debtor. Hence, as anywhere else in life, the balance (that is, the balance of justice) should provide for the wellbeing of the financial system, which is based on these classical relationships, no matter how much modern they are.

Fundamentally, the legal system should ensure that contract and property rights are sufficiently clear, protected and predictable.

In more concrete terms, the parties should not only be aware of these rights, but also exercise them freely and fully during the binding of the agreement or in cases of litigations. For this reason, the independent role of the court, its perception, the efficiency in judgment and the enforcement of the court decision are essential features, whose deformation has a direct impact on the functioning of the financial system.

To better illustrate this idea, worth to note is that the motionless of ownership titles, the delay in ownership-related litigations and the non-execution of the collateral have a direct impact on the share that mortgage loans in particular and the loans in general have compared to other countries. This yet unsolved legal issue has yielded the discouragement of the economy support with banking loans. As long as the banking system manages the people's deposits, it must be safe and avoid any possible financial losses that may arise from the legally binding loan relationship. Undoubtedly, it is not easy.

The risk elements that associate this relationship are numerous and different in nature. Namely, there is a risk which relates to the type of currency, a second one to the

performance of collateral prices, a third one may relate to the operational risk, and so on. The materialization of a single or a number of risks would put the bank into a difficult position.

However, the Bank of Albania, in its capacity as the supervisory authority, compels the banking system to create reserve funds for any jeopardized loans. The only direction the Bank of Albania and the banking system feel powerless relates to **the non-execution of the collateral and the *de facto* impossibility to provide the disposition of the collateral, in particular when the collateral is in the form of real estate.**

Thus, the banking and financial market need to be built and developed alongside the legal system. Unless there is certainty in exercising and protecting contracting rights, there could be no domestic or cross-border financial transactions.

The perception and exercise of these rights, the independent judgement in cases of litigations, the reasonable time in solving the conflict, the efficiency and velocity in enforcing the court decision are the greatest warranties to offer not only to the domestic and foreign investors, but first and foremost to the MARKET itself.

The Bank of Albania has intensified its efforts in this context, in particular in terms of defending before the Constitutional Court the quality of banking and financial contracts as executive titles. The same arguments support the legal changes made to the execution of mortgages and collaterals. These changes are presently being discussed in the Parliament and the market is looking forward to their finalisation.

Based on this philosophy of market functioning and regulation and believing that the market and the right are dynamic, the Bank of Albania has supplied the banking market and the banking right with a new instrument – the Repurchase Agreement. By means of the Law on Repurchase Agreement and the master contract, the Bank of Albania has initiated a process which needs to be further developed by the specialists of the area. Personally and institutionally, we are expecting these efforts to be concluded with the execution of the first transactions of this kind.

It is for this purpose that I invite all the participants in this workshop, which for the first time has brought together judges, prosecutors and lawyers from the banking market, to be active and complement one another.

With the conviction that our initiative will be followed by other similar activities in the future, I wish you good proceedings.

Thank you for your attention.