

# The Financial System in Albania

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## Abstract

The Albanian public has gone through a lot of important economical crises and is still very sensitive from factors, even small ones that affect their beliefs in key sectors of the economy. However progress has been made towards the opinion of the general public, in recognition of the financial mediators and financial markets from a good part of the population, since public trust is important to a lot of sectors. Our financial system has gone through a lot of phases, starting from the fall of communism when the country entered a transition phase and the need of a new genuine financial system arose, since there was not any in existence, to continue with the need of development of the banking sector as the most important sector and while creating later a legal basis to help in the progress of this failed system.

Developed countries constantly perfection their financial systems. It is astonishing how far they have gone and achieved in their development and in the regulation of some imperfections. Everything seems like it has an answer and the opportunities for investments are huge. Technology has also influenced because it has made everything easier. The role of financial intermediaries is well defined and they are precisely financial intermediaries that help in the regulation of imperfections of the financial markets, and the financial markets are structured in such a way that makes possible the realization of transactions and investments in an instant and very easy way and have a wide sufficient function.

**Keywords:** Financial system, banks, insurance market, burse

## The financial system in Albania

Radical political changes in Albania in the beginning of 90' made it an absolute necessity the reform of the Albanian economy, which would enable the transformation from a planned economy system to a market economy system (Biberaj, E, 2001). Albania entered the transition as a country with little preparation from the economic, politic, social and cultural points to realize a radical reform towards market economy because it was the only European communist country that did not take any significant economic and politic reforms such as decentralization of decision-making, market role increase and democratization of the country (Kolodko, G.W., 2000). The transition towards market economy was accompanied by the reform of the financial system, where the essence of the economic reform to move to a market economy was the privatization or reduction of the public sector and the growth of the private sector. The financial system relied on principles from the centralized economic system that was led by the government, like: state ownership of financial intermediaries, the lack of banking system with two levels, limited roles of banks as financial intermediaries for credit decision making and interest rates through the state plan (Gramoz, P.,1993).Through these reforms in the economic field and with the help of international financial institutions the Albanian government made possible privatization of enterprises since until 90' they were owned by the government (Kaser, M., 2001). Also brought changes in the distribution of national income through price liberalizing and the rapid development of private enterprises. Over the years the financial system in the country developed, but it also had moments of crisis and confusion and suffered a big hit from these crises. It is the crisis that was caused by the pyramid schemes in 1997 and later the liquidity crisis which was a crisis of bank deposits in 2002. It is not possible for a country in transition like our country to create such activities because these activities can only be managed by developed countries that have gained experience dealing with pyramid schemes (Biberaj, E, 2001). When pyramid schemes develop without the surveillance of specialized institutions, they are destined to fail. Later in 2002 another crisis took place, the crisis of the banks which had to do with the massive withdrawals of deposits from the public. This happened from quite a few factors, but some of the most important were: Bank of savings the bank with the highest percentage of deposits was offered for privatization. This affected the public trust of banks because the public feared changes and this insecurity perhaps was created by the collapse of pyramid schemes (Bitzenis, A. and Nito, E., 2005). Given that banks are systems supported from public trust, by not having much alternative options to cover the exits they went on to experience a crisis from those withdrawals. Even though officially our country is not believed to have gone through a third crisis in 2008 I think that we really have not but we were really close to. The fear and danger has always been constant in the banking system as well as in others sectors of the economy of the country, since the government deficit rose sharply and the financing of it was impossible given the countries income (Modigliani, F. and Bumberg, R. 1954). Despite the adventures that our country has gone through the years after 90' there has been improvement and it has been getting better and better as a system. Even the public is now feeling better about the important sectors of the financial system and is more prepared and more informed which affects the economic life of the country, it also has to be noted that there is a good prospect for the coming years in many respects. Many banks now offer their services and the

role of a mediator has improved significantly, which improves the economic life of the country since it constitutes the most important sector in the financial system and it has a major importance. Subsequently also non-banking sectors and financial markets are being listed. To make a clear and more detailed approach on the important sectors of the financial system in the country I have treated them below while sorting them one by one.

### **Financial intermediaries in Albania**

The transition to a market economy made necessary the transformation of the financial institutions, in order to respond to the market mechanism. Leading mediators that evolved over the year till to this day are:

**Banks:** The banking system is the core of the financial system in transition economies. After the fall of communism (Kaser, M., 2001), where the banking system was dominated by a monopoly system which simultaneously fulfilled the function of both Central Bank and commercial banks and none played a real role of a financial mediator, the two-tier banking system was created, which was implemented with the laws “for the bank of Albania” and “For the banking system in the republic of Albania” in April 1992, laws which are subsequently perfected over time. On the basis of these laws the way was opened to the licensing process of the new private banks to divide the financial system into two levels, regulation of the banking system by the Central Bank to determinate its duties and powers, determining lek as the official currency of republic of Albania. In the second tier banks commercial banks are included, some newly created and some transformed, such as: National Commercial Bank (BKT) that was separated from the State Bank, Commercial Agrarian Bank that emerged from the transformation of the former Agricultural Bank and the Savings Bank that was created by the transformation of the Institute of Savings and Social Security. While the Bank of Albania was established as the country's central bank, whose status is regulated by a special law. The fact that our country was open to private banks and their number grew with time, I am convinced that it has contributed to several factors for the better because as a start competition has raised and this affects directly the services offered to please the clients, so the client does not address another bank that meets his requirements better, also I would say that it has influenced in the fact that it has expanded the banking activities that is really important for the economy of the country and in particular for individuals and businesses, etc. The entry of Raiffeisen Bank in 2003 in the Albanian market, as a buyer of Savings Bank was very important for the economy of the nation because through the privatization of the Savings Bank the process of privatization of banks was over, the banking sector is the first sector of the economy of Albanian that closed in 100% of its processes of privatization. In the following years 2005 and 2006 the Albanian government issued the law for its privatization of its participation of 40% in Banca Italo Albanese, to San Paolo IMI Group, 60% of the shares of BKT (National Commercial Bank) to Calik Consortium and Sekerbank. In 2007 San Paolo IMI and Intesa Group bought 80% stake in the American Bank of Albania. With these changes the financial situation of the banking system has been satisfactory and has been consistently profitable ensuring its liquidity and filling more and more credit needs of the economy, and it shows that banks began to fulfill the true good of their role, that of intermediation. Continuous improvement of banking infrastructure, the creation of the

Deposit Insurance Agency in 2002, improvement of banking supervision have led to increased confidence in the banking system, the establishment of a system of mandatory employees salary payment through banking systems brought individuals at bank counters which were achievements for our country because they have made possible to make the public trust these institutions, to deposit and work with them and in this way both sides can profit. I think they have been important steps in this sector and further developments have been even more important (Hanna, S. D. & Chen, P., 1997). Over the next years there is an increase from previous years of the sustainability of profitability, the expansion of the branch distributions in different parts of the territory and also the placement of ATM's. There has been an increase in banking indicators of market penetration, deposits and bank lending as the most important direction of the mediation process, over the years there has been an increase from the previous years and we have expressed it in the growth of the report of the portfolio of loans to total assets of banks (Purcell, J., 1997). There was an enrichment of the portfolio of loans in different currencies, but this diversification of the loans has increased rapidly in bad loans to the total loans and I think it may have influenced the exchange rate fluctuations. The Banking system's ability to cover losses with capital stemming from loans has been hit or miss, sometimes it has decreased and some it has increased, however it has remained at good levels (Bogdan, Ioan 2002). All banks in the country have in common the fact that in Albania operate banks the type of trading specialized in collecting deposits, in lending and in the fact that they invest the deposits, they use, in treasury bills, investment which in my opinion is a requirement because of the lack of other options.

The main functions of commercial banks in Albania are:

- Function lending

Banks borrow money systematically in the form of deposits and use them to give loans. In this process that is called transformation process of savings where two functions are combined:

Expiry conversion that has to do with the harmonization of deposit time-lines that is generally short-term with those that are long-term loans. Risks, it has to do with the fact that banks give loans with a big risk since they use the bills of others. They are able to offer loans at a higher rate than the volume of deposits.

- Monetary function

It consists of the main functions as the ability that banks have to establish different payment tools that facilitate more trade transactions. This feature can be accomplished in several ways: By establishing various means i.e checks, bank payments, circulating checks etc. Through compensation of credit relationships which is realized through bank accounts.

- Investment Function

A large portion of deposits banks direct them to steady type investments. So besides loans, banks also focus on investing with financial character or on organizational investments which

is necessary for their operational function. In the latter group we include all the equipment, facilities, buildings that enable the banks logistical support.

- The function of services

As is known banks are known for the diversity of the financial services they offer. Initially, these services have been limited, but in recent years they offer a wide range of services. Among them we can mention: credit cards, ATM, cash services etc.

- The function of the direction of the payment system

The entirety of the instruments and procedures that enable movement between economic operators is called payment system. The organization of this payment system is better realized by the banking system. As mentioned in the monetary function, banks can regulate relations between different individuals through bank accounts. This function eases by a lot the realization of transactions between different economic operators which gives a pulse to the economy in general (Roman, Angela., 2010).

Insurance companies: In our country insurance companies they have had a history since 1944 and have been English, French and Italian societies, which have helped create a good tradition for the necessity of insurance in Albania with the exercise of their insurance activities, concentrated in the main cities of the country, mainly in industry, buildings, accidents, life and natural disasters (Tora I. G., 2009). Later on the development continued by bringing different insurance products, but remaining at an early stage and away from developments that other countries had. In 1991 “INSIG” SH.A. The first insurance company in Albania is created, on the basis of the transformation of the Institution of Cash Savings and Insurance and is organized as a joint stock company. Performs extensive activity by providing insurance for a number of events that cause financial damage. Characteristic of the use of resources by INSIG is the investment in long-term activities, primarily in mortgages. Over the years a legal basis is created that regulates the rights and obligations between the insurance company and the insured, there has been an expansion in the range and types of insurance coverage, as well as requests from the public for insurance contracts, where we divide the insurance market to voluntary and mandatory and both respectively have been increasing from year to year, likewise has increased the portfolio of investment of insurance companies, some of them have extended their activities into neighboring countries turning into regional companies etc.

The current insurance market consists of several companies, which carry out their activities in the field of life and non-life insurance:

1. Non-life insurance companies: INSIG sh.a; SIGMA sh.a; SIGAL UNIQA Group AUSTRIA sh.a; ATLANTIK sh.a; INTERSIG sh.a; ALBSIG sh.a;
2. Life insurance companies: INSIG sh.a; SICRED sh.a; SIGAL-LIFE UNIQA Group AUSTRIA sh.a.

Some of the companies have mixed capital, Albanian and foreign, and all are privately owned except INSIG which is state-owned.

Classes of insurance under the legislation insurance of Albanian are: Insurance of accidents, illnesses, the land vehicles, vehicles moving on rails, airplanes, ships, goods transport, fire and natural forces, other damage to property, civil liability from the use of vehicles, civil liability of aircraft use, the liability for ships, general civil liability, credit insurance, guarantees, and other financial losses, legal protection, assistance, life-death, marriage, birth, life insurance linked to investment funds, collective funds administration, funds for payment.

Pension funds: the Albanian Parliament approved the law nr.10197, dated 10.12.2009 "On Voluntary Pension Funds." This law made a fundamental change in the field of organization, management and operation of private pension funds, while increasing safety, assurance of these funds and therefore their appeal (Shahu, A. and Liperi, O. 2003). There are two types of pension funds: Voluntary Pension Fund, which represents the community of physical individuals that can participate in one or more pension plans. A contract is made between the individual and the Society of Pension Fund Administration, where the terms and conditions are determined for both sides, to obtain voluntary pension. Participants can be any individual, regardless of location, age, size of the contribution, etc. only after the contract has previously been associated with the Fund. Professional Pension Fund, which represents the desire of a private or public employer, to provide a pension fund to his workers, with a professional plan. In this case, between the employee and the Society of Pension Fund Administration an affiliation contract, specifying the conditions to be fulfilled by both parties, the names of the persons that will benefit from this agreement, the amount of monthly contribution, timeline, etc.

A society to administer one or more pension plans has to be licensed by the Financial Supervision Authority. Administrative Society must have as main feature the collection of contributions and their investment in securities backed (Wilhelmson, K., Andersson, A., Waern, M. and Allebeck, . 2005.). However, in special cases, this society has the right to conduct the activity of administrating the Investment Funds and Pension Fund Assets, provided that they have been licensed for this activity by the Authority.

### **Financial markets in Albania**

On August 10 of 2006 came into effect the Law No. 9572, dated 03.07.2006 "On the Financial Supervisory Authority (AMF)". The purpose of this law is the establishment of the Financial Supervision Authority, as the only institution responsible for the licensing of the subjects in the financial field of non-banking and supervising the operation of this market.

Field of activity for the Authority is regulation and supervision (Shahu, A. and Liperi, O., 2003):

- 1) the market of securities and activities of this market, which includes activities of subjects related to investment in securities and operate in this market
- 2) the insurance market and the activity of this market, which includes activities of insurance, reinsurance, brokerage and operations that derive from these activities
- 3) the supplementary pensions market and the activity of this market, which includes all



activities of supplementary pension insurance, offered by private institutions of supplementary pensions

4) the new non-banking financial activities, as defined by the special laws of this field, that later will be called “non-banking financial markets”

This authority united functions previously held by the KLV (Securities Commission), AMS (Insurance Supervisory Authority) and IIPP (Inspectorate of Private Institutes of Pensions). The Authority is a public entity, independent and the governing body of this institution is the board of directors, it is composed of seven people appointed by the Parliament which reports back on the performance of the activities of AMF.

Securities Commission was established to act on the basis of law No. 8080, dated 01.03.1996 "On securities value". It was the institution overseeing the capital markets and agents acting on them, and now is part of AMF which means that these functions are performed by AMF.

Capital market for the first time in Albania was born with the creation of the bourse of Tirana, as a department of the Bank of Albania. Any physical or legal person, except the Bank of Albania, is not allowed to establish a securities market, which is not licensed by the AMF. This market is regulated by Law No. 8080 "On securities" and the rules of KLV No. 06/01, dated 17.06.2002.

Only a market society can apply to the AMF to get a license for the operation of the securities market and is created and functions in the same manner as is projected to be created and function a stock company, regulated by Law No. 7638 dated 19.11.1992 "On commercial companies".

Albania currently operating two securities markets:

- Treasury Bills Market (Cash market)
- Bourse of Tirana sh.a. (Capital market)

Treasury Bills Market: From May of 1996 to 1998, primary and secondary market of Treasury Bills has been organized by Bourse of Tirana as.a. In 1998 with the decision of the Governor of the Bank of Albania this competence passed to another department within the Bank of Albania. In 2005 the Bank of Albania and the AMF made an agreement under which the secondary market surveillance was passed to AMF. The primary market of Treasury bills is organized by the Department of monetary operations, in Bank of Albania, on behalf of the Ministry of Finance as representative of the Government of the Republic of Albania. Participants of this market are: Bank of Albania, second-tier banks and legal entities and individuals. The emission of Treasury Bills is made through auction sales in the primary market organized by Bank of Albania in regular time periods.

Auctions for the issue of Treasury bills held: Every month Treasury Bills 3 and 6 months, every 2-Week 12-month Treasury Bills. Natural and legal persons participate in the emission of Treasury Bills through a second tier bank, before which should have opened a bank account exclusively for investing purposes in Treasury Bills. The secondary market is the

market where an investor buys a security from an investor other than the issuer. This market is organized in branches (physical or virtual) of second tier banks, where the most important is the Raiffeisen Bank. Participants in this market that perform transactions in bonds may be physical persons, legal entities, residents and non-residents (Constantinescu, Dan Anghel., 1999). The AMF regulates the exchange of Treasury bills between banks and individuals, but does not regulate the exchange between banks in the interbank market because it is in the competencies of Bank of Albania, also it does not regulate the exchange between private individuals directly.

Banks are required to maintain a register to record all the data belonging to the secondary market treasury bills. If the bank does not maintain this data it delegates to another bank that holds the registry for the secondary market of Treasury Bills and it affects enough to the licensing by the AMF.

Burse of Tirana sh.a.: Burse of Tirana was created in 05.01.1996 as a department of Bank of Albania, which means that it is a government and not private initiative, but with the approval of Law No. 8754, dated 22.02.2002 it was turned into a stock company. It is approved by the Financial Supervisory Authority to conduct activities as a securities market of government debt, corporate debt and the stock in Albania, for an indefinite period. In early 2002, Burse of Tirana became a joint stock company without public offering and sole owner the Finance Minister, so a then state-owned corporation. Initial capital of the company was 20 million (1 Euro = 124 Lek) allocated 20,000 shares with nominal value, where each share had 1000 lek value. The scope of Burse of Tirana is the creation and development of a market of capital or securities by creating a trading system by which "offers for sale, purchase or exchange of securities are accepted regularly (Shahu, A. and Liperi, O., 2003). Regular information is given on prices and rewards by specific persons or groups propose or expect to sell, to buy or exchange securities".

The vision of Tirana Stock Exchange is: To provide a sufficient capital flow (domestic and foreign) for financing the private society and public sector, to ensure that investors, both individual and institutional, enjoy broad opportunities to invest and diversify their portfolios, to guarantee, especially individual investors, reasonable levels of protection and to ensure a reasonable level of return on capital invested in the capital markets (Ciuhureanu, Alina Teodora., 2004).

Also in this country operates the foreign exchange market. This market is regulated by Law No. 8269, dated 23.12.1997 "For the Bank of Albania", Articles 59 and 60 and also by the decision No. 66, dated 08.30.2006 taken by the Supervisory Council of the Bank of Albania. It is a market under the supervision of the Bank of Albania and is what approves and implements the policy of foreign exchange rate. Also it approves the procedures used to determine the value of lek in relation to foreign currencies. Bank of Albania has also other rights, among which I will mention the issuing of regulations and guidelines that govern the operation of this market, to determine and monitor foreign exchange dealers licensing them and when it deems it necessary to revoke his license, and purchase, sell, dispose, maintain and administer its activities reserves of international assets.



## Conclusions and Recommendations

Albania as a small country and in development is still far from advanced activities that perform financial intermediaries in other countries.

The role of a mediator is much more advanced and far from what intermediaries are in the nation, which is very limited.

Financial intermediaries operating in Albania are very few compared to the intermediaries that operate in other developed countries and their activity is very limited, for example commercial banks are limited to invest in Treasury Bills as a safer security because they can not invest in other securities because financial markets in the country say they are in an embryonic stage.

Brokers operating in Albania are still in their infancy and are dependent on the public because they are unable to create additional capital through investment in the most favorable and profitable case.

Intermediaries such as insurance companies and pension funds are still in the stages of doing their basic services, which often even have difficulty with given that the addition of their capital is hard though a way other than profits and investments from auctioneers.

Funding of the deficient units of these financial intermediaries is extremely difficult for a individual or legal person in Albania because there are still many strict rules and complex to implement since the country is in the early stages of development, and the strength of payment is low in general and considering the banks as the greatest lending power, they fear giving out loans due to complex procedures.

Albania still needs a lot of work to advance in our roles as intermediaries and in the growth of this important activity in the economy. We must develop and “increase” the capital for brokers that operate in the country to increase their intermediary activities and the more the public gets to know closely these ingredients of the financial system the better will be for the economic life in the country because a lot of bad investments will be avoided. Now we are at the stage when we have entered the path of knowledge, activity growth and diversification of services offered by them and hoping that in the future there will be an increase in the role of an intermediary.

Despite deficiencies these Albanian sectors of the financial system are better than what they were years ago and we are recovering from that dark period of transition, but as a developing country we will develop slowly and I believe with proper care and the impact of developed countries, since we try to follow their footsteps because they have already been through many adventures before us, I believe the way towards a healthy developments will be easier.

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