



SPI Albania Project on Revising Foreign Currency Open Position Project

Project Objective

To enhance banks' foreign exchange risk management by reviewing the current regulatory framework according to international guidelines and best practices and introducing a new method of calculation on FX Open Positions.

Project Management Team

Project Owner (PO): Miranda Ramaj, Supervision Deputy Director, Bank of Albania

Project Manager (PM): Ermira Curri, Head of Sector, Supervision Department, Bank of Albania

Co- Project Manger (CPM): Elona Bollano, Risk Division, Pro Credit Bank

Co- Project Manger (CPM): Astrit Alijaj, Risk Division, Pro Credit Bank

Minutes

First meeting

December 10, 2010—AAB premises

Attendees: Ermira Curri, BoA (PM)
Elona Bollano, PCB (CoPM)
Astrit Alijaj, PCB (CoPM)
Edlira Zenjelaj, BoA
Anila Kola, BoA
Gerond Ziu, BoA
Erin Shehu, CB
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AGENDA

- I. Welcome Note and Introduction of Participants
- II. SPI Albania Presentation
- III. Project Terms of References (Discussion and approval)
- IV. Scoping of the Problem Document (Discussion and approval)
- V. International Experiences (Discussion)
- VI. Conclusions and Distribution of Tasks
- VII. Closing Remarks

I. Welcome Note and Introduction of the Participants

SPI Secretariat welcomed all the PWG members and introduced the PMT and the SPI Albania Secretariat. All members introduced themselves and the institutions they were representing.

II. Presentation of SPI Albania

In order for the PWG members to have a better understanding on the SPI work process and methodologies, SPI Secretariat held a short presentation focusing on the SPI Albania project management and methodologies.

SPI Albania is a partnership lead by a high level public private Committee with representatives from BoA , AAB (Chairman) and the Head of Convergence Program (World Bank) as well as MoF, AMF, Market Surveillance Department-METE. European University of Tirana and Italian Banking Association are Permanent Observers to the SPI Committee. SPI Secretariat orchestrates different working groups for each SPI Project.

SPI Secretariat presented the role and responsibilities of the PMT and PWG members as well as the role of the Secretariat throughout the entire project process from the start to enactment.

SPI Secretariat presented the methodology followed for every SPI Albania project. After the Terms of Reference are endorsed by the SPI Committee and reviewed / approved by the PMT,

the PWG first target is identifying the problem and its causes (a market or a regulatory failure) in order to understand if it creates the case for a regulatory intervention or for self-regulatory actions. PWG defines the policy objectives to be achieved with this project and considers if 'do nothing option' could be a solution and its costs. PWG identifies then the possible regulatory/self-regulatory policy options that could be envisaged for solving the problem.

Once the Scoping of the Problem is concluded as described above, the PWG is focused on the Analysis of the impact that is: to identify and state the costs borne and benefits yielded by consumers, by the regulator and regulated firms, and to collect market structure data to perform a quantitative cost and benefit analysis. SPI Albania work has created a significant impact on the regulatory financial reforms through projects of legal natures as the changes of Civil Procedure Code, Private Bailiff and Bank and several Bank of Albania regulations.

With the conclusion of the analytical work, the policy document is drafted and consultations are run with various stakeholders. PWG has to agree on the final PWG Recommendations document. The actual work of the PWG is concluded with the SPI Committee approval of the final PWG recommendation. However the PWG members, representing the professional experts for each respective project, will stand ready to participate in further consultations with the regulators or other authorities during the enactment process.

PWG members should evaluate, at the end of the project, SPI Secretariat's performance based on a questionnaire that is presented at the first meeting in order to get acquainted with the criteria to follow for this evaluation.

III. Project Terms of Reference presentation (Discussion and approval)

SPI Secretariat presented the Project Terms of Reference as the outlining document that will guide the PWG through all the project steps.

The authority of the Bank of Albania in establishing rules for foreign currency open position is defined by Law no. 8269 dated 23.12.1997 "On the Bank of Albania" chapter VII, article 26 and Law no. 8365 dated 02.07.1998 "On banks in the Republic of Albania", article 27. On the basis of these laws, a regulation on Foreign Exchange Open Positions no. 59 has been issued on 05.05.1999. The current regulation on FX open position does not account the dynamics of the financial sector and of its instruments. For example, under the current framework, banks have discretion to value the off balance sheet items expressed in foreign currencies, which is one of the components taken into account when calculating FX open position. This creates difficulties in the process of valuating the foreign open position since it is not specified which items have to be included.

Another important aspect when calculating FX open positions is the foreign exchange rate used in calculation. According to the current framework foreign currency reevaluation is done using either the reporting day exchange rate or the historical exchange rate, whereas according to IFRS foreign currency reevaluation is done using exchange rate of the transaction date, which reflects the reality better.

This situation may have negative consequences for the:

- Banks being exposed to greater FX risks;
- Worsening supervision role of the Central Bank of Albania;
- Consumers bearing the risks and paying higher costs.

By amending the FX Open Positions regulation banks will benefit from having a real dimension of their exposure to FX risks and to control foreign currency risk. Also, it promotes banking system stability by a better coverage of risks with regulatory capital. A better risk management gives an enhanced coverage for the customers. On macro level, the investments could increase and therefore economic development would be stimulated.

Therefore the objective of the PWG will be enhance banks' foreign exchange risk management by reviewing the current regulatory framework according to international guidelines and best practices and introducing a new method of calculation on FX Open Positions.

IV. Scoping of the Problem Document

SPI Secretariat presented the Drafted Scoping of the Problem Document. The objective of this document is to help the PWG better understand if the cause of the problem is related to a market/regulatory failure and if this is the case for regulatory intervention.

The current regulatory framework on foreign currency open position has not been updated to the product development dynamics of the financial sector. The methodology used in the current regulation on FX open position does not cover all types of risks having an impact on the regulatory capital for the banks. According to the Bank of Albania assessment, this situation in the near future may lead to regulatory failure, as the regulation would be wrongly prescribed for the market. Therefore, the Bank of Albania as the banking supervisory authority should act in a prudent manner to prevent occurrence of banking instability in the future.

Also, the adoption of International Financial Reporting Standards (IFRS) in 2008 raised the emergency to the Bank of Albania to adjust the banking regulatory framework and align it with the new accounting and reporting standards. In the framework of the SPI Albania project on "Amending the Banking Regulatory for IFRS implementation", which was closed in 2008 the Project Working Group recommended a comprehensive list of banking regulations that would need future amendments. With reference to the amending priority, the regulation on foreign currency open position was considered as high priority

The banking system in Albania is in the process of convergence with international capital adequacy requirements and standards. This convergence requires that banks adjust their methodologies and regulations to such requirements to ensure sound prudential risk management. The non-revision of the regulation on foreign currency open position would make banks more vulnerable to risks and involve additional costs with impacts on regulatory capital. Also, the situation would involve a weakened supervision role of the Bank of Albania with impacts on financial system stability.

V. International Experiences

SPI Albania projects have typically emphasized on the importance of international experience as an important benchmark for the adequate solution to the problems tackled. International or regional best practices often provide for a very useful benchmark in building up PWG recommendations.

SPI Secretariat presented some possible examples of international experience to be taken into account when revising the FX open positions regulation. However, a complete version will be delivered to the PWG before their second meeting

SPI Secretariat, in close cooperation with the PWG individual members, is willing to research other countries experiences other than the ones to be presented on the note on International Experience..

VI. Conclusions and Distribution of Tasks

For the next PWG meeting:

- SPI Secretariat will send the meeting minutes and the revised drafts of the documents for final approval to the PWG;
- SPI Secretariat will send the Note on International Experiences for review and approval to the PWG members;
- PWG members will contribute with their comments on the received documents. ;
- Bank of Albania will deliver the draft regulation for review and discussion in the next PWG meeting ;

VII. Closing Remarks

The second PWG meeting is preliminarily scheduled to take place in late January 2010.