

**Creating a conceptual framework to  
assess financial sector modernization  
needs:  
Application to Albania**

"Progetto SPI Albania" – Progetto Interreg "Aquifalc"

Bari, 7<sup>th</sup> of November 2008

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# ACKNOWLEDGEMENTS

**ABI, ECB, and CFS provided an important support to the realization of this project**

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- ¶ Scope of the project.
- ¶ General framework
- ¶ Objective and tools
- ¶ Application to Albania
- ¶ Next steps

# MISSION, METHODOLOGY, AND OUTCOMES

## Mission

- Define a framework to assess the modernization needs of financial markets, with a crucial focus on *efficiency issues*
- Build up a search engine of the interventions available to stakeholders (to pursue modernization and efficiency)

## Methodology

- Top-down:
  - Create a conceptual framework
  - Identify relevant markets, objectives, tools, and specific provision
- Bottom-up:
  - Classify the activities of the Italian Banking Association within the conceptual framework

## Outcome

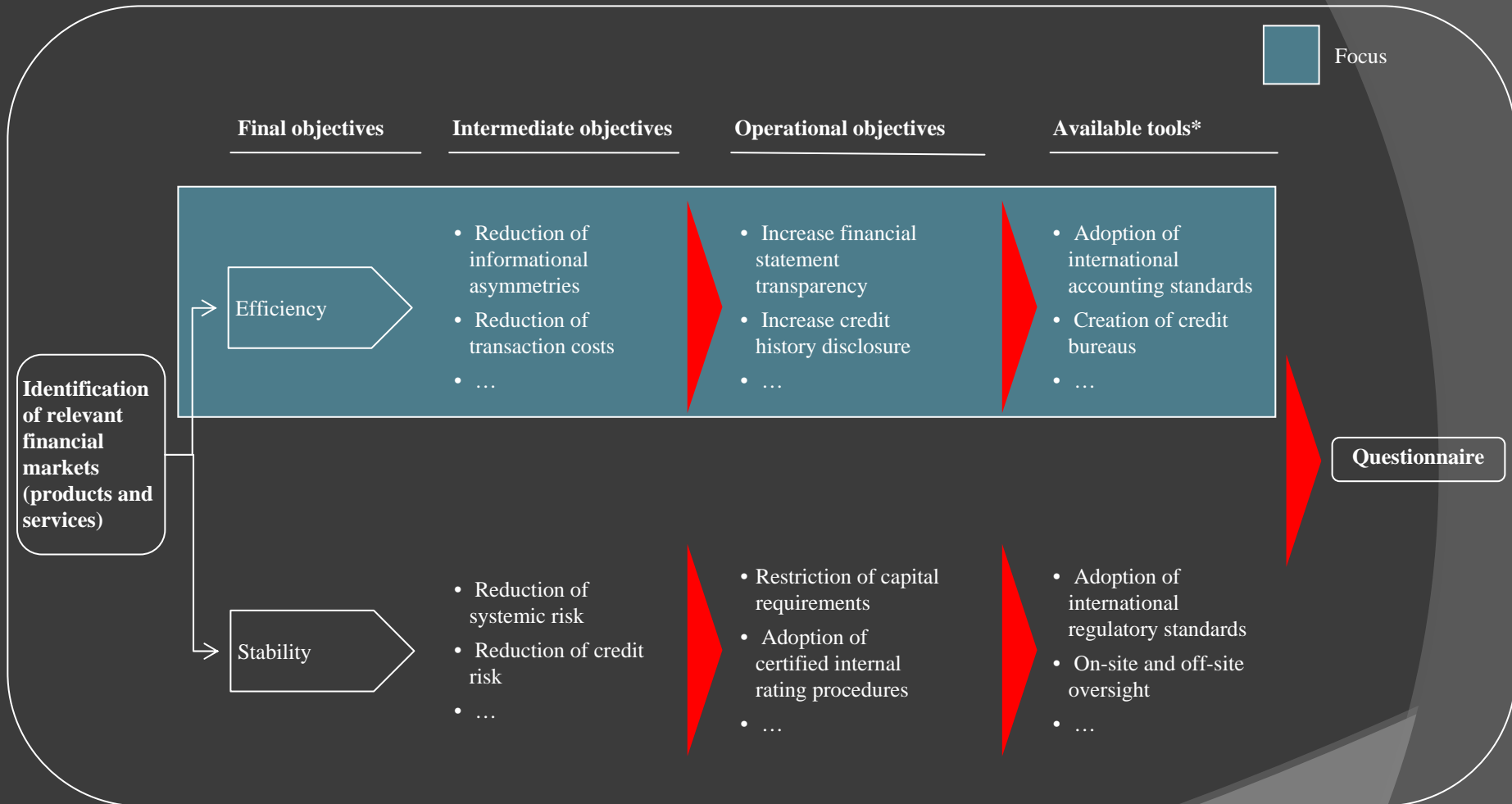
Design a questionnaire to allow country experts to prioritize among modernization needs

Make use of the questionnaire to survey Albanian financial markets' experts and to prioritize among available interventions

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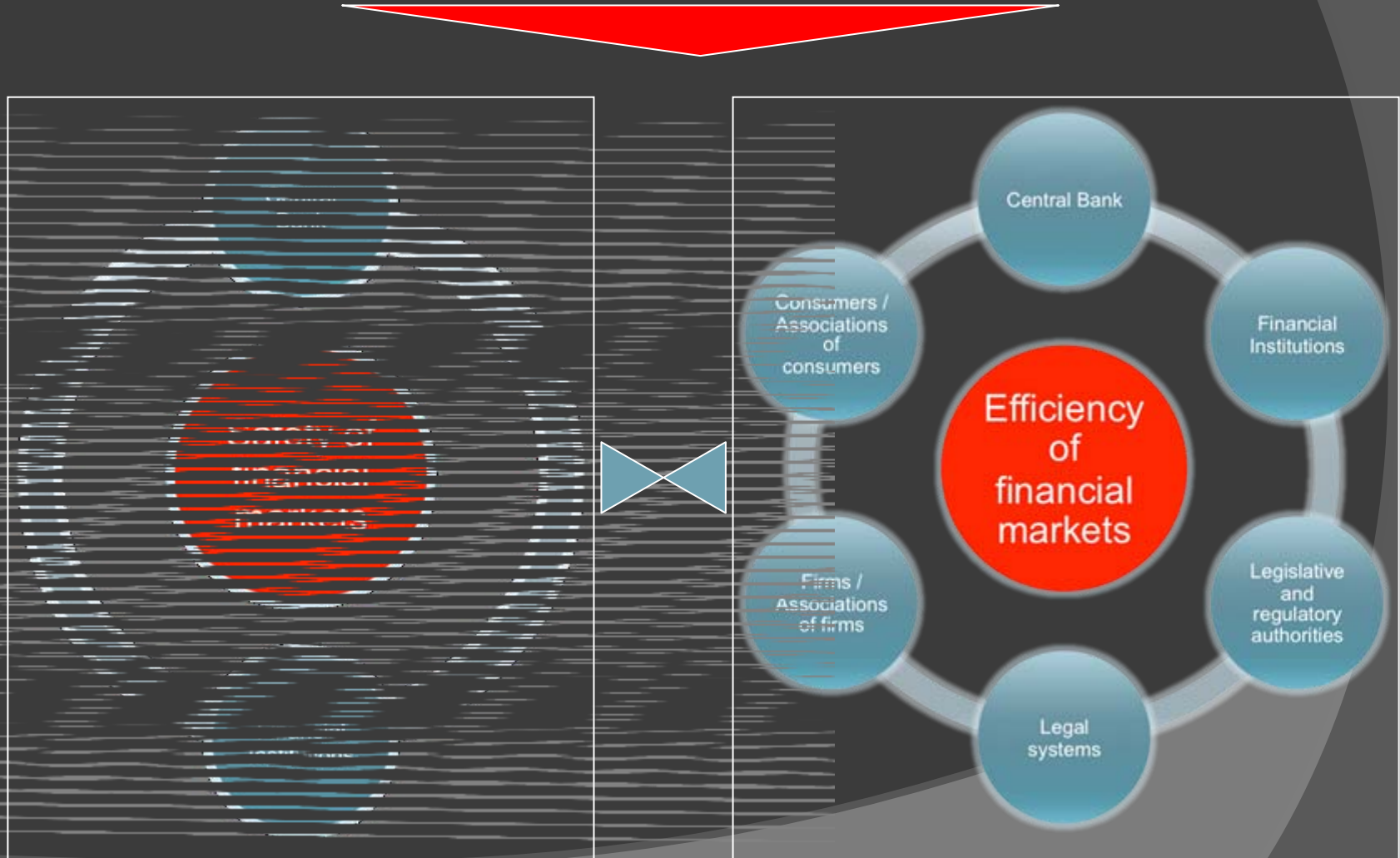
# FRAMEWORK: EFFICIENCY FOCUS



\*To be extended through a set of specific provisions

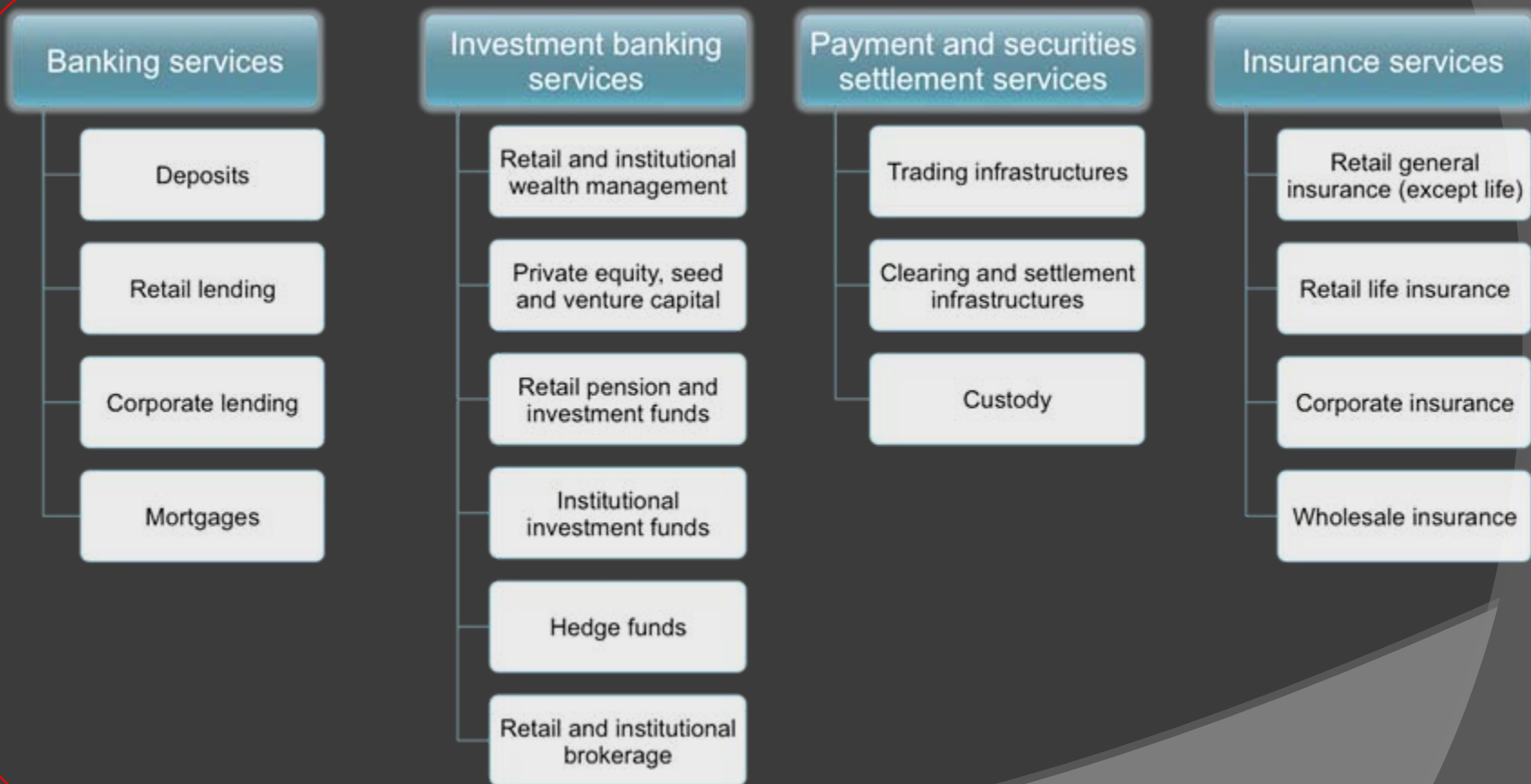
# SAFETY VS EFFICIENCY OF FINANCIAL MARKETS: MAIN ACTORS

Given the complexity of efficiency issues in financial markets, pursuing efficiency and modernization involves many actors, not only central banks and financial institutions



# METHODOLOGY: SINGLE MARKET APPROACH

Our approach implies a single market analysis. In particular, we focus on the markets for banking services, investment banking services, payment and securities settlement services, and insurance services





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# INTERMEDIATE OBJECTIVES

- Pursuing the modernization and the efficiency of single financial markets implies targeting intermediate and operational objectives through the utilization of a set of available tools
- As for the intermediate objectives, our main references are the ECB criteria expressed in the Financial Integration Report (2008)



Informational asymmetries

Incompleteness of markets

Lack of opportunities of engaging in fin. transactions

Transaction costs

Lack of competition

# OPERATIONAL OBJECTIVES AND AVAILABLE TOOLS

## EXAMPLE: INFORMATIONAL ASYMMETRIES

### Operational objectives

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- Corporate relationships:
  - Increase of firms' financial statement transparency
  - Improvement of information gathering technologies
  - Creation of long term bank-firm relationships
- Retail relationships:
  - Increase of credit history disclosure
  - Improvement of information gathering technologies
  - Creation of long-term bank-customer relationships
- Interbank relationships:
  - Increase of network transparency

### Available tools (illustrative examples)

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- International accounting standards
- Investment monitoring technologies
- Information sharing facilities
- Venture capital facilities for start-ups
- Technical assistance (seed capital, business angels, ...) to SMEs
- Credit bureaus
- Information sharing facilities
- Supply of multiple financial services (asset management, real estate management, ...) to customers
- International financial accounting standards

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# ALBANIAN BANKING SECTOR: FACTS AND FIGURES

- The banking sector is mainly composed of commercial privately owned banks, soundly managed
- Banking sector is competitive
- The number of ATMs and bank branches is rapidly increasing
- The percentage of the population using modern payment systems (credit cards, debit cards, ...) is rapidly increasing
- The total amount of credit is only 25% of GDP (very low if compared with other countries of the region) and it is mostly directed toward business
- The population living in rural areas faces difficulties in accessing the credit market
- On line banking is still to be developed (only 15% of the population have internet access)

# RETAIL LENDING

- Retail lending is not yet developed because banks face difficulties in selecting creditworthy customers
- Moreover, the population living in rural areas does not participate the market
- Finally, on-line banking is yet to be developed



## Intermediate objectives

- Reduction of informational asymmetries
- Increase the opportunities of engaging in fin. transactions

## Pursued operational objectives

- Increase credit history disclosure
- Increase of product delivery infrastructures

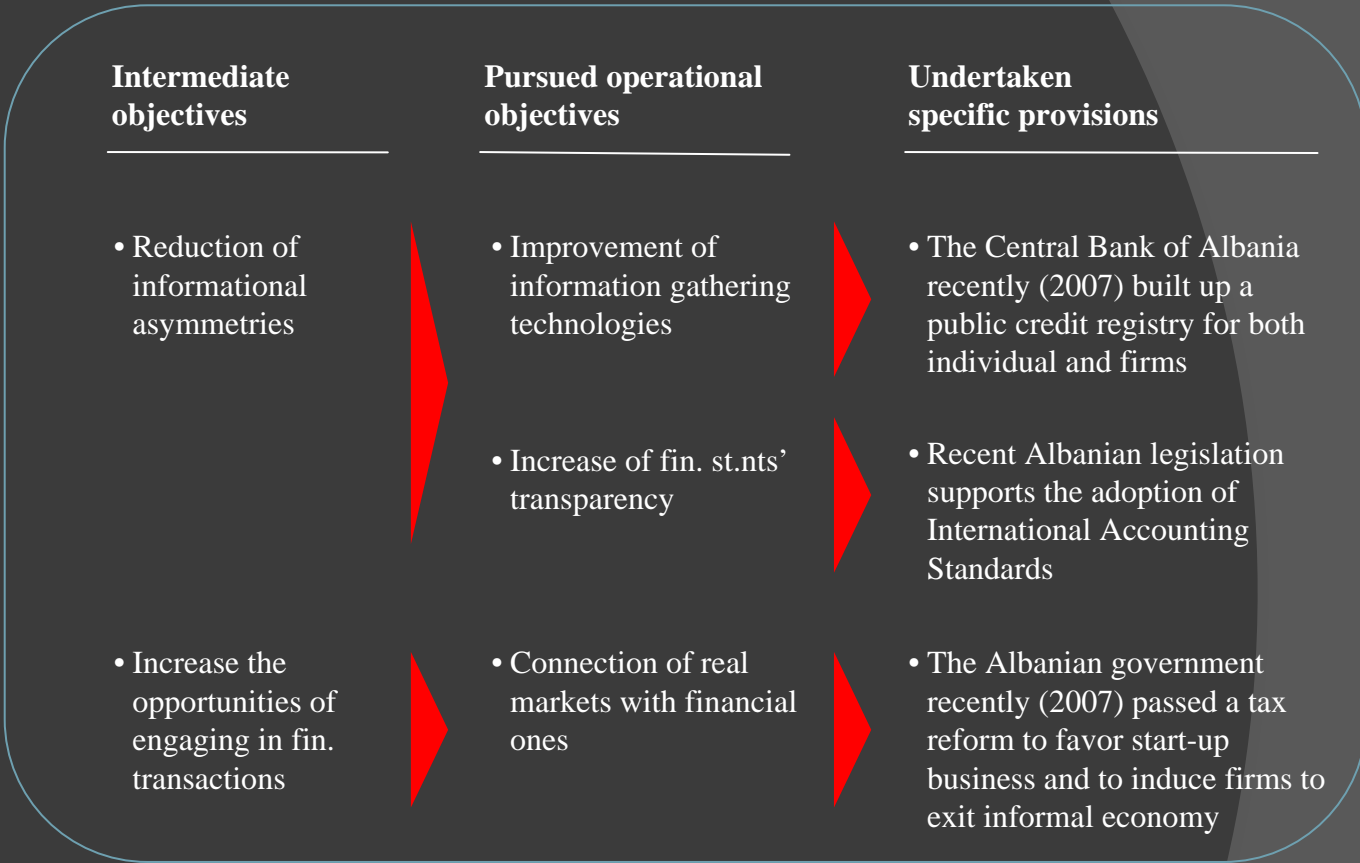
## Undertaken specific provisions

- The Central Bank of Albania recently (2007) built up a public credit registry for both individual and firms
- The Albanian government together with IFAD launched a program to install thousands of computerized branches in rural areas

Much has been done, much remains to be done in terms of reduction of informational asymmetries (only 8% of consumers are covered by the public credit registry), and reduction of transaction costs.

# CORPORATE LENDING

- Corporate lending is not yet developed because banks face difficulties in selecting creditworthy customers
- Moreover, a large fraction of Albanian firms operate in the informal economy and do not participate the market



Much has been done, much remains to be done to reduce the size of the informal economy, and to make the financial markets easy to access for small entrepreneurs.

# ALBANIAN INSURANCE SECTOR: FACTS AND FIGURES

- The insurance sector is rapidly growing (30% is the rate of growth in 2007)
- The insurance sector is open to foreign investors and competitive
- The institution of a supervisory agency for non-bank financial institution (FSA) together with the adoption of EU capital requirements should ensure sound management and stability
- Expertise in the insurance sector is rapidly growing
- The market is still strongly oriented towards motor compulsory insurances;
- There is a low penetration of insurances in both life and P/L segments
- A large fraction of the population is not informed about insurance products



# RETAIL INSURANCE

- Retail insurance market is rapidly growing, but life and P/L segments are yet to be developed
- Moreover, a large fraction of Albanian population is not informed about insurance products



## Intermediate objectives

- Increase the opportunities of engaging in fin. transactions

## Pursued operational objectives

- Increase of market participants' information
- Increase of investors' / creditors' protection

## Undertaken specific provisions

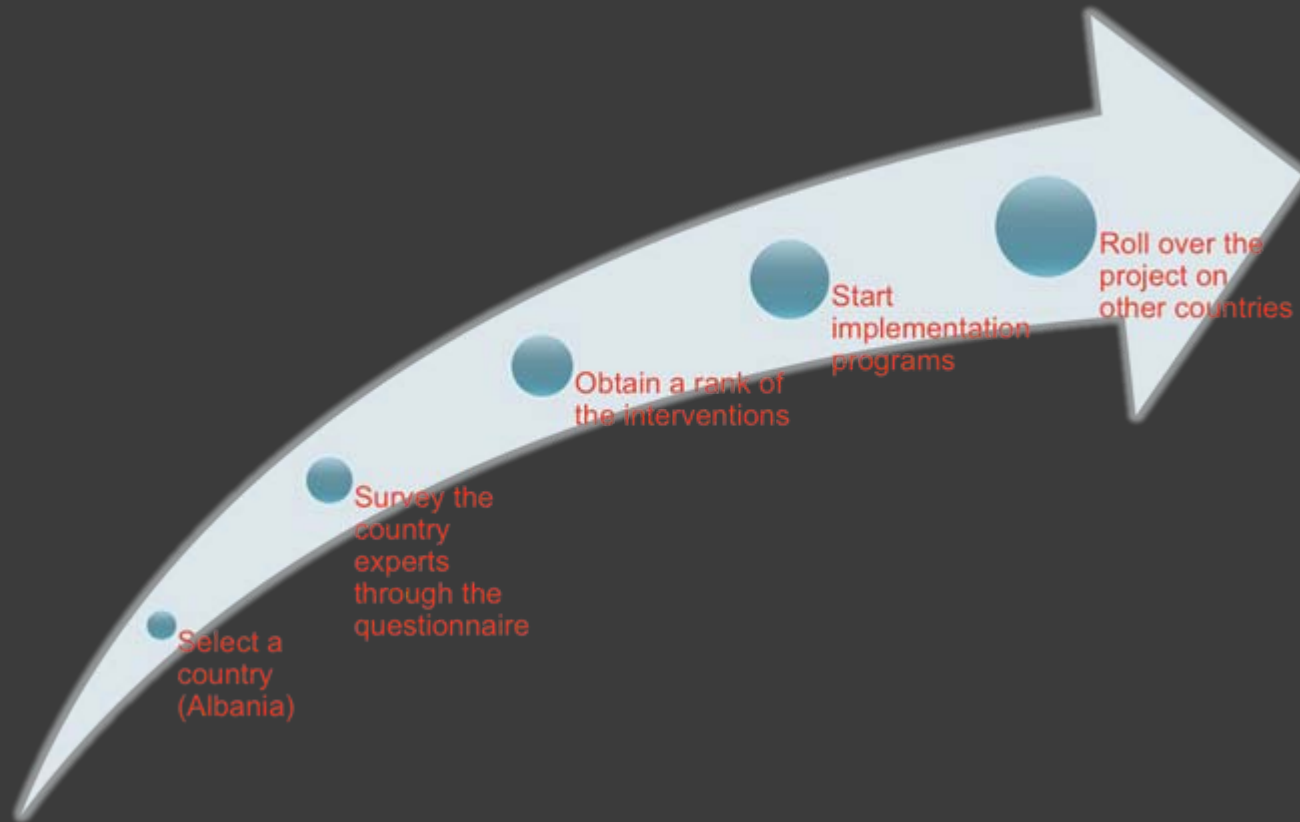
- The first class of Albanian actuaries was certified in 2007
- A supervisory authority was recently established (FSA), international accounting standards and capital requirements were adopted

Much has been done, much remains to be done to improve the life and P/L segments of the insurance market and to make population aware of insurance products

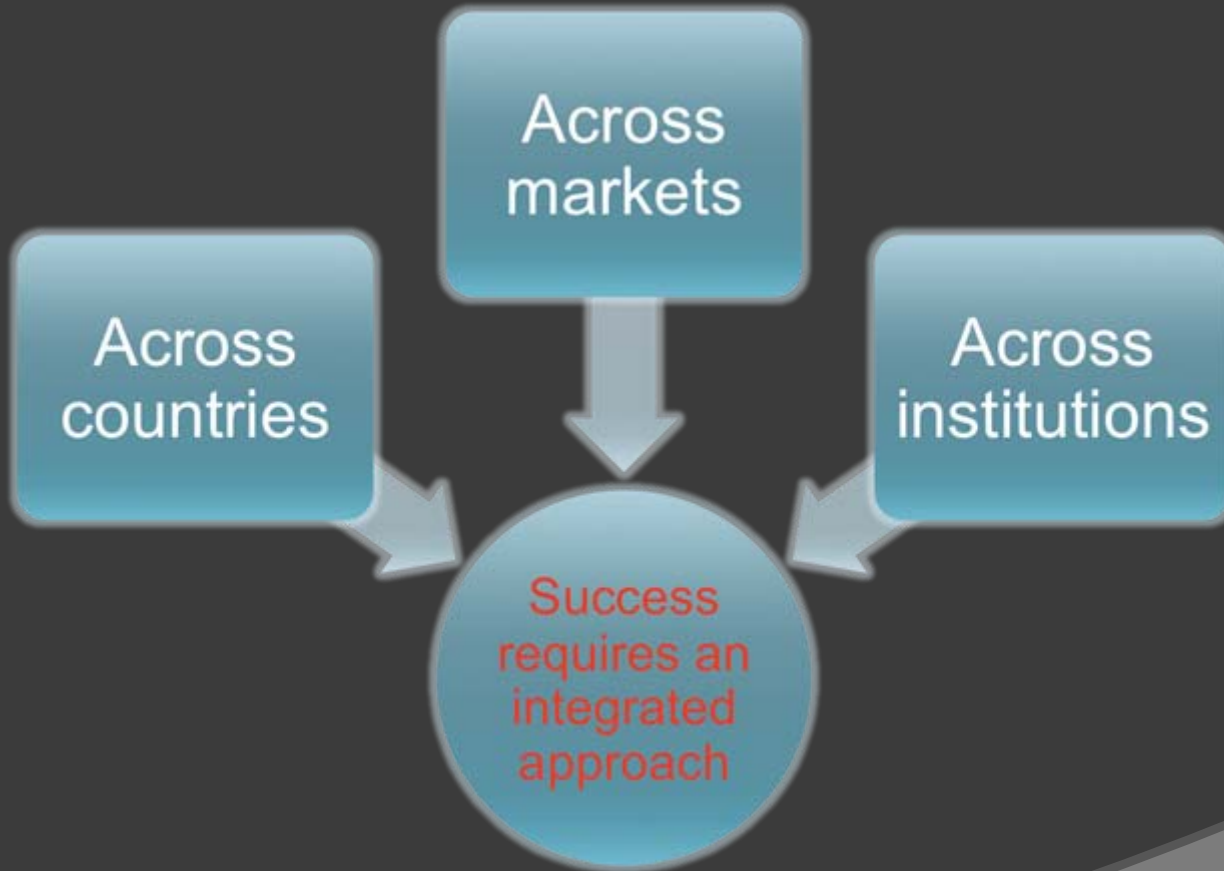
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# APPLICATION OF THE FRAMEWORK



# KEY FOR SUCCESS



## A PROPOSED APPROACH

Start cooperation with Central Banks and Universities in South-East Europe to identify market segments, their structural data and sources of inefficiencies along with the ECB taxonomy



Prepare a long list of micro-regulatory changes that several countries could tackle working together



This approach could be a good contribution to regional collaboration with the purpose of accelerating modernization

**BACKUP**

# INTERMEDIATE OBJECTIVE: ECB CRITERIA

- The focus of our project, as defined before, is on financial modernization needs
- Our main references are the ECB criteria expressed in the ECB “Financial integration in Europe” (2008)
- An analysis of this criteria confirms that many subjects are involved in efficiency issues

Source of inefficiency	Definition	Examples
Asymmetric information	Inefficiency arises because the amount of information available to agents engaging in financial transactions is different; hence, prices and traded quantities do not reflect an efficient allocation of resources	A bank may not be able to evaluate correctly the quality of an SME investment project; hence, it charges a higher interest rate (risk premium), or it does not lend at all (credit rationing); a client may not be able to evaluate the appropriateness of bank products and services for its needs
Incompleteness of markets	Inefficiency arises because lack of suitable products and services prevent banks and potential clients from coping with time and risk mismatches	Students may wish to leverage on their human capital to pay their college fees, or to increase consumption during college years; if there is not a market for student loans, they cannot do it
Lack of opportunities to engage in financial transactions (contracts)	Inefficiencies arise because of a range of factors that inhibit the full utilization of existing banking products and services. Factors are mainly the lack of reliability of underlying contracts (due to legal system inefficiencies), and the difficult access to the underlying markets (due to the lack of banking skills, or the lack of financial education of both consumers and firms).	If a commercial disputes takes a long time to be resolved in court, parties may choose to avoid subscribing contracts, hence avoid to engage in transactions
Transaction costs	Inefficiency arises because agents engaging financial transactions incur costs that are not related to the quality or the quantity of the goods and services that they are willing to trade	Economic agents must consider search and information costs prior to the purchase of a financial asset; moreover, they must pay a transaction fee to their brokers
Lack of competition	Inefficiency arises because market power may lead to high prices and low traded quantities	If banks adopt fee coordination policies, they may charge high prices to end users (checking and saving account holders)

# OPERATIONAL OBJECTIVES: SINGLE MARKET APPROACH

Given the ambitious objective of our project, the only methodological approach available is a single market one. In particular, we focus on the markets for banking services, investment banking services, payment and securities settlement services, and insurance services

## Potentially Relevant Markets

Banking services	Deposits
	Retail lending
	Corporate lending
	Mortgages
Investment banking services	Retail and institutional wealth management
	Private equity, venture and seed capital
	Retail pension and investment funds (advice, provision, and management)
	Institutional investment funds (advice, provision, and management)
	Hedge funds (advice, provision, and management)
	Retail brokerage
	Institutional brokerage
Payment and securities settlement services	Trading infrastructures (provision and management)
	Clearing and settlement infrastructures (provision and management)
	Custody
Insurance services	Retail general insurance (except life assurance)
	Retail life assurance
	Corporate insurance
	Wholesale insurance



# INFORMATIONAL ASYMMETRIES

## Operational objectives

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- Corporate relationships:
  - Increase of firms' financial statement transparency
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- Retail relationships:
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- Interbank relationships:
  - Increase of network transparency

## Available tools (illustrative examples)

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- International accounting standards
- Investment monitoring technologies
- Information sharing facilities
- Venture capital facilities for start-ups
- Technical assistance (seed capital, business angels, ...) to SMEs
- Credit bureaus
- Information sharing facilities
- Supply of multiple financial services (asset management, real estate management, ...) to customers
- International financial accounting standards

# COMPLETENESS OF MARKETS

## Operational objectives

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- Current markets:
  - Increase of market efficiency
  - Increase of market liquidity
- New markets:
  - Increase of the number of markets for products and services

## Available tools (illustrative examples)

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- Competitive market providers
  - Advanced network facilities
  - Standardized operational procedures
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- International openness
  - International harmonization
- 
- Legislative / Regulatory support to market providers
  - Up-to-date regulation of OTC markets
  - Training to potential market participants
- 

# OPPORTUNITIES OF ENGAGING IN FINANCIAL TRANSACTIONS

## Operational objectives

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- Access to markets:
  - Increase of market participants' information
  - Increase of investors' / creditors' protection
  - Increase of product delivery infrastructures
- Reliability and enforceability of contracts:
  - Simplification / standardization of financial contracts
  - Improving legal system efficiency
- Fulfillment of business needs:
  - Connection of real markets with financial ones

## Available tools (illustrative examples)

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- Information to consumers
- Training to bank officers
- Simple / standardized operational procedures
- Efficient credit recovery procedures
- Transparent (minority) shareholders' rights
- Transparent corporate governance rules
- Branches
- ATMs
- International contractual forms
- Specialized courts
- Training to judges about advanced financial issues
- Pre-trial settlement procedures
- Private judges (previously agreed upon by counterparts)
- Tailored financial products
- Clear real markets' regulation
- Interaction between firms / associations of firms and financial institutions / association of financial institutions

# COMPETITION

## Operational objectives

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- Banking law:
  - Elimination of entry barriers
  - Support of international competition
- Market self-regulation:
  - Increase of competitive behavior
- Antitrust regulation:
  - Enhancement of financial markets' competition
  - Supervision of financial markets' concentration
  - Elimination of abusive dominant positions

## Available tools (illustrative examples)

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- Quick and efficient licensing procedures for prospective national financial institutions
- Bilateral agreements to allow foreign licensed institutions to operate in the national market
- Competitive market procedures for the acquisition of distressed national banks / financial institutions
- Information to the public
- Competitive marketing strategies
- International standards on antitrust regulation and transparent criteria to identify abusive dominant positions
- Independent antitrust authority, with the power to investigate financial institutions and enforce antitrust regulation, and veto power over M&A operations in the financial sector
- Interaction between the antitrust authority and the national associations of banks and consumers

# TRANSACTION COSTS

## Operational objectives

- Payment and settlement systems:
  - Increase of payment / settlement systems efficiency
- E-banking:
  - Increase of on-line banking services
- Financial innovation:
  - Increase of supply of financial services / products
- Regulation:
  - Reduction of administrative costs



## Available tools (illustrative examples)

- International core principles for payment and settlement systems
- Up-to-date network infrastructures (ATM, credit cards, ...)
- Computer penetration
- Internet penetration
- Security of on-line transactions
- Sight deposits
- Credit cards with overdraft facilities
- Credit to consumers
- Labor taxation
- Safety codes

# SELECTION OF RELEVANT MARKETS

 Focus

Potentially Relevant Markets	
Banking services	Deposits
	Retail lending
	Corporate lending
	Mortgages
Investment banking services	Retail and institutional wealth management
	Private equity, venture and seed capital
	Retail pension and investment funds (advice, provision, and management)
	Institutional investment funds (advice, provision, and management)
	Hedge funds (advice, provision, and management)
	Retail brokerage
	Institutional brokerage
Payment and securities settlement services	Trading infrastructures (provision and management)
	Clearing and settlement infrastructures (provision and management)
	Custody
Insurance services	Retail general insurance (except life assurance)
	Retail life assurance
	Corporate insurance
	Wholesale insurance