

CHALLENGES OF THE DEVELOPMENT OF THE FINANCIAL SYSTEM IN ALBANIA

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Abstract - This article aims to present an overview of the financial system in Albania, emphasizing the current reality, the progress achieved and the challenges that still need to be addressed. After the period of communism, Albania has experienced a long road towards the modernization and development of the financial system. The transformation from a planned economy to a market economy has brought significant changes in the structure and operation of the financial system in the country. Thus, over the years, the financial system has had a stable and ever-increasing development, both from an architectural and institutional point of view, as well as from a legal and regulatory point of view. While the non-banking sector has its early beginnings quite modest, since 1996 with the creation of the state stock exchange (Tirana Stock Exchange), which was never included in the privatization process, keeping the capital market in a stagnant phase. Also, the liberalization of the insurance market began only after 1998, while the first stages of the development of collective savings and investment schemes (pension and investment funds) began to be created after 2012. In recent years, Albania has made considerable progress in the financial sector and has taken important steps towards modernization and harmonization with international standards. This article will examine the development of the financial system in Albania over the years, focusing on the progress and challenges it faces.

Keywords: Financial System, FinTech, Bank, Institutions, Stock Market

I. INTRODUCTION

The financial system is a network of institutions and markets that facilitate financial transactions between individuals, businesses and governments. So, the financial system includes financial institutions such as banks, account companies, pension funds, financial markets as well as their regulatory and supervisory authorities. After the fall of the communist regime in 1990, the financial system in Albania has had a gradual development during its journey in the free market economy. This brought about the collapse of financial monopolies and the opening of opportunities for new financial institutions and foreign banks. In this period, foreign commercial banks began to invest in Albania and several new local banks were established. This stimulated competition in the banking sector and

improved access to financial services for citizens and businesses. Currently, there are about 11 commercial banks operating in the banking sector, as this sector has undergone a series of restructurings and movements of foreign capital with purchase and sale, as a result of the conjuncture of the international markets. Also, the sector has about 38 operators, such as non-bank financial institutions (microfinance, factoring, leasing, electronic money, money transfer, etc.), as well as more than 500 Foreign Exchange Offices (ZKV) supervised by the Bank of Albania (BSH). Reforming the financial system assumes great importance in macroeconomic stability. All the countries that have had this transformation as their objective have aimed at creating a two-level banking system, increasing the degree of autonomy

of the central bank, increasing competition within the banking system, encouraging the development of the monetary and financial market, rationalizing the payment system, establishing an efficient system of bank control as well as restructuring the banking system and privatizing it.

II. LEGAL FRAMEWORK

The legal framework of the financial system in Albania has followed the process of harmonization and adaptation with the directives of the European Union (EU) to improve its access, transparency and stability. This has been one of the main conditions for Albania's integration into the structures of the European common market. As part of the negotiation process, the component of harmonizing national legislation with the *acquis communautaire* has had an extraordinary impact in this regard. In addition to the readiness of the Albanian Governments, the merit here has undoubtedly also belonged to foreign donors, who already coordinate the allocation of funds towards priority sectors, increasing the efficiency of the use of these funds.

The 2019 earthquakes and the COVID-19 pandemic have had significant impacts on the financial system, causing major challenges for financial institutions, businesses and citizens. However, it must be said that the year 2020 has marked a very successful year in terms of revolutionizing the legal framework in the financial system. Thus, after a strong support given to this sector by EU and World Bank funds through the Swiss Secretariat for Economic Affairs (SECO), the Albanian Parliament approved 4 very important laws covering the financial markets. These laws were prepared by BSH and AMF in cooperation with the Ministry of Finance and Economy as well as the invaluable assistance of World Bank experts. The Bank of Albania and the Financial Supervision Authority (AMF) intervened to protect the banking system from the risk of damage to financial stability. Supervisory mechanisms were strengthened to ensure that banks are resilient to face financial challenges. During 2020, the Bank of Albania took several steps to cope with the consequences of the pandemic and to support economic development, including:

1. **Reduction of Interest Rates:** The Bank of Albania reduced interest rates to ease the cost of

credit and stimulate borrowing demand from individuals and businesses. With interest rates falling, banks were more motivated to offer lower-cost loans, stimulating investment and consumption.

2. **Stimulation of Liquidity:** The Bank of Albania intervened to ensure sufficient liquidity in the banking system. This included actions such as the provision of credit by the central bank through the liquidity extension program for commercial banks. This action has helped banks maintain stability and face the financial challenges caused by the pandemic.

3. **Monitoring of Financial Stability:** The Bank of Albania has carefully monitored the stability of the financial system and intervened if there were indications of the risk of crisis.

4. **Aid to Affected Sectors:** The Bank of Albania and the government have provided aid to some sectors most affected by the pandemic, such as tourism and construction. This included actions such as postponing payment deadlines to improve businesses' liquidity.

These actions and policies undertaken by the Bank of Albania have aimed to stabilize the financial system and improve the economic situation and adapt to the consequences of the pandemic.

Beyond the classic functions that regulators and competent bodies have in each country, which are related to the development of industries under supervision, licensing and supervision of operators, consumer protection and the minimization of risks that can damage all the above-mentioned parameters, it must be said that developing countries such as Albania have many other challenges to face similar situations such as pandemics or natural disasters, which require an address as quickly as possible, enabling the financial market in the country to integrate as quickly as possible. in European markets. There are three main pillars that constitute a constant challenge:

- Increasing the level of financial inclusion of the population and the use of financial services by eliminating the cash economy,
- Development and support of capital markets as a very useful way to promote competition, reduce financial costs and increase efficiency in financial markets, positively influencing the growth of the economy.

- Increasing the use of products and tools of modern financial technology (FinTech) in every financial service.

III. BANKING MARKET

The banking market in Albania is one of the main components of the country's financial system, playing an important role in economic development and the financial inclusion of the population. After a transition period of challenges and transformations, the Albanian banking market has experienced some positive changes, but there are still major challenges that need to be addressed in order to reach the full potential of growth and stability. Today, banks are no longer simply intermediary institutions that transfer funds from surplus to deficit units (SSU-DSU). Banks today have a universal and modern character. They engage in a variety of activities, which mainly include: borrowing, lending, underwriting and selling of Securities, payment services, asset management, real estate trading and brokerage.

In recent years, the banking market in Albania has experienced positive developments. Commercial banks dominated the market by offering a wide range of financial services to their customers. The increase in financial stability and the further management of bad loans have helped to increase the credibility of the Albanian banking system. The Bank of Albania has played a key role in the monitoring, controls and supervision and regulation of the banking market, contributing to increasing its integrity and security. Each bank must monitor the adequacy of its capital, using, among other things, the rules and ratios set by the Bank of Albania, which ultimately determines the legal capital required to support its business.

Banks are generally funded through customer deposits which means that money market funding is not widely used. During the last years, banks have started to increase capital also through the issuance of medium and long-term bonds, which are offered privately to investors (up to 100 investors) in order to comply with the provisions of the Bank of Albania Regulation no. 78/2020 "On the minimum requirements for regulatory capital instruments and eligible liabilities" (MREL) which was drafted in accordance with Directive 2019/879 (BRRD II) amending Directive 2014/59/EU and Regulation (EU) 2019/876 of the European Bank 2019/876 of

this Regulation of the European Bank. The perspectives of the banking market in Albania are different. On the one hand, there are various signs of progress, with increased credit and improved financial inclusion. On the other hand, remaining challenges, such as low accessibility and financial literacy, must be addressed to reach the full potential of the banking market in Albania. Recent reports from international institutions emphasize the need for the banking sector to diversify its loan portfolio as it is currently overexposed to the real estate sector (approximately 40%). This is a big challenge for the entire banking sector.

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Another challenge is the digitization of banking services. Fintech companies have grown in Albania and are trying to serve the non-resident or unbanked in Albania (approximately 50-60% of the population). In order not to lose their market share, banks must further increase the digitization of their services. For the future, the banking sector in Albania has great potential to contribute to economic growth and improve the well-being of the population. For this purpose, it is important that financial institutions continue to improve their efficiency, offer products and services suitable for the needs of the time, while at the same time maintaining the level of social responsibility and protecting the interests of consumers, by:

- Banks offer financial instruments to protect clients from exchange rate movements;
- The impact of interest rate changes on lending and on the quality of the loan portfolio;
- Open Banking (Open Banking);
- Preparation of a new law for banks, in accordance with EU directives, and the resolution of the banks' requirement for the minimum capital adequacy of 8%;
- Studying the options for the deposit insurance premium, depending on the obligations arising from the process of approximation of the legislation with that of the EU;
- Acceleration of the work for the FINREP Project, which also resolves the banks' request for the treatment of repossessed properties, etc.

IV. CAPITAL MARKET

Economic growth depends on the fact that how efficiently resources are allocated to the most productive projects or sectors, this allocation being realized between developed financial markets. So, financial markets and financial intermediaries are promoters of economic growth, since they channel funds from savers to those who invest. Also, if attractive financial instruments are created, the capital market can attract a number of savings that enable portfolio diversification, risk transfer or even provide liquidity for investors. The capital market in Albania is still small and has a low weight in the financial system. However, this market has high potential to play, in the long term, an important role in the country's economy. The capital market is dominated by the primary market of government securities and its other segments, such as the secondary market, investment funds and voluntary pension funds, which have still performed modestly, which means that the untapped potential remains high. The best international experiences have shown that the development of the capital market in an evolutionary way has required several centuries (the countries that have developed stock exchanges today have a 5-century history). While in countries like Albania that have a modest history of capital market development, they have applied various legal and fiscal incentives to encourage business to use the capital market, as a more favorable alternative for financing the activity. Legal incentives are related to the improvement of the financial market infrastructure or the easing of bureaucracies, in order to facilitate a faster listing of the business on the stock exchange. Whereas fiscal incentives are related to the reduction or complete removal of various taxes for listed entities (businesses) or for citizens who generate income from investing in securities. In order to increase the efficiency of the capital market, it is important to define a clear vision for the development and functioning of the capital markets, as well as to ensure the full implementation of this vision through a series of action plans that must be undertaken. The aim is to create opportunities for the participants of the capital market, as well as to provide the

appropriate incentives for the improvement of this market. In the case of Albania, the lack of a real capital market, complete with all its constituent elements, makes the choice more difficult for both parties, both for those who want to invest and benefit from more diversified financial instruments, and for those who want to be financed through them in order to grow and improve. The last few years have been significant for the steps that have been taken and this can be seen in several aspects.

First, in completing the legal framework with the necessary elements and links to have a genuine capital market.

Second, there are investments in platforms at its service.

Third, there is an increase in the number of constituent actors which means that the potential is there, albeit minimally exploited.

Fourth, there is the maturity of some private companies that have consolidated their position in the market and aligned their financial reporting standards, offering more transparency.

The final part that remains to be completed is finding ways to encourage participation in this market and the first test, according to experts, should be the active participation of public companies to be followed by private ones. In parallel with this, it is underlined that financial education should be continued, which still remains lukewarm and, therefore, inhibiting. Another element that is a deterrent for businesses looking for long-term funding is bureaucracy and the length of the process. Because commercial banks in the country have abundant liquidity, this gives them the opportunity to take many times less time (usually 1 month) in fulfilling business needs with loans. While the process of issuing securities and listing on the stock exchange, although less expensive, is a process that requires businesses from 6-12 months, pushing them more towards the banking sector. For this reason, the orientation of the second level banks should be towards the investment service.

This would not only not create for these financial Institutions competition with themselves (instead of a loan, they would lend by buying the bond of a corporation), but would encourage the rapid development of the capital market by increasing the volume of business. Currently, investment funds and pension funds are not developing at the speed

they should for the sole reason that there is a lack of instruments to invest and diversify the portfolio in stock exchanges and organized markets. The conversion of corporate loans into bonds issued by corporations and invested by public banks would bring a faster and more stable development, not only of the capital market in the country, but of the entire financial sector as a whole.

V. FINTECH

Financial technology, or FinTech, has undergone significant development in Albania in recent years. Changes in the way the financial sector operates, mediated by technological innovations, have brought about visible impacts on the way individuals and companies use, utilize and come into contact with financial services. In this context, the search for innovation and improvement of access and efficiency has increased in Albania. From January 2021, the new law on payment services came into force where the changes and improvements brought by the revision of this law enable a resizing in the market of this service, accommodating in the system a wider participation of actors in this field, not only banking institutions, but also non-bank financial ones. Banks have given and give their contribution to the development of payment services, but, of course, this New Law opens new windows and challenging opportunities for all actors to contribute to a market, which can be called mature. In the banking sector, FinTech has brought fundamental changes. Traditional banks have invested in mobile platforms and applications to provide simple and accessible banking services. Customers can now access their bank accounts, make transactions and receive other financial services from their mobile phone. This has increased the use of e-banking and improved customer access and experience.

In the field of payments, FinTech has brought significant innovations. Electronic payment applications have become popular and widely used by consumers. Through these apps, they can make payments in stores, send and receive money from others, and perform other financial transactions without the need for cash. This development has increased the security and ease of payments and has influenced the growth of e-commerce in Albania. Another important aspect is the development of the microcredit sector. FinTech microcredit platforms

have facilitated access to credit for individuals and small businesses that do not have traditional access to financing. These platforms have used technology to screen loan applications efficiently and provide customized solutions to their requirements. This has stimulated entrepreneurship and the development of the small business sector in Albania. However, despite the progress, the development of FinTech in Albania also faces challenges. Albania is a "cash" economy with a significant number of "unbanked" population and, as such, creates many opportunities for development in this direction. The geographical extent of our banking system does not allow access to payment services by the entire population, while other alternative forms at a distance can bring these services closer to them. Building a communication and interaction infrastructure is a separate challenge for our financial system, which will enable and change the approach to these services. A major challenge is adapting to existing rules and policies. Rapid changes in technology and financial innovation require appropriate regulation to protect consumers and ensure the safety and integrity of the financial system. Other challenges include protecting personal data and electronic payments from cyber security threats and changes in people's approach to new technologies. In the future, it is expected that FinTech will continue to influence the Albanian financial system and bring new innovations. Increasing the population's access to financial services, the development of new platforms and applications and investments in technological infrastructure will have a significant impact on the development of the financial system in Albania.

VI. CONCLUSIONS

The financial system in Albania has experienced positive developments, but there is still a lot of work to be done. Financial inclusion and investment should be the main focus points to improve financial market stability and development. The Albanian financial system has experienced a positive transformation and significant growth in recent years. The process of consolidation of the banking sector, increased capitalization and improvement of regulators and supervisors has helped to increase the reliability and stability of the financial market. The development of the network of subsidiaries and services offered online and through mobile phones

has facilitated the access of the population and businesses to loans and other financial services. This has boosted economic activity and investments in the country. In the meantime, authorities and financial institutions must work together to address remaining challenges, such as:

1. Need for financial education: Due to low levels of financial literacy, a large part of the population needs more education in the field of finance. Efforts to raise financial awareness should continue to help citizens better understand financial services and products.

2. The need for advanced technology and security: Albanian banks should continue to invest in advanced technology to ensure safer and more efficient transactions. Improving the security of the financial system is very important to protect the interests of consumers and prevent criminal activities.

3. Fight against organized crime and money laundering: State authorities and financial institutions should continue cooperation to fight organized crime and money laundering. This is a big challenge, and different forces must work together to minimize such risks.

4. Potential for the future: The Albanian financial system has great potential to contribute to the economic growth of the country and the improvement of the well-being of citizens. In the future, a continuous development of the financial infrastructure, the improvement of the investment climate and a careful approach to risks can help to advance the Albanian financial system. The Albanian financial system has made significant progress and has undergone an important change in several aspects. However,

challenges remain and it is important to continue efforts to further improve financial infrastructure, financial education and system security to achieve a financially stable and developed market.

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