# Reducing Systemic Risk Associated with Foreign Exchange lending in Albania

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# The market information

- Floating rates – pretty stable domestic currency
- 44,5% in unhedged customers
- 16 banks – 95% of the market
- 7 NBFI – 5% of the market
- Interest rates – 9% on loans in FX
- Interest rates – 14% on loans in domestic currency
- Surplus of savings over loans
- 50% of borrowers are individuals

# Problem identification (1)

- Management failure- banks expose themselves to too much risk
- Regulatory failure – minor because the problem is still manageable
- Market failure- comes from market wide management failure
- Asymmetrical info – between banks and customers

# Problem identification (2)

- Why is regulatory intervention necessary – in this time of financial turmoil banks will probably react too late and too slow to the flip of foreign currency loans / LEK loans ratio, many customers will go default and will bring risk to banks, other customers and a whole system.

# Policy objectives

- Protect market stability
- Protect customer rights

# Goals

| Statutory | Specific | Operational |
|---|---|---|
| •Financial stability | •Risk management<br><br>•Soundness of banking system | •Guidelines management<br>•Definition of U-H lending<br>•Sanctions<br>•Limit to FX exchange<br>•Reporting |
| •Consumer protection | •Reduce asymmetrical information<br>•Reduce risk exposure<br>•Fair competition | •Transparency of transactions<br>•Sanctions<br>•Definition  of U-H lending<br>•Advertising rules |

# Policy options

1. Do nothing

<u>Financial stability</u>

- No incentives to change the situation
- No harmonized guidelines

<u>Consumer protection</u>

- No transparency due to high competition
- Advertising with hidden information

# Policy options

2. Create law, forbidding unhinged lending
3. Creating a guarantee fund funded and operated by banks on the basis of % of unhinged lending
4. Impose rules on risk management – ceiling on loans, minimum reserve on Fx funds, accounting to ratio UBFx/TDfx 1pp for each 10pp over 100

# Expetations  Option 2

| BANKS | CUSTOMERS | REGULATOR | NBFI |
|---|---|---|---|
| 1. Depends on percentage of the profit formed by unhinged loans<br>2. Implication of new regulation<br>3. Lower risk in long term<br>4. Several new products<br>5. Increasing the quality due to reduced risk<br>6. New credit products<br>7. Improve competition between big and small banks | Decreased access to loans<br><br>Better customer protection | Costs for:<br>- regulation<br>-Education<br>-Extra inspections to enforce new loans<br><br>-Increase market stability<br>-Reduce number of inspections | 1. Depends on percentage of the profit formed by unhedged loans<br>2. Implications of new regulation<br>3. Lower risk in long term<br>4. --<br>5. Increasing the quality due to reduced risk |

# Expectations / Option 3 Guarantee fund

| BANKS | CUSTOMERS | REGULATOR | NBFI |
|---|---|---|---|
| 1. Setting up costs for the fund | Costs passed on by the banks | Creating an ordinance/law | - // - Same as banks |
| 2. Installments to the fund | Costs passed on by the banks | Costs for inspecting compliance | |
| 3.Lower default loans ratio | Better access to credit | Reduced market risks | -- // -- |
| 4.Increased profits, products | Higher access | Increased credits to economy | -- // -- |
| 5,6. Increased quality and variety | Better choice | | |
| 7. Improved position of less exposed banks | Positive effects<br>Reduced local currency interest rates | | -- // -- |

# Expectations 4. Risk management

| BANKS | CUSTOMERS | REGULATOR | NBFI |
|---|---|---|---|
| 1. Opportunity costs | ---- | -Supervision costs | -- // -- as banks |
| 2.No additional costs | ---- | ---- | -- // -- |
| 3. less risk | | | |
| | Less risk | -Improved stability | -- // -- |
| 4. Less quantity | | | |
| | Less quantity | -Reduced risk in economy | -- // -- |
| 5. Shifted variety to hedge lending | | | |
| | Hedged loans to customers | --- | -- // -- |
| 6. Export loans to mother banks | | | |
| | Higher prices | Reduced efficiency of competition | |
| *lower competition | | | |
| -Space for banks to increase | | | |
| -Lower capital building capacity | | | |

# Consulted stakeholders

- Banks
- Non-banking financial institutions
- Consumer protection agencies
- Banking associations
- Customers (individuals and businesses)

# Policy recommendations

**<u>Option 4 – Risk management</u>**

Reasons to recommend this option:

- Less time
- Fast effects
- Most efficient in terms of stakeholders benefits
- Best addresses identified problems
- Biggest quantity and quality of products of all options analyzed
- Positive side effect: increase in bank share capital
- Negative side effect : export of loans to headquarter bank abroad