



DRAFT  
 SUBJECT TO PMG AGREEMENT  
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## TERMS OF REFERENCE

### Project: Revising Foreign Currency Open Position Project

<b>Project Owner:</b>	<b>Bank of Albania, Supervision Department</b>
<b>Project Manager:</b>	<b>Bank of Albania, Supervision Department</b>
<b>Project Co-Manager:</b>	<b>A bank representative</b>
<b>Technical Anchor (TAN):</b>	<b>One peer reviewer from Central Banks in the region and ABI</b>
<b>Project Working Group:</b>	<b>Representatives of BoA, Supervision Department and representatives of all banks</b>

### I. - Background - Problem Identification

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.

In their activity to satisfy their customers’ demands through extending loans, accepting deposits in foreign currency etc, banks undertake the risks of foreign exchange fluctuations. A bank has a net open position in a certain foreign currency when its assets and liabilities are different. When assets are bigger than liabilities we have a purchasing position (+) long, whereas when liabilities are higher than assets we have a selling position (-) short.

The above mentioned regulation determines rules for measuring the open foreign exchange positions of banks. The rules are intended to limit the losses of banks from both foreign exchange transactions and precious metal ones. All the banks when performing banking transactions in foreign currencies shall monitor the process and shall not exceed the following rates at the end of each day:

1. A maximum ratio of 20% of the net open foreign exchange position in each foreign currency to bank regulatory capital;
2. A maximum ratio of 30% of net total open foreign exchange position to bank regulatory capital.

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.

Looking at the experience of other countries in the region many Central Banks have adopted new regulations which take into consideration real exposure of FX risks through a better capture of product development trends in the financial sector.

For the reasons mentioned above, there is a need to amend the relevant regulation on FX Open Positions through revising the calculation method on FX positions in accordance with international standards and best practices.

In addition, the adoption of the International Financial Reporting Standards (IFRS) in 2008 raised the emergency for 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<sup>1</sup> recommended a comprehensive list of banking regulations that would need future amendments. With reference to the amending priority, the regulation on FX Open Positions was considered as high priority.

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.

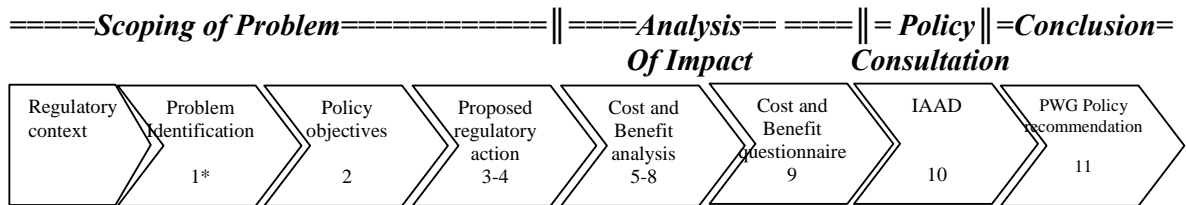
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<sup>1</sup> The IFRS Project Working Group included representatives from the Bank of Albania, Banks, Ministry of Finance, Financial Supervisory Authority, Pricewaterhousecoopers, KPMG, Ernst & Young, Deloitte & Touche.

## **II. - 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.

## **III.- Intended Strategy-Description of the Better Regulation**



The project management group (Project Owner, Project Manager, Deputy Project Manager), supported by the SPI Secretariat, will act based on the mandate received from the SPI Committee to prepare a proposal to amend the current regulation on FX Open Positions.

The project working group (PWG), with the support of SPI Albania Secretariat, will analyze other countries' experience in relation to FX open positions in order to understand and apply them in the current Albanian regulatory framework.

Planned steps to achieve project's objective:

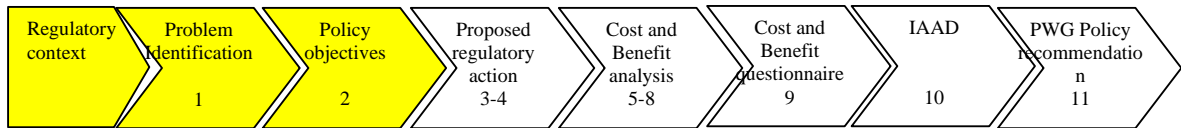
1. To identify the current legal framework that regulates FX open positions as well as the problems identified on the implementation of the existing regulation and methodological guideline by banks.
2. To acquire a clear understanding on experiences in other European Countries in calculating the FX open positions.
3. Based on the analyzed documents, to formulate options for regulatory amendment proposals.
4. To assess the possible impact of regulatory amendment proposals and run consultations on the proposed amendment options
5. Based on the consultations, prepare a final recommendation for SPI Committee consideration.

#### **IV- Methodology: from kick off to the accomplishment of the project**

The Project Owner will appoint PM and DPMs. SPI Secretariat will draft the invitation letters. The project working group members will be appointed by PM and by banks, following the invitation sent through AAB.

##### **A. First PWG meeting**

###### ***Preparation of PWG 1<sup>st</sup> meeting (PM/DPM and SPI Secretariat)***



###### ***Preparatory work***

PMG and SPI Secretariat to prepare: a. a background note on current regulatory framework; b. a note on international experience.

After PMG clearance and before the 1<sup>st</sup> meeting, SPI Secretariat will send to PWG members the following documents:

1. Draft TORs;
2. Draft of “Scoping of Problem” document;
3. Background note on current regulatory framework;
4. Note on international experience

**Objectives:** To understand the current context and the policy goals

To acquire knowledge on other European countries’ experience in regulating FX open positions.

**Outputs:** Final ToRs

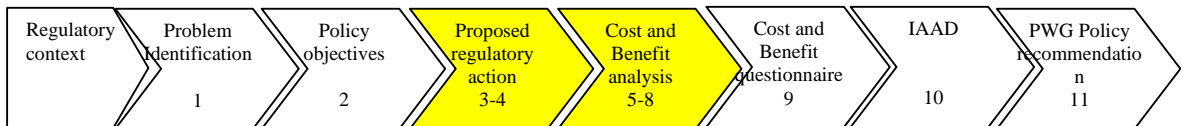
Final “Scoping of Problem” document

Approved note on international experience

SPI Secretariat will prepare the minutes of the meeting

**Tentative timeline:** [first half December]

##### **B. PWG 2nd meeting**



###### ***Preparatory work***

PWG members will send to SPI Secretariat the description of their internal methodology and policy for FX open positions.

A core team of the PWG, with SPI Secretariat support, will prepare a proposal for potential PWG recommendations to amend the current regulatory framework.

SPI Secretariat will prepare the draft qualitative analysis of the potential PWG amendment proposal/s.

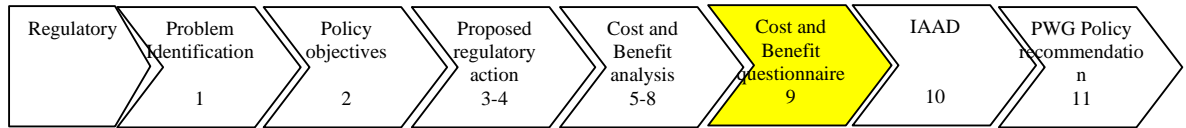
**Objectives:** To formulate recommendations on policy implementation;  
To analyze the qualitative impact for users and regulators.

**Output:** Proposed regulatory action (amendment/s)  
Approved IAAD document up to qualitative impact assessment

SPI Secretariat will prepare the minutes of the meeting

**Tentative timeline:** [first half January]

**C. PWG 3rd meeting**



**Preparatory work**

SPI Secretariat with PMG support, will draft the questionnaire for data collection. SPI Secretariat will base its approach on the very clear understanding of the current banks practice and of the changes brought in the methodology by the amendment proposal.

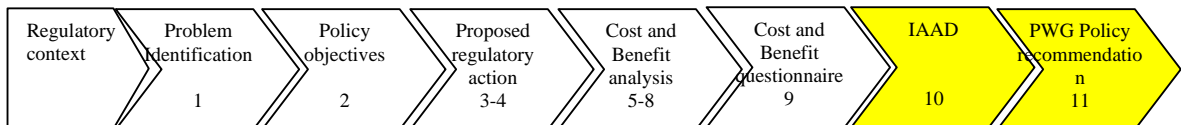
**Objective:** To discuss and agree on the cost and benefit questionnaire for assessing the quantitative impact of the regulatory amendment/s.

**Output:** Final questionnaire.

SPI Secretariat: will prepare the minutes of the meeting.

**Tentative timeline:** [second half January]

**D. PWG 4<sup>th</sup> meeting**



**Preparatory work**

SPI Secretariat will collect data from PWG participating banks and will summarize questionnaire results, preparing the draft “summary impact assessment” for PWG discussion and endorsement.

PMG and SPI Secretariat: to draft PWG recommendations on regulatory amendment proposal/s.

**Objectives:** To endorse Impact Assessment Analysis Document including “Summary Impact Assessment”;  
To finalize PWG recommendations.

**Output:** IAAD  
Final PWG recommendations.

**Tentative timeline:** [first half February]

***Following PWG 4<sup>th</sup> meeting:***

Preparation of the SPI Committee paper that will be approved by PMG.

#### **V - Project Team**

The team is composed of:

- Bank of Albania
- All Banks

Consulted documents:

1. Law no. 8269 dated 23.12.1997 “On the Bank of Albania” chapter VII, article 26;
2. Law no. 8365 dated 02.07.1998 “On the Banks in the Republic of Albania” article 27;
3. Decree no. 59 dated 05.05.2009 of the Supervisory Department on FX open positions;
4. Methodological guideline on foreign exchange risks.

Attachment

<b>The EU Better Regulation Approach</b>	
<b>Steps</b>	<b>Purpose</b>
<b>Scoping of problem</b>	
1. Problem identification	To understand if a market/regulatory failure creates the case for regulatory intervention.
2. Definition of policy objectives	To identify the effects of the market /regulatory failure to the regulatory objectives.
3. Development of “do nothing option”	To identify and state the status quo.
4. Alternative policy options	To identify and state alternative policies (among them the “market solution”).
<b>Analysis of impact</b>	
5. Costs to users	To identify and state the costs borne by consumers
6. Benefits to users	To identify and state the benefits yielded by consumers
7. Costs to regulated firms and regulator	To identify and state the costs borne by regulator and regulated firms
8. Benefits to regulated firms and regulator	To identify and state the benefits yielded by regulator and regulated firms
9. Data Questionnaire	To collect market structure data to perform a quantitative cost and benefit analysis
<b>Consultations</b>	
10. Policy Document	To learn market participant opinions on various policy options
<b>Conclusion</b>	
11. Final Recommendations	Final report to decision-makers, based on Cost Benefit Analysis and market feedback

Source: CESR-CEBS-CEIOPS 3L3 Guidelines, adjusted by the Convergence Program based on experience.