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Improving Auction Procedures for Immovable Collateral under Foreclosure:
 Supporting the enactment of law amendment proposals
www.spi-albania.eu/en/2008-program/improving-auction-procedures-for-immovable-collateral-under-foreclosure

Project information

PUBLIC-PRIVATE FINANCIAL SECTOR MODERNIZATION MATRIX					
Italian Banking Association CRITERIA	European Central Bank CRITERIA				
	<i>Asymmetric information reduction</i>	<i>Completeness of the market</i>	<i>Increased opportunities to engage in financial transactions</i>	<i>Reduced transaction costs</i>	<i>Increased competition</i>
Business development				X	
Industry competitiveness					
Industry reputation					

Short description of the context: Banks complain that the foreclosure procedures are too long and cumbersome and result in increased uncertainties, costs and impairment of the collateral value. Actually the process is rarely successfully completed. Banks are indirectly forced to take possession of the immovable when it is offered in a public auction and, due to the ceiling in the fixed assets to total assets ratio, the immovable has to be sold in a short time and sometimes in unfavorable conditions.

Stakeholder proposing the project: AAB

Other Stakeholders involved (sponsors): BoA, MoJ – Bailiff Department, Appraisers’ Association

Project objectives:
General: To undertake analytical activities that would support the enactment of law amendment proposals.
Specific: To support the Ministry of Justice in its initiative to amend the Civil Procedure Code - CPC.
Operational: To provide proposals on specific provisions of CPC;

Description of the project contribution toward financial modernization:
 By reaching the project’s objectives, the recovery process of the bad debts under foreclosure procedures would be facilitated and banks’ costs with foreclosing the immovable collateral would decrease. These effects will be reflected in the cost of the bank products and services (loans) and in more loans granted due to the quickly recovery and to the decrease in the risk of loss.

Project Working Group:

- Banka Kombetare Tregtare; - Banka e Shqiperise
- Banka Nder – Tregtare; - Tirana Bank
- Emporiki Bank; - Banka e Bashkuar
- Raiffeisen Bank; - Banka Credins
- Banka Alpha; - Ministria e Drejtesise; - IFC

Peer reviewer: EURALIUS

PWG meetings:

1st meeting – July 4, 2008; Output: Project ToRs, Note on the impact of the current legal framework on enforcement, on banks and on consumers;

2nd meeting – July 30, 2008; Output: Comparative table - the current provisions of CPC compared to the latest version of CPC amend proposal approved by the Council of Ministers (in 2007), the individual contributions of the PWG members, Euralius’ recommendations and extracts from the Romanian CPC as illustrative example.

3rd meeting – September 26; Output: PWG proposals for CPC amendment

4th meeting – October 27; Output: Document on the PWG Recommendations on CPC amendment proposal;

Contributions:

PWG members: participation in PWG meetings and discussions; individual contributions and comments on the suggested amendments; answers to the Impact Assessment questionnaire.

PMT [Ms. Veronika Prifti, BKT and Ms. Rudina Gorishti, Bank of Albania]: in addition to the above mentioned, formulated draft PWG amendment proposals.

PM [Ms. Veronika Prifti, BKT]: in addition, participated in the discussions with the Ministry of Justice; and, was the person responsible to present to the Legal Affairs Parliamentary Commission the comments and the PWG amendment proposal.

SPI Secretariat: drafted Project ToRs; Note on the impact of the current legal framework on enforcement, on banks and on consumers; comparative table and aggregation of the individual contributions; Impact Assessment Questionnaire; collection of individual contributions and draft Summary of Impact Assessment Questionnaire; draft Document on the PWG Recommendations on CPC amendment proposal; participation in the discussions with MoJ and in the Legal Parliamentary Commission.

Other contributions: Euralius – peer reviewer; AAB - Legal Committee and support for bank survey running.

Other Supportive Activities:

June – July Request for collaboration letters to the Ministry of Justice.

July PM called for an out-of-agenda meeting the AAB Legal Committee, to inform and establish collaboration with the SPI project.

July Meeting with the three representatives of the Enforcement Department, MoJ.

September Preliminary PWG discussions on CPC amendment proposal

First negotiation round – meeting with the Ministry of Justice

October Second negotiation round – participation in the discussions of the Commission of Legal Affairs, Public Administration and Human Rights

Methodology: EU Better Regulation (Annex 6)

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1. Summary of PWG analysis

In Albania, the current legal framework on collateral execution is covered by the provisions of Civil Procedure Code (CPC), Chapter 3, Art.560-580 “The enforcement on immovable property, ships and airplanes”.

Despite the fact that there are no statistical data available on how many cases ended with the bidder paying the fixed price in an auction and became the new owner, bailiffs confirm that this number is extremely low¹. It happens very seldom that after the second auction the creditor takes the immovable against the price designated for the second auction. In case the immovable has been appraised by the experts contracted by the Bailiff Offices at a value higher than the debt, the creditor has to pay to the debtor the difference between the appraised value and amount of the debt. Due to the ceiling in the fixed assets to total assets ratio, banks have to sell the immovable in a short time and sometimes in unfavorable conditions.

In addition to the above mentioned, there are other problems generated by the legal framework, and particularly the CPC, as the pivotal pillar of the enactment system, related to:

- unclear provisions, which result in inadequate and/or subjective application of the law by the bailiff;
- undefined time periods for most of the procedures;
- long time periods and cumbersome auctions procedures. According to the 2009 Doing Business report an enforcement process has to go through 39 procedures vs. 20 as the best practice and lasts 390 days vs. 120 days as the best practice².

PWG identified the problem and analyzed the market context, assessing that the low efficiency in the current enforcement system is the result of a **regulatory failure**. The current regulation is not appropriately prescribed for the market, resulting in cumbersome procedures, work inefficiency, subjectivity and unequal treatment of parties. This regulatory failure threatens the policy objectives on improving the competitiveness of the market and on better access to finance, and generates additional uncertainty and costs, directly and indirectly, to all economic agents. PWG appreciated that the correction of the existing situation needs a regulatory initiative and identified three alternative options for actions. For more details, please see **Annex 5 - Scoping the Problem**.

SPI Albania with the support of the Albanian Association of Banks (AAB) undertook a survey on the economic impact that the CPC amendment proposals would have in the banking community. **Annex 4.2** presents the questionnaire prepared for the bank survey.

¹ EURALIUS, Proposal for Improvements of the Civil Procedure Code (EURALIUS Activity 8.5), Part I: Enforcement on immovable assets, 2006.

² Anyhow, developments in the enforcement of the contract section in Albania are similar to other comparable economies in the region.

Consultations and negotiations were also performed with the Ministry of Justice and with the Commission for Legal Affairs, Public Administration and Human Rights, Albanian Parliament on the identified alternative policies options and the amendment proposal. The statistics and the main results of the consultation process are presented in **Annex 4 – Consultation process**.

2. PWG Policy Recommendations

The Project Working Group Members, based on the draft proposal approved by the Council of Ministers in 2007, the documents prepared by SPI Secretariat, EURALIUS' recommendations, the Romanian CPC and their professional and practical experience in the foreclosure process, have discussed and agreed on 18 amendment proposals to the CPC. The purpose of these proposals is to achieve:

- fairness and equal treatment of parties during the foreclosure process;
- better use of resources and better regulated process;
- enhanced efficiency of the enforcement system.

In order to achieve the project objective a strong collaboration with the Ministry of Justice (MoJ) has been considered crucial. A team representing the SPI project has met and discussed with representatives from MoJ three times. In the last meeting, October 13, the PM, SPI Secretariat and AAB legal advisor met with the advisor of the Minister of Justice and with the Head of the Enforcement Department to discuss on the draft proposals prepared under SPI Albania project framework.

The draft proposal prepared by Ministry of Justice, in which is embodied the SPI Albania PWG proposal is currently under discussions in the Parliamentary Commission of Legal Affairs, Public Administration and Human Rights. This procedure proceeds the plenary session in the Parliament.

The detailed PWG amendment proposal is presented in **Annex 1**.

The amendment proposals would contribute to decrease costs above mentioned problems faced by the banks result in increased cost, wasted time in complicated procedures and impairment of the value of the collateral. SPI Albania performed a quantitative assessment of the impact of the proposed amendments based on data collected through a bank survey and using other information and assumptions.

The most immediate and visible effect of the amendment proposals will be a **lower number of days for the enforcement process**. Currently the foreclosure process, in average, lasts 390 working days; the 18 proposed amendments could lead to a decrease in this period by 120 working days, increasing thus the efficiency of the enforcement process

The enhanced efficiency of the enforcement system will have positive ramifications on the assessment performed by various international institutions to measure and compare the business climate of large pools of countries regarding their economic and legal efficiency. A very important assessment of this kind is the one prepared by the World Bank on the easiness of

doing businesses -the Doing Business report. This report investigates the regulations related to the business activity and assesses whether the legal structure in place enhances or constrains it.

In the 2009 Doing Business, through a set of quantitative indicators on 10 stages of the business cycle, 181 countries were analyzed, compared and ranked. For 2009, Albania was ranked 86th on the overall business environment, while in the section of Contract Enforcement was ranked 89th. According to our calculations, **if the Civil Procedure Code revision process and the consequent improvement of the foreclosure process was undertaken and finalized during 2008, Albania would have improved its rank in the Contract Enforcement section by 7 (seven) places.** These improvements would have made more resilient all the achievements made by Albania thus far.

The main findings of the analysis on the impact on banks and on consumers of the amendment proposals are presented in Annex 2.

3. Proposed SPI Committee Decision

SPI Committee recommends that the PWG Proposal is forwarded for comments to the General Regulatory Directorate in the Market Surveillance Department part of the Ministry of Economy, Trade and Energy.

SPI Committee send a follow-on letter confirming the full availability of SPI Albania PWG to further assist the Legal Affairs Parliamentary Commission considering the draft proposal.

Annexes

Annex 1.

PWG Recommendations to Amend the Civil Procedure Code

No.	Current Provision (no)	Proposed amendment
Package 1 - Core changes that increase the efficacy of the enforcement system		
1	<p><u>Article 511</u> The executive title is executed on the request of the creditor. For this purpose the order of execution is issued which is given :</p> <p>a. by the court which has taken the decision in cases stipulated in letters a and b of the preceding article;</p> <p>b. by the Court of Appeals with regard to decisions by courts of foreign countries and of foreign arbitration courts which have been given implementation power in conformity with the provisions of this Code;</p> <p>c. by the court of the place where decision has been issued in cases stipulated in letter ç of the preceding article;</p> <p>ç. by the court of the place where it has been determined to make the execution in cases stipulated in letters d, dh and e.</p>	<p><u>Article 511</u> The first paragraph is changed as follows: “For this purpose the executive title is issued within 5 days from the date of the creditor’s, which is given:”</p> <p>The last paragraph is changed as follows: “For the sigurimine padise and the fines written by the court are not issued executive orders, which are executed directly from the bailiff office, after the notification of the decision.”</p>
Stance of the MoJ		Agrees with the proposal
2	<p><u>Article 513</u> The executive order The execution order is issued in only one copy. When separate properties must be handed over or when the execution title has been issued to the benefit or against several persons separate execution order may be issued making a note as which part of the title must be executed for each execution order.</p>	<p><u>Article 513</u> The first sentence is changed as follows: “The execution order is issued in two copies.”</p>
Stance of the MoJ		MoJ agrees with the problem identified, but the solution will be further discussed internally
3	<p><u>Article 515</u> Commencement of the execution</p> <p>The execution title is executed by the bailiff on request by the creditor as well as by the prosecutor in cases when he has sued.</p>	<p><u>Article 515</u></p> <p>For the execution of the executive titles the creditor should prepare the file containing: The request for execution, the executive title, the executive order, the receipt of paid tax, if necessary the act of procurement. If the bailiff considers the file is not adequately complied the creditor has 5 days to fill in the file correctly.</p>

No.	Current Provision (no)	Proposed amendment
		<p>The request for execution is considered as registered from the date presented in the bailiff office.</p> <p>The bailiff should execute the executive order within 15 days from the submission of the request.</p> <p>Court orders on masen e sigurimit te padise / charge of securing the lawsuit and the penalties issued by the court are executed within 5 days from the day of announcement.</p> <p>The tax for the execution process is not prepaid in the cases defined by the law.</p>
Stance of the MoJ		MoJ did not agree to reduce time periods
4	<p><u>Article 564</u> Valuation of the property</p> <p>The seized immovable asset is appraised by the bailiff on basis of the value registered in the registers of immovable property or of the financial organ and in absence of such registration by experts. When the debtor or any other person having interest claims a higher value of the asset in comparison with the one existing in the registers of immovable property or of the financial the bailiff performs an other appraising process with an expert.</p>	<p><u>Article 564</u> Valuation of the property</p> <p>The article 564 is changed as follow:</p> <p>“If the debtor and the creditor do not reach an agreement, the bailiff officer determines within 15 days the value of the property based on the expertise act presented by a <i>licensed</i> expert based on the market value, in the moment of seizure. The bailiff should notify the debtor and the creditor on the appraised value within 10 days from the appraisal process. Against the value both parties might appeal.”</p>
Stance of the MoJ		<p>Agreed on the time periods;</p> <p>Not agreed on the initial value of the auction (PWG liquidation value vs. MoJ market value)</p>
5	<p><u>Article 567</u> Auction procedures</p> <p>After placing the seizure the bailiff send to the debtor a notice that the asset shall be sold if he does not fulfill his obligation within 10 days from the notification.</p> <p>On the expiry of the above term the bailiff announces the sale of the asset by auction.</p>	<p><u>Article 567</u></p> <p>The article 567 To be abrogated</p>
Stance of the MoJ		Agreed
6	<p><u>Article 577</u> Repetition of the auction</p> <p>When in the first auction no additional amount above the price at which sale started is offered, or there is no bidder, a new auction for the sale of the asset is held, applying the rules for the first auction. The new auction is held after three months have passed from the end of the first auction and on basis of a new price not lower than 20% of the first price designated by the bailiff in agreement with the debtor. When the asset is not sold even by the second auction the bailiff suggests to the creditor to</p>	<p><u>Article 577</u></p> <p>The article 577 is changed as follows:</p> <p>If in the first auction no bidder has offered a higher price than the initial price, or there has been no bidder the sale continues with a second auction. The bailiff officer within 10days from the first auction determines the price, which is <u>20%</u> lower than the initial price. The second auction should start not later then 15 days after the price is set.</p> <p>Within 30 days from the payment of the price from</p>

No.	Current Provision (no)	Proposed amendment
	<p>take the asset against the claim/loan at the price designated for the new auction and when he refuses raises the seizure on the asset.</p> <p>When the creditors that request to take the asset against credit are several the bailiff declares as buyer the creditor who within three days from the suggestion gives a higher price than the one designated for the new auction.</p>	<p>the buyer or from the acceptance of the property form the bank, the bailiff places the property under the possession of the buyer / creditor.</p>
Stance of the MoJ		MoJ agrees with the problem identified, but the solution will be further discussed internally
Package 2 - Other changes that further improve the efficacy of the enforcement system		
7	<p><u>Article 141</u></p> <p>Notification to institutions, enterprises and other legal persons is made by means of delivering the copy to the office of the chief executive officer and to the persons responsible for receiving acts. Notification to non-state legal persons is made to their headquarters by means of delivering the copy of the act to the representative or person responsible to receive notification and in their absence to another person who works in those headquarters of that legal person.</p>	<p><u>Article 141</u></p> <p>The article 141 is changed as follows: The notification process for the legal persons is the same as for the private persons (art.133).</p> <p>The last sentence of article 133 is changed as follows: The notification is posted in district court, district commune or birthplace or last known location</p>
Stance of the MoJ		Agreed
8	<p><u>Article 517</u></p> <p>The voluntary execution</p> <p>At the start of the execution, the bailiff sends to the debtor a notice to execute voluntarily the obligation contained in the execution order designating for this a term of 5 days when its subject is salary or obligation for sustenance and of 10 days in all other cases.</p> <p>On request by the debtor, the first level court of the execution place, in special cases, taking into consideration other circumstances of the case may postpone the term of execution of the obligation in cash or may divide such an obligation in installments. The decision is given in court session, after the parties have been notified and a special appeal may be made against such decision.</p>	<p><u>Article 517</u></p> <p>In the second paragraph is added: “Upon the debtor’s request and after the creditor is expressed the court might postpone the time of the payment”</p> <p>The last sentence is changed as follows: “Against the decision parties might appeal.”</p>
Stance of the MoJ		Agreed
9	<p><u>Article 522</u></p> <p>The execution if the debtor’s address in not known When the residence of the debtor is not known, the court of the district of the place of execution, on request by the bailiff, after being directly clarified on this circumstance, nominates a representative of the debtor.</p>	<p><u>Article 522</u></p> <p>In the article 522 after the works “...on this circumstance...” is added “...within 10 days...”.</p>

No.	Current Provision (no)	Proposed amendment
Stance of the MoJ		Agreed
10	<p><u>Article 560</u> The sequester order The execution of the decision of the court or of other executive titles on immovable assets of the debtor is made by placing seizure on them. Seizure is placed by its registration in the office of the register of immovable property of the act of the bailiff in which are noted the kind, nature and at least three borders of the immovable asset, its location as well as the mortgages and real rights which may be held on it. A copy of the act of the bailiff is communicated to the debtor bindingly.</p>	<p><u>Article 560</u> In the second paragraph of the article 560 is added a sentence, as follows: “The act issued by the bailiff is registered by the Immovable Property Registry Office within 10 days after it has arrived. The last sentence of the article 560 is changed as follows: “A copy of the registry is forwarded to the debtor.”</p>
Stance of the MoJ		Agreed
11	<p><u>Article 573</u> Notification of the winner The last paragraph of the article 573 is changed as follows: “The specific rules on the auction procedures are defined / set with a directive of the Council of Ministers.”</p>	<p><u>Article 573</u> The last paragraph of the article 573 is changed as follows: “The specific rules on the auction procedures are defined / set with a directive of the Council of Ministers.”</p>
Stance of the MoJ		Agreed
12	<p><u>Article 574</u> Time limit to pay the price The buyer must pay the price of the asset within 5 days from the end of the auction. On payment of the price of the asset and the tax on the acts of sale of the asset the bailiff issues the decision for the transfer of the asset in ownership of the buyer. From that day the buyer gains all the rights that the debtor had on the asset.</p>	<p><u>Article 574</u> In the first paragraph of the article 574, words “...5 days...” change in “...15 days...”</p>
Stance of the MoJ		Agreed
13	<p><u>Article 575</u> Taking the possession The buyer is given possession of the asset by the bailiff officer against the debtor or the person to whom it is left in custody as well as against any other person who has the asset in possession. The third person may be defended against the removal of the asset from possession only by means of the suit on recognizing the right of ownership on the asset.</p>	<p><u>Article 575</u> In the first sentence of the article 575, after the words “...the bailiff officer ...” is added “...within 10 days...”</p>
Stance of the MoJ		Agreed
Package 3 - Changes that achieve fairness and equal treatment		
14	<p><u>Article 144</u> The court may order by decision also other means of notification than those stipulated by the law such as by a telegram, facsimile, when the reception is</p>	<p><u>Article 144</u> Following the article 144 is added the article 144/a: “The rules in this chapter on notifications are</p>

No.	Current Provision (no)	Proposed amendment
	confirmed in writing, by a written notice delivered by hand and other means which guarantee a regular notification, when required by special circumstances or by the necessity of a fast notification.	applied by the public and private Bailiff Service.”
Stance of the MoJ		Agreed
15	<u>Article 152</u>	This provision to remain as it is.
Stance of the MoJ		Not agreed
16	<u>Article 525</u> Execution expenses The costs incurred for the execution of each action are initially paid by the creditor and then are withheld from the ensuing amount and returned to the creditor.	<u>Article 525</u> A paragraph is added at the end of article 525, as follows: “The creditor has to pay only for the initial fees of the procedures”
Stance of the MoJ		Agreed with the concept, banks will pay only the fees
17	<u>Article 528</u> The sequester order on a different property On request by the debtor, seizure may be placed also on another property other than the one indicated by the creditor when the bailiff estimates that it fulfils the request of the creditor.	<u>Article 528</u> At the end of article 528 is added, as follows: “...apart the case when both parties with an act have defined the wealth (properties) that will secure the claim in which execution is requested.”
Stance of the MoJ		Agreed
18	<u>Article 569</u> The premises for the auction The auction of the immovable property is held in the office of the bailiff. It continues for 15 days and ends at the end of the official working hours of the last day which is indicates in the announcement for the sale by auction.	<u>Article 569</u> In the article 569 after the works “...in the bailiff office...” is added “...in the lodgment of the immovable property or in any other appropriate public place...”
Stance of the MoJ		Agreed

Annex 2

Main Finding of the Impact Assessment Analysis

The quantitative impact assessment analysis aimed at assessing the economic impact of the Civil Procedure Code amendment proposal on banks / creditor, consumers / debtor and authorities.

The most immediate and visible effect of the amendment proposals will be a **lower number of days for the enforcement process** (as presented in Table 1). Currently the foreclosure process, in average, lasts 390 working days; the 18 proposed amendments could lead to a decrease in this period by 120 working days, increasing thus the efficiency of the enforcement process.

Table 1. **Present and estimated detailed impact of the proposed changes on the length of the enforcement process** (Note: - reduction; + increase; *Minimum number of days saved for each of the provisions).

Days	Total	Phase I Court	Phase II Preparatory Bailiff office	Phase III 1 st auction Bailiff office	Phase IV 2 nd auction Bailiff office	Phase V Proceedings Bailiff office
Present	390	45	130	90	95	30
Estimate	270	30	100	60	55	25
Difference* (impact in days by article)		Article 141 - 15 days	Article 511 -10 days Article 515 -10 days Article 522 -10 days	Article 564 -5 days Article 567 -15 days Article 560 -10 days	Article 577 -40 days	Article 574 +10 days Article 575 -15 days

The impact on banks / creditors was measured based on a scenario analysis. In this analysis there are compared the outcomes of (i) the current situation, (ii) the situation improved with reference only to time and (iii) the situation (slightly) improved with reference to other improvements in the efficiency of the process.

The conclusion is that **the recovery rate** of the bad debt will improve as follows:

(i) Under the current situation, for a five year period, banks recover 61.7 million euro or 80% of the amount of debt under foreclosure.

(ii) In the improved situation, with reference only to lower number of days, for a five year period, banks would recover 77.2 million euro or 87% of the amount of debt under foreclosure. The net difference due to regulatory change: a benefit of 15.5 million euros.

(iii) Under a slightly improvement of efficiency during the enforcement process (the process for small share of the portfolio under foreclosure is terminated in the auction organized by the bailiff office), banks would recover 80.2 million euro, or 90% of the amount of debt under foreclosure. Net difference due to regulatory change: a benefit of 18.5 million euros.

Table 1. Summary of the scenario analysis (Euro million)

	2009	2010	2011	2012	2013	Total
New Doubtful & Lost loans under foreclosure	11.7	14.3	17.5	21.4	26.2	123.3
Loans under foreclosure as % of total new doubtful & lost loans	20	20	20	20	20	
Loans under foreclosure as % of total loans	0.4	0.4	0.4	0.4	0.4	
Current situation – Foreclosure process 390 days						
Amount recovered in euro	9.3	10.6	12.1	13.9	15.9	61.7
Recovery ratio (Total amount recovered / Loans under foreclosure)	69%	69%	69%	69%	69%	
Scenario 1 – Foreclosure process for a lower number of days, 270 days						
Amount recovered in euro	11.6	13.3	15.2	17.4	19.8	77.2
Recovery ratio	87%	87%	87%	87%	87%	
Difference – benefit	2.3	2.7	3.0	3.5	4.0	15.5
Scenario 2 –Other improvements in the efficiency of the foreclosure process						
Amount recovered in euro	12.0	13.8	15.8	18.0	20.6	80.2
Recovery ratio	90%	90%	90%	90%	90%	
Difference – benefit	2.8	3.2	3.6	4.2	4.7	18.5

In terms of the costs related to the enforcement process and the costs of accrued interest to be paid to the creditor, the main findings of the Impact Assessment Analysis showed that a more efficient enforcement process would save costs and generate benefits to both debtors and creditors:

- **Benefits or cost savings for the creditor** would be achieved through the increased debt recovery ratio and the earlier usage of “frozen” funds i.e. bad loans under foreclosure. The benefits for the banking community would vary from **15.5 million to 18.5 million euros**. In an annual basis **these benefits amount to 5 - 7% of banks’ operational expenses** depending on the recovery moment (in the first or in the second auction).
- **Benefits and cost savings for the debtor** would be achieved firstly, through benefit transfers from banks / creditors to consumers / debtor. Over a five year period a sustainable portion of these benefits will be transferred to consumers in the form of lower interest rates or higher funds available for loans. Secondly, debtors will benefit from the improved enforcement system through reduced fees and other payments and accrued interest paid to the creditor. A slight improvement in the efficiency of the process would save **0.4 million euros for the debtors**. Cost saved through reduced fees and payments would be in addition to the costs saved in the form of accumulated accrued interests (the interest accrued until the debt is recovered).

Box. 1 Data sources

Bank of Albania – aggregated for the whole banking system:

- Outstanding loans balance at the banking system level, annual end year-stock, period 2000 - 07, in million ALL;
- Quality of the loan portfolio, in percentage to the total amount, quarterly, Quarter1 2004 – Quarter 2 2008.
- Government bonds yield rates.

Albanian Association of Banks:

- Outstanding real estate loan balance, annual end period stock, period 2007 – Half 1 2008.
- New loans interest rates, for ALL, USD and EUR, period 2007 – Half 1 2008.

Assumptions for the period 2009 - 2013:

1. Estimated average annual growth rate of the loans to economy portfolio **22%**. This estimation is based on the loans portfolio growth trend of the past eight years;
2. Share of doubtful loans to the total loan portfolio **0.9%**. This estimation is based on the past average share of doubtful loans during the last 4 years;
3. Share of lost loans to the total loan portfolio **1%**. This estimation is based on the past average share of doubtful loans during the last 4 years;
4. Estimated share of doubtful and lost loans that go in foreclosure procedures **20%** of the total portfolio - based on the discussion during PWG meetings;³
5. Loans under foreclosure are kept in bank's financial statements for one year. The figures presented are considered as yearly flows of loans under foreclosure.
6. Estimated real estate lending interest rate **9%**. This estimation is based on the on the past average interest rate on real estate lending, during the last 2 years;
7. Estimated discount rate flat at **7%**. This estimation is based on the on the past average interest rate on government yield rate, during the last 3 years.

³ For the Assumptions 2, 3 and 4, the analysis was supposed to rely on the information collected through the bank survey. Maybe due to the limited time, banks were not able to fill in the questionnaire with all the requested information.

Annex 3

Note on

The Impact of the Current Legal Framework on Collateral Execution on Banks and on Consumers

1. Current legal framework on and process of collateral execution.
2. Impact on banks.
3. Impact on consumers.

1. Current legal framework on and process of collateral execution

The current legal framework on collateral execution is given by the provisions of Civil Procedure Code, Chapter 3, Art.560-580 “The enforcement on immovable property, ships and airplanes”.

According to the legal provisions, upon a debtor’s default, the chargeholder has an automatic right to obtain a court order, which will empower an execution officer (bailiff) to take possession of the charged assets. Realization can then take place through public auction, as a whole or in commercial units or part. Table 1 below presents the detailed process of enforcement. However, execution officers proved not to be as reliable and efficient as needed. Courts are also reported to be slow and not very experienced in handling enforcement cases, with a high risk of corruption issues.

According to the EBRD’s (2006) assessment, the secured transactions legal framework (covering also mortgages), generally, is **appropriate** and **sound** but its effectiveness is hampered by the **slow enforcement system** and flaws in the administrative system. The enforcement system is characterized by relatively long and cumbersome procedures that result in a moderate recovery of the initial amount by the secured creditor. Compared to other developing economies in Europe, Albania is considered to have an enforcement system less than median efficient and creditor-friendly. In the complex of issues related to the enforcement system, the process of enforcement of the immovables, with regard to simplicity and certainty for the charge over immovables, is one of the weakest points that should be tackled with special attention.

2. Impact of the current foreclosure procedures on banks

Despite the fact that there are no statistical data available on how many cases ended with the bidder paying the fixed price in an auction and became the new owner, bailiffs confirm that this number is extremely low⁴. It happens very seldom that after the second auction the creditor takes the immovable against the price designated for the second auction. In case the immovable has

⁴ EURALIUS, Proposal for Improvements of the Civil Procedure Code (EURALIUS Activity 8.5), Part I: Enforcement on immovable assets, 2006.

been appraised by the experts contracted by the Bailiff Offices at a value higher than the debt (even after it was reduced by 20% in the second auction), the creditor has to pay to the debtor the difference between the appraised value and amount of the debt . Due to the ceiling in the fixed assets to total assets ratio, banks have to sell the immovable in a short time and sometimes in unfavorable conditions.

In addition to the above mentioned the successful enactment of the foreclosure procedures is hindered also by:

- Undefined time periods for the bailiff to notify the debtor;
- Subjectivity in determining the value of the collateral for the first auction and redefining the value of the collateral for re-auction, in the case that the first auction has failed, as there are no commonly set standards for real estate property valuation;
- Long time periods and cumbersome auctions procedures. According to the 2008 Doing Business report an enforcement process has to go through 39 procedures and lasts 390 days.

3. Impact of the current foreclosure procedures on consumers

The non-execution of the foreclosure has negative ramification in the domestic economy as well, influencing the consumers' access to loans. Due to the difficult process of recovering a debt, banks might be reluctant in approving some clients' applications. The financial consequences of the foreclosure procedure for collaterals are reflected in the price of banks' products and services and thus the "good" clients are bearing the costs produced by the "bad" clients.

By enhancing creditors' confidence that they can recover real value from mortgaged or charged assets, the availability of credit should increase and the terms (typically, the amount of the loan, the period for which it is granted, the loan to collateral ratio and the interest rate) on which it is available should improve.

Annex 4

Consultation with Stakeholders

Consultation process	
1.1. Consultations with banking community on improving the Civil Procedure Code – Impact Assessment Questionnaire	
<p>In order to assess the cost and benefits of the current legal framework and of the amendment proposal SPI Secretariat drafted an Impact Assessment Questionnaire. The questionnaire was delivered to the AAB’s Legal Committee members⁵ and the Project Working Group Members. The purpose of this survey was to assess the economic impact that these amendment proposals will have in the banking community. The Regulatory Impact Assessment (RIA) seek to provide an estimate of the possible incremental costs and benefits generated by each individual provision, trying to identify as well the area where the major part of underling costs and benefits will be concentrated.</p>	
<i>Summary of Consultation Process Statistics</i>	
Total members of AAB (no.):	16 banks
Total respondent banks (no.):	9 banks
Respondent ratio:	56 %
Market share of the respondent banks: (reference indicator: total loans)	57 %
Size of the respondent banks:	small, medium, large
1.2. Summary of the consultation feedback with the banking community	
<p>The Report on the Findings of the Impact Assessment survey, prepared by SPI Secretariat will be presented and discussed in the 5th meeting of the Project Working Group – PWG.</p>	
The bank survey	
<p>In order to assess the cost and benefits generated by the changes in the current legal framework as proposed by the Project Working Group, SPI Secretariat run a bank survey based on a questionnaire. The Regulatory Impact Assessment (RIA) seek to provide an estimate of the possible incremental costs and benefits generated by each individual provision, trying to identify as well the area where the major part of underling costs and benefits will be concentrated.</p>	
<p>The Impact Assessment Questionnaire was focused on:</p> <ul style="list-style-type: none">- The actual duration of the enforcement process, divided in 5 phases;	

⁵ AAB Legal Committee is gathering Legal Departments’ representatives of all bank.

- The estimated time reduction of the process due to amendment proposals;
- Qualitative Impact Assessment analysis;
- Individual bank information regarding collateral backed loans, share of doubtful and lost loans, loans in foreclosure process;
- Other bank individual information related to loans in foreclosure process.

As no complete data could be obtained on loans, bad loans, loans under foreclosure, etc, SPI Secretariat used **assumptions and secondary data sources**.

1.3. Consultation with Ministry of Justice and the Parliament

In order to achieve the project objective a strong collaboration with the Ministry of Justice (MoJ) was considered as crucial. MoJ was firstly approached by Bank of Albania, as an SPI Committee member, in order to establish a relation on the initiative prompted by the banking community to improve the enforcement system. As a second step, the Project Owner of SPI Albania Project in its communication with MoJ, further clarified the contribution that this project intended to provide to the ministry on the legal initiative to improve the enforcement system through the liberalization of the bailiff activity. As a response, MoJ appointed a representative of the Enforcement Department to be part of the PWG.

Initiation of the negotiations

Following the developments in the enactment process for amendments to the CPC, on October 03, 2008, PO sent the draft proposals prepared by the PWG to the Chairman of AAB for further forwarding to the Head of the Commission for Legal Affairs, Public Administration and Human Rights, Albanian Parliament, to the Head of the Commission for the Economy and Finance, Albanian Parliament and to the Prime Minister. PM of the project delivered the draft proposals to the Ministry of Justice.

First round of negotiations

On October 13, 2008, PM, SPI Secretariat and AAB legal advisor met with the advisor of the Minister of Justice and with the Head of the Enforcement Department in order to discuss on the draft proposals prepared under SPI Albanian project.

1.3.1. Summary of the consultations with the Ministry of Justice

No.	Proposed article (no)	MoJ Agreed / Not agreed	Comment
Package 1 - Core changes that increase the efficacy of the enforcement system			
1	Article 511	Agreed	
2	Article 513	Partially agreed	MoJ agrees with the problem identified, but the solution will be further discussed internally
3	Article 515	Partially agreed	MoJ did not agree to reduce time periods
4	Article 564	Partially agreed	Agreed on the time periods; Not agreed on the initial value of the auction (PWG liquidation value vs. MoJ market value)
5	Article 567	Agreed	
6	Article 577	Partially agreed	MoJ agrees with the problem identified, but the solution will be further discussed internally
Package 2 - Other changes that further improve the efficacy of the enforcement system			
7	Article 141	Agreed	
8	Article 517	Agreed	
9	Article 522	Agreed	
10	Article 560	Agreed	
11	Article 573	Agreed	
12	Article 574	Agreed	
13	Article 575	Agreed	
Package 3 - Changes that achieve fairness and equal treatment			
14	Article 144	Agreed	
15	Article 152	Not agreed	The right for the other party to be present in the process is considered as normal
16	Article 525	Agreed with the concept	Banks will pay only the fees
17	Article 528	Agreed	
18	Article 569	Agreed	

1.3.2. Summary of the consultations with the Legal Parliamentary Commission

Second round of negotiations

On October 27, 2008, Ms. Veronika Prifti, lawyer and PM of the project on the foreclosure procedures, Ms. Elona Bollano, SPI Secretariat, Mr. Elvin Meka the General Secretary of AAB and Ms. Brunilda Kostare Legal advisor of AAB, took part in a hearing session of the Parliamentary Commission of Legal Affairs, Public Administration and Human Rights.

Ms. Prifti presented before the chairman, Mr. Rusmaili, and the members of the commission the PWG amendment proposals and the rationality behind each proposal. In the hearing session was present as well a group representing the Ministry of Justice.

In the next meeting the commission is going to discuss in details on amendment proposal.

Annex 5

Scoping the Problem

1.1. Problem identification
<p>1.1.1. Background information</p> <p>In Albania, the procedures for the foreclosure of the collateral are regulated by the Civil Procedure Code, Chapter 3, Art.560-580 “The enforcement on immovable property, ships and airplanes”. The acts of the loan are executive titles (art. 510) and the execution of the executive titles is within the bailiff’s exclusive competences (art. 527). At present, the enforcement on immovable property is very rarely a success. In the World Bank’s Doing Business 2009 Report, Albania is ranked 89th on the Enforcing Contracts section, this being attributable to all involved institutions and to the regulatory framework. Some of the problems related to the legal framework, and especially to the Civil Procedure Code, are related to the vagueness of the legal provisions that leaves room for subjectivity, and even inappropriate, application of the law and undefined time periods for most of the procedures.</p>
<p>1.1.1.1. Analysis of the market</p> <p><i>General market:</i> Banking, lending activity. <i>Specific segment:</i> Secured lending, lending secured by immovable collateral – mortgage loan. <i>Sub segment:</i> Default loans in the lending secured by immovable collateral segment.</p>
<p>1.1.1.2. Legal framework</p> <p>a) The <u>enforcement activity</u> is governed by the following: Law no. 8417, dated 21.10.1998 “The Constitution of The Republic of Albania”, Chapter “On human rights”; Law no. 8036, dated 22.11.1995 “On mutual court support in the civil and commercial sphere”; Law no.9443 dated.16.11.2005 “Ratification of the Hague Convent, October 19, 1996, “On the protection of basic human rights”; Law no. 8688, dated 14.05.2001 “On the organization and function of the Ministry of Justice”; Law no. 8730, dated 18.01.2001 “On the organization and the function of the Bailiff Service”; Law no. 8812, dated 17.05.2001 “Civil Procedure Code of Republic of Albania”, changed; Law no.7850 dated 29. 07.1994.”Civil Code of Republic of Albania”; Law no. 8435, dated 28.12.1998 “On the tax system in the Republic of Albania”; Law no. 8894, dated 14.05.2002 “On the Agency that treats default loans”.</p> <p>Other laws and convents related to the fair treatment of different groups.</p> <p>b) The <u>lending activity</u> is governed by: Law no. 9662 dated 18.12.2006 “On commercial Banks”; Regulation no.52, dated 14.07.2004 “On credit risk administration”.</p>
<p>1.1.1.3. Stakeholders - Institutional framework</p>

The **main stakeholders** of the enforcement process are:

- **The Bailiff Service** is a centralized **public** service with national - wide coverage under the competences of the Ministry of Justice. Its functions are performed through the bailiff officers who are responsible to execute the executive titles in full compliance with the provisions of the Civil Procedure Code
- **Commercial banks.** The Albanian banking system consists of 16 commercial banks having as main area of activity lending to individuals and companies. In December 2007 lending to economy reached 30.2% of GDP; out of this amount of outstanding loans, almost 37% of the credit portfolio is real estate lending. Regarding the quality of the loan portfolio, in December 2007, 92% of the portfolio are standard, good quality loans and nearly 9% of portfolio are problematic loans (including special attention loans - 5% of the portfolio, substandard loans - 2% of the portfolio, doubtful loans - 1% of the portfolio and lost loans - 1% of the portfolio).
- **Courts.** The judges in district courts issue the executive title that serves as the main legal document for the bailiff officers to start the execution process of the immovable collateral.
- **Consumers**

Other stakeholders involved in the enforcement process:

- **Ministry of Justice** - The ministry defines the organizational structure, functions and responsibilities of the General Directorate of Enforcement and Bailiff Offices.
- **Bank of Albania** – Supervisor of the banking activity and guardian of the financial stability.
- **Ministry of Public Order – State order Police**
- **Immovable Property Registry Office**
- **Regional Directory of Transport**
- **Tax office**

1.2. Market and Regulatory Failure Analysis

In the 2009 Doing Business Report by the World Bank, in the section of Contract Enforcement, Albania is ranked 89th. In Albania, in order to enforce a contract, the involved parties have to pass through 39 procedures that last on average 390 days and the costs of the process amounts to 38.7% of the claim. With these indicators, Albania is far behind other Eastern European and Central Asia countries in terms of the number of procedures and cost of the process.

In 2006 EBRD has assessed as well the secured transactions legal framework in transition countries. According to this assessment, the secured transactions legal framework (covering also mortgages) in Albania, generally, is **appropriate** and **sound** but its effectiveness is hampered by the **slow enforcement system** and flaws in the administrative system. The enforcement system is characterized by relatively long and cumbersome procedures that result in a moderate recovery of the initial amount by the secured creditor. Compared to other developing economies in Europe, Albania is considered to have an enforcement system less than median efficient and creditor-friendly

In additions to the international institutions, banks – the largest users of the enforcement system in Albania - complain on the effectiveness of the enforcement system and enforcement institutions.

EURALIUS, the European assistance mission to the Albanian Justice System has envisaged the elaboration of a large list of gaps in need for improvements to the CPC to achieve an effective and timely enforcement of judicial decisions.

The deficiencies in the legal framework combined with problems in the Bailiff Service produce an inefficient enforcement system.

Under these circumstances, we assess that the low efficiency in the current enforcement system is result of a **regulatory and administrative / management failure**. The current regulation is wrongly described for the market, resulting in cumbersome procedures, work inefficiency, subjectivity and unequal treatment of parties.

This regulatory failure generates additional uncertainty and costs to all the users of the enforcement system.

1.3. Policy Objectives at Risk due to regulatory failure

General Objectives:

- To improve the economy competitiveness;
- To increase the opportunities to engage in transactions.

Specific objectives:

- To improve the efficiency of the enforcement system;
- To stimulate the development of lending activity;
- To decrease in the cost of bank products and services.

Operational:

- To steady increase the execution rate of court orders;
- To secure the timely execution of the court orders;
- To ensure rapid recovery of bad debts.

1.4. “Do nothing” option

1.4.1 Possible medium-term (max 2 years) self – corrective actions

To deal with the regulatory failures described above, banks already have taken several corrective actions. They apply conservative loan-to-collateral ratios. They could also establish real estate subsidiaries in order to diminish the loss registered from the transactions they are forced to enter in. There is no guarantee, however, that this would solve the problem, while it is certain that costs will be covered from the “good” consumers and that the too conservative measures

decrease the consumers' access to finance and hampers the market development. Therefore, a legal intervention is necessary in order to address the regulatory failure which created a market distortion by overprotecting one category of consumers (bad debtors) and thus transferring the generated costs to other category of consumers (the good debtors or loan applicants).

1.4.2. Impact of the “Do Nothing” option to the various stakeholders

The low rate of court orders executions and the inefficiency of the enforcement system negatively affect all the stakeholders involved in the enforcement process.

➤ Regulated firms / Banks:

- Operate in an unsecure environment;
- Pay additional costs to enforce respective contractual rights or to recover bad debts;
- Transfer (part) of the cost to consumers to cover for the additional expenses;
- Follow a less ambitious strategy (loosing business opportunities) in the lending activity.

➤ Consumers:

- Have less access to finance – mortgage loans / have fewer opportunities to engage in financial transactions because of banks' more prudent attitude;
- Pay additional costs/interest due to the process of cost transfer by banks from bad customers to good customers.

➤ Authorities:

- Forgo growth opportunities, due to less business and less financing to investment activities.

1.5. Alternative options

1st Alternative Policy Option: To amend a core package of articles in CCP that will tackle the fundamental problems created by the current framework.

This package refers to the provisions on: The executive order (art. 511); The execution (art. 515); Evaluation of property (art. 564); Auction procedures (art. 567); Repetition of the auction (art. 577).

2nd Alternative Policy Option: To amend a more extensive package than package 1, that, in addition to fundamental issues, will achieve a better use of resources and better regulated process –increase in efficacy.

In addition to the provisions in Package 1, this package refers to: Notification for the legal entities (art. 141); The voluntary execution (art. 517); The execution if the debtor’s address is not known (art. 522); The sequester order (art. 560); Notification of the winner (art. 573); and Time limit to pay the price (art. 574); Possessing the purchased property (art. 575).

3rd Alternative Policy Option: To amend a comprehensive package that will ensure a just and effective process of collateral enforcement.

In addition to the provisions in Package 1 and Package 2, this package contains: Article 144; Article 152; Execution expenses (art. 525); The sequester order on a different property (art. 528); The premises for the auction (art. 569).

The Ministry of Justice has accepted all the proposals part of Package 2, the largest number of the proposals in Package 3 and some of the proposals in Package 1, mostly was agreed with the raised problem but not with the identified solution.

Summary Problem Scoping			
Bailiff service			
Market failure			
Asymmetric information	Market power	Positive externalities	Negative externalities
(Existing) Regulatory failure			
Regulation wrongly prescribed for the market	Regulations succeeded in addressing the failure; a different market failure (e.g. side effect)	Regulation made it worse	Regulation so far has failed to work; maybe in due course
X			

Annex 6

SPI Albania Methodology

The EU Better Regulation Approach	
Steps	Purpose
Scoping of problem	
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”).
Analysis of impact	
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
Consultations	
10. Policy Document	To learn market participant opinions on various policy options
Conclusion	
11. Final Recommendations	Final report to decision-makers, based on Cost Benefit Analysis and market feedback