Report Number : ICRR0021673

1. Project Data

Operation ID	Operation Name
P152064	AL Financial Sector DPL
Country	**Practice Area(Lead)**
Albania	Finance, Competitiveness and Innovation

L/C/TF Number(s)	Closing Date (Original)	Total Financing (USD)
IBRD-86980	31-Mar-2018	100,000,000.00
Bank Approval Date	**Closing Date (Actual)**	
13-Mar-2017	31-Mar-2018	

	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	100,000,000.00	0.00
Revised Commitment	100,000,000.00	0.00
Actual	100,000,000.00	0.00

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2. Project Objectives and Policy Areas

a. Objectives

The Development Policy Loan (DPL) involved a single tranche operation. The program objectives as stated in the Program Document (PD, page 1) was:

"To strengthen the resiliency of the banking sector and the regulation and supervision of nonbank financial institutions"

This ICR Review will assess the achievement of the project's overarching goal of strengthening the resiliency of the banking sector and regulation and supervision of nonbank financial institutions, in terms of the following three specific project development objectives (PDOs), which correspond directly with the DPLs three policy pillars (presented immediately below).
PDO1: To enhance the financial safety net by adopting policy measures to reduce nonperforming loans (NPLs).
PDO2: To strengthen regulation, supervision, and resolution regime of banks and Savings and Credit Associations (SCAs).
PDO3: To strengthen the regulation and supervision of investment banks.

b. Pillars/Policy Areas

Pillar 1. Reducing NPLs and enhancing the financial safety net. This pillar supported policy reforms aimed at reducing the extent of NPLs of the banking system through establishing a mechanism for expediting bankruptcies and extending the financial safety net for small enterprises through extending deposit insurance coverage to SCAs.

There were four prior actions: (i) The parliament enacts the new bankruptcy law for expediting bankruptcies; (ii) The parliament introduces new bailiff reforms (discussed in section 4) for facilitating the collateral execution process; (iii) The parliament establishes the Public Oversight Board with its own funding sources and (iv) The parliament enacts legislation for supervising SCAs and adopts new licensing, reporting and risk management regulations for SCAs.

2. Strengthening regulation, supervision and resolution regime of banks and SCAs. This pillar supported policy reforms aimed at strengthening the regulatory framework for supervising banks and SCAs.

There were four prior actions: (i) The parliament enacts legislation for commercial banks' resolution framework, that was in line with the European Union (EU) Recovery and Resolution Directive; (ii) The Bank of Albania completes evaluation of systemic banks' recovery plans for 2015 crisis management; (iii) The parliament enacts legislation for strengthening the regulation and supervision of SCAs; and (iv) The Bank of Albania adopts new licensing, reporting and risk management regulations for SCAs.

3. Strengthening the regulation and supervision of investment funds. This pillar supported policy reforms aimed at improving the regulation of investment funds.

There were two prior actions. (i) The parliament approves legislation for strengthening the Albania Financial Supervisory Authority's (AFSA's) enforcement powers and (ii) The AFSA adopts new regulations on liquidity requirements.

c. Comments on Program Cost, Financing, and Dates

The DPL operation was financed by an IBRD loan of US$100.00 million. The operation was approved by the Board on May 13, 2017 and closed as scheduled on March 31, 2018. The loan amount was fully disbursed.

3. Relevance of Objectives & Design

a. Relevance of Objectives

Country context

Since the early 2000s, Albania had undertaken several reforms, which enabled the country to attain candidate status for the European Union (EU) in June 2014. Economic growth in Albania, in the years before appraisal was however affected in the wake of the global financial crisis in 2008 and subsequently by anemic growth in the euro area, given Albania's close economic and financial links to Europe's poorer performing economies (Italy and Greece). Although Albania was able to avoid the recession seen elsewhere in Europe, the deceleration of growth, coupled with fiscal indiscipline, had resulted in severe macroeconomic imbalances, with a rapid escalation of public debt and financial sector shortcomings.

Financial Sector Context

The financial sector (the banking and the nonbank sector) faced challenges, in the wake of the global financial crisis in 2008. The challenges included rising share of NPLs - with the NPL ratio to the total loans rising from 6.5% in 2008 to 21% in September 2016 -, due to factors such as, large age government arrears, overexposure to sectors such as construction, loans in foreign currency to unhedged borrowers and judiciary process which prolonged the collateral execution process. Regarding the insurance market, the insurance companies had not financed their outstanding liabilities for many years. The SCAs which provided financial services to small farmers and low-income people in the rural areas was fragmented, with more than 100 SCAs. The operation's objectives of promoting a stable financial sector through providing an enabling environment for banks and nonbanks to expand credit, were important in the country context.

Government Strategy

The program objectives are highly relevant to the government strategy. The first pillar of the government's *National Strategy for Development and Integration (NSDI),* approved in 2016 for 2015-2020, highlighted the importance of macroeconomic stability for ensuring the predictability of the economic environment and enabling long-term capital allocation. The policy measures supported under this operation also included key components of the government's NPL Plan, endorsed by the Prime Minister and the Bank of Albania, for reducing NPLs. The objectives continued to be relevant to the government strategy, given the ongoing efforts by the government to operationalize the measures and improve the reforms.

Bank strategy

The objectives are highly relevant to the priorities outlined in the Bank's *Country Partnership Framework* (CPF) for 2015-2019. The first focus area of the CPF called for restoring macroeconomic imbalances. This focus area also considered “macro-fiscal sustainability and financial sustainability to be the highest priority and having a fundamental impact on the country’s ability to an accelerated and sustainable growth model." (ICR, page 8) The ICR (page 8) notes that though preparation of a new CPF has not yet started to date, maintaining macro and financial stability is expected to be an important pillar of the upcoming Bank strategy for Albania. This DPL was one of several other World Bank policy lending operations to Albania in recent years, including the 2014 Financial Sector Modernization (FSM) DPL, aimed at supporting a wide range of reforms aiming to restore macro-financial stability and rekindling economic growth.

Given that the objectives of improving the resiliency of the financial sector continues to be relevant to both the Government and bank strategy, relevance of objectives is rated as High.

Rating

High

b. Relevance of Design

Albania's macroeconomic framework, when this DPL was prepared, was satisfactory (Program Document, paragraph 16). Following weak economic growth in 2012 and 2013 due to downturns in neighboring Greece and Italy, real Gross Domestic Product (GDP) grew by 1.8%, 2.6% and 3.2% in 2014, 2015 and 2016, respectively. The annual average inflation at 1.9% in 2016 was lower than the target band, due to lower oil and food prices. The current account deficit, mainly financed by worker remittances, was projected to increase to 12% of GDP in 2016 (up from 10.8% in 2015). Although public external debt was increasing from 2008 to 2015, where it reached the peak at 73.7% of GDP, it had started falling and as at the end of 2016, stood at 72.7% of GDP. A review of Albania's Extended Fund Facility (EFF) arrangement conducted by the International Monetary Fund (IMF) in January 2017 (for a three year EFF arrangement for supporting the government's reform program, approved on February 28, 2014), concluded that most quantitative performance criteria had been met and that there was overall good progress in implementing the structural reform agenda (Program Document, paragraphs 31 and 32). The economy however remained vulnerable to external risks, given Albania's high exposure to Greece and Italy through workers' remittances, exports and direct foreign investment.

There is logical causal relationship between the prior actions and the intended achievement of objectives. Reforms aimed at improving the framework for addressing bankruptcies and collateral execution through bailiff reforms can be expected to lead to the achievement of the program objectives of reducing the extent of NPLs of the banking system. Reforms aimed at extending deposit insurance coverage to SCAs can directly lead to the enhancement of the financial safety nets of small enterprises. Reforms aimed providing a resolution framework and recovery planning of systemic banks would provide the basis leading to improvements in the banking system's ability for crises management. Reforms aimed at licensing and reporting and risk management requirements for SCAs are linked directly to strengthening the regulation of SCAs. Similarly, reforms aimed at strengthening the enforcement powers of the Albania Financial Supervisory Authority for investment funds and liquidity regulations were directly relevant for strengthening the regulation of investment funds. The combination of these activities can be expected to contribute causally to strengthening the resiliency of the banking sector and the regulation and supervision of nonbank financial institutions.

Unlike in the prior Bank-financed Financial Sector Modernization DPL, the design of this DPL included prior actions that were more binding and required parliamentary approval of legislation (rather than just submission to the parliament). The three pillars were complementary and mutually reinforcing on addressing the key constraints faced by the financial sector. The results indicators appropriately included both quantitative and qualitative indicators, where actions supported by the DPL would take longer to materialize, given that the time frame for this operation was a year (discussed in section 9a of this review).

Rating
Substantial

4. Achievement of Objectives (Efficacy)

Objective 1

Objective
To enhance the financial safety net by adopting policy measures to reduce NPLs.

Rationale
This pillar supported reforms aimed at expediting bankruptcy proceedings of the banking sector and thereby reducing the extent of NPLs of banks and extending the financial safety net through extending deposit insurance coverage to SCAs.

Sub-objective 1. Adopting policy measures to reduce NPLs. There were three prior actions. One. the Parliament enacted the new Bankruptcy law in 2016 (Law # 110, prior action) (ICR, page 9). Regulations were established for the Bankruptcy agency and to facilitate out-of-court settlements. The ICR notes that a complete evaluation of the new law was not possible, as it became effective only on May 2017 and only 16 cases were filed between May 2017 and December 2018 under the law. (Bankruptcy cases which started before were being tried under the old Law). Two, the Parliament amended the Civil Procedures Code (Law # 114) and the Private Bailiffs Law (Law # 109, prior actions) on 2016 (ICR, page 10). These legislations aimed at addressing deficiencies of the collateral auction process and regulating bailiffs, by introducing the concept of the success fee (Before the amendment, bailiffs' fees were fixed and payable in advance and hence there were no incentives for bailiffs to perform their functions with due diligence). Under the new arrangement, bailiff's fees were contingent upon completion of the collateral process. The ICR (page 10) notes that there was a policy reversal in 2017 due to the appeal by private bailiffs, which was eventually overturned by the Administrative Appeals Court. Three, the Parliament established the Public Oversight Board (POB, prior action) in 2017, following the amendments to the Law on Statutory Audit (Law # 47) in 2016. Funding for POB came from fees on statutory bank audits, insurance companies, investment companies, large non-financial companies and from professional organizations. This self-financing arrangement allowed the POB to hire its own staff thereby minimize potential conflicts of interest.

There was one outcome target: decrease in the number of NPLs. The ratio of NPLs of banks decreased from 20% in June 2016 to 13.4% in March 2018, exceeding the target of 16% (ICR, page 9). The NPL ratio declined further to 12.7% by November 2018. This reduction came in the backdrop of negative credit growth and hence represented reduction in the stock of NPLs (the NPLs decreased from 110 billion Albanian Lek (ALL) in December 2016 to ALL 77 billion in June 2018). The reduction of NPLs was due to factors, such as loan restructurings, loan repayments to various classes of the NPL portfolio and write-offs of loans (Since 2015, banks were required by the Bank of Albania to write-off loans that were classified as loss for more than three years).

Sub-objective 2. Enhancing the financial safety net. The Parliament enacted amendments to the Law on Deposit Insurance (Law # 39) on 2016. This law aimed at tightening requirements for licensing, reporting and risk management of SCAs. Following this amendment, there was a consolidation of SCAs, with the number of SCAs declining from 108 in 2015 to 13 in 2018. Out of the 13 SCAs, eight were licensed by the Bank of Albania and covered by deposit insurance when the operation closed (ICR, page 12).

There was one outcome target. 100% of eligible legal entities' deposits were covered by deposit insurance coverage by March 31, 2018, as targeted. The deposit insurance coverage represented an improvement of the financial safety net, as 90% of the eligible entities covered represented small and medium-size enterprises.

In summary, given that the two targets were achieved, efficacy of this objective is rated as substantial.

Rating
Substantial

Objective 2

Objective

To strengthen regulation, supervision and resolution regime of banks and SCAs.

Rationale

This pillar supported reforms aimed at addressing issues pertaining to strengthening the regulatory oversight of banks and SCAs.

Sub-objective 1. Strengthening regulation, supervision and resolution regime of banks. There were two prior actions. First, the parliament enacted the Bank resolution law (Law # 133) in 2016. This law was in line with the European Union's Bank "Recovery and Resolution Directive'. Following this, a resolution unit was established in the Bank of Albania. The unit had finalized by-laws for a resolution fund and resolution plans. The ICR (page 11) notes that a resolution fund was established in January 2018, with assets of ALL 600 million and the unit signed a cooperation agreement with the European Systemic Risk Board. Two, the Bank of Albania adopted the regulation "on recovery plans of banks" by decision # 72 (prior action) in December 2017. This regulation required the banks to submit details such as, the minimum requirements for recovery plans, bank's governance structure and recovery measures.

As an outcome indicator, all banks submitted annual recovery plans that were in accordance with the new regulation issued by the Bank of Albania, when the operation closed.

Sub-objective 2. Strengthening regulation, supervision and resolution regime of SCAs. There were two prior actions. First, the parliament enacted the SCA law (Law # 52) in 2016 for strengthening the regulation and supervision of SCAs.and second, the Bank of Albania adopted the new licensing, reporting and risk management regulations for SCAs, by adopting Board Decisions #s 104, 105 and 106 respectively.

There was one outcome target, pertaining to consolidation of SCAs. The number of SCAs declined from 108 in 2015 to 13 in 2018. This exceeded the target of 20 SCAs. Of the 13 SCAs, eight were licensed and covered by deposit insurance when the operation closed. The ICR (page 12) notes that Bank of Albania was in the process of licensing two more SCAs, thereby bringing the number of SCAs to ten. The ICR notes that the remaining three SCAs were under liquidation, with no active operations or depositors and that the Bank of Albania conducted on-site inspections of the SCAs.

Given that the targets had been achieved when the operation closed, efficacy of this objective is rated as substantial.

Rating

Substantial

Objective 3

Objective

To strengthen the regulation and supervision of investment funds.

Rationale

This pillar aimed at strengthening the enforcement powers of the Albania Financial Supervisory Authority and introducing new liquidity regulations.

There were two pillars. One, the parliament enacted amendments to the Collective Investment Undertakings Law (Law # 36) in 2016. This law aimed at strengthening Albania Financial Authority's (AFSA's) enforcement powers. The ICR notes that AFSA regularly conducted on-site inspections to ensure compliance with the regulations. Two, the AFSA adopted new regulations on liquidity management (Decision # 45, prior action). This decision mandated that investment funds to keep at least 10% of their portfolio in liquid assets (Five percent of total assets were to be kept either as cash or financial instruments with a residual maturity of no longer than seven days and another five percent of assets in financial instruments with residual maturity up to one month). The definition of liquid assets did not include longer-term Albanian bonds due to the lack of a liquid secondary market. The liquidity regulation was extended in February 2018 by adding past gross redemptions as an additional threshold (ICR, page 13).

There was one outcome target, namely, increase in the liquid assets of investment funds. The liquid assets of investment funds increased from 5% in 2015 to 14% in 2018. This exceeded the target of 10%.

Given that the target was exceeded, efficacy of this objective is rated as substantial.

Rating

Substantial

5. Outcome

The relevance of the DPL's objectives to the strategies of the Government and the Bank is **high**. The relevance of design is **substantial**, given the logical and causal relationship between the prior actions and achievement of objectives and the complementarity of reforms supported by the operation. The DPL's efficacy is **substantial** in achieving the three objectives - to reduce NPLs and enhance the financial safety net, to strengthen regulation, supervision and resolution regime of banks and SCAs, and to strengthen the regulation and supervision of investment funds - since the quantitative targets were exceeded, and the qualitative targets met. The overall DPL outcome is **satisfactory**.

a. Outcome Rating

Satisfactory

6. Rationale for Risk to Development Outcome Rating

Government commitment. The risk associated with government commitment to the reforms is rated as Low, given that open and transparent financial sector is a key part of European Union (EU) eligibility and hence important for Albania's efforts for EU accession, a priority for the country.

Political risk. There is moderate risk associated with contract enforcement arrangements and collateral execution process. The team clarified that the deficiencies included issues associated with bailiffs' fees. Although this issue has been resolved for now following the appellate court decision, there remained other deficiencies in the auction process, such as lack of standardized real estate evaluation methodology and professional qualification of bankruptcy administrations. The bankruptcy administrators needed to be trained to apply the requirements of the new law. The team further clarified that the regulations (under the new law) on the functioning bankruptcy agency still needed approval by the Ministry of Justice.

a. Risk to Development Outcome Rating

Modest

7. Assessment of Bank Performance

a. Quality-at-Entry

Several analytical works underpinned the operation. These included, the prior Bank-financed 2014 Financial Sector Modernization DPL, the Financial Sector Assessment Program of 2013, technical assistance by the Bank on building institutional capacities to regulate the investment funds sector and technical assistance from the Financial Sector Advisory Center (a consultative entity to assist in the coordination of policies among its members (the Ministry of Finance, the Bank of Albania, the Albania Deposit Insurance Authority and the Albania Financial Supervisory Authority). Lessons incorporated at design included, requiring parliamentary approval of laws as prior actions, addressing the key regulatory gaps for the bank and nonbank sectors and collaboration with interested parties (banks, bailiffs and SCAs). The operation was prepared in collaboration with the International Monetary Fund on aspects pertaining to financial reforms, the European Commission to ensure that the proposed measures are in line with Albania's EU commitments, the Swiss Secretariat for Economic Affairs on financial reporting reforms and the United States Agency for International Development, which had an ongoing country financial sector development program. Several risks were identified at appraisal, including substantial risk associated with governance and uncertainties pertaining to upcoming elections in October 2017 and moderate risks associated with spillovers from weaker euro growth in general and political developments in neighboring Italy, in particular. Mitigation reassures included consultations with relevant ministries and regulators. With the mitigation measures, the operation risk was rated as moderate (PD, paragraph 93).

There were shortcomings in M&E design (discussed in section 9a).

Quality-at-Entry Rating

Satisfactory

b. Quality of supervision

The ICR provides little details (ICR, page 16) but notes that the supervision team provided active support to the implementation of this operation. The team included appropriate experts and held frequent missions. The missions helped in maintaining high quality dialogue with the authorities. The location of a team member in Tirana helped in maintaining close contact with the counterpart agencies. The supervision team aided in monitoring the operations objectives both through supervision missions from headquarters and regular communication with authorities by the country office. The supervision team along with the Albanian Banking Association aided in resolving the issue associated with policy reversal by the interim government formed before the elections (of increasing the front-end fee for bailiffs by about 200%) (ICR, page 10). The supervision team collected the required information from stakeholders during implementation.

Quality of Supervision Rating

Satisfactory

Overall Bank Performance Rating

Satisfactory

8. Assessment of Borrower Performance

a. Government Performance

As indicated in Section 3a, the objectives of the DPL were closely related to the national development strategies and government's priorities in view of Albania's commitments to EU accession. Following the parliamentary approval of the laws, the authorities implemented the necessary next steps (by laws and regulations) to operationalize the measures. The government agencies demonstrated strong commitment to reforms supported by the DPL, given that the supported prior actions were prepared in close cooperation with senior leadership of the implementing agencies (ICR, page 6). There was policy reversal relating to the changes to the regulation for bailiff fees made by the interim government in June 2017. This issue was however resolved with the government with the new government reversing this decision.

Government Performance Rating

Highly Satisfactory

b. Implementing Agency Performance

The government implemented the program, and there is no separate assessment of implementing agency performance.

Implementing Agency Performance Rating

Not Rated

Overall Borrower Performance Rating

Highly Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

The results indicators included both quantitative outcome indicators (such as, the NPL ratio, the number of recovery plans submitted, the coverage of deposit coverage to SCAs and increase in the number of liquid assets of investment funds) and qualitative output indicators where actions supported by the DPL would take longer to materialize (such as establishment of a well-funded Public Oversight Board and a resolution unit), The proxies used for some indicators were appropriate (For instance, the number of SCAs was appropriate for the reforms aimed at consolidation of the SCA sector). (ICR, page 6).

One shortcoming at design was the indicator associated with the ratio of NPLs to total loans for monitoring the Bankruptcy law. Since the law was only effective for cases started after May 2017, it had been applied to a limited number of cases. It is hence not clear as to what extent the large observed reduction in NPLs can be attributed to the new Bankruptcy law.

Baseline data and target values for all indicators were included in the Program Document.

b. M&E Implementation

The information provided in the ICR on M&E implementation is sparse. The ICR (page 7) notes that the Ministry of Finance, the Bank of Albania, the Ministry of Justice, the Financial Supervisory Authority and the Deposit Insurance Agency were responsible for overall coordination of data collection on M&E indicators.

c. M&E Utilization

The ICR provides no indication that the indicators were used for purposes other than monitoring performance of this operation.

M&E Quality Rating

Modest

10. Other Issues

a. Environmental and Social Effects

The Program Document (paragraph 80) notes that policies supported by the operation were not expected to have environmental impact, as the policies focused on legal, regulatory and supervisory reforms in the financial sector. The Program Document also notes that the operation did not modify the existing environmental regulatory framework in any way or facilitate the circumvention of any environmental regulations. The ICR (page 14) notes that the policies supported by the DPL did not have environmental impacts.

b. Fiduciary Compliance

No issues with fiduciary compliance are reported in the ICR.

c. Unintended impacts (Positive or Negative)

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d. Other

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11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Satisfactory	Satisfactory	---
Risk to Development Outcome	Modest	Modest	---
Bank Performance	Satisfactory	Satisfactory	---

Borrower Performance	Highly Satisfactory	Highly Satisfactory	---
Quality of ICR		Substantial	---

Note
When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

12. Lessons

The ICR draws the following two lessons from the experience of implementing this operation, with some adaptation of language.

(1) A quick and comprehensive response to a crisis can lead to sustainable improvements in financial stability. This operation was in response to the crisis due to the high NPLs. The urgency created by the crisis facilitated in the passing of complex pieces of legislation.

(**2) Continuous engagement with the authorities during the program design and implementation phase and a strong on the ground support can help in program implementation**. In this operation, this aided in providing timely support to react to problems (such as the bailiff reform setbacks during implementation).

13. Assessment Recommended?

No

14. Comments on Quality of ICR

The ICR is concise, well-written and provides a good description of the problems that were encountered during implementation (such as the issues pertaining to policy reversals on bailiff reforms). It discusses financial sector issues in a clear way. The ICR is consistent with the guidelines and the ratings for the most part is well-reasoned.

On the other hand, while the ICR has the merit of being brief, it would have been more useful to provide more information on aspects pertaining to Bank supervision and M&E implementation.

a. Quality of ICR Rating
Substantial