



SHOQATA E BANKAVE TË KOSOVËS
KOSOVO BANKING ASSOCIATION



FINANCE FAIR 2014

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**PERIODIC OVERVIEW OF FINANCIAL
SECTOR IN KOSOVO**



PERIODIC OVERVIEW OF FINANCIAL SECTOR IN KOSOVO

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AUTHORIAL DISCLOSURE

The views and opinions expressed in this publication are a summary of the discussions by panels of the Finance Fair 2014. These views and opinions do not necessarily reflect the views of the Kosovo Banking Association. This review will serve as a reflection on what has been concluded from the discussions at the two-day Conferences and Forums of the Finance Fair 2014 so that the relevant institutions can take respective measures to improve the business environment in Kosovo.

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PART I

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HISTORY OF THE FINANCE FAIR

Kosovo Banking Association organized the Finance Fair for the first time in 2005 in collaboration with different partners. Initially it was organized once every two years; while since 2011 the Finance Fair is organized annually by the Kosovo Banking Association.

The Finance Fair aims to create and expand contacts between financial institutions, businesses, contributing agencies in this area and potential investors by identifying best cooperation practices that could push forward the development of the financial sector and economic development in Kosovo. Every Finance Fair event aims to address sector-specific issues, bringing together all the relevant institutions to address the challenges and problems facing the sector.

Finance Fair also aims to facilitate the promotion of financial services, namely services that are new and not well known to visitors and which can be very welcome to businesses in particular.

The Finance Fair contains several parallel activities at the same time:

Exposition - represents only one of the main parts of Finance Fair during two full working days, where the financial industry has the opportunity to present its products and services, but at the same time to communicate with different stakeholders, including: individual clients and businesses, regulators and legislators, the media and international organizations as well as potential future employees.



Conferences / Forums - are organized simultaneously with the Finance Fair exposition during the two days of the fair. Each year particular topics, part of the agenda of the financial sector are treated and discussed. Through these events, it is aimed to gather all the relevant stakeholders of the financial industry in one place to discuss the challenges of this sector, where panelists share their experiences, their commitment and contribution to the topics that are selected depending upon the interest of the industry.

Workshop - various workshops are organized during the Finance Fair which also aim to provide financial education to various segments of society. So far, various workshops were organized, including: workshops with students, workshops with certain sectors of industry (i.e. accountants, businesses selling petroleum products, etc.), workshops with journalists etc.

FINANCE FAIR 2014

Finance Fair 2014 was organized on September 23rd and 24th, 2014 at the Swiss Diamond Hotel. Within the Finance Fair this year various companies were exposed, including: banking institutions, microfinance institutions, insurance companies, local public agencies, educational institutions, international organizations and consulting companies.



FINANCE FAIR 2014

FINANCIAL SECTOR COOPERATION
WITH BUSINESSES IN KOSOVO
ACCESS TO FINANCE

September 23rd and 24th 2014
Swiss Diamond Hotel
Pristina



Besides the exposure activity, two conferences were organized within the Finance Fair 2014 during the first day, a workshop with journalists and a forum during the second day. Topics of first two conferences were: 1. Contract Enforcement and Access to Finance, and 2. How to cooperate with banks for better interest rates? Whilst the forum organized during the second day of the fair contained a discussion on the "Risk on financial environment and credit risk."

During the Finance Fair 2014 a visitor rewards activity was organized with the objective to promote and increase the number of visitors to the fair and reward them in gratitude as clients of financial institutions. The rewards activity was located in the "Mother Teresa" Boulevard during the two days of the Finance Fair 2014. All the fair visitors who managed to collect at least 15 brochures of the exhibiting companies at the fair were qualified to enter the rewards activity. The withdrawal of three individual prizes from KBA was done through the television program "Time for Finance" on KTV.



In this event, Kosovo Banking Association was supported by the General Sponsors: Banka Ekonomike, Bank Kombetare Tregetare, Banka per Biznes, Is Bank, NLB Prishtina, ProCredit Bank, Raiffeisen Bank and TEB - Economic Turk Bankasi. Finance Fair 2014 was also supported by the supportive sponsors Villesa NBF, Crimson Finance Fund and IPKO, while the media sponsors were Telegrafi and Radio Dukagjini.

THE OPENING OF FINANCIAL FAIR 2014

The opening remarks of Finance Fair 2014 were made by Mr. Petrit Baliija, Executive Director of Kosovo Banking Association, Mr. Robert Wright, Chairman of the Board of Directors of Kosovo Banking Association and Mr. Bedri Hamza, Governor of Central Bank of Kosovo. In their speeches was assessed that Finance Fair has become a traditional event and a place where all banking and non banking financial industry stakeholders meet in order to promote and develop further the Kosovo's economy overall. It was also assessed that Kosovo banking sector continues to be attractive to investors and to reflect high level of sustainability in all aspects, including high level of capitalization, strong liquidity position and good quality portfolio. Today's Finance Fair, besides its role in promoting the financial sector and offering opportunities for new partnership and collaboration between parties, it is also very important platform for financial education to the public and to identify new challenges for the further development of the sector.



Petrit BALIJA
Executive Director
of Kosovo Banking Association



Bedri HAMZA
Governor of Central Bank
of Kosovo



Robert WRIGHT
Chairman of the Board of Directors
of Kosovo Banking Association

DISCUSSION PANELS DURING THE FINANCE FAIR 2014

During the Finance Fair 2014 two conferences were organized on the first day and a forum on the second day, where some of the most important financial sector institutions were represented.

Contract Enforcement and Access to Finance

The first panel of the Finance Fair 2014 conference consisted of six panelist: Fehmi Mehmeti - Deputy Governor of the Central Bank of Kosovo (CBK), Ilir Aliu - Executive Director of ProCredit Bank, Frank Lakwijk - International Monetary Fund representative for Kosovo, Asllan Krasniqi - Member of the Judicial Council of Kosovo, Anton Kobakov - Director of the European Bank for Reconstruction and Development, and David Greer - Head of the USAID Program for Execution and Commercial Legislation.



In the first discussions of the conference it was assessed that despite the challenges that the banking sector is faced with, it is constantly contributing to the economy and is stable and sound. CBK has constantly monitored the financial sector closely and at the same time has amended and adopted regulations based on sound international practices.

The initiation of bailiff procedure implementation in early 2014 has greatly influenced the process of contract enforcement. This procedure enabled more adequate investment planning and the preparation of reports making the institutions more transparent, which indirectly affects the economic stability of the country, since it enables better debt management. Better debt management means reducing spending and therefore impacts on improvements of market offers. It was also assessed that the projects in the field of credit insurance are welcome, as these projects will significantly facilitate the lending process as well as impact on risk reduction. Valuation of collateral is currently being done by banks' internal valuers, but local institutions are working to quickly have the first licensed assessors who will assess the property in a more professional and standardized way.



Contract enforcement is the last stage after evaluation of all criteria, so when something doesn't go right, we turn to justice. The borrower pays the loan when knowing that the justice system functions. So we are dealing with a more complex process and involves a whole set of processes. According to the World Bank report on doing business, Kosovo is enlisted as 138 on contract enforcement, which means that in relation to other countries, Kosovo is lagging behind and must make progressive steps compared to countries of the region. This means that expenditure on contract enforcement is higher than elsewhere in the region. This is also one of the reasons why interest rates are higher. It also makes the value of the collateral to be higher than in the region in order to cover for the higher risks prevailing in comparison to other countries.

Based on studies conducted in different countries of the world it is estimated that for a given location is very important how fast the justice system functions. Based on these studies, the analysis has shown that there is a correlation between the speed in handling court cases and interest rates, so the sooner the court cases have been handled, the lower the interest rates on loans have been. This definitely affects the economy in Kosovo.



Like all private sectors in Kosovo's economy, the banking sector also faces the important challenge of access to financing. In the World Bank report on Doing Business, Kosovo ranks as 30 for access to finance, while for the contract enforcement ranks between 130-140 countries in the world. The banking sector has progressed consistently with respect to access to finance, while contract enforcement has stagnated. The judicial system has accumulated cases deposited over five years ago and the issue raises many questions that reflect uncertainty and affect performance. Based on internal estimates of the industry, the justice system is deemed to have over 10,000 cases only from the banking sector that reach a value of over 250 million Euro that have been provisioned for an additional 250 million Euros meaning that about 500 million Euro are blocked. If the banking sector would be assured that the debt will be paid off through the justice system, it would be an easier and faster procedure and banks would be less conservative, while access to finance would be more efficient. All this affects the cost of financing and the interest rates that banks apply. The effectiveness of the courts affects the reduction of informal economy and it also affects the promotion of foreign investors.

In the panel discussion it was also concluded that there is still room to turn the level of non-performing loans back to the level before the global crisis (2007-2008) when it was at 5% although the actual rate of non-performing loans is the best in the region. The banking sector in Kosovo recommends Kosovo institutions to establish special chambers or courts which would work separately with the cases of the financial sector due to their unique case specifications. Another recommendation is for banks to be allowed to disburse higher short-term funding, for example through promissory notes, in which case the bank does not require collateral, but in the event of a dispute, the case goes directly through bailiff procedures where the bank immediately executes the debt through a more efficient justice system.



The justice system in Kosovo is assessed to have been improving and it has been constantly supported by donors such as the Program for Enforcement and Commercial Legislation (CLE USAID). Kosovo Judicial Council has signed an agreement with the Central Bank of Kosovo through which courts are informed on bank account numbers. The Commercial Court with the help of private bailiffs and the support of this program now reaches on average to successfully execute 50-100 cases per month. If this trend persists, the justice system would be closer to the region. In the panel discussion it was emphasized that case execution is not the only obstacle of the justice system, but also the laws that are amended from 2 to 3 times, for example the Law on Execution Procedure was enforced in 2008, but it has just begun being implemented and its results will only be evident next year.



The panel discussion also focused its attention on the lack of capital growth, where businesses can enhance their operations, enter new markets or finance important purchases without making changes in control of the business.



In the end it was considered that the adoption of the new Law on Execution Procedure will be reflected in the assessment of the World Bank which will be done this year. Kosovo now has a new system and this will be a good new start that can only be further developed through a joint collaboration of the Central Bank of Kosovo, the private sector and other public institutions.



How to cooperate with banks for a better interest rate?

The second Conference of the Finance Fair 2014 accounted for six panelist: Ardiana Bunjaku - Executive Director of the Society of Certified Accountants and Auditors of Kosovo, Nahit Sharku - Deputy Director of the Tax Administration of Kosovo, Robert Wright - Executive Director at Raiffeisen Bank, Shefik Gërbovci - Executive Director of the Technical Department at Illyria Insurance, Ismet Hulaj - Financial Officer at Stone Castle and Bersant Disha - Director at Recura Financials.



The opening of the second conference during the first day of the fair was a discussion on the issue of interest rates and the fact that multiple factors should be taken into account in the lending process; also there was a discussion on access to credit and the criteria necessary to be met to qualify for loans. During the discussion it was evaluated that banks in Kosovo are liquid, while funded mainly by their customer deposits. Interest rates on loans are declining, but at the same time deposit interest rates have declined as well. Political and physical security risk have improved, while the judicial system with the new procedures and private bailiffs is improving but at a much slower pace and much remains to be done, in order to positively influence the improvement of business conditions for banks and other businesses.



The panel continued its discussion assessing that one of the reasons why the interest rates are still relatively high is associated with risk factors, namely legal risk, i.e. efficiency of the justice system. Another reason is the risk of the client which can significantly affect in reducing this average, since depending on the number of criteria that the customer meets, the loan interest rates are determined. The higher the number of good clients, the more likely it is to get loans with lower interest rates. The average loan was 10.8% by the end of the second quarter of 2014, but we have issued loans with 7% or even 13%. The client has a high influence on determining the interest rate, depending on the business financial statement audits, tax avoidance history, the concentration of many businesses in a sector, insurance of collateral, business plan, assets, compliance with contractual terms, credit history and many other

aspects that can affect the determination of credit risk. The banking and non-banking financial sector also provides financing for businesses that are not secure and do not offer collateral as pledge for the loan provided, but in such cases it is then reflected in the interest rate of their loans.



In this panel it was also evaluated that businesses in Kosovo face many difficulties during the process of their operation, as they are constantly faced with non-competition policies, unfavorable conditions and lack of financing. Currently bank loans are the leading funders of small and medium enterprises, while these enterprises face many difficulties in access to bank loans due to lack of collateral. In this case it was suggested to improve this situation by enabling these businesses to be financed through bank letter- guarantees, in the absence of collateral.



The discussion also focused on the issue of reporting, evaluating that appropriate reporting and audit of financial statements is very important in the recognition of business history. Some of these businesses keep from two to three financial statements, separate financial statements for the Tax Administration, others for business office purposes, and another set for banks. Based on comments received and evaluations it has been verified that the audit reports were not at a satisfactory level either and that it takes time to change the historical position of the previous system where the auditor assumed the inspectors' role and adapting to new conditions takes time. It is important that attention be given to this issue and contribute more to the quality of auditors' certification based on international best practices, where their inspection is done through the Council of Financial Reporting, a council which now does not verify the quality of Auditors' Reports.



Since 2009, based on its designed strategy, the Tax Administration (TAK) has begun using a new approach to businesses in Kosovo by implementing a more transparent system through incentives rather than punitive measures; although these measures can be used as the last resort since they are obligated under law to act in this regard. Tax Administration has developed a detailed action plan dividing businesses by sector, adapting to their needs for which it has developed services to businesses in an educational form. During the discussion it was concluded that for the Tax Administration of Kosovo, the major problem is the malfunction of courts as well, while it was stressed that TAK maintains a very good cooperation with banks. For the future it is recommended the need for financial statement harmonization that businesses present to TAK and banks' approach in these statements, through a transparent process of exchanging information. Electronic declaration has enabled businesses to engage real time and pay obligations that businesses have towards the state. TAK has also created several working groups to unify financial statements for businesses. These changes made recently to the TAK will impact on cost reduction and thus the interest rates that banks apply.



The insurance sector provides services that help the banking industry reduce credit risk for the banks, but it is on the market and therefore the banking sector to see whether the risk cuts should be reflected on the interest rate reduction. It was estimated that the contribution of the insurance sector in the financial sector is only 3.5%, so it is necessary to have a greater contribution from the sector. It was mentioned by the panel that the insurance sector offers several types of services that help the banking sector in insuring agro-businesses' property, while regional governments subsidize these properties. So Kosovo has not fully developed this type of insurance and government offers no such subsidies. Hence, nor the insurance companies have taken over this risk, especially due to recent climate changes, while the businesses have not been well informed about the product and consequently were not even interested. Insurance companies offer insurance options on agricultural yields, properties against natural disasters, borrowers' life insurance, and insurances that help these businesses to have easier access to financial resources. Insurance companies currently contribute to the banking sector with deposits of around 70-80 million Euros which are available for longer term. Finally it was recommended that the Central Bank of Kosovo should not calculate the costs which the client pays for insurance within the effective interest rate, since this expense should not go under it and consequently increases the average percentage.

The risk in the financial environment and credit risk

The Forum of the Finance Fair 2014 which was held during the second day of the fair was organized in cooperation with the Centre for the Promotion of Development which is led by Prof. Dr. Muhamet Sadiku, which consisted of five panelists: Haxhi Gashi - legal expert, Jan Peter Olters - World Bank representative Kosovo, Michael Gold - Managing Director of Crimson Capital Fund and Flamur Keqa - a pundit of financial sector issues.



In the panel discussion of the second day it was agreed that the main activity of commercial banks in Kosovo is lending. The banking sector structure largely consists of the loan portfolio which greatly influences the performance of the sector, while the Central Bank of Kosovo has an obligation to evaluate the values of revenues, quality, and liquidity. During the discussion it was suggested that credit risk should be managed in such a way as not to allow for greater tolerance which could pose a serious problem in the future for the banking business.



The panelists of this forum evaluated several types of risk, such as the local, regional, global or sector risk. Global risk and the global crisis of 2008, although stated earlier that posed no direct impact on Kosovo's economy, however in this discussion was estimated that this crisis has affected Kosovo, but in a later period, therefore no one can be immune to crisis. Business non-performing loans were estimated as higher than the country level average, while the main attention was paid to the possibility that these businesses have access to finance. In Kosovo there are many businesses that do not qualify for a loan, so the most important question to be addressed is not how much the interest rate is, but whether these businesses are eligible to gain access to finance. During the discussion, United States practices were brought up and stated that there are lots of businesses that fail to meet the criteria to gain access to these credit lines. They can use various products such as cash in advance or credit cards, but not credit lines. A very important aspect was deemed to be the area of financial education, whereby customers should be informed more about credit agreements or pledge agreements, and be informed on the possible consequences and obligations they undertake when receiving a credit line.



Kosovo has advanced in the World Bank report on doing business as a result of the improved situation in Kosovo's cadastre. The agency is working and is ready to launch the system for real time information exchange. Cadastral Agency recommended that financial institutions write off repaid loans from the cadastre, since they are not removed from the cadastre registry until an official request is received. Removal can be done at the municipal cadastral offices or in the Cadastral Agency.





The issue of risk is subjective, which means there is lack of trust or lack of information. Currently in Kosovo, the average interest rate is approximately 10.8%, while in Germany it is around 7%, Montenegro about 9.5%. The difference between the interest rates reflects the risk premium, i.e. the difference in risk between these countries. At the discussion, it was considered that the most important thing is that the banking sector is sound, liquid and profitable, but also it is important for banks to be careful not to overestimate the risk of the market, as it may impede the growth or development of the country by as far as the overestimation goes. It is also important that the banking sector cooperate closely with the insurance sector, since the insurance sector still needs to be improved and thereby help each other. It was assessed that it is also important that the banking sector finances sectors or areas that have potential for growth, because there are some sectors in Kosovo that have this potential.

In legal terms the panel discussed mainly on the difficulties encountered by the banking sector in law enforcement. A challenge that was deemed important had to do with contracts, i.e. credit agreements are not fully explained and the client is not fully aware of the obligations it assumes. Also except for the pledge agreements, banks must register the pledge in the register in order to have priority, while all agreements or contracts must be notarized. Regarding the legal infrastructure it was estimated that the fault lies in their interpretation and application. One issue that has been identified as a concern for banks and that later on has been fixed were mortgage agreement cases of disputes that have been processed through the dispute procedure while should have been processed through the execution procedures. This has taken more time to execute the mortgage from banks. Many properties do not have adequate clarification of property rights especially for agricultural lands and as a result this property can't be used as collateral. Also many new properties are not recorded in the Cadastral Agency at all, especially in Pristina.

At the end of this forum, it was concluded that the problems are multi-sector, so the risk is multi-dimensional and each sector and institution must assume their own responsibilities and improve or perform better. The stronger one party is, the more powerful the other one will be.



With the completion of this forum, the official closing of conferences and forums of the Financial Fair 2014 was marked whereby Mr. Petrit Balija, Executive Director of the Kosovo Banking Association thanked the Chairman of the Board of the Banking Association Mr. Robert Wright and KBA Board members for their support in organizing this event. Mr. Balija also thanked the general sponsors and supporting sponsors of the Finance Fair 2014 and other participants at the fair.



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PART II

- BANKING INDUSTRY NEWS THAT MARKED THE MONTH OF SEPTEMBER



BANKING INDUSTRY NEWS THAT MARKED THE MONTH OF SEPTEMBER

PROPOSAL FOR ESTABLISHING A REGIONAL STOCK EXCHANGE

Kosovo remains the only country in Europe and in the region that does not have a stock exchange market. The expert in this field, Petrit Baliija, president of the Kosovo Banking Association, said that Kosovo has opened the way for the development of financial markets in early 2012, when for the first time treasury bills were issued by the Government of Kosovo and since then much progress has been made in this direction.

“In this regard, it has often been discussed about the possibility of a joint stock exchange market in the region, but there is still nothing concrete,” said Baliija. According to Baliija, creating a successful stock exchange market would enable three main functions for the citizens and businesses of Kosovo: growth of capital for companies and other organizations that need funding, good investment opportunities for those who have excess liquidity where they can choose from a wide range of investment alternatives and the possibility of investment liquidity, as securities can be bought and sold freely at any time.

“Therefore, I consider that the establishment of a regional stock exchange market, where supply and demand is sensational would provide a good opportunity for economic development,” he said. (*Kosova Sot, September 2nd, 2014*)

KOSOVO BANKING ASSOCIATION (KBA) SIGNED A MEMORANDUM OF UNDERSTANDING WITH THE EUROPEAN BANKING FEDERATION (EBF)

On September 1st, 2014, a memorandum of understanding was signed between Kosovo Banking Association and the European Banking Federation. On the one hand, Kosovo Banking Association as the representative of the banking sector in Kosovo, representing the eight banks, and on the other hand the European Banking Federation as the voice of the joint banks established in Europe, have reached an memorandum of understanding with the aim of developing, strengthening and intensifying the cooperation between the parties to achieve objectives and common goals.

The objectives of this memorandum will be achieved by exchanging information on regulatory developments, exchange of ideas and views on a close cooperation at the global level and with global organizations.

Executive Director of the Kosovo Banking Association, Mr. Petrit Baliija said that the memorandum of understanding paves the way for further membership in international instances for faster integration in the financial system of Kosovo and the Republic of Kosovo in the European Union. The scope of this cooperation includes exchange of information, publications and resources, promotion of best banking practices, arrangement, promotion and support events and meetings between the parties. (*Kosovo Banking Association, September 16th, 2014*)

FINANCE FAIR 2014 IS CONCLUDED

Today, the Finance Fair 2014 organized by the Kosovo Banking Association (KBA) was concluded. This Fair presented different companies /institutions such as banking institutions, non-banking financial institutions, microfinance institutions, insurance companies, auditing and accounting companies, educational institutions, other diverse agencies and programs.

Besides exposing these various companies, the Finance Fair organized two conferences and a forum. The first conference entitled "Contract enforcement and access to finance" was held on the first day of the Fair, and on the same day also the second conference "How to cooperate with banks for better interest rates?" was held. While the forum with the theme "Financial Risk Environment" was held on the second day of the Finance Fair 2014. The Executive Director of the Kosovo Banking Association, Petrit Balijsa said that this fair is considered to be one of the best so far, because the interest of visitors was greater during the fair and priority themes for the country's economy and financial sector in particular were treated.

Conclusions of these conferences held within the Finance Fair 2014 will be published in the Periodic Review of the Financial Sector of Kosovo published by the Kosovo Banking Association in October, a publication which can be downloaded from the web site of the KBA. (*Bota Sot, infodirekt, KosovaLive360, September 25th, 2014*)

CREDIT ACTIVITY IS RECOVERED

Kosovo's banking market continues to be attractive to investors and continues to reflect the high level of sustainability in all aspects, including the high level of capitalization, strong liquidity position and good quality loan portfolio. This was claimed by the governor of the Central Bank of Kosovo (CBK), Bedri Hamza at the opening of Finance Fair 2014, organized by the Kosovo Banking Association. (*Kosova Sot, September 25th, 2014*)

DEPOSITS GREW BY 25.9 MILLION EUROS

Based on official CBK data, Kosovo Banking Association and representatives of one of the commercial banks, despite the decline of interest rates on deposits, there was no decline in deposits of citizens. Besnik Kada, media relations and communications officer at CBK, said the banking sector deposits amounted to 2.42 billion Euros on June 2014, marking an annual growth of 10.0 percent, which represents the highest rate of growth in the last two years. Moreover, Petrit Balijsa, president of the Kosovo Banking Association, says that based on the reports of the first half of 2014 from the banking sector, deposits have increased by 25.9 million Euros, reaching 2 billion and 474.9 million Euros from the 2 billion and 449 million Euros as of the end of 2013. "According to some studies conducted by several commercial banks in Kosovo, the interest rate is not one of the main selection criteria of the bank by customers in Kosovo," said Balijsa. He added that research shows that customers prioritize other aspects, such as reliability, customer service, the range of products, a network of branches and ATMs, online services, etc." (*Kosova Sot, September 4th, 2014*)



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