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“Comparative Regional Study on the Potential Impact on Economic Growth and Credit Availability from Strengthening the Legal and Regulatory Framework for Non-Bank Financial Institutions in the Balkans”

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Author: Center for Research in Economics and Finance

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The purpose of this document is to present a comparative regional study on the potential impact on economic growth and credit availability from strengthening the legal and regulatory framework for nonbank financial institutions in the Balkans, for review by the Segura Consulting LLC.

It has been prepared by the Center for Research in Economics and Finance for the purposes of the Regional Economic Growth Project.

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Abbreviations and Acronyms

AFSA	The Albanian Financial Supervisory Authority
AR	Annual Report
Bn	Billion
BoA	Bank of Albania
CAGR	Compounded Annual Growth Rate
CB	Central Bank
CBBH	Central Bank of Bosnia and Herzegovina
CBK	Central Bank of Kosovo
CEE	Central and East Europe
EIOPA	European Insurance and Occupational Pensions Authority
EMN	European Microfinance Network
EU	European Union
FSR	Financial Stability Report
GDP	Gross Domestic Product in current prices
GWP	Gross Written Premium
M	Million
MCI/MFI	Microfinance/Microcredit Institutions*
MSME	Micro Small and Medium Enterprise
MTPL	Mandatory Third Party Liability
NBFI	Non-Banking Financial Institution
NBRM	National Bank of Republic of Macedonia
NBS	National Bank of Serbia
NPL	Non Performing Loan
OFI	Other Financial Institution
SAR	Supervision Annual Report
SCO	Savings and Credit Organizations
SLA	Saving and Loan Association
SME	Small and Medium Enterprise
VAT	Value Added Tax
y-o-y	Year on year

Note: Microfinance and microcredit institutions are used interchangeably.

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1 Executive Summary

The reconstruction of the financial sector in Balkan countries (Albania, Bosnia and Herzegovina, Kosovo, Macedonia and Serbia) in past two decades was mainly focused on the expansion of commercial banking. After the long period of economic instability during the 1990s, this process led to the relatively intense credit growth, which positively influenced the dynamics of economic activity, macroeconomic stability and the level of public and private welfare. The relatively rapid reconstruction of the banking sector was significantly based on the import of foreign savings through European banking groups, which have quickly become significant participants on national markets. Banking crises in Europe impede the capital inflow, in some countries even causing reversion to capital outflows.

After their initial expansion, financial markets, especially the stock market, went into a phase of decline. The main symptoms of crisis were the decrease of absolute and relative capitalization and low liquidity. There was a phenomenon of increasing concentration of shareholders equity generated by some of the schemes of mass privatization. Laws and regulatory authorities often required public listing of stocks of privatized companies on stock exchanges, but with insufficient disclosure of relevant information and often with imperfect corporate governance. Weak institutions without the capacity to apply laws, inefficient court procedures and subpar financial reporting led to the degeneration of the stock market in a sense that in most cases it became a takeover market with intensive trading in a relatively short period of time.[1] Minority shareholders (citizens and employees), whose stocks were traded, were not sufficiently protected by laws and regulators (a somewhat similar pattern was registered in CEE countries). There have been cases of publicly traded companies going private, i.e., moving from a joint stock company to limited liability status with delisting from the exchange. At the same time, there have been hardly any cases of companies going public on their own free will.

The conclusion is that capital markets do not serve the financing of enterprises in the Balkans. Bond markets are mostly reduced to primary trading in government bonds. In conditions where there is not enough disclosure by the issuers and the system of investor protection is inefficient, it is not realistic to expect faster growth of corporate bonds or equities trading in the near future. Growth prospects of financial markets are still limited, both in the short and medium term. The precondition for anticipated growth of the capital market in the long run is in the increase of institutional and professional capacity and the enterprises' initiative for raising capital by going public i.e. IPOs.

Some of the common characteristics of financial markets in the Balkans are the following:

- A short term phenomenon of increasing ownership concentration.
- Insufficient disclosure of relevant information and imperfect corporate governance of listed companies.
- Financial markets have become a takeover market (in most cases of mass privatization).
- Minority shareholders are not sufficiently protected by laws and regulators.

[1] In most of the Balkans countries, creation of public companies was mandatory by laws of privatization.

- Cases of publicly traded companies going private, i.e., moving from a joint stock company to limited liability status with delisting from the exchange.
- Capital markets do not serve the purpose of improving financing SMEs in the Balkans.
- Bond markets are mostly reduced to government bonds trading. Corporate bonds have often high transaction costs.
- Insufficient disclosure by the issuers.
- Insufficient system of investor protection.
- Publicly available rating on the sub-national level does not exist.
- Absence of liquid and low-risk domestic financial instruments sometimes causes institutional investors to invest abroad.

There are certain areas that could potentially be addressed in regional initiatives:

- Cooperation between the financial markets' regulatory authorities in improvements to disclosure of listed companies and raising the quality of financial reporting.
- Development of national (alt. regional) rating agencies.
- Increase in investor protection. There is potential to adopt a special law on investor protection throughout the Balkans.
- Anti-manipulative regulation, especially in the area of price discovery process.
- Finally, there is a possibility of establishment of a common trading platform. Such activities have already begun, but their future is uncertain. It could be very useful to investigate similar experiences elsewhere in the world.

Specific evolution of financial markets in the Balkans had its impact on the evolution of **institutional investors** (investment funds, pension funds and insurance companies) in the region. A shallow and illiquid market (and presence of FX risk in some countries) has caused the withdrawal of institutional investors from corporate instruments and their return to foreign exchange denominated government bonds and bank deposits. The development of a local bonds market is a natural first step to improve development prospects of institutional investors.

The initialization of microfinance institutions (MFIs) was accompanied by high expectations and good intentions. Both domestic and foreign parties have expressed interest to participate in this market.

Common characteristics of MFIs in the Balkans include:

- Rapid market penetration in those countries where it was allowed. The experience of MFIs in Bosnia and Herzegovina is especially interesting (the country has the second-highest MFI penetration in the world).
- Accelerating MFI growth was financed by external financial sources and the strong profit motivation of creditors.
- Credit portfolio structure is characterized by the dominance of consumer credits to households, instead of credits for business activities of micro-, small- and medium-sized enterprises (MSMEs).

- An increase of NPLs since 2008.
- The problems of moral hazard and predation have damaged the reputation and initial purpose of MFIs in BiH.
- MFI regulation is incomplete or absent in all countries.

These institutions can undoubtedly be a useful element of any financial system, especially in the circumstances of limited access to finance for MSMEs. The disadvantageous consequences in MFI evolution have probably been caused either by late or incomplete regulation. It is important to formulate legislation and procedures for this activity in those countries where they are nonexistent. It is advisable for the countries in the region to share their experiences regarding know-how and regulation of MFIs.

The regional cooperation could be useful in formulating an MFI-implementation agenda by exchanging experiences concerning the following questions:

- Can MFIs accept deposits from individuals? If this concept is to be accepted, there is another important question. Can this solution influence the public interest in deposit security, and in what volume? Do deposits of MFIs enter national deposit-protection schemes?
- How to achieve the existence of MFIs and secure the effects as observed in those countries with good practice? How to constrain and/or eliminate financing with extremely high interest rates and moral hazard issues?
- How to regulate the relationship between MFIs and commercial banks? Can MFIs be founded as subsidiaries of commercial banks?
- How to define the scope of MFIs financial products? What kind of credit can be considered microcredit? Can MFIs give mortgage loans?
- How can MFIs be included in a credit bureau system and the interchange of credit information?
- How to define the scope of prudential supervision reporting of MFIs and to whom?
- How to break up the relationship between MFIs and the gray (shadow) economy?

Development of MFIs in the Balkans could be supported by adoption of the Law on MFIs in the countries without this type of act (Albania, Macedonia, Serbia) and by reviewing and possibly amending existing laws (BiH, Kosovo). Assistance could be useful also in a subsequent potential creation of adequate by laws for MFIs.

The leasing sector followed the banking sector evolution in the whole region.

The following are characteristics of the leasing sector:

- Banks have established most of existing leasing companies. All bank-founded leasing companies work predominantly with financial leasing. Operational leasing, contrary to financial, has fiscal advantages for SMEs.
- Operational leasing and equipment leasing have developed significantly more slowly.

  The supply of leasing has decreased to both sectors (enterprises and individuals) as a consequence of the diminishing credit supply and reduced inflow of foreign resources.

Development of leasing sector in the Balkans would potentially benefit from an effort to reform legislation in such a direction as to encourage operational leasing, having certain costs and fiscal benefits for customers.

Factoring is in its initial phase in Balkan countries. With regard to asset volume, factoring has a negligible share in the financial system, but the factoring market has a realistic growth prospective. Regionally, there are positive experiences regarding factoring development, including the existence of the Law on Factoring (in case of Serbia). The factoring market has potential to grow and can be useful for development of SMEs.

The following are characteristics of factoring in the Balkans:

- In its initial phase.
- Still negligible share in the financial system.
- Realistic growth prospective.

Serbia has a good Law on Factoring (done with USAID support).

Developing of Factoring in the Balkans could be supported if other countries (besides Serbia) would adopt a separate law governing factoring activities.

Residual financing in the Balkans (e.g., **private investment funds, venture funds**, etc.) is present in relatively very small volumes.

Access to finance for MSMEs in the Balkans has been reduced since the beginning of the crisis. The main causes are diminishing credit activity of commercial banks and NPL growth in the SME sector. Additionally, support from public sources has been reduced. Fiscal problems contracted sources for financial support to SMEs in most countries in the region. Officially, government policies strongly support MSME development in all observed countries. Despite the fact that development financing from public sources (development banks, development funds, grant funds for SMEs and similar schemes) has in some cases failed, this area deserves to be explored further. Regional cooperation in this area is desirable. It should be directed towards finding new and innovative ways of development financing from both private and public sources. Public development support should seek solutions in indirect financing and with minimum outright discretionary government spending.

Recommendations for MSME access to finance in the Balkans are the following:

- Adequate regulation and introduction/further development of MFIs and other non-banking savings institutions.
- Finding new and innovative ways of development financing from both private and public sources.
- Reduction of MSMEs credit risks potentially by activating mutual guarantee schemes.
- Increase of credit profile of MSMEs by improvements in collateral valuation and regulation of mortgage lending.
- Public development support should seek solutions in indirect financing and with minimum outright discretionary government spending.

2 Regional Overview of Size and Growth of NBFIs Compared to EU Averages

The financial system in the Balkans is strongly dominated by banks.

On the other hand, NBFIs are generally underdeveloped. This structure of financial system, together with a vast shortage of domestic savings, left those countries very vulnerable to the 2008-2009 crisis influence. Dependence on foreign capital, strong contraction of foreign capital inflows, which caused contraction of domestic consumption, and sharp adjustments of current account balance of payment are important common characteristics of the national banking systems in the Balkans. Banking panics (shifting deposits) and the strengthening of credit conditions took place in all observed countries at the beginning of the crisis. Except for Albania, all Balkan countries recorded a significant decrease of dynamics and level of economic activity lasting at least one year during the first phase of the private debt crisis (2008-2010. Those were the years with strong and lasting consequences for national financial systems. The credit supply of the banking sector was either decreasing or stagnating after the period of rapid growth in the pre-crisis period in most of the countries. Adverse macroeconomic conditions (diminishing dynamics of economic activity, NPL growth and public debt growth) significantly influenced private sector development through environment changes. The external position of all observed countries deteriorated. A combination of those factors could lead to a long-term stagnation of the entire region and, as a result, lower its possibility of joining the EU. Table 2.1 presents a basic description of the financial sector in Balkan countries at the end of 2013.

Table 2.1 Financial Sector Indicators of Balkan Countries – Comparison with EU, 2013

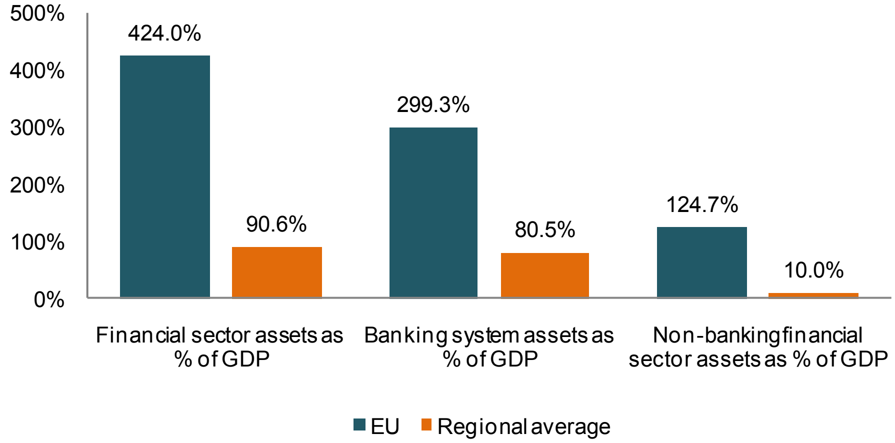
	Financial sector assets as % of GDP	Banking system assets as % of GDP	Non-banking financial sector assets as % of GDP
EU	424.0%	299.3%	124.7%
Albania	108.9%	101.0%	7.9%
BiH	95.5%	83.5%	12.0%
Macedonia	89.1%	78.1%	11.0%
Kosovo	80.6%	57.4%	23.2%
Serbia	85.0%	77.6%	7.4%
Regional average	*90.6%*	*80.5%*	*10.0%*

Source: CREF research.

As presented in the table above, discrepancies between the EU and the Balkans, in terms of development of the financial system, are significant. The real difference is more significant, given the fact that stated EU data are somewhat underestimated due to the lack of data on EU non-banking financial institution assets.[2] Graph 2.1 shows an overall underdevelopment of the financial sector in the Balkans in terms of the financial sector share in GDP.

[2] Data on private pension funds and mutual funds is for the euro area; data on leasing companies is based on the EU group of 22 countries that submitted their data to the Lease Europe Association; data on other non-banking financial institutions (microfinance institutions, factoring companies, saving unions, etc.) is not available due to the absence of obligation for submission of financial reports to the EU authorities.

Graph 2.1 Regional Financial Sector Overview, Comparison with EU, 2013



Source: CREF Research.

The implied question is whether the accelerating development of NBFIs can remove or diminish barriers caused by crisis and reconfiguration of the EU financial system.

2.1 Insurance Sector

Insurance sector development was mainly driven by the insurance of industrial sector property and insurance of motor vehicles (CASCO and motor third party liability insurance [MTPL]). New insurance products such as life insurance, pension insurance, private health insurance, and insurance of agriculture crops have started developing during the last two decades. Insurance has the second largest share in total financial sector assets, after the banking sector. It ranges from 1.5% (Albania) to 4.7% (Serbia), as presented in Table 2.2. The poorest development of the insurance sector was seen in Albania, accounting for barely 1.5% of GDP. Other countries' insurance sector was more or less at the same level of development, accounting for 3-4% of GDP.

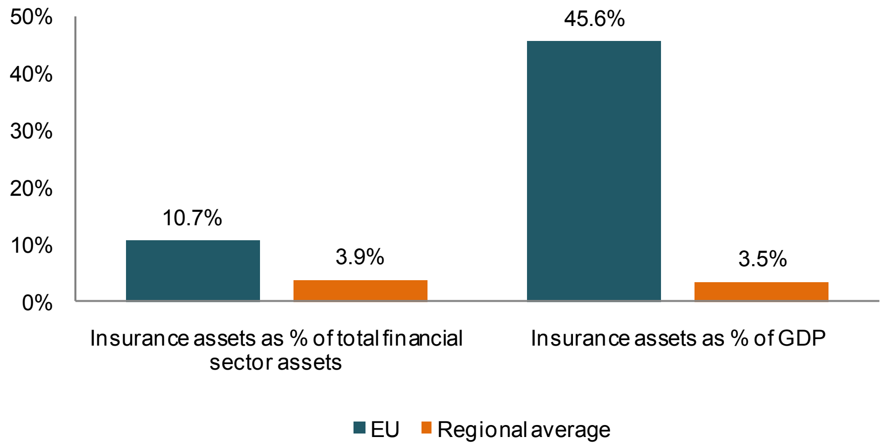
Table 2.2 Insurance Sector Indicators of Balkan Countries – Comparison with EU, 2013

	Insurance assets as % of total financial sector assets	Insurance assets as % of GDP
EU	10.7%	45.6%
Albania	1.5%	1.6%
BiH	4.5%	4.3%
Macedonia	3.3%	2.9%
Kosovo	3.1%	2.5%
Serbia	4.7%	4.0%
Regional average	*3.9%*	*3.5%*

Source: CREF research.

Development of the regional insurance sector (as per share of assets in GDP) is poor in comparison with EU indicators (Graph 2.2), suggesting a lot of room for improvement.

Graph 2.2 Regional Insurance Sector Overview, Comparison with EU, 2013



Source: CREF Research.

In spite of its rapid development in the pre-crisis period, the insurance sector has remained undeveloped compared with both EU and CEE countries. Market growth has slowed due to the downturn in economic growth and problems in payments of premiums in property insurance of the industrial sector during the last three years. This trend is especially noticeable in countries dominated by the non-life insurance segment. Significant growth in 2007 and 2008 was followed by a decrease of premiums in 2009, due to the economic crisis. Non-life premiums followed the same pattern as total premiums, whereas life insurance premiums started growing. MTPL insurance, which presents a significant segment of non-life insurance, also recorded a decrease. Nevertheless, this decrease was relatively lower in comparison with the decrease in total premiums in the period 2009-2010. Such a tendency relatively offset a vast increase in total premiums.

Over time, the portfolio structure of insurance companies had evolved from solely deposit arrangements with commercial banks to investing in corporate securities (stocks and bonds). This encouraging practice seen in some countries either stopped or lagged due to the crisis on national financial markets. The crisis caused a diminishment in value of stocks (Serbia, Macedonia and Bosnia and Herzegovina), defaults of corporate bonds issuance (Serbia) and a strong squeeze out of investors. This squeeze out was driven by the increase of government bonds and treasury bills supply, among other reasons. Government pressure on domestic financial markets will probably continue due to the high values of public debt-to-GDP ratio and necessitate refinancing of public debts on domestic markets. Financial market uncertainty has caused insurance companies to adjust their portfolio structure towards reducing long-term and increasing short-term investments (one-year period). Described changes refer to financial assets as well as to real estate assets.

2.2 Financial Markets

The development of financial markets and their individual segments (stock market, bond market, derivative market) varies significantly among the countries.

The establishment of stock markets in the Balkans was mainly driven by various massive privatization models (in the case of Serbia, Macedonia and Bosnia and Herzegovina). The evolution was predominantly influenced by the choice of privatization model, which was primarily the obligatory listing of privatized companies.

A strong correlation between bond market development and public debt management was observed in Albania and Kosovo. Namely, financial markets in these countries are primarily used for public debt placement.

The third important factor which influenced the evolution of financial markets in the Balkans is the presence and performance of foreign investors whose region-wide entrance on financial markets was seen in 2004. This factor strongly influenced the increase and rapid decline of the market turnover and liquidity in the pre- and post-crisis period, as presented in Table 2.3.

Table 2.3 Capital Market Indicators of Balkan Countries – Comparison with EU, 2013

	Stock market capitalization (EUR m)	Stock market capitalization as % of GDP
EU*	8,094,295	61.9%
Albania	0	0.0%
BiH	4,052	30.0%
Macedonia	1,670	21.7%
Kosovo	0	0.0%
Serbia	5,791	18.1%
Regional average	*11,513*	*16.9%*

Note: (*) Data refer to 2012.

Source: CREF research.

Note: Market capitalization of listed companies.

The liquidity of financial markets (both equity and bond markets) has been low since its establishment. A substantial number of enterprises have listed their shares on stock exchanges in Serbia and Bosnia and Herzegovina only in order to comply with the Law on Privatization. Moreover, financial markets were characterized by the growing stock supply owned by employees and citizens (also in line with the Law on Privatization). Such an enormous supply was significantly overcoming domestic demand. The accelerating concentration of stock ownership was followed by a significant undervaluation of stocks. This undervaluation of stock prices was possible due to the low level of minority shareholders rights, in addition to undeveloped pricing mechanisms, maintained by regulatory and legislation mechanisms.

In analyzing standard indicators of financial market development, such as market capitalization, it could be assumed that financial markets in Serbia, Bosnia and Herzegovina and Macedonia expended strongly. Nevertheless, this indicator is inadequate and does not reflect the real condition, since the vast part of total market capitalization is illiquid. The main obstacles for further development of financial markets are the low level of actively traded corporate stocks and their low turnover.

Ownership concentration has predominantly influenced development of capital markets. This phenomenon happened in all transition countries, especially in those where there was no regulated takeover procedure. Concentration of ownership usually took place during the privatization process, regardless of the applied model of privatization. The main outcome of such a tendency was that companies were going private (closing) by takeovers and squeeze outs, instead of going public (opening) in order to increase their capital. This process was made under conditions of low information and price efficiency, commonly resulting in large losses of minority shareholders. It is assumed that under those circumstances the market undervalues stocks, which accelerates its process of deterioration.

An analysis of Balkan corporate bonds markets has shown that it is in its initial phase of development, with almost negligible capacity and economic impact. Within the region, issuance of corporate bonds has taken place only in Serbia and Bosnia and Herzegovina. There were two public offers of corporate bonds in Serbia, both issued by banks. Issuing corporate bonds by real sector enterprises is rare and usually done as closed issuance. Namely, common practice assumes issuance of corporate bonds for pre-arranged, well-known investors. Investing in corporate bonds is still followed by high risk. Issuers' non-transparent behavior and the nonexistence of a rating agency and regulation in case of bankruptcy do not give a satisfactory level of creditor protection.

Transaction costs and issuing costs for corporate bonds are high, especially for small- and medium-sized enterprises. Corporate bonds could be an important source of MSME funds, given the relatively adverse conditions for taking banks' loans. Apart from high expenses, large issuers emphasize high transparency requirements as a major barrier. Instead of promised benefits (such as cheap access to capital, better reputation, etc.) transparency requirements generate only high expenses. In addition, the overall environment is extremely non-transparent, with both government and competition behaving non-transparently. On the other hand, banks benefit from the fact that they are not required to leave mandatory reserves for issuing securities for maturity longer than two years. In addition, corporate bonds present a superior alternative for financing in conditions of increased domestic-currency credit demand and extremely expensive domestic-currency borrowing from other banks.

2.3 Investment Funds

Two main characteristics of investment funds in the Balkans important for evaluation are low capacity (with a share of 1.3% in total financial sector assets), and the relatively modest structure of their portfolio. The crisis ended the developing trend of these institutions. The largest relative decrease was recorded in Bosnia and Herzegovina, while the highest increase was recorded in Macedonia. Its impact on accessibility of funds to enterprises is negligible, as presented in Table 2.4.

Table 2.4 Regional Mutual Funds Indicators, Comparison with Euro Area, 2013

	Investment funds assets as % of total financial sector assets	Investment funds assets assets as % of GDP
Euro Area*	82.8%	45.6%
Albania	3.4%	3.8%
BiH	3.0%	2.9%
Macedonia	0.2%	0.2%
Kosovo	0.0%	0.0%
Serbia	0.0%	0.1%
Regional average	*1.3%*	*1.2%*

Note: (*) Data for EU were not available.

Source: CREF Research.

Aside from their low capacity, investment funds have rather small impact on availability of financial sources due to the specific structure of their portfolio. Namely, portfolio structures of all institutional investors are dominated by low-risk instruments, such as government bonds and treasury bills. In addition to the high systemic risk of financial markets, the small and non-diversified supply of financial instruments presents current as well as prospective constraint to further improvements in their investments structure. That is one of the reasons why the demand of institutional investors is concentrated on a relatively narrow segment of the stock market. Consequently, institutional investors are faced with a portfolio optimization problem, in which diversification is egged by the low liquidity of most stocks. As a concept, aversion to risk varies among the institutional investors. High-risk investment funds (especially so-called private funds) and non-life insurance companies have less aversion to risk than pension funds (either private or mandatory).

2.4 Pension Funds

Pension system reforms in the Balkans include three major problem groups:

1) Reform of the pay-as-you-go (PAYG) system (Serbia, Bosnia and Herzegovina and Kosovo);
2) Partial capitalization of the pension system through the creation of non-obligatory private pension funds; and
3) Partial change of the system of mandatory private pension funds.

Voluntary pension funds are important for our analysis. Their presence on the market can strongly influence the capacity of the financial sector through their growth potential. Voluntary pension funds give the opportunity to all people, regardless of whether they are employed or not, to obtain an additional pension by saving on their accounts. Those institutions do not exist in all the countries in the region. Nevertheless, they experienced strong growth on markets where they were established. The highest compound annual growth rate (CAGR) was 43% in Albania, whereas in Serbia and Macedonia it amounted 28% and 27%, respectively. Table 2.5 presents pension fund assets in the region's countries.

Table 2.5 Private Pension Fund Indicators, Comparison with Euro Area, 2013

	Private pension fund assets as % of total financial sector assets	Private pension fund assets as % of GDP
EU*	3.3%	19.3%
Albania	0.0%	0.0%
BiH	0.0%	0.0%
Macedonia	6.6%	5.9%
Kosovo**	21.5%	17.3%
Serbia	0.6%	0.5%
Regional average	*3.9%*	*2.3%*

Note: (*) Data for EU were not available; (**) Includes regular pension funds, given that they are large investors.

Source: CREF Research.

The Balkans as a region is characterized by macroeconomic conditions (e.g., an aging population, fiscal crises and uncertainty of budget financing of the PAYG system) favorable for the expansion of these institutions. The key constraint to higher efficiency of voluntary pension funds currently present on the Balkan market is the lack of good financial instruments that will enable appropriate portfolio diversification. Although investments in corporate bonds are generally allowed by law, government bonds have the largest share in total assets, even more than 80% in some countries (e.g., Serbia). Private pension fund assets were entirely invested in government bonds and T-bills in Albania, which is an extreme case. The following investment categories comprise the investment portfolio: bank deposits, stocks and sight deposits, in addition to the government debt instruments. The largest share of pension fund assets is exposed to interest rate risk, which is highly concentrated in investments in government instruments. This investment portfolio structure, formed in the period of economic crisis, has remained unchanged.

2.5 Microcredit Institutions and Local Financing

The dominant role of banks in the financial sector, together with a highly concentrated banking sector, have indirectly lead to the credit concentration of large enterprises. SMEs have a less favorable position in terms of loan availability compared with the large enterprises. In the absence of data detailing the breakdown of credit-availability by enterprise size for all countries, indirect proof of this hypothesis could be derived from the structure of NPLs. Large enterprises NPLs account for the largest share in NPL structure.

It is very important to enable better access to finance for MSMEs in order to increase employment and to accelerate economic growth. In order to address these issues in Balkan countries, three groups of institutions have been established: microcredit institutions (Bosnia and Herzegovina and Kosovo)[3], credit unions (Albania), and public (government) development

[3] Some financial institutions in Macedonia are officially registered as Savings houses, but also provide microcredit financing.

projects (Bosnia and Herzegovina and Serbia). Table 2.6 presents microcredit institutions in our region.

Table 2.6 Microfinance Institutions Indicators, 2013

	Microfinance institutions assets as % of total financial sector assets	Microfinance institutions assets as % of GDP
Albania	1.0%	1.1%
BiH	2.6%	2.5%
Macedonia	0.0%	0.0%
Kosovo	2.6%	2.1%
Serbia	0.0%	0.0%
Regional average	*0.9%*	*0.8%*

Note: (*) Data for EU were not available.

Source: CREF Research.

Microcredit institutions in Bosnia and Herzegovina had the highest share, both in terms of influence and assets, in this group of institutions. Approximately 560,000 persons used microcredit, with an average of 4.5 credits per person (Union of Microcredit Organizations Bosnia and Herzegovina data). The credits were used for business purposes according to the same source. The independent study provided by Bateman, Sinković and Škare (2012) argued that the largest portion of microcredit was used for personal consumption.

The evolution of microcredit institutions began by 2000 with very high expectations, buttressed by positive experiences of such institutions in Bangladesh and India. The first Law on Microfinance Institutions (2006) stipulated to those institutions the possibility of transforming from firstly established non-governmental organizations (NGOs) to commercial and profit-orientated institutions, but without the possibility of accepting deposits. This conversion, under the conditions of inelastic credit demand, allows the members of a supervisory board and board of directors of microcredit institutions personal enrichment and the accumulation of NPLs.

The crisis of microcredit institutions (MCIs) commenced as early as 2007-2008 with the accelerating indebtedness of clients. Clients' credit demand was driven by an increase in consumption, instead of investments in business activities. The basic model of borrowing expansion is multiplication of loans per borrower. The expansion of MCIs in Bosnia and Herzegovina was mostly financed through foreign sources, both public and private (Bateman, Sinković and Škare, 2012). Non-performing micro loans (NPMLs) had already doubled in 2009. Loan provisioning increased by more than 250% in 2010, leading to losses for the whole sector. A new increase of share capital and individual household deleveraging have been used to address problems caused by crisis since 2010.

MFIs in Kosovo are defined as NGO or joint stock companies under the Law on Business Organizations. They are gaining importance in Kosovo’s economy. Nevertheless, this importance gaining was not as expansive or with fewer problems comparing with Bosnia and Herzegovina. They are not allowed to take deposits, as in Bosnia and Herzegovina. The main sources of financing include foreign sources similar to those in Bosnia and Herzegovina: the

EBRD, IFC and European Fund for Southeast Europe (Ministry of Trade and Industry of Kosovo, 2012). They peaked in 2009, when their share in the total credits and total assets of the financial sector started decreasing. The third important similarity with Bosnia and Herzegovina is high interest rates (Central Bank of Kosovo, Financial Stability Report and Annual Report).

2.6 Leasing Sector

The region's leasing sector is predominantly influenced by banks, both in terms of ownership structure and operationally. Specifically, nearly all leasing companies are owned by banks. The structure of leasing companies' supply has basically followed the pattern of banks' business policy in periods of increasing credit supply. Such a policy included the maximization of placements to individuals that led to the dominance of financial vs. operational leasing. Asset structure is characterized by light and freight vehicles as the two most common leasing objects. This structure led to a decrease of leasing companies' assets in most of the countries, with the exception of Albania. Table 2.7 presents indicators of the leasing sector.

Table 2.7 Leasing Sector, Indicators, Comparison with EU Group of Countries,[4] 2013

	Leasing assets as % of total financial sector assets	Leasing assets as % of GDP
EU group of countries*	1.1%	5.0%
Albania	0.6%	0.7%
BiH	2.4%	2.3%
Macedonia	1.7%	1.3%
Kosovo	1.5%	1.2%
Serbia	2.1%	1.8%
Regional average	*1.8%*	*1.6%*

Note: (*) Data for EU were not available.

Source: CREF Research.

The previously described evolution pattern of the leasing sector is not particularly favorable for the real sector. Commonly, leasing can be a very useful source of financing for SMEs. In general, access to leasing is easier than access to loans, because the basic criterion for leasing financing is liquidity of the user. Therefore, SMEs can finance equipment through leasing even when their solvency does not allow them to obtain a regular bank loan. The implicit interest rate can be higher, compared with the interest rates implied by a regular bank loan; however, the access to finance is easier. The maturation of the leasing market will likely lead to an increase in operational shares compared with financial leasing shares. In addition, it will most likely lead to a change in the structure of assets that are provided through leasing financing.

2.7 Factoring

Factoring is in its initial phase of development in the Balkans. Prvi Faktor, Slovenia is the most significant market player, regionally present and active in most Ex-Yugoslavia countries. It

[4] In accordance with Leaseurope data, comprising the following countries: Austria, Belgium, Bulgaria, Czech Republic, Germany, Denmark, Estonia, Spain, Finland, France, Greece, Hungary, Italy, Latvia, Netherlands, Poland, Portugal, Romania, Sweden, Slovakia and United Kingdom.

operates exclusively with corporations, buying receivables on condition of recourse. Its effective interest rates are rather high, ranging between 12% and 15% per annum.

The most developed factoring market is in Serbia (see country report). In addition, Serbia is the only Balkan country where factoring is governed by a specific law (the Law on Factoring).

The future development of factoring is desirable, since factoring can be a useful source for financing operating capital of SMEs.

3 Regional Overview of Obstacles in the Legal and Regulatory Frameworks that Impede Market-Based Growth of NBFIs

The institutional infrastructure of all countries, despite the latest efforts, remains underdeveloped and has a few common characteristics.

A relatively rapid **modernization of basic legislation** of the financial sector is the first common characteristic. All of the countries are on an EU-membership path and intend to adopt modern legal regulation in accordance with EU directives. Examples include laws regulating banking, financial markets, insurance companies and investment funds. There is an obvious, continuous effort to modernize the legal framework in all of the countries.

The second common characteristic that can be emphasized is a **low level of efficiency in law implementation.** Parallel with the legal modernization processes, informal procedures have been developing, in which decisions are made in accordance with procedures not defined by laws and outside of formal institutions. Allocation of NBFI assets is often influenced by informal decisions. An example is the allocation of assets of MCIs in Bosnia and Herzegovina (see Bateman, Sinković and Škare, 2012). Policies stipulated by the laws often diverge in practice. This is partially owing to omissions made in the course of legal development, which led to the adoption of laws that are not applicable in practice.

Informality diminishes the capacity of national regulatory and supervisory authorities. Their capacity, education and equipment are often unable to follow reforms related to legislature and the dynamics of adopting the modern solutions. An example has been seen in the regulatory board of financial markets in Serbia and Bosnia and Herzegovina. Massive modernization of legislature in these areas was not accompanied by the professional, financial and technical capacity of regulators. The independence of those institutions is relatively low. Changes in top management each time the government changes is a common proof, which further implies that top management is dependent on the government.

The fourth common characteristic is the more or less obvious **presence of lobby groups influencing the implementation of laws**. Lobby groups often appear in formal structures, such as professional and civic organizations. It is common for these groups to even formally request changing the application of legal procedure and other regulatory boards' decisions in order to gain certain conveniences or benefits. They often recommend that regulators "take a more flexible approach," which assumes a more flexible interpretation of new regulations, instead of consistent enforcement of the law.

The fifth common characteristic of institutional infrastructure is **high transaction costs**. High transaction costs mostly materialize directly through fees and compensations for different operations that market participants have to pay in order to realize their activity. This especially applies on those NBFIs that are associated with the financial markets. The issuing costs for financial instruments are often as high, violating competition rights compared with the other market alternatives. A good example is issuing corporate bonds in Serbia.

There are a lot of specific problems that should also be addressed and regulated, apart from the general problems related to institutional infrastructure.

The process of investors withdrawing from the financial market, followed by a rapid decrease of capitalization and low liquidity, will continue. Although exacerbated by to the crisis, its main cause is the high concentration of widely dispersed ownership created by mass privatization. There is no motivation for the corporate sector to issue new instruments, since this process strongly compromised both institutions and participants in the financial markets. Regulators can solve this problem by better regulating the process of going private for those companies that were going public by law. Currently, this process is under a strong dominance of major shareholders and low level of protection of minor shareholders. The goal of this regulation is to enable the future of the market and to prevent its further compromise.

The current status of financial markets will be maintained in the medium term, although all three countries (BiH, Macedonia and Serbia) have already made a lot of regulatory effort in order to improve the quality of corporate governance and level of investors' rights protection. The experiences of countries from the CEE region argue in support of this forecast. In order to improve the quality and level of protection of investors, the following conditions should be satisfied: reform of financial markets and corporate legislation, and improvement of institutional infrastructure quality (elimination of informal decision making, reduction of interest groups' influence on the decision-making process, increased efficiency of courts and quality of financial reports, and improvements in ethical auditing standards). The low level of protection of investors' rights together with the low level of liquidity on the one hand, and dispersion of equity on the other hand, are apparently impeding the further development of financial markets. Relevant studies have shown that this is a global problem: ownership concentration is much higher in the countries with a low level of rights protection, and ownership is mostly concentrated by insiders.[5] At the same time, a feedback loop can be observed, since the concentration of ownership per se leads to undeveloped and illiquid capital markets, which implies a low level of investor protection and finally leads to market collapse. The application of EU recommendations formulated by The Winters Group[6] would change the current status of financial markets in the manner of creation and issuance of new instruments on markets (IPOs, an increased supply of corporate bonds, etc.).

A unique problem on the financial markets in Serbia and Bosnia and Herzegovina is the absence of good anti-manipulation regulation and practice. Illiquid markets with a low level of protection of investors' rights and deep information asymmetry create a favorable atmosphere for manipulation of financial asset prices and information, and trading based on insider information, which are all a widespread and unsanctioned phenomenon. Accounting systems and auditing practice are unreliable. Basic assessment of the variability of prices confirms the

[5] See Shleifer, Andrei and Robert Vishny, (1997), “A Survey of Corporate Governance,” Journal of Finance 52, 737-783.

[6] See Winter, J., et al., (2002), "Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids."

assumption that such practices exist, although there are no direct proofs of punishable manipulations, since there have not been any public investigations or verdicts. A relevant finding is the behavior of stock prices of enterprises exposed to takeovers. Instead of the usual phenomenon of a price increase (takeover premium), a decrease in stock price was registered by and large. This has been observed in a few important takeovers in Serbia. One of the reasons is the lack of a law on takeovers, which could enable the formation of the stock control package without the public takeover offer. The regulators possess neither knowledge nor authority to investigate such cases, which leads to further continuous compromise of the market.

Financial market problems cause a whole series of institutional investors' problems (investment funds, pension funds, insurance companies), apart from the expropriation of small individual stocks. The process of investor withdrawal from the financial market and illiquidity will remain key issues in the medium term, since the IPO market is undeveloped. The current market constellation reduces the investment base and limits efficiency of institutional investors, as was evident during the observed period. Institutional investors, both domestic and foreign, were reluctant to invest in corporate bonds. This is mainly due to the fact that they are exposed not only to price risk generated by crisis, but risk of extreme illiquidity, as well. Currently, turnover is obviously concentrated on a few stocks and government bonds. If new corporate and government instruments are not issued, market viability will be challenged. A consequence of a possible increase of foreign demand (registered in the last few months[7]) will additionally lower capacity and efficiency of diversification. This property will probably last in the medium run as well, consistently endangering efficiency of institutional investors, especially investors whose capacity of risk takeover is limited by standard regulatory norms. This phenomenon is also present in the behavior of private pension funds. The regulatory answer to this issue can go in two directions. The first one is short-term: enable pension funds to invest in foreign instruments without required prudential norms. Certainly, this concept will improve the performance of those funds, but will undoubtedly lead to an outflow of already modest savings. The second solution will be combined: to retain a conservative prudential policy portfolio structure with efforts to allow issuance of quality instruments by the corporate sector, especially corporate bonds.

In general, leasing regulation has two types of problems. The first is related to the dominance of the financial leasing sector in comparison with the operational, which is unequivocally more useful for the real sector, especially SMEs. This is an indirect proof of the hypothesis that the regulatory framework is more suitable for financial leasing, although it should be proved by more precise legal arguments. Moreover, decreasing assets of leasing companies impedes further development of the leasing sector, despite the fact that leasing companies are obviously acting as departments of commercial banks.

The most significant differences between operational and financial leasing important for financing SMEs are listed. The contract period is often shorter than the economic life of the asset. The asset is returned to the lessor in the case of operational leasing. The lessee becomes the owner of the asset in the case of financial leasing, since the period of the leasing contract is mostly equal to the economic life of the asset. The lessee, in the case of financial leasing, bears all the costs and risks related to the leasing asset (maintenance, insurance, etc.). In the case of operational leasing, maintenance costs are mostly paid by the lessor. Value

[7] As of the date of this report.

added tax (VAT) is mostly paid immediately after the contract is made, whereas in operating leasing the lessee pays VAT mostly in installments (through leasing installments).

The second regulatory problem is linked with persistent difficulties of ownership protection rights in the Balkan countries. Ownership rights of leasing companies are insufficiently protected, especially in Bosnia and Herzegovina. Regardless of the fact that leasing objects are the property of leasing companies, there are problems in claiming assets in cases of default. This is a common practice with vehicle leasing. Trial processes for protecting rights on property are extremely long. This increases transaction costs, since prudential norms of the central bank (supervisor authority) require reserving 100% of the outstanding value.

Factoring is the least-regulated financial sector in the region. It is in its beginning phase. Serbia is an exception, where the Law on Factoring was recently adopted with the technical support of USAID. The necessity and conditions for the development of factoring exist in all those countries. Therefore, further improvements in regulation are highly recommended.

Microcredit financial institutions experienced accelerated credit supply growth accompanied by NPL growth and high interest rates in some countries (Bosnia and Herzegovina). Failures and moral hazard in asset allocation caused losses, defaults and a decrease in credit activity.

The experience of credit unions in Albania is significantly better and more positive compared with that of MCIs in Bosnia and Herzegovina. The allocation omissions) are not very significant. These institutions are allowed to take deposits from their members, who at the same time have the right to credit. Such institutions have a long tradition in almost all Balkan countries. Their compromise during the 1990s is not a reason to completely abandon the concept. A detailed analysis of the Albanian experience can provide a strategy for resolving the problem (see Cibuku, 2012).

The following Table 3.1. presents a review of non-bank institutions that are engaged in credit activity and/or deposit-taking (MFIs, savings houses and credit unions), as well as the regulatory framework for MFIs by country.

Table 3.1 Existence of Quasi-Banking Institutions and Law on MFIs by Country

	Albania	BiH	Kosovo	Serbia	Macedonia
MFIs	Yes	Yes	Yes	Yes	No
Credit Unions / Savings Houses	Yes[8]	No[9]	No	No	Yes
Law on MFIs		Law on Microcredit Organizations,	Law on Banks, Microfinance		

[8] Savings and loans associations.
[9] Currently there is not a single savings and credit organization operating in BiH, although they existed during the period 2008-2013 in an RS entity.

		Official Gazette of the Federation of Bosnia and Herzegovina, 01-02-695/06 Law on Microcredit Organizations, Official Gazette of Republika Srpska, No. 64/06 and 116/11	Institutions and Non-Bank Financial Institutions, Law No. 04/L-093, Official Gazette of the Republic of Kosovo, No. 11, May 11, 2012, Pristina		

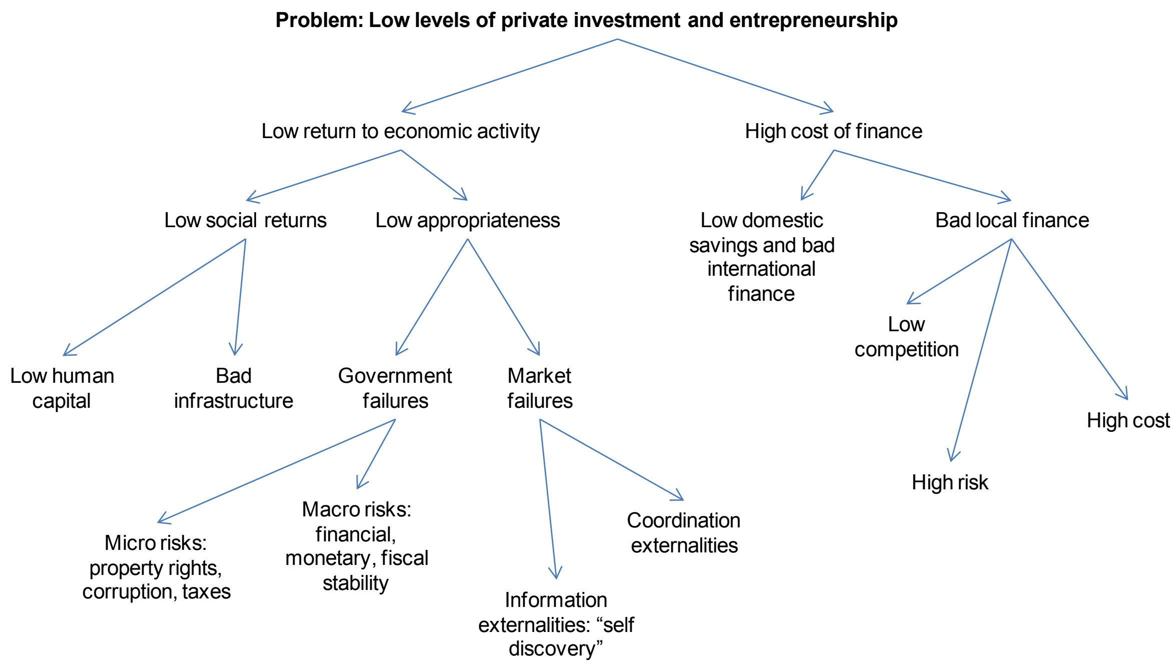
4 Estimated Medium-Term Impact on Economic Growth and Credit Growth from Resolving Obstacles in the NBFI Legal and Regulatory Frameworks

All Balkan countries have had serious problems concerning economic growth since the beginning of the global economic crisis. In 2012, the average real GDP growth rate fell close to 0 (0.14%) in 2012. Modest growth in 2013 was neither sufficient nor sustainable enough in the medium run to improve living standards and increase employment. The poverty rate and unemployment rate were increasing, even reaching maximum values greater than 30% (the unemployment rate in Macedonia). Expected GDP growth rates are either negative or zero.

The second most significant problem related to the economic growth in the covered countries refers to inherited problems. Namely, the growth model used to be based on a large import of capital. Macroeconomic imbalances generated by this model (foreign debt and current account deficit) have merged with a devastating real economy and massive deindustrialization. Structural and industrial reforms are delayed. The capability of the government to change the growth model, relying on domestic savings and expansion of production in the tradable sector is limited. The financing of domestic demand with credit expansion is no longer possible. Foreign direct investments are not sufficient to quickly change the GDP structure. Export is limited by the capacity of neighboring countries' real economies. Private investments are not sufficient to change the model and dynamics of economic activity.

A simplified classification of factors influencing economic growth is presented in Graph 4.1. For our analysis the right part of the tree is relevant. The final conclusion shows that financing costs are high in all countries, influencing dynamics of economic growth. The left part of the tree at the end shows a reduction of competitiveness and return on investments. Similar conclusions have been found in recent relevant studies. Moore and Vamvakidis (2008) defined the main constraints to growth in Croatia as mainly associated with a weak business environment and the excessive role of the state in Croatia. Sen and Kirkpatrick (2009) identify lack of access to finance as a significant constraint to growth, as well as weak property rights and poor provision of public goods such as electricity and transport in Kosovo (for more details see Kuzmanović and Sanfey, 2014).

Graph 4.1 Growth Diagnostic Tree



Source: R. Hausmann, J. Hwang and D. Rodrik (2007), “What you export matters,” Journal of Economic Growth, 12(1), pp. 1-25, Marija Kuzmanović and Peter Sanfey, "Diagnosing Growth Constraints in South-Eastern Europe: The Case of Serbia," EBRD, Working Paper No. 167, April 2014.

Findings of Sen and Kirkpatrick (2009) for Kosovo and Kuzmanović and Sanfey (2014) for Serbia could be generalized for all countries in the Balkans. The main problem is the fact that domestic demand for external finance sources is higher than domestic supply. The financial sector becomes a constraint to growth if there is one or more of the following causes:

- low level of savings;
- high lending interest rate (scarce finance is expensive);
- investment elastic to interest rate (high shadow price of constraint);
- low net cash flow from banks.

Shortage of domestic savings is the long-run problem of all countries. It is influenced partly by the level of income and welfare, but also by institutional factors. Dramatically difficult experiences in the past, such as hyperinflation, compromise of pyramid schemes, and low level of ownership protection have negatively influenced the level of savings, which is mostly owned by the household sector. Bank deposits are the main savings instruments. Precautions saving (pension funds and life insurance) are relatively small and characterized by an uncertain growth prospective. A realistic assumption is that part of private savings (from the shadow economy and other similar activities) does not stay in the country of origin.

The corporative and public sector have a negative savings rate in the long run. Budget imbalances are long-lasting. Leverage of the corporate sector has a tendency to grow. Insufficient savings will have an important influence on credit supply in the medium run. Instead of an expansion of foreign savings supply, banks, members of the Vienna 2 Initiative, intend to use their own domestic savings for further growth.

Landing interest rates in all Balkan countries of are high compared with EU and Central European (CE) countries. Central bank interest rates are also high. Nevertheless, countries with floating exchange rates have a relatively higher interest rate, since foreign exchange rates risk. High NPLs have mainly caused high interest spread in the last few years. The second important problem of the current baking sector situation in the region is diminishing credit activity in the enterprise sector. The problems are linked, since the lowering of credit level is a consequence of increasing risk aversion due to the current and expected level of NPLs. The resolutions to these problems are interrelated.

There is high uncertainty with respect to future dynamics of both credits and NPLs in all countries in the region. Banking portfolio recovery is highly unlikely without new placements. This further implies an increased share of those credits whose principle is not decreasing with time. Secondly, this demands more banking resources in managing the non-performing part of their credit portfolio and a “squeeze out” of good clients from the credit portfolio. There has been a consistent, significant decrease in investment projects, which have the potential to drive the recovery in the medium run.

One of the drivers of NPLs in systems with flexible exchange rates and predominantly un-hedged borrowers is FX lending. This is present in Serbia and Albania. Kosovo (unilateral Euroization), Bosnia and Herzegovina (currency board) and Macedonia (a practically fixed exchange rate) are not exposed to FX lending risk as a key driver of NPLs. The transmission mechanism in Albania and Serbia is the same. Banks are largely financed by foreign sources and approve loans with a foreign exchange rate indexation. Their obligation in domestic currency may significantly increase as a consequence of the depreciation of domestic currency. At the same time, their ability to service debt may stay the same or even diminish.

The main problems in the relation between economic growth and the financial sector are concentrated in the banking sector. Other segments cannot significantly influence GDP dynamics both in the short and medium run.

Financial markets have negatively influenced dynamics of economic growth in the last decade. The first argument for this statement is the following: this mechanism has not significantly transmitted resources to the real economy. Recapitalizations were mostly organized as private stock placements, with few exceptions. Proper recapitalization was mostly done by banks and insurance companies. Recapitalization in Serbia and Bosnia and Herzegovina was accompanied by a capital dilution strategy, so that the existing majority shareholder bought additional issuance for a price lower than the fair value of stocks. The equity capital increase was often realized as a takeover procedure. The second argument is the following: the stock market was transformed into a takeover market with rapid concentration of ownership. Ownership oligarchies were created, as were complicated conglomerates of a large number of diversified enterprises controlled by one owner. Ownership preferences to take over real estate of enterprises instead of maintain its business constitute one of the worst consequences of the formation of these unusual conglomerates. The third argument is the fact that formed conglomerates rapidly became insolvent, since buying new enterprises was often financed through loans. Collaterals were the assets of previously privatized enterprises. Most of those loans have now become NPLs.

On the other hand, financial markets have the possibility to positively influence economic growth. Resolving the problems that obstruct their functioning could open the possibility to create a corporate bonds market and government bonds denominated in national currency in the medium run. These problems are the following: a large number of companies listed by force, high transaction costs, insufficient price efficiency and a low level of investor protection.

Bank loans are the dominant choice of financing enterprises in most of the CEE countries. Corporate bonds are the alternative for bank loans in the medium and long term. As opposed to the government debt securities market, the development of corporate bonds is still in its initial stage, and has only recently been founded in some of the covered countries (Bosnia and Herzegovina and Serbia). Experiences of CEE countries show that in the post-crisis conditions, this market has great potential for growth, especially in the energetic and infrastructure sector.

Institutional investors (investment funds, insurance companies and pension funds) will have only a small influence on dynamics of growth in the short run, due to their limited capacity. Life insurance and pension funds are expected to have significant influence in the medium run. It is necessary to remove obstacles to the normal development of financial markets in order to have incentives for economic growth. These incentives are supposed to enable domestic institutional investors to form portfolios with sufficiently high return and acceptable transaction costs.

The opinion how microcredit institutions influence economic growth is twofold. The professional association of those institutions in Bosnia and Herzegovina (where their number and capacity is the largest) considers that its influence is positive (see "MCI Report for Bosnia and Herzegovina"). On the other hand, independent researchers have the opposite opinion (see Bateman, Sinković and Škare, 2014). Despite this difference in opinion, the existence of this kind of institution is desirable in poor countries with insufficient external sources of finance.

5 Detailed Programming Recommendations for Targeted Regional and Bilateral Follow-Up Activities

Non-bank financial institutions in Balkans are underdeveloped. Increase in their activities can facilitate overcoming the problem of decreasing bank credit activity which is the main reason for decreasing economic activity and lower access to finance of MSMEs in the Balkans.

Non-bank financial institutions can be divided in several broad categories:

1. Non-banking credit institution (MCI/MFI, credit unions, savings and loan associations, leasing companies, factoring companies, consumer finance companies);
2. Securities markets and institutions (corporate bond markets, insurance companies, money market funds, investment funds, private pension funds);
3. Residual finance institutions for increased MSMEs access to finance (venture capital funds, private equity funds, credit risk guarantee funds etc.).

1. **Non-bank credit institutions** are not fully legally regulated in the Balkans. That is most obvious for MCI/MFIs and factoring. Also, there is room for additional credit institutions like credit unions and saving & loan associations. First and important step in this area in the Balkans would be to introduce a good legal framework for these institutions in countries that do not have an adequate regulation in place. Law on Factoring introduced in Serbia (with the help of USAID) could potentially serve as a model for other countries. In designing of an adequate regulation for MCIs it is important to start from regional experience and regulation (in BiH) and to develop an adequate model for MCIs in the Balkans. Useful guidelines for this exercise would be to provide adequate answers for the following questions:

- Can MCIs accept deposits from individuals? If yes, would there be an additional deposit insurance scheme for MCI deposits?
- How to constrain and/or eliminate financing with extremely high interest rates observed by MCI in various jurisdictions?
- How to control moral hazard of borrowers (taking loans for one purpose and using it for a different purpose, etc.)?
- How to regulate the relationship between MCIs and commercial banks? Can MCIs be founded as subsidiaries of commercial banks?
- How to define the scope MCI products? What kind of credit can be considered microcredit? Can MCIs give mortgage loans?
- Can MCIs be included in a credit bureau system? If not, how to control the overall ineptness of the borrowers?
- How to define the scope of prudential supervision reporting of MCIs and to what authority?
- How to break up the relationship between MCIs and the shadow economy?

2. **Securities markets and institutions** in the Balkans have a relatively solid legal framework (in BiH, Macedonia, and Serbia), but week institutions, low disclosure, and a recent heritage of manipulative practices and investor rights abuse.

Major improvements in this area would be in:

- Strengthening institutional capacity in terms of independence, competence, and overall credibility (securities and exchange commission, Stock Exchange, Association of auditors, Association of accounting professionals, Association of brokers and dealers etc.);
- Better legal regulation of anti-manipulative practices and protection of investors' rights;
- Legal regulation and establishment of national rating agencies.

3. **Residual finance institutions for increased MSMEs access to finance** are important aspect that needs to be considered. There are no obstacles for foreign private equity funds and venture capital funds participation in these markets. Moreover, there are no legal obstacles for establishment of such institutions in the Balkans. Also, international SME development institutions have no obstacles to participate (Enterprise Expansion Fund (ENEF), Western Balkan Enterprise Development and Innovation Facility (EDIF), Enterprises Innovation Fund (ENIF).

Forming of those institutions is extremely important, especially when some of the national programs for SME support (development banks, development funds, grant funds for SMEs) have been somewhat compromised in recent years.

But, despite the failure of some public SME development credit guarantee programs in the region, they should be reassessed, and potentially again implemented in more cost effective and robust moral hazard form.

In addition, some private (mutual) credit guarantee schemes should be explored. In this area, Portuguese experience with mutual guarantee schemes is especially interesting, given it was based on the mechanism of a mutual guarantee scheme, the main characteristic of which is its private and independent status.

Most companies in the Balkans consider access to finance to be a significant constraint that they face. A lack of credible information on both collateral and credit quality of borrowers in the bank–borrower relationship creates a major difficulty in accessing loans for enterprises. SMEs are generally perceived as a highly risky group. The main obstacles for getting bank loans are the following: collateral requirements, high transaction costs, slow and immense bureaucracy, as well as high interest rates as stated by SME management and/or owners in Serbia and BiH. Access to finance for SMEs is bad (an almost unanimous opinion, as answered in our regional SMEs' survey).

Credit guarantee schemes (CGSs) can help reduce the information asymmetries between borrowers and lenders that undoubtedly exist. CGSs can also mitigate the high collateral requirements demanded by banks. On these lines EU Guarantees are operated by the European Investment Fund (EIF).[10] The EIF finances entrepreneurship and innovation across Europe. Under the EU Competitiveness and Innovation Framework Program (CIP 2007-2013),

[10] For more about the EIF see http://www.eif.org/.

the guarantees are provided by the EIF to financial intermediaries, free of charge. SMEs benefit from better access to finance, e.g., by reduced requests for collateral, or by providing loans to otherwise excluded SMEs (e.g., start-ups). Similar framework could be explored to be implemented in the Balkans.

Credit guarantee schemes (CGSs) can help reduce information asymmetries between borrowers and lenders that exist in the Balkans. They can prove to be a valuable vehicle of MSME access to finance in the Balkans, both in terms of tapping banking and non-banking financial sources.

5.1 Potential Areas of Regional Follow-Up Activities

There are a number of potential regional activities that could be conducted in the Balkans concerning development of non-bank financial institutions.

1. In the area of **non-banking credit institutions**, substantial regional developments could be made. These institutions can undoubtedly be a useful element of any financial system, especially under circumstances of limited access to finance for MSMEs. Important regional activity would be raising **regional awareness** in the Balkans concerning:
    a. The role of MCI/MFI, credit unions and Savings and Loan Associations;
    b. Adoption of a standardized structure of non-banking credit institutions in the Balkans;
    c. Establishment of similar regulatory environment in order to discourage regulatory arbitrage among non-banking credit institutions in the Balkans.

These activities could be supported by regional round tables and joint legislative cooperation.

2. In the area of Securities markets and institutions it would be useful:
    a. To initiate regional discussions and raise awareness on the problem of underdeveloped securities markets;
    b. Jointly, on a regional level, to initiate discussion on how to regulate anti-manipulative practice and increase the level of investor protection and confidence;
    c. To initiate regional discussions on disclosure requirements for listed companies, financial reporting and auditing;
    d. To discuss the potential for establishment of a common regional trading platform.
3. In the area of Residual finance institutions for increased MSMEs access to finance it would be useful to initiate discussion and promote:
    a. Activities of venture capital and private equity funds as a source of finance in the Balkans;
    b. Debate and discussion on modalities of public and private credit guarantee schemes.

5.2 Potential Areas of Bilateral Follow-Up Activities

1.	**Law on MCI/MFIs**	Full implementation: Albania, Serbia, Macedonia, Assessment and possible amendments: BiH, Kosovo
2.	**Law on Factoring**	Full implementation: Albania, BiH, Kosovo, Macedonia.
3.	**Law on credit unions and S&Ls**	Full implementation: BiH (FBiH), Serbia, Kosovo, Albania Assessment and possible amendments: BiH (RS), Macedonia
4.	**Law on sub national rating organizations or agencies**	Full implementation: BiH, Macedonia, and Serbia
5.	**New regulation (or amendments to existing regulation) on anti-manipulative practices and protection of investors rights**	Full implementation: BiH, Macedonia, and Serbia
6.	**Feasibility study on public credit guarantee schemes**	Full implementation: Albania, BiH, Macedonia, Kosovo, and Serbia
7.	**Feasibility study on private or mutual credit guarantee schemes**	Full implementation: Albania, BiH, Macedonia, Kosovo, and Serbia
8.	**Law on leasing**	Assessment, possible amendments regarding operational leasing: Serbia Assessment, possible amendments and harmonization among entities: BiH
9.	**Law on insurance**	Full implementation: Kosovo
10.	**Set of securities markets laws**	Full implementation: Albania, Kosovo

After the conducted analyses of the region, it is relatively clear that non-banking financial institutions are underdeveloped and do not participate to their full potential in financing growth. Part of that is a consequence of the fact that Balkan countries are part of a continental European financial heritage where bank dominance is a tradition. However, part of underdevelopment of non-banking financial institutions is due to lack of regulation and week institutional framework. This study has aimed to address the later, and to recommend the specific regional and bilateral activities that could be conducted in a reasonable time with the aim to support development of these institutions and increase access to finance in the Balkans, especially for SMEs and MSMEs.

In that respect, further development of more traditional non-banking financial institutions based on new and amended legal framework and creation of more effective development programs based on credit guarantee schemes, could prove to be most important for increasing access to finance and prospects of economic growth in the Balkans.

6 Country Overviews

6.1 Albania

6.1.1 Financial Sector Overview

The Albanian financial system consists of banks, non-bank financial institutions (NBFIs), savings and loan associations (SLAs), insurance companies, private supplementary pension funds and investment funds.

As of the end of 2013, the total financial sector's assets amounted to EUR 10.4 bn, which presents a 4.5% y-o-y growth rate compared with the previous year and accounted for 108.9% of GDP.

A detailed structure of financial system assets in the period 2007-2013 is given in Table 6.1.

Table 6.1 Albania: Breakdown of Financial Sector Assets

Financial Sector Assets Breakdown (% of Total Financial Sector Assets)	2007	2008	2009	2010	2011	2012	2013
Banking system assets	96.0%	96.0%	95.5%	95.0%	95.4%	94.9%	92.7%
Insurance assets	1.7%	1.8%	1.7%	1.7%	1.6%	1.5%	1.5%
Private pension fund assets	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Mutual fund assets	0.0%	0.0%	0.0%	0.0%	0.0%	1.1%	3.4%
Factoring assets	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Leasing assets	0.6%	0.5%	0.7%	0.9%	0.9%	0.8%	0.6%
SLA assets	0.8%	0.9%	0.9%	0.9%	0.8%	0.8%	0.7%
Microfinance institutions	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Institutions licensed for lending assets	0.9%	0.8%	1.0%	1.4%	1.2%	0.9%	1.0%

Financial Sector Assets Breakdown (% of GDP)	2007	2008	2009	2010	2011	2012	2013
GDP (EUR m)	7,806	8,623	8,506	8,829	9,108	9,470	9,581
Banking system assets	78.0%	78.0%	75.5%	80.7%	88.5%	100.0%	101.0%
Insurance assets	1.4%	1.5%	1.4%	1.4%	1.5%	1.5%	1.6%
Private pension fund assets	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Mutual fund assets	0.0%	0.0%	0.0%	0.0%	0.0%	1.2%	3.8%
Factoring assets	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Leasing assets	0.5%	0.4%	0.6%	0.8%	0.9%	0.8%	0.7%
SLA assets	0.6%	0.7%	0.7%	0.8%	0.8%	0.8%	0.8%
Microfinance institutions	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Institutions licensed for lending assets	0.7%	0.6%	0.8%	1.2%	1.1%	1.0%	1.0%
Financial sector assets	81.3%	81.2%	79.0%	84.9%	92.8%	105.4%	108.9%

Source: Bank of Albania data (Financial Stability Report and Supervision Annual Report), CREF research data and IMF data for GDP.

Notes: Pension funds data for 2007 and 2008 obtained from International Organization of Pension Supervisors.

The first investment fund began to operate in 2012 when the Albanian subsidiary of Raiffeisen Bank established an investment fund.

The overall financial system is unsophisticated and bank-centered. A key obstacle to further development of the financial sector is the absence of a capital market.

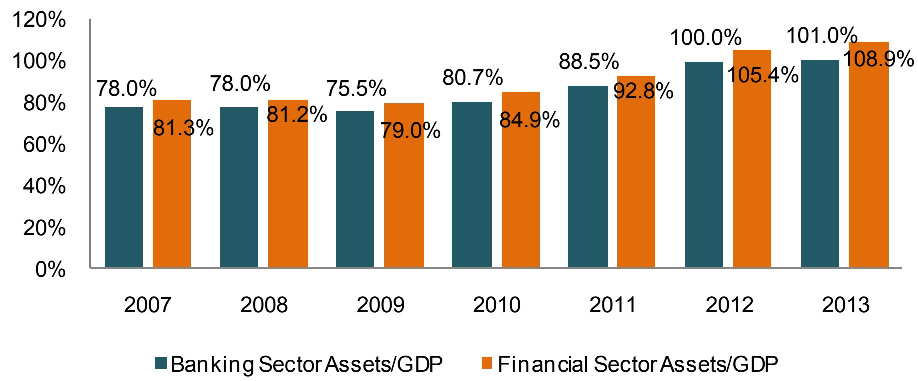
As mentioned above, the financial system is considerably bank-centered, with the banking system ranging between 76% and 101% of GDP in the observed period (2007-2013). Other financial institutions comprised a marginal share of GDP in the observed period.

6.1.1.1 Banking System Overview

The banking sector dominates the financial system of Albania, accounting for 92.7% of the total financial sector at the end of 2013. Total assets of the banking sector amounted to EUR 9.7 bn, which presents a 2.2% y-o-y growth rate compared with the previous year.

Graph 6.1 presents the banking system assets and total financial sector assets as a percentage of GDP in the period 2007-2013. The difference between total financial sector assets and banking sector assets as a percentage of GDP is only few percentage points, although the difference increased with the time period, which could be an indicator of the strengthening of non-banking financial institutions as a part of the financial sector of Albania. The biggest difference was recorded in 2013, peaking at almost 7.9 pp.

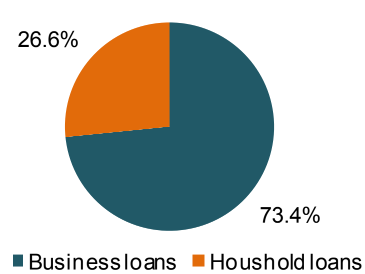
Graph 6.1 Albania: Financial System Assets and Banking System Assets as % of GDP, 2007-2013



Source: CREF research.

Over the course of 2013, monthly credit growth was volatile with the average credit growth rate amounting to 1.5%. The private sector share in total loans accounted for 69.7% and 68.9% at the end of 2012 and 2013, respectively. More than two thirds of total private loans were business loans. Graph 6.2 presents the structure of total private loans. The structure is almost unchanged in comparison with the two previous years (BoA, FSR, 2H 2013).

Graph 6.2 Albania: Lending Activity by Sector 2013



Source: Bank of Albania, Financial Stability Report, 2013.

The major part of outstanding loans was in foreign currency, accounting for 63% of outstanding loans at the end of 2013. Long-term loans had the major share in the total loan portfolio, followed by short and medium-term loans, 48.1%, 34% and 17.9%, respectively, at the end of 2013 (BoA, SAR, 2013).

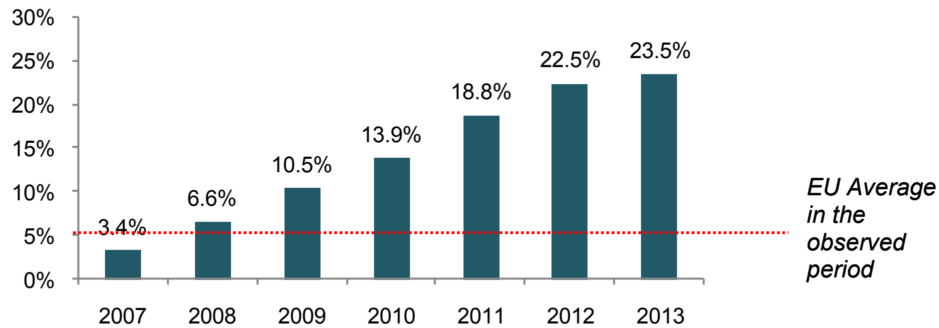
During 2013, non-performing loans (NPL) hit the lowest annual growth rate since 2008, which was mainly due to the sale of NPL portfolios and their write-off from balance sheets (BoA, FSR, 2013). The share of non-performing loans to total loans increased by 1 pp, peaking at the highest level of 23.5% at the end of 2013.

"Key drivers of the loan supply downturn:

- ✓ crisis in eurozone and neighboring countries, which is imported into Albania
- ✓ decrease of investments in economy by government
- ✓ high unemployment rate
- ✓ increase in bankruptcy rate of companies
- ✓ low purchasing power of households
- ✓ decrease in remittances"

MFI

Graph 6.3 Albania: NPL as % of Total Gross Loans, 2007-2013



Source: World Bank database.

At end of 2013, the business non-performing loan ratio was 27.7% (a y-o-y increase of 1.8 pp), while the household non-performing loan ratio was 16.7% (a y-o-y decrease of 0.5 pp) (BoA, SAR, 2013).

"The Albanian banking system has grown significantly since the onset of sweeping liberalization reforms during the early 1990s. Banking system assets now occupy roughly 90% of the GDP. The phase of major structural changes associated with rapid growth and extension of banking services throughout the country can now be considered complete. Future developments in the banking system are expected to be mainly driven by prospects of a recovery in economic growth rates, the eventual outcome of efforts to repair bank balance sheets, the risk appetite of large EU banking groups dominating the banking market in the region, and the overall regulatory reforms being undertaken in the EU (Banking Union). The combined effect of these driving forces is expected to be a cautious growth over the medium term."

BoA

6.1.1.2 Non-Bank Financial Institutions

This chapter gives a brief overview of the non-bank financial institutions operating in Albania by the end of 2013. The analysis is presented only for the institutions significant to the financial system of Albania. The section is divided into subsections: Insurance Market (6.1.1.2.1), Investment Funds (6.1.1.2.2), Stock Exchange (6.1.1.2.3), Private Voluntary Pension Market (6.1.1.2.4), Savings and Loans Associations (SLAs) and Credit Unions (6.1.1.2.5) and Other Non-Bank Financial Institutions (6.1.1.2.6).

For the purposes of this research, other non-bank financial institutions are comprised of:

1. Institutions licensed to conduct lending operations
2. Institutions licensed to conduct microcredit operations
3. Institutions licensed to conduct financial leasing
4. Institutions licensed to conduct factoring operations

The Albanian Financial Supervisory Authority (AFSA) is responsible for the regulation and supervision of the following non-banking financial system and its operators: the insurance market and its operators, the securities market and its operators, and the private supplementary pensions market and its operators.[11]

The financial markets cannot turn into serious systemic risks for the financial system as a whole. Despite their early stage of development, the financial markets supervised by the AFSA are an important segment of the Albanian financial system. The AFSA planes to effect development of the financial markets in the medium-term period 2014-2016 by expanding the range of financial products, educating, assisting financial reforms, and increasing the effectiveness of market supervision and regulation (AFSA, 2013).

The Bank of Albania is responsible for the regulation and supervision of the banking system, non-bank institutions[12] and SLAs and their credit unions.

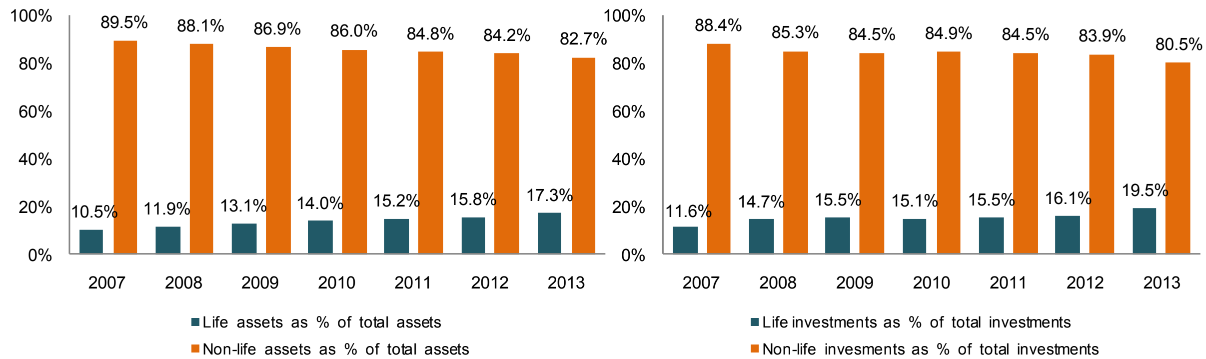
6.1.1.2.1 Insurance Market

The insurance market has experienced continuous growth since 2007, with the CAGR amounting to 5.6% in the covered period.

Non-life assets were a dominant part of both total assets and total investments, even though their percentage share of total assets and investments was decreasing, as presented within Graph 6.4.

[11] AFSA.
[12] Operating in the field of payment services and money transfer, financial leasing, lending, factoring, microcredit, foreign exchange, guarantees, commitments received and advisory, intermediation and other auxiliary services for the above-listed activities, etc.

Graph 6.4 Albania: Share of Life and Non-Life Assets as % of Total Assets (Left Graph) and Share of Life and Non-Life Investments as % of Total Investments (Right Graph), 2007-2013



Source: Albanian Financial Supervisory Authority database.

The average EU insurance penetration rate in terms of gross written premiums (GWP) as a percentage of GDP amounted to 7.6% at the end of 2012,[13] while the insurance penetration in Albania was stable in the period 2007-2013, ranging between 0.6-0.7% of GDP,[14] which implies a great potential for further development of the insurance market.

Considering GWP data in more detail, it can be observed that the growth rate of GWP was positive except in 2013, when GWP declined by 4.6%. Non-life insurance accounted for 89-93% of GWP in the period 2007-2013. The drop in GWP in 2013 was recorded due to a 6.1% decline of non-life GWP. A modest growth rate of GWP (0.2%) was seen in 2011. Life insurance GWP increased by nearly 11%; nevertheless, non-life GWP decreased by 1%, which impacted the GWP growth rate significantly, due to weights of life and non-life insurance (11% vs. 89% in 2011) (AFSA database).

Motor GWP accounted for 77% of total non-life GWP in 2007, but the share was declining, reaching 51% in 2013. Motor GWP dropped by 14% in 2013, mainly due to the shrinking of domestic MTPL products. The AFSA implemented the Project on Liberalization of Compulsory MTPL Insurance, which enabled the transition to more effective charging in the calculation of compulsory motor insurance premiums, in cooperation with the World Bank. The key objectives were to ensure risk-based pricing of compulsory MTPL and to minimize the number of uninsured persons (AFSA, 2013).

The insurance market is governed by the Law on the Activity of Insurance, Reinsurance and Intermediation in Insurance and Reinsurance. Investment policy is constrained by Article 58 and Article 95 of the Law. Furthermore, precise regulation of investment policy is determined by the AFSA Regulation “On Insurance Companies' Capital Investments Limits” (No. 4 as of February 8, 2007).

Investment portfolio of insurance companies will be presented in detail for both life (Table 6.2) and non-life (Table 6.3) insurance companies, in order to determine whether there is a significant difference between investment decisions of those two types of insurance companies.

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[13] Insurance Europe, 2014.
[14] AFSA data.

Portfolio items include government securities, bank deposits, land and buildings, investments in subordinated undertakings, other shares and participating interest, mortgage loans and others.

Table 6.2 Albania: Breakdown of Life Insurance Portfolio (2007-2013)

Investment portfolio of life insurance companies (% share of total investment value)							
Balance sheet item	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Government securities	28.1%	30.0%	15.6%	17.2%	20.7%	29.9%	29.0%
Bank deposits	65.8%	53.4%	68.7%	80.8%	76.4%	66.4%	67.5%
Land and buildings	1.5%	1.4%	1.0%	2.0%	1.8%	1.6%	1.3%
Investments in subordinated undertakings	0.0%	0.0%	0.0%	0.0%	0.0%	2.1%	2.3%
Other shares and participating interest	4.6%	15.3%	14.7%	0.0%	1.1%	0.0%	0.0%
Mortgage loans	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Others	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Albanian Financial Supervisory Authority database.

At the end of 2013, the investment portfolio of life insurance companies was dominated by bank deposits with a share of 67.5%. Together with government securities, bank deposits accounted for 96.4% of total investment value.

More conservative investment policies of life insurance companies were seen in the period after 2009. Namely, in 2010 a complete portfolio encompassed government securities, bank deposits and land and buildings. On the other hand, other shares and participating interest peaked in 2008, accounting for 15.3% of total investment value, while at the end of 2010 there were no such investments, implying a turnaround in investment policy toward the less risky assets. A low share of other shares and participating interest was recorded in 2011.

Table 6.3 Albania: Breakdown of Non-Life Insurance Portfolio (2007-2013)

Investment portfolio of non-life insurance companies (% share of total investment value)							
Balance sheet item	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Government securities	19.5%	16.3%	13.6%	13.6%	11.7%	12.3%	7.5%
Bank deposits	50.8%	45.2%	54.5%	50.5%	47.6%	47.9%	51.5%
Land and buildings	15.8%	19.8%	16.6%	18.6%	16.3%	16.9%	17.8%
Investments in subordinated undertakings	6.9%	7.4%	5.9%	5.8%	13.8%	22.9%	23.2%
Other shares and participating interest	3.7%	6.5%	5.6%	7.7%	6.9%	0.0%	0.0%
Mortgage loans	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%
Others	3.1%	4.7%	3.9%	3.8%	3.7%	0.0%	0.0%

Source: Albanian Financial Supervisory Authority database.

The investment portfolio of non-life insurance companies was dominated by bank deposits (around half of the total investment value), although their share is lower than the respective share of total investments of life insurance companies. The structure changed more during the period compared with the structure of investments of life insurance companies. Mortgage loans had the smallest share in the structure, although not present in the value structure of investments of life insurance companies. Land and buildings are much more present in the non-life insurance investment structure (the difference is more than 14 pp), compared with the life insurance investment structure. It is interesting to observe that the share of government bonds was constantly decreasing, reaching 7% in 2013, which is not the case with life insurance. The share of life insurance investments in government bonds amounted to 29% at the end of 2013. The share was lower in the period 2009-2011, but in 2012 and 2013 it returned to a pre-crisis level.

The investment portfolio of non-life insurance companies is much more diversified compared with the investment portfolio of life insurance companies. The insurance investment portfolio comprises low risk assets. Bank deposits and Albanian government T-bills have the highest share in investment structure. Hence, the insurance companies are less exposed to price volatility in the financial market than other institutions, due to their conservative structure (BoA, FSR, 2H 2013).

The insurance market's share in the financial system is rather small (less than 2% of total financial sector assets), indicating a lot of room for improvement. Although y-o-y growth rates of total assets and total investments of insurance companies even reached the double digits, the size of the insurance market relative to the financial market and GDP is virtually negligible. Insurance companies decelerated their activity due to a decrease in number of concluded contracts and GWPs (BoA, FSR, 2H 2013).

6.1.1.2.2 Investment Funds

Since 2012, there have been two investment funds in the Albanian financial markets. At the end of 2013, the net value of investment funds amounted to EUR 359 m. Investment fund assets more than doubled in 2013 in comparison with 2012, which is a significant increase.

Regarding its investment structure, it mainly comprised government bonds (84% of total assets) at the end of 2013, which is 12 pp greater than in the previous year. Treasury bills had a 9% share of total assets at the end of 2013, which is 4 pp less than a year ago.

As of the end of 2013, investment fund assets accounted for a small share of GDP (3.8%).

6.1.1.2.3 Stock Exchange

The capital market is still undeveloped. The Tirana Stock Exchange has all the structure of a joint-stock company. It has not yet started to trade in any securities and no companies are listed on it (AFSA, 2013). As of the end of 2013, there were 101 joint-stock companies registered at the Share Registration Center. Trading among the shareholders is done through the recording of change in ownership (AFSA, Annual Report 2013).

Relevant legislation regarding the capital market was upgraded in 2008 and includes:

- Law on Securities (No. 9879, as of February 21, 2008)
- Rules of the Tirana Stock Exchange

The stock market comprises a Market Officer (Level I and Level II) and Parallel Market.

As for now, in accordance with the Tirana Stock Exchange rules, the minimum value for the companies to be listed on Level I (Market Officer) is EUR 357 thousand, and EUR 179 thousand for Level II. Companies that do not meet requirements could be listed on the Parallel Market.

The development of the capital market is very important and will affect the expansion of other financial institutions.

6.1.1.2.4 Private Voluntary Pension Market

As of the end of 2013, three private pension funds were operating in Albania (Sigal, Raiffeisen and SiCRED Pensions). The total assets of private pension funds amounted to EUR 3.1 m at the end of 2013, accounting for 0.03% of GDP.

Total investments reached EUR 3 m at the end of 2013 (AFSA, 2013 database), all of which were invested in the Republic of Albania Treasury Bonds and Bills.

Legislation regarding private pension funds was introduced in 1995, enabling the establishment of these types of institutions in Albania (Law on Supplementary Pensions and Private Pension Institutions, No. 7943 as of June 1, 1995). Currently, these institutions are governed by the Law on Voluntary Pension Funds (No. 10 197 as of December 10, 2009).

Private pension funds are regulated and supervised by the Albanian Financial Supervisory Authority. Investment policy is regulated by the AFSA Regulation "On Allowed Assets, Restrictions and Maximum Limits of Pension Fund Investments" (No. 1 as of January 28, 2010).

6.1.1.2.5 Savings and Loans Associations (SLAs) and Credit Unions

Assets of the savings and loans association network (SLAs) amounted to EUR 50.4 m at the end of 2013, whereas assets of SLAs and unions amounted to EUR 73.3 m. The share of SLAs and unions in GDP and total financial sector assets was almost 0.8% at the end of 2013, which is a rather small share (BoA, SAR, 2013). The total loans portfolio of both SLAs and unions amounted to EUR 46 m, which is 32% of NBFIs' total loans portfolio. The NPL share in total gross loans is higher for SLAs than for unions, 13.05% versus 9.8%, respectively. Despite the increase in non-performing loans, the loan quality ratio worsened due to reduced union lending to member SLAs. Nevertheless, the loan portfolio quality of the union and SLA network remained better than the credit quality of the banking system and NBFIs (BoA, SAR, 2013).

SLAs are a significant determinant in developing rural areas in Albania. Poverty is highest in rural areas, where 57%[15] of Albania's people live, most of them dependent on agriculture for their livelihood. Poverty is 66% higher in rural areas than in Tirana, the capital, and it is 50% higher in rural areas than in other urban centers.[16] These categories of people do not have the opportunity to get financial support from commercial banks, since such clients belong to the extreme risk category. The agriculture industry has growth prospective, but farmers are unable to make high-level investments because of a lack of crediting and no interest from investors (Cibuku, 2012).

The Albanian Savings and Credit Union (ASC Union)[17] is a voluntary union of individual savings and credit associations, created on January 25, 2002 on the basis of the Law on Savings and Credit Associations and licensed by the Bank of Albania. The ASC Union is a product of the first microfinance program in Albania. Members of savings and credit associations are individuals and legal entities who wish to deposit their savings and borrow among themselves within savings and credit companies, and who accept the bylaws approved by savings and credit companies. The mission of the Albanian Savings and Credit Union is to support, both financially

[15] Estimate.
[16] International Fund for Agricultural Development (IFAD).
[17] Albanian Savings and Credit Union webpage.

and technically, the savings and credit associations. These are village financial institutions, created and managed by the members with the aim of promoting productive activities in rural areas.

The services offered by the ASC Union are the following: microcredit, MSE small loans and savings deposits.

Microcredit is the core financial product for the activity of both the ASC Union and the SLA network. The conditions are the following:[18]

1. Microcredit in ALL, with an annual interest rate of 16%, ALL 1,000,000 is the maximum loan amount up to five years, which is approximately EUR 7,133 (exchange rate 1 EUR=140.2 ALL);
2. Microcredit in EUR, with an annual interest rate 9% + Euribor, equivalent in EUR of ALL 1,000,000 (exchange rate 1 EUR=140.2 ALL), up to three years.

An MSE small loan is a relatively new product offered by the ASC Union for the promotion and development of small to medium-size businesses. This product is offered directly from the Union to SLA members. An MSE small loan is provided in ALL under the following conditions:[19]

3. MSE loan in ALL, with an annual interest rate of 16%, maximum amount ALL 3,000,000, up to seven years;
4. MSE loan in EUR, with an annual interest rate of 9% + Euribor, up to EUR 15,000, up to three years (exchange rate 1 EUR=140.2 ALL);
5. MSE loan in EUR, with an annual interest rate of 8% + Euribor for amounts over EUR 15,000, up to three years (exchange rate 1 EUR=140.2 ALL).

The savings deposit is a service offered by a savings and credit association to its members. This product is offered with different maturity times and with terms described in Table 6.4.[20]

Table 6.4 Albania: Savings Deposit Conditions

Months	1	3	6	9	12	18	24	36
Time Deposit	3%	4%	4.8%	5.2%	5.5%	5.6%	5.7%	5.7%
Guarantee	7.5%							
Conditional	Depending on the maturity of the loan							
Child Deposit	7.5%							
Flexible	3.5%							

Source: Albanian Savings and Credit Union data.

The savings and credit association network injected over EUR 12 m in new loans for Albanian agriculture and rural businesses (ASC Union, Annual Report, 2013). Social welfare improvement is the main goal of establishing and developing the ASC Union. Table 6.5 presents assets and the NPL share of SLAs and their unions.

[18] Data as of the date of this report.
[19] Data as of the date of this report.
[20] Data as of the date of this report.

Table 6.5 Albania: Selected indicators of SLAs and their unions, 2007 - 3Q 2013

	2007	2008	2009	2010	2011	2012	3Q 2013
Assets (EUR m)	50.4	62.3	71.9	79.6	80.4	86.9	84.1
NPL/outstanding loans (in %)	0.6%	1.3%	2.0%	5.1%	4.4%	6.4%	13.3%

Source: Central Bank of Albania, Financial Stability Report.

Non-performing loans as a percentage of total loans outstanding increased in the last periods, reaching 13.3% at the end of Q3 2013.

6.1.1.2.6 Other Non-Bank Financial Institutions

These institutions are non-deposit taking institutions and are governed by the regulation of the Bank of Albania's "On Risk Management in the Activity of Non-Bank Financial Institutions" (No. 02 as of January 17, 2013). They are mainly financed through borrowings (57.5%, out of which domestic banks account for 43.8% and non-resident financial institutions account for 32.1%) and own capital (36.9%).[21]

These institutions are a significant source of financing for MSMEs. Despite their non-deposit-taking character, in line with the regulations,[22] these institutions are obliged to classify their assets, set aside loan loss reserves, etc. (institutions licensed to conduct lending activities, financial leasing companies, microcredit institutions and factoring companies).

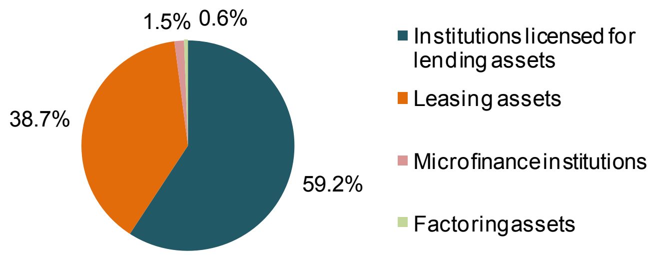
As of the end of 2013, these institutions comprise:

- **Non-banking financial institutions licensed to conduct lending activities**: Besa Fund Sh.a., NOA Sh.a., First Albanian Financial Development Company – FAF Sh.a., and Tranzit Sh.p.k.
- **Financial leasing companies:** Raiffeisen Leasing Sh.a., Tirana Leasing Sh.a. (100% owned by Piraeus Bank S.A. Greece), Credins Leasing Sh.a., Landeslease Sh.a., Fin-al Sh.p.k., and Porsche Leasing Sh.a.
- **Microcredit institutions:** Vision Fund Albania Sh.p.k., and Capital Invest Sh.a.
- **Factoring companies:** Albanian Factoring Services (AFS) Sh.a., Omnifactor Sh.p.k., and Profactoring Albania Sh.p.k.

Total assets of other NBFIs amounted to EUR 170 m at the end of 2013. The highest share among other NBFI assets corresponded to NBFI conducting lending activities (non-deposit-taking lending institutions) with total assets amounting to around EUR 100 m and accounting for more than half of total NBFI assets. Leasing assets amounted to approximately EUR 66 m, assets of microcredit activities only EUR 1 m, while the assets of NBFIs conducting factoring activities amounts to just EUR 2.5 m. The structure of NBFIs is presented in Graph 6.5.

[21] Bank of Albania, Supervision Annual Report 2013.
[22] In accordance with the Regulation "On Risk Management in the Activity of Non-Bank Financial Institutions" (No. 02 as of January 17, 2013).

Graph 6.5 Albania: Structure of NBFI Assets, 2013



Source: Bank of Albania, Supervision Annual Report, 2013.

The main risk to non-bank financial institutions is credit risk. NPLs' ratio reached 13.2% at the end of 2013, which is a y-o-y increase of 4.8 pp. Although a profit and an upward capitalization level were registered, these institutions' asset quality was falling (Bank of Albania, 2H 2013).

6.1.2 Concluding Remarks

The banking system of Albania represents the main share of the financial system (around 90% of total financial sector assets). Non-bank financial institutions are mostly underdeveloped. The share of newly established institutions such as leasing companies is less than 1% of total financial sector assets. Factoring assets as a percentage of GDP are 0.01%. The insurance sector has an asset share of only 1.6% of GDP, and it is one of the most developed non-bank financial institutions. The development of the insurance market is mainly owing to compulsory motor insurance. The stock exchange does not function; only government securities are traded. The private voluntary pension market is relatively new and undeveloped. The investment fund industry has potential to grow, since it experienced significant growth in the first two years of existence. The first fund started operating in 2012. The share of total non-bank financial institution assets in total assets of the financial sector was less than 2% in 2013, indicating a lot of room for further development.

The investment fund industry experienced impressive growth immediately after the foundation of the first operator. The anticipated pension reform and investment fund industry will influence further development of the securities market, which is practically nonexistent.

Investments of pension funds, investment funds and insurance companies comprise mainly government bonds, T-bills and bank deposits. Such investment policy is owing to governing laws on the one hand, and lack of credible investment (such as publicly listed companies) on the other hand.

As with the other Balkan countries, Albania doesn't have credit rating agencies, the establishment of which is of great importance for the development of the financial sector.

Although decreasing due to crisis, remittances[23] as a percentage of GDP amounted to 6.2%, significantly more than the share of all the NBFI institutions in GDP.

[23] World Bank data.

Table 6.6 Albania: Summary of Financial Institutions and Their Legal Framework[24]

Institution	Supervisory Authority	Legislation	Ability to take deposits
Banks	BoA	Law No. 9662, dated 12.18.2006, amended by Law No. 10481, dated November 17, 2011, On Banks in the Republic of Albania	**Yes**
Insurance	AFSA	Law on Activity of Insurance, Reinsurance and Intermediary in Insurance and Reinsurance, Official Gazette of the Republic of Albania, No. 9267	
Stock exchange	AFSA	Law on Securities, Official Gazette of the Republic of Albania, No. 9879	
Private pension fund	AFSA	Law on Supplementary Pensions and Private Pension Institutions, Official Gazette of the Republic of Albania, No. 7943 Law on Voluntary Pension Funds, Official Gazette of the Republic of Albania, No. 10 197	
Investment funds	AFSA	Law No. 10198 of December 10, 2009, On Collective Investment Undertakings	
Factoring	BoA	Decision on the approval of regulation: “On Licensing and Activity of Non-Bank Financial Institutions,” No. 01, dated January 17, 2013, Bank of Albania	

[24] Note: Factoring, SLAs, MFIs and Institutions licensed for lending are not regulated by specific laws, but there are regulations and decisions regulating their operations.

Institution	Supervisory Authority	Legislation	Ability to take deposits
Leasing	BoA	Law No. 9396, dated May 12, 2005, On Finance Leasing	
SLAs	BoA	Regulation on “Licensing of Saving & Loan Associations and Their Unions,” No. 11, dated 02.27.2002, Bank of Albania	**Yes**
Microfinance institution	BoA	Decision on the approval of regulation “On Licensing and Activity of Non-Bank Financial Institutions,” No. 01, dated 01.17.2013, Bank of Albania	**No**
Institutions licensed for lending	BoA	Decision on the approval of regulation “On Licensing and Activity of Non-Bank Financial Institutions,” No. 01, dated 01.17.2013, Bank of Albania	**No**

6.2 Bosnia and Herzegovina

6.2.1 Financial Sector Overview

The financial system consists of banks and non-bank financial institutions (NBFIs). NBFIs comprise: insurance companies, investment funds, leasing companies, microcredit organizations, brokerage houses and stock exchanges (CBBH). Factoring companies are included in the financial system in our analysis,[25] whereas brokerage houses are excluded per se.[26] The following table presents financial system assets by segment, expressed as a percentage of total financial sector assets and GDP.

[25] CBBH.
[26] Brokerage houses are excluded from the analysis due to their nature in generating growth.

Table 6.7 BiH: Breakdown of Financial Sector Assets

Financial Sector Assets Breakdown (% of Total Financial Sector Assets)	2007	2008	2009	2010	2011	2012	2013
Banking system assets	79.6%	80.6%	82.4%	85.3%	85.8%	86.0%	87.4%
Insurance assets	3.5%	3.4%	3.8%	3.9%	4.4%	4.8%	4.5%
Private pension fund assets	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Mutual fund assets	7.2%	4.7%	3.5%	3.7%	3.3%	3.2%	3.0%
Factoring assets	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	n/a
Leasing assets	5.6%	6.2%	5.7%	3.1%	3.1%	2.9%	2.4%
Microcredit institutions assets	3.8%	4.7%	4.3%	3.6%	3.0%	2.7%	2.6%

Financial Sector Assets Breakdown (% of GDP)	2007	2008	2009	2010	2011	2012	2013
GDP (EUR m)	11,181	12,722	12,378	12,708	13,159	13,158	13,488
Banking system assets	89.5%	83.7%	85.1%	82.1%	81.6%	82.3%	83.5%
Insurance assets	3.9%	3.6%	3.9%	3.8%	4.2%	4.6%	4.3%
Private pension fund assets	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Mutual fund assets	8.1%	4.9%	3.6%	3.6%	3.1%	3.1%	2.9%
Factoring assets	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	n/a
Leasing assets	6.3%	6.5%	5.8%	3.0%	3.0%	2.8%	2.3%
Microcredit institutions assets	4.3%	4.9%	4.5%	3.4%	2.9%	2.6%	2.5%
Total financial sector assets	112.4%	103.8%	103.3%	96.2%	95.1%	95.7%	95.5%

Source: Central Bank of Bosnia and Herzegovina, Financial Stability Reports, CREF research data and IMF data for GDP.

Notes: No data for factoring assets in 2013; factoring companies' assets are estimated in the period 2007-2012.

As of the end of 2013, the total financial sector's assets amounted to EUR 12.9 bn, which presents a 2.3% y-o-y growth rate compared with the previous year, and accounted for 96% of GDP.

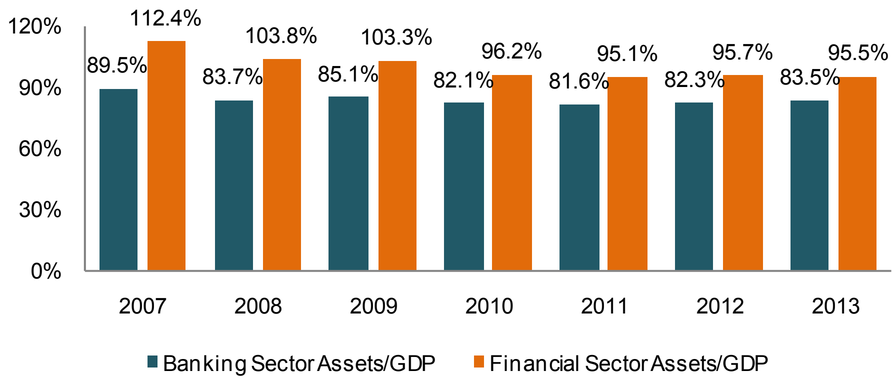
The financial system of Bosnia and Herzegovina is bank-centered with a share of banking system assets in total financial sector assets of 87%. Other non-bank financial institutions had a much smaller share. The insurance sector had the second-highest share at 4.5% of total financial sector assets. Factoring had a negligible share.

This chapter is divided into two main subparts: banking system overview (6.2.1.1) and other financial institutions (6.2.1.2).

6.2.1.1 Banking System Overview

The banking system has a dominant role in the performance of both the financial sector and real economy. The assets of the banking sector reached almost 84% of GDP and 87% of total financial sector assets. Graph 6.6 presents the share of financial sector assets and banking system assets as a percentage of GDP. Financial sector assets accounted for more than 100% of total GDP in the period 2007-2009. The difference between financial sector assets and banking sector assets as a percentage of GDP was as much as 23 pp in 2007. The difference reduced with time and amounted to 12 pp at end of 2013, implying a reduction of the banking sector's significance in the total financial sector.

Graph 6.6 BiH: Financial Sector Assets and Banking Sector Assets as % of GDP, 2007-2013



Source: Central Bank of Bosnia and Herzegovina, Financial Stability Reports.

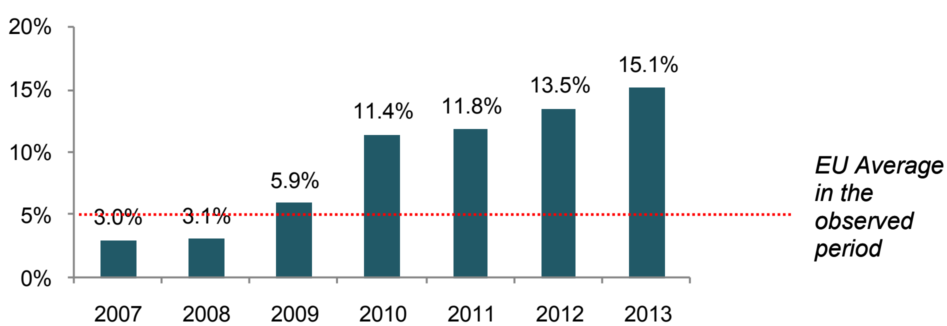
The banking sector in Bosnia and Herzegovina retained its stability in 2013, with the exception of a few banks that displayed significant weaknesses in their business operations. The main risk for the banking sector in 2013 was in continued growth of non-performing loans. The ratio of NPLs to total loans was constantly increasing, from a level of 3% in 2007, to its peak of 15% in 2013, as presented in Graph 6.7.

"Key drivers of NPLs:

- ✓ Underestimation of risks by bankers
- ✓ Lack of risk management competencies
- ✓ Deterioration of condition of existing clients"

CBBH

Graph 6.7 BiH: NPL as % of Total Loans, 2007-2013



Source: Central Bank of Bosnia and Herzegovina, Financial Stability Reports.

The total NPL share was higher for the RS entity than for the FBiH, but also the NPL share that corresponded to the sector of natural persons. The NPL share total, of natural persons, and of legal entities amounted to 14.6%, 10% and 18.8%, respectively, in 2013 in the FBiH (Banking Agency FBiH, Banking Sector in the Federation of Bosnia and Herzegovina, 2013). The NPL share total, of natural persons, and of legal entities amounted 16.2%, 12.3% and 18.2%, respectively, in 2013 in the RS (Banking Agency RS, Report on the Banking System in RS, 2013).

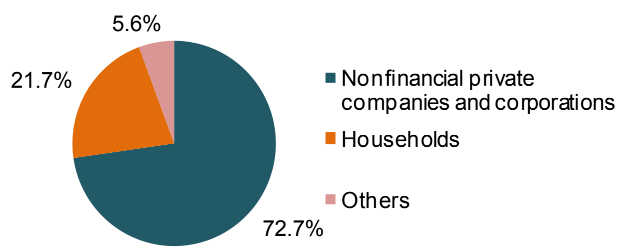
Credit growth (3.4% y-o-y growth rate at the end of 2013 compared with 2012) was largely caused by refinancing, which involved extension of clients' repayment periods by banks and the provision of additional loans for the continuation of clients' business operations (CBBH, FSR, 2013). The highest y-o-y loan growth rate was recorded in 2008 with an increase of 21%, followed by a decrease of 4% in the next year, whereas the CAGR amounted to 5.2% for the period 2007-2013 (CBBH database).

Around 60% of new loans approved to enterprises in 2013 were short-term maturity. This could be interpreted as short-term liquidity problems of enterprises, as evidenced by the increase in the number of blocked[27] accounts in BiH reported regularly by the CBBH. An increasing amount of outstanding claims between enterprises is overcome by these borrowings (CBBH, AR, 2013).

The short-term loans share in total loans was 26%, whereas the long-term loans share accounted for the remaining 74%. The structure has changed slightly since in 2007, when the share of short-term loans was 22%[28] (CBBH, AR, 2013).

Loans to enterprises continue to dominate the loan structure (73% in 2013). The structure does not vary significantly in the covered period (a few percentage points). The loan structure in 2013 is presented in Graph 6.8.

Graph 6.8 BiH: Lending Activity by Sector 2013.



Source: Central Bank of Bosnia and Herzegovina, Annual Report, 2013.

Note: Other loans comprise the following categories: loans to Bosnia and Herzegovina's institutions; loans to entity governments; loans to cantonal governments; loans to social security funds; loans to non-bank financial institutions; loans to non-financial public companies; loans to nonprofit organizations; and other loans.

6.2.1.2 Non-Bank Financial Institutions

This section provides an overview of NBFIs operating in Bosnia and Herzegovina, as well as some comments about factoring, which could influence and improve the performance of the financial sector and is still undeveloped in Bosnia and Herzegovina's financial sector. The section is divided into the following subparts: insurance companies (6.2.1.2.1), investment funds (6.2.1.2.2), stock exchanges (6.2.1.2.3), leasing companies (6.2.1.2.4), microcredit organizations (6.2.1.2.5), factoring (6.2.1.2.6) and savings-credit organizations (6.2.1.2.7).

6.2.1.2.1 Insurance Sector

Insurance assets were growing in the period 2007-2012, reaching a y-o-y growth rate of 14.5% in 2011, whereas there was a shrink in assets in 2013 of 2.4%. The CAGR was 5% in the covered period. The share of insurance assets as a percentage of GDP was stable, around 4% in the period 2007-2013. Non-life insurance had a share of 81% in total GWP in 2013, whereas

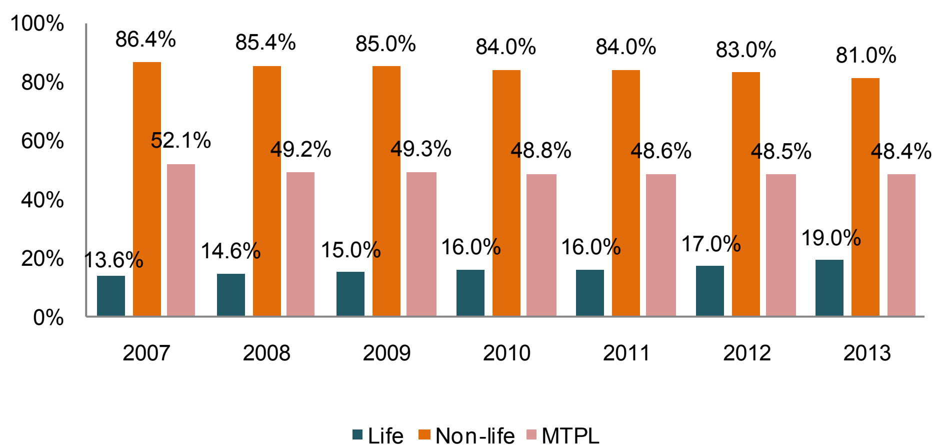
[27] Form of enforced collection by debiting accounts, without the holder's prior consent.

[28] The maturity is divided into short-term and long-term; there is no medium-term maturity.

life insurance had a share of 19%. GWP as a percentage of GDP was 2% in 2013, and the share of GWP as a percentage of GDP was almost unchanged.

The structure of GWP by life and non-life insurance changed slightly during the period, since there was a constant increase in the life share of GWP. Although constantly increasing its share, life insurance is still far below the non-life share in GWP. Graph 6.9 presents life and non-life share of GWP, as well as the MTPL share, which was a significant share of both non-life and total GWP.

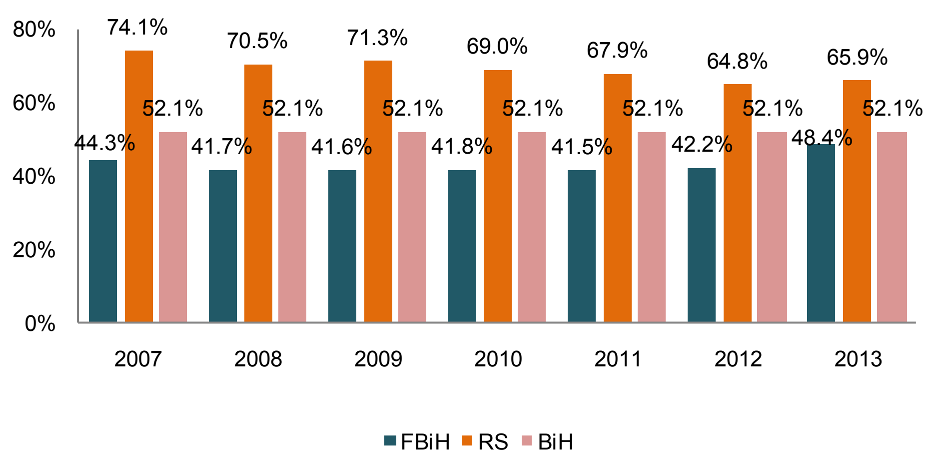
Graph 6.9 BiH: Share of MTPL, Life and Non-life GWP as % of total GWP, 2007-2013



Source: Insurance Agency of BiH, database.

It is interesting to note that the MTPL share in total GWP differs significantly in the Republic of Srpska (RS) and the Federation of Bosnia and Herzegovina (FBiH). Graph 6.10 represents disaggregated data for the RS and FBiH in the covered period.

Graph 6.10 BiH: Breakdown of MTPL Share in GWP by Entity



Source: Insurance Agency of BiH, database.

The difference in share of MTPL in total GWP between the RS and FBiH was nearly 30 pp in the first few years (2007-2009), and has been decreasing since 2010. The difference amounts 18 pp in 2013. MTPL has a higher share in total GWP in the RS than in the FBiH.

There is also an immense difference in GWP structure (life and non-life) between the RS and FBiH. Life insurance had a much higher share as a percentage of total GWP in the FBiH than in the RS. In the FBiH, the non-life GWP share in total GWP amounted to 78%, whereas the life share in total GWP amounted to 22% in 2013. On the other hand, the life share in total GWP amounted to only 9%, whereas the non-life share was 91% in the RS in 2013. Life insurance increased its share in total GWP in the RS during the covered period, since it amounted to only 5% in 2007. Other categories with a share worth mentioning are the following: accident, all-risk (motor CASCO), fire and other natural perils, and other damage to property (for both the RS and FBiH).

> "Non-life insurance sector development is certainly limited by general economic conditions. This sector has reached its limits of extensive growth. Intensive growth demands changes in the premium structure, tax incentives, subsidies for agricultural insurance and small business, increasing the number of compulsory insurance and enhancement of the population's financial literacy. Further development depends not only on the general economic situation (employment, GDP growth, household debt and the economy), but also on the introduction of new products by insurance companies. Life insurance can expect further growth in the upcoming period, but certain incentives (tax, education, etc.) are needed. Health insurance is also expected to start developing in the future period."
>
> Insurance Agency of the Republic of Srpska

Investments of insurance companies amounted to EUR 110 m in the RS at the end of 2013 (67% of total assets). Long-term financial placements amounted to 35%, whereas short-term financial placements amounted to 17% of total assets. Real estate for investment purposes accounted for 14% of total assets.

Investments of insurance companies amounted to EUR 281 m in the FBiH. Investments accounted for 60% of total assets in 2013.

6.2.1.2.2 Investment Funds

Investment fund assets were constantly decreasing except in 2010, when the y-o-y growth rate increased by 2%. The cumulative decrease of mutual fund assets was 43%. Consequently, mutual fund assets as a percentage of total financial sector assets and GDP were decreasing, dropping to 3% of total financial sector assets at the end of 2013. The vast majority of their assets included shares obtained in the process of privatization of state-owned companies that took place in the late 1990s. Since their establishment, they have supplied almost no new capital to the financial sector (FIRMA, 2014).

Under the FBiH and RS Acts on Funds,[29] investment funds also include "any legal entity, company, or several property where, regardless of the legal form, participation is offered on the basis of shares or similar security with the aim of collecting deposits in cash and the express purpose of investing over 60% of these investments in a securities portfolio, money deposits, or other assets, so that investors do not supervise decisions on investment on a day to day basis

[29] Law on Investment Funds ("Official Gazette of the RS," No. 46/2006, 51/2009 and 31/2011), and Law on Investment Funds ("Official Gazette of the FBiH", No. 85/08).

and the basic aim is to secure a return on investment for investors, whether in profit or other form of benefit" (CBBH).

6.2.1.2.3 Stock Exchanges

The capital market is organized and regulated in two capital markets, one in the Federation of Bosnia and Herzegovina, the other one in the Republic of Srpska. Consequently, this section is divided into two subparts: the Sarajevo Stock Exchange (SASE) and Banja Luka Stock Exchange (BLSE). The main participants in the Bosnia and Herzegovina capital markets are: the Securities Commission, Securities Register, investment funds (IFs), fund management companies (DUFs), brokerage houses, depository banks, custodian banks, brokers and investment advisors (CBBH).

- *Sarajevo Stock Exchange (SASE)*

The total market capitalization of the SASE was EUR 2.420 m, whereas the turnover amounted to EUR 125 m at the end of 2013. The ratio of turnover to market capitalization ranges between 0.02 and 0.08, with a peak of 0.08 in two years, 2007 and 2012. The y-o-y growth rate was very volatile for both indicators, market capitalization and turnover. The biggest increase in turnover was in 2011, reaching an impressive 125%, whereas the sharpest decline was in 2008, when turnover declined by 63%. Market capitalization reached a peak growth of 5% in 2013, whereas it experienced a steep decline of almost 50% in 2008. The consequence of this volatility in growth is that the CAGR was negative, amounting to 24% for turnover and 18% for market capitalization.

Stock market capitalization was constantly decreasing in the covered period, with a cumulative decrease of 70%. The share of stock market capitalization in GDP decreased from 65% in 2007 to 16% in 2013. There are no corporate bonds traded at the SASE. It is interesting to observe that the share of total turnover of the SASE in total BiH turnover was changing significantly during the covered period. It was 63% in 2007, then constantly declined, reaching 37% in 2011, only to increase in 2012 to 60%. The share of SASE turnover in total turnover was 41% in 2013. The trend is similar when looking at market capitalization. The share of SASE market capitalization to total market capitalization was 67% in 2007, but it decreased to 53% in 2013.

- *Banja Luka Stock Exchange (BLSE)*

The total market capitalization of the BLSE was EUR 2.113 m, whereas the turnover amounted to EUR 192 m at the end of 2013. The ratio of turnover to market capitalization ranges between 0.01 and 0.11, with the peak of 0.11 in 2011. The y-o-y growth rate was very volatile for both indicators, market capitalization and turnover. The biggest increase in turnover was scored in 2011, reaching an impressive 141%, whereas the sharpest decline was seen in 2008, when turnover declined by 82%. Market capitalization reached a peak growth of 10% in 2010, whereas it experienced a steep decline of 52% in 2008. This volatility in growth rate led to a negative CAGR for both turnover (7%) and market capitalization (10%).

Stock market capitalization was mostly decreasing in the covered period, with a cumulative decrease of 57%. The share of stock market capitalization in GDP decreased from 38% in 2007 to 14% in 2013. It is interesting to note that the share of total turnover of the BLSE in total BiH turnover was changing significantly during the covered period. It was 31% in 2007. After reaching a low of 12% in 2009 its share continuously increased, reaching 71% in 2012, but then decreased in 2013 to 61%. A similar trend was seen with market capitalization. The share of

BLSA market capitalization in total BiH market capitalization was increasing in the covered period, from 33% in 2007 to 47% in 2013. The market capitalization of corporate bonds amounted to just EUR 3 m at the end of 2013. The only corporate bonds traded in 2012 and 2013 were issued by Kaldera Company d.o.o. Laktaši. Other corporate bonds traded in the period 2008-2010 were issued by the following companies: MKD Sinergija plus d.o.o Banja Luka (in bankruptcy), Cer a.d. Prnjavor, and the Balkan Investment Bank a.d. Banja Luka. In the last ten years, market development has been primarily based on the concept of mass voucher privatization of state-owned capital (BLSE).

Bonds were issued on the capital market in Bosnia and Herzegovina in 2009, as a consequence of the government's obligation to return old foreign exchange savings and to pay ware indemnity. The capital market was in a downside phase, when bonds were presented for the first time, so this new instrument slightly mitigated the negative trend. Bonds were issued on both stock markets. Treasury bills were presented in 2011, issued by the entity government. These short–term instruments represent the beginning of a money market (Kumalić, 2013). Turnover as a percentage of GDP is no more than 3% in the period 2008-2013, which is an indicator of an undeveloped market (less than 5% is a benchmark).

Strategic goals for the development of the Banja Luka Stock Exchange in the period 2009-2014 are the following:[30]

- ✓ Increase the market liquidity
- ✓ Increase the quality and quantity of securities offered to investors
- ✓ Increase efficiency of the stock exchange trading system
- ✓ Support primary market development
- ✓ International promotion of domestic capital market to foreign investors
- ✓ Implement a systemic approach to education
- ✓ Maintain partnership with capital market institutions and listed companies.

On October 19, 2012 in Sarajevo, the Sarajevo, Banja Luka and Montenegro stock exchanges signed an agreement on developing a single common trading platform. The main purpose is to improve liquidity and to attract foreign investors to invest in capital markets in Bosnia and Herzegovina and Montenegro. Two years later, the project has not still been implemented, and there are significant delays. In contacting the SASE, we could not obtain any further information about the reasons for stagnation of the whole process.

> “The structure of the financial system of the Republic of Srpska remains extremely bank-oriented and an inadequate attitude towards saving and investments has a significant impact on companies that, although they have a need for the new capital, still make insufficient use of the capital market as a primary source of financing their own development. Since the development of financial markets depends on the commitment to a balanced development of the banking sector and financial markets, the key driver of the discrepancy between turnover and market capitalization is a bank-oriented financial system.”
>
> Republic of Srpska Securities Commission

[30] Banja Luka Stock Exchange http://www.blberza.com/Pages/docview.aspx?page=SP3.

6.2.1.2.4 Leasing Companies

The negative trend in the economy has influenced the leasing business,[31] as well. The encouraging fact was the growth of industry production presented in 2013, which could positively influence the demand for leasing products. The share of leasing assets in total financial system assets amounted to 2.4% at the end of 2013. Leasing assets amounted to EUR 305 m at the end of 2013. The y-o-y growth rate was mostly negative in the covered period (except in 2008 when the assets increased by 17%), leading to a diminished share of leasing assets in total financial sector assets (it was 5.6% in 2007).

There are two leasing companies established in the RS and six leasing companies established in the FBiH in 2013. The assets of leasing companies in the FBiH had a 97% share in total leasing companies' assets (BiH) in 2013.

Looking closely at the disaggregated data, we can discern reasons for a decrease in the balance sheet assets in 2013.

Assets of leasing companies in the FBiH amounted to EUR 296 m at the end of 2013, which is a 16.74% y-o-y decrease compared with the previous year. The reasons for the decline are the following (Banking Agency FBiH, Leasing Sector in the Federation of Bosnia and Herzegovina, 2013):

- ✓ Revocation of the license of one leasing company whose assets amounted to EUR 13 m, at the end 2012
- ✓ Takeover of receivables under the loan agreement used for financing construction of business premises by a non-resident commercial bank
- ✓ Following the owner's decision, one leasing company cancelled new financings to stabilize its business and recover the existing non-performing placements
- ✓ Two leasing companies declared significant amounts of new value adjustments and values of receivables under financial leasing arrangements and loans, write-offs of receivables, and a decrease in the value of inventories of repossessed leasing objects
- ✓ Volume of new financings shrank

Assets of leasing companies in the RS[32] amounted to EUR 10 m at the end of 2013, which represents a 11.5% y-o-y decrease compared with the previous year. The crisis in the real sector influenced the financial sector as well, and consequently leasing sector development.

The structure of financial leasing receivables by leasing objects in the FBiH at the end of 2013 was as follows: passenger vehicles 29%, company vehicles 27%, machinery and equipment 28%, real estate 15%, and other 1% (Banking Agency FBiH, Leasing Sector in the Federation of Bosnia and Herzegovina, 2013).

The structure of financial leasing receivables by leasing objects was as following in the RS in 2013: passenger vehicles 33%, company vehicles 39%, machinery and equipment 27%, and real estate 1% (Banking Agency RS, Report on the Banking System in RS, 2013).

[31] The Banking Agency of the Republic of Srpska has been the authority for leasing since November 7, 2007, whereas the Banking Agency of the Federation of Bosnia and Herzegovina as been the authority since December 26, 2008.

[32] The first leasing company in the RS was founded in 2008: Nova Leasing, a.d., Banja Luka.

The share of receivables by leasing objects differs in the RS and FBiH. The main difference is in the real estate category, which had a negligible share in the RS, while the share in the FBiH was significant (15%).

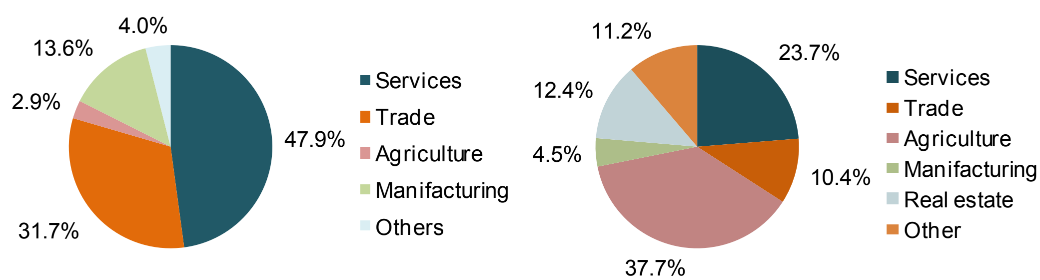
The distribution between financial and operational leasing was almost the same in the RS (95% and 5%, respectively) and the FBiH (94% and 6%, respectively) in 2013.

There are several problems related to the leasing business worth mentioning. The most important one is the legislative. The two entity's laws[33] regulating the leasing sector have not been completely harmonized. The Law on Direct Taxes significantly limits the whole administrative procedure, thereby making it more costly. Lengthy court procedures in order to return the ownership of leasing objects impede development of the leasing sector (Association of Leasing Companies in Bosnia and Herzegovina, 2012).

6.2.1.2.5 Microfinance Institutions

The total assets of microcredit institutions[34] amounted to EUR 341 m at the end of 2013. Assets were decreasing at a CAGR of 6% in the observed period (2007-2013), having a share in total financial sector assets and GDP around 2.6%. Observed by entity, 71% of total assets of microcredit institutions refer to the FBiH entity. The share varies between 68% and 74% in the covered period, but significantly more than the share of the RS entity. The share of credits in total assets was dominant, 82% in the FBiH and 79% in the RS in 2013, which is similar. In 2008, the share was even higher, amounting to 92% for both entities. In both the RS and the FBiH, 98% of total microcredits correspond to individuals, and only 2% to the corporate sector. Among individuals, the sectors of services and agriculture were the two most dominant, 23% and 37% in the FBiH, respectively, and 26% and 41% in the RS, respectively, in 2013. The structure is presented for BiH in Graph 6.11.

Graph 6.11 BiH: Breakdown of Micro-Loans to Enterprises (Left Chart) and Households (Right Chart)



Source: Banking Agency of FBiH and RS, 2013.

It is interesting to note how the structure differs significantly whether individuals (natural persons) or enterprises (the corporate sector) are debtors. Agriculture has the dominant share for individuals, 38%, whereas only 3% for enterprises. Services have the dominant share in microcredits to enterprises 48%.

[33] Law on Leasing ("Official Gazette of the Federation of Bosnia and Herzegovina," No. 85/08, 39/09 and 65/13), and Law on Leasing ("Official Gazette of the Republic of Srpska," No. 01-1708/11)

[34] Supervised by entity agencies, according to the Law on Microcredit Organizations FBiH (June 27, 2006) and Law on Microcredit Organizations RS (June 14, 2006).

To finance their credit portfolio, microcredit organizations primarily use international commercial sources and domestic sources, as well as their own funds accumulated through income surplus or profit from crediting operations.

The ten most important creditors of MFIs in the FBiH (66% of total credit obligations) are: the Spanish Agency for International Development Cooperation (AECID), the European Bank for Reconstruction and Development (EBRD) United Kingdom, the Oikokredit Netherlands, the Instituto de Credito Oficial (ICO) Spain, the European Fund for Southeast Europe (EFSE) Luxembourg, World Vision International USA, the Development Bank of FBiH, Responsibility SICAV Switzerland, the Ministry of Finance FBiH, and Triodos–Doen Netherlands (Banking Agency of FBiH, 2013).

The creditors of MFIs in the RS (93% of total credit obligations) are: the Spanish Agency for International Development Cooperation (AECID), The Republic of Srpska Investment-Development Bank (IRBRS), the European Fund for Southeast Europe (EFSE) Luxembourg, ResponsAbility Luxemburg, Symbiotics Luxemburg, the Microfinance Enhancement Facility Luxemburg, KFW Germany, Triple Jump Netherlands, and the IOOC Fund USA (Banking Agency of RS, 2013).

6.2.1.2.6 Factoring

There are two non-bank financial companies which are registered as factoring companies: Prvi Faktor and the IGA – Export-Credit Agency of Bosnia and Herzegovina.

Prvi Faktor targets corporate clients, and purchases receivables only on condition of recourse. It only operates with a limited list of companies whose receivables it will take, mostly distributors of retailers. Nova Banka is a bank in the RS offering relatively low discounts for buying receivables, and does so on a non-recourse basis (FIRMA, 2014).

The IGA was established by the Ministry of Justice and is registered as a non-profit and tax-exempt organization. Besides factoring, this agency provides services of export credit insurance (assurance of collection of receivables), which is its core business, as well as guarantees for export contracts (Company data).

6.2.1.2.7 Savings-Credit Organizations in the RS Entity[35]

Development of savings-credit organizations (SCOs) in the Republic of Srpska has short and unfortunate history. Their activity lasted during the period 2008-2013.[36] The Banking Agency of the Republic of Srpska is a supervisory authority for SCOs; the regulatory framework is the Law on Savings-Credit Organizations No. 01-1128 /06.

There were four SCOs established by the end of 2008 in the RS, employing four people (Banking Agency of RS, 2008). Their total assets amounted to 0.28 m EUR (a marginal share in total financial sector assets, less than 0.005%). The SCO sector was in its initial phase of development during 2008. The sector as a whole lacked the human capital and technical knowledge necessary for successful and efficient business. It is worth mentioning the education attainment of employees: the majority had completed high school, with only one employee with a university degree.

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[35] There are no SCOs in the FBiH entity.
[36] See Report on Condition of the Banking System of the Republic of Srpska, for the period 2008-2013.

The SCOs could not deal with the task of regular reporting (according to standards for precise and timely reporting) to the Banking Agency of the Republic of Srpska. One SCO had already been de-licensed by the end of 2009. The SCO failed to get funds for development from the International Fund for Agriculture Development. By the end 2012, there were none of the funds necessary for supporting regular business activity, causing the de-licensing of another SCO. There was not a single SCO operating by the end of 2013.

Without adequate human resources and technical support the development of these types of institutions is impossible.

6.2.2 Concluding Remarks

A low level of economic activity and weak domestic demand also determined trends in the non-bank financial sector in 2013. Assets of the non-bank financial sector declined mostly due to a sharp decrease in assets of leasing companies, but other financial institutions also experienced a decline.

The share of leasing companies and MFIs in total financial sector assets is constantly decreasing, accounting for 2.4% and 2.6% of total financial sector assets at the end of 2013, respectively. This decrease was driven by a decrease in demand and living standard, and an increase in bankruptcy, which strongly influences the whole financial sector, as well. Leasing companies complain about legal procedure, which limits development of their business, as well as MFIs. On the other hand, insurance assets were increasing, reaching a share of nearly 5% in the last two years. Life insurance is still in its beginning phase, whereas MTPL (obligatory insurance) was the key driver of GWP in the covered period. Insurance penetration amounted to 2%, which is below the EU average. Capital markets suffer from a lack of liquidity, high risk and low ratio of turnover to market capitalization. Corporate bond issuance, even though in modest amounts, was performed on the Banja Luka Stock Exchange only. The factoring business includes two specialized companies, which are taking receivables only on condition of recourse.

Table 6.8 BiH: Summary of Financial Institutions and Their Legal Framework

Institution	Supervisory Authority	Legislation	Ability to take deposits
Banks	Banking Agency of the Republic of Srpska Banking Agency of the Federation of Bosnia and Herzegovina	Law on Banks in the Republic of Srpska, Official Gazette of the Republic of Srpska, Nos. 44/03, 74/04, 116/11, 05/12 and 59/13 Law on Banks, Official Gazette of the Federation of BiH, Nos. 39/98, 32/00, 48/01, 27/02, 41/02, 58/02, 13/03, 19/03, 28/03 and 02/13	Yes
Insurance	Insurance Agency of the Republic of Srpska	Law on Insurance Companies in Private Insurance, Official Gazette of	

Institution	Supervisory Authority	Legislation	Ability to take deposits
	Insurance Supervisory Agency of the Federation of Bosnia and Herzegovina	the FBiH, Nos. 24/05 and 36/10 Law on Insurance Companies, Official Gazette of the Republic of Srpska, Nos. 17/05, 01/06, 64/06 and 74/10	
Private pension fund	Insurance Agency of the Republic of Srpska	Law on Voluntary Pension Funds and Pension Plans, Official Gazette of the Republic of Srpska, No. 13/09	
Investment fund	Republic of Srpska Securities Commission Securities Commission of the Federation of Bosnia and Herzegovina	Law on Investment Funds, Official Gazette of the Federation of Bosnia and Herzegovina, No. 85/08 Law on Investment Funds, Official Gazette of the Republic of Srpska, Nos. 46/2006, 51/2009 and 31/2011	
Factoring		No law on factoring, but Article 23 of the BiH Law on Foreign Trade Policy (Official Gazette of BiH, No. 7/98) and Article 27 of the FBiH Law on Foreign Trade Business (Official Gazette of the FBiH, No. 2/95) define factoring as a service	
Leasing	Banking Agency of the Republic of Srpska Banking Agency of the Federation of Bosnia and Herzegovina	Law on Leasing, Official Gazette of the Federation of Bosnia and Herzegovina, Nos. 85/08, 39/09 and 65/13 Law on Leasing, Official Gazette of the Republic of Srpska, No. 01-1708/11	
Microcredit institutions	Banking Agency of the Republic of Srpska	Law on Microcredit Organizations, Official Gazette of the Federation of	No

Institution	Supervisory Authority	Legislation	Ability to take deposits
	Banking Agency of the Federation of Bosnia and Herzegovina	Bosnia and Herzegovina, No. 01-02-695/06 Law on Microcredit Organizations, Official Gazette of the Republic of Srpska, Nos. 64/06 and 116/11	
Stock exchanges	Republic of Srpska Securities Commission Securities Commission of Federation of Bosnia and Herzegovina	Security Market Law, Official Gazette of the Federation of BiH, No. 85/08 Law of the Securities Market, Official Gazette of the Republic of Srpska, Nos. 92/06, 34/09, 30/12, 59/13, and 108/13	
Savings-credit organizations	Banking Agency of the Republic of Srpska	Law on Savings-Credit Organizations, Official Gazette of the Republic of Srpska, No. 01-1128 /06	Yes

6.3 Kosovo

6.3.1 Financial Sector Overview

The financial system of Kosovo consists of commercial banks, insurance companies, microfinance institutions and pension funds. Table 6.9 presents a breakdown of financial sector assets.

Table 6.9 Kosovo: Breakdown of Financial Sector Assets

Financial Sector Assets Breakdown (% of Total Financial Sector Assets)	2007	2008	2009	2010	2011	2012	2013
Banking system assets	80.1%	80.2%	78.7%	75.3%	74.5%	72.5%	71.2%
Insurance assets	4.0%	3.5%	2.9%	3.0%	3.0%	3.4%	3.1%
Private pension fund assets	0.0%	0.0%	0.2%	0.2%	0.1%	0.1%	0.1%
Pension system assets	16.0%	11.4%	13.6%	15.1%	16.6%	19.1%	21.4%
Leasing assets	0.0%	0.0%	0.0%	2.1%	2.2%	1.9%	1.5%
Microfinance institutions	0.0%	4.9%	4.7%	4.3%	3.6%	3.0%	2.6%

Financial Sector Assets Breakdown (% of GDP)	2007	2008	2009	2010	2011	2012	2013
GDP (EUR m)	3,461	3,885	4,064	4,406	4,813	5,061	5,327
Banking system assets	41.5%	46.5%	54.3%	55.7%	55.3%	55.9%	57.4%
Insurance assets	2.0%	2.0%	2.0%	2.2%	2.2%	2.6%	2.5%
Private pension fund assets	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.1%
Pension system assets	8.3%	6.6%	9.4%	11.2%	12.3%	14.7%	17.2%
Leasing assets	0.0%	0.0%	0.0%	1.5%	1.6%	1.5%	1.2%
Microfinance institutions	0.0%	2.8%	3.2%	3.2%	2.6%	2.3%	2.1%

Source: Central Bank of the Republic of Kosovo, Annual Report and Financial Stability Report, and IMF data for GDP.

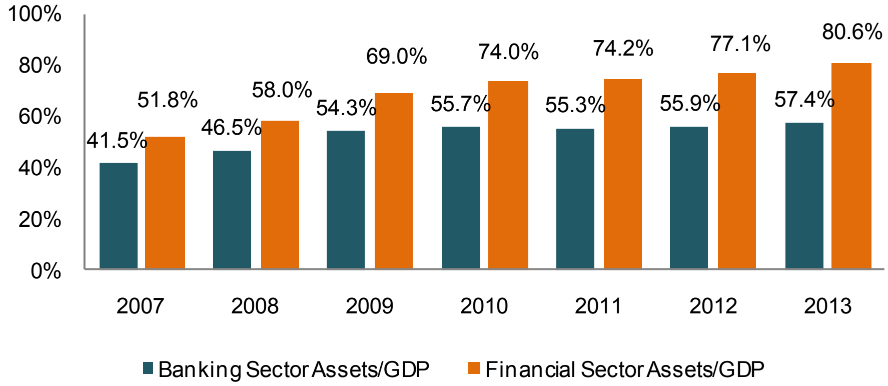
The financial system of Kosovo is dominated by commercial banks. In spite of its decrease in the covered period, the share of bank assets remained high, accounting for 71.2% of total financial sector assets at the end of 2013. Pension fund assets were the second most significant segment of financial system. Their share in total financial system assets recorded an upward trend, reaching 21.4% of total assets value in 2013. Other segments of the system, such as insurance companies and microfinance institutions, have a rather small share in total financial assets. The relative size of the overall financial sector (as a percentage of GDP) was increasing, reaching 80.6% of GDP in 2013. Such a trend reflects the strengthening influence of the financial sector in generating economic activity.

This chapter is divided into three main subparts: banking system (6.3.1.1), non-bank financial institutions (6.3.1.2) and others (6.3.1.3). Section 6.3.1.2 gives an overview of the non-bank financial institutions (NBFIs) currently operating in the financial system, whereas part 6.3.1.3 briefly describes which common NBFIs still do not exist in Kosovo's financial sector.

6.3.1.1 Banking System

The banking sector dominates the financial sector. The difference between the share of financial sector assets and the share of banking sector assets as a percentage of GDP was increasing in the observed period, reaching 23.2 percentage points in 2013, as presented in Graph 6.12.

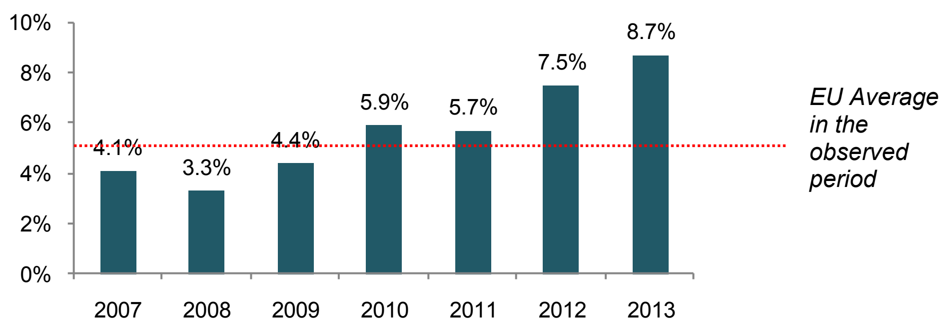
Graph 6.12 Kosovo: Financial Sector Assets and Banking Sector Assets as % of GDP, 2008-2013



Source: Central Bank of the Republic of Kosovo, Annual Report.

Gross loans comprised a major part of total banking assets, accounting for 59% of total assets as of the end of June 2013. The total value of banking sector loans was EUR 1.810 m (June 2013). Lending was characterized by a slower growth trend. Credit risk is the major risk to which the lending sector is exposed. Graph 6.13 represents the share of non-performing loans to total loans in the period 2007-2013.

Graph 6.13 Kosovo: NPLs as % of Total Loans, 2007-2013

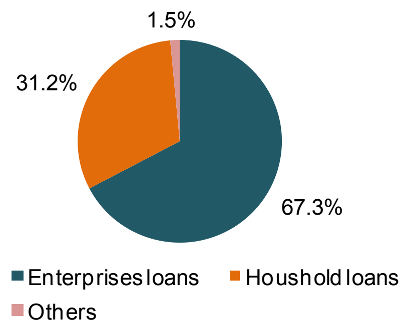


Source: Central Bank of the Republic of Kosovo, Annual Report.

The lowest share of non-performing loans in total loans was in 2008 and amounted to 3.3%, whereas in the period 2009-2013, NPLs were increasing, reaching 8.7% in 2013. The increase in the NPL share to total loans in the last two years mainly reflects the declaration of total loans. The annual growth rate of total loans decreased in 2012, reaching a level of 3.8%, compared with the level of 16.4% from the previous year, 2011 (CBK, AR, 2013). During 2012, economic performance in general deteriorated, and consequently the banking system as well. Difficulties faced by the eurozone countries, as well as the performance of neighboring countries, were reflected in Kosovo's banking system. Despite a decrease in the credit portfolio over the course of 2012, its quality remained fairly good in comparison with the other countries analyzed (CBK, AR, 2012). The enterprise sector was more exposed to credit risk, especially trade (12.2%), manufacturing (15.2%) and agriculture (8%) in 2013. Credit risk for the household sector remained low, with an NPL rate of 2.6% (CBK, AR, 2013).

A major part of the loans comprises enterprise loans, which accounted for 67.3% of total loans. The structure did not change significantly. The loan structure in 2013 is presented in Graph 6.14.

Graph 6.14 Kosovo: Lending Activity by Sector (2013)



Source: Central Bank of the Republic of Kosovo, Annual Report 2013.

Regarding maturity structure, long-term loans had the highest share, representing 67.2% of total loans at the end of 2013. A slight shift towards loans with a shorter maturity period was seen in the covered period. Such a shift may reflect the tightening of commercial banks' criteria in the form of a reduced maturity period. Moreover, the second highest share comprised loans with maturity up to one year, whereas the third place corresponds to loans with maturity from one to two years. The share of short-term loans in the period 2010-2012 was around 21%, whereas in 2013 the share increased to 25% (CBK, AR, 2013).

6.3.1.2 Non-Bank Financial Institutions

This chapter gives a brief overview of the non-bank financial institutions operating in Kosovo, and is divided into the following subsections: Insurance sector (6.3.1.2.1), Pension funds (6.3.1.2.2) and Microfinance institutions (6.3.1.2.3).

6.3.1.2.1 Insurance Sector

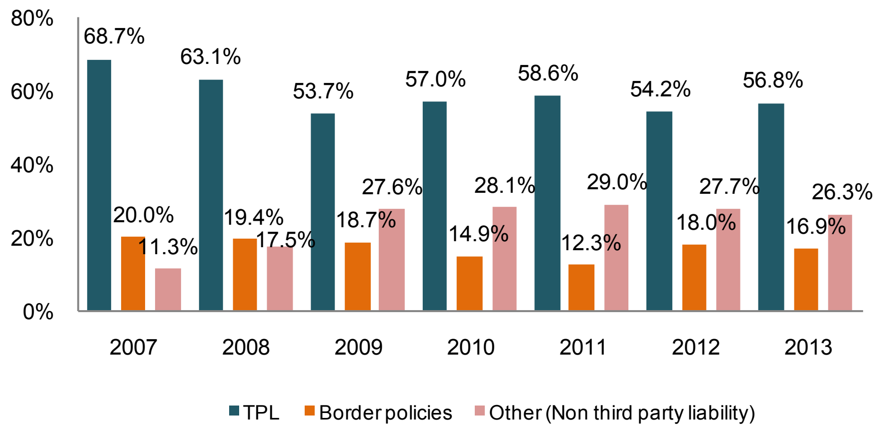
Although insurance sector assets recorded a growth in the period 2007-2013, the share of insurance assets as a percentage of GDP was stable and modest, accounting for around 2% of GDP. The share of insurance assets as a percentage of total financial assets varied between 3% and 5% (the maximum share was in 2007), which is a rather small share in the total financial system. The lowest y-o-y growth rate was in 2013, when insurance assets increased by a mere 1.3%. The highest increase of insurance assets was in 2012, peaking the growth rate at 23.4%.

Non-life assets were the dominant part of total assets, participating with 91% and 90% in total assets in 2012 and 2013, respectively (CBK, AR, 2013). The insurance market of Kosovo introduced life insurance services in 2008 (CBK, AR, 2009). There was only one life insurance company operating in 2009. In 2011 two new companies entered the life insurance market, bringing the total number of companies dealing with life insurance to three (CBK, AR, 2011). The non-life segment of insurance is much more developed than the life one. The life gross written premium (GWP) represented only 2.3% of total GWP in 2013. The activity of insurance companies in Kosovo is mainly focused on the issuing of third party liability (TPL) insurance policies. The remaining part of received premiums comes from the voluntary insurance policies.

GWP was increasing in the period 2007-2012, but contracted in 2013 at a rate of 3.1%. GWP as a percentage of GDP was rather small, 1.4-1.6%. The insurance penetration is far below the EU average of 7.6% (Insurance Europe, 2014).

The structure of non-life GWP in the period 2007-2013 is given in Graph 6.15. The structure showed little variance, since TPL is the dominant part of total GWP. More variability in the total share of GWP is presented for border policies[37] and other.

Graph 6.15 Kosovo: Structure of Gross Written Premiums by Components, 2007-2013



Source: Central Bank of the Republic of Kosovo, Annual Report.

Premiums within the non-life segment consist of obligatory insurance premiums (TPL and border policies) and other (non-third party liability). The "Other" category consists of voluntary insurance, which includes health insurance policies, CASCO insurance and property insurance. Third party liability has the highest share in total premiums received, 57% in 2013, whereas premiums received from border policies have a share of 17%, and the remaining 26% corresponds to "other" (non-third party liability).

The insurance sector has further potential to grow, although the cumulative growth of assets in the period 2007-2013 reached 87%. Obligatory insurance is the main component of insurance sector policies. The activity of life insurance companies increased, measured by both number of policies and share of total GWP. The number of life insurance policies saw a significant increase, reaching 23,800 in June 2013, compared with 3,000 in June 2012 (CBK, FSR, 2013). The share of life GWP was 2.3% in June 2013, compared with 1.7% the year before. Insurance companies' assets structure continued to be dominated by deposits, which comprised 58% of total assets in 2013 (CBK, AR, 2013).

The investment policy of the insurance sector is regulated by the CBK. Current legislation regarding investment policy includes the CBK "Rule on Deposit of Assets as Security, Capital Adequacy, Financial Reporting, Risk Management, Investment and Liquidation" (Rule No. 8, entered into force as of January 1, 2007). In accordance with the previously mentioned

[37] Kosovo is not a member of the Green Card system for the time being, since Article 4.2 of the Council of Bureaux Constitution provides that a Bureau seeking such membership has to be the Bureau of a State that is internationally recognized and admitted as a member of the United Nations. Motorists of Kosovar vehicles wishing to cross the borders and motorists of foreign vehicles wishing to enter Kosovo are requested to conclude frontier insurance (Kosovo Insurance Bureau, Department of Motor Liability Border Insurance).

regulation, the investment policy of insurance companies is not predefined by the regulations. Instead, insurance companies are obliged to submit their investment policies, made on a yearly basis, to the CBK. The investment policy of insurance companies at the end of June 2013 was characterized by a high share of bank deposits (58% of the insurance sector assets). In addition to previously mentioned regulation, insurance companies' activities are regulated by approximately 34 different rules.

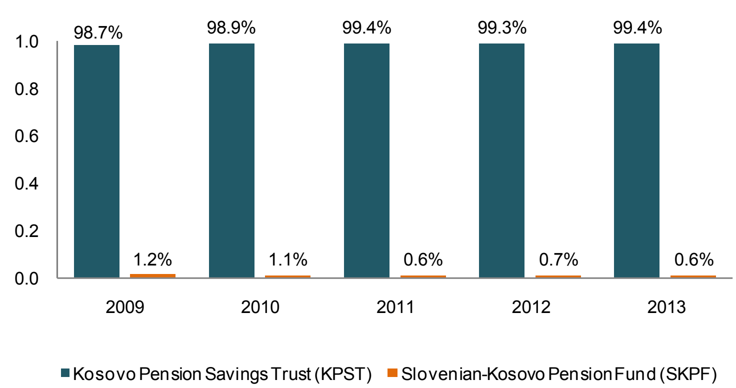
In line with the IMF findings, "The insurance industry was facing growing reputational risk due to a poor record of claim payment. This will likely hamper growth and development in the near future. CBK should enact and implement a regulation to introduce an out-of-court insurance dispute resolution mechanism (e.g., private arbitration with binding decision powers), in order to address the growing volume of consumer complaints against insurers and the lack of technical capacity of local courts to properly address insurance related disputes" (IMF, Kosovo Financial System Stability Report, 2013).

6.3.1.2.2 Pension Funds

Kosovo's pension system comprises three pillars. The first pillar includes a basic pension of EUR 75 (data for 2009), which is paid from the budget of Kosovo to all people older than 65. The mandatory individual pension contributions are managed by the Kosovo Pension Savings Trust (KPST) and constitute the second pillar. The Slovenian-Kosovo Pension Fund (SKPF), founded in 2006,[38] and is a voluntary pension fund representing the third pillar in the pension system.

The pension system represents a significant share of the total financial system. The share of pension fund assets in total financial assets was increasing in the period 2008-2013, reaching nearly 22% in 2013. Pension assets amounted to EUR 919 m in 2013, which presents a 23% y-o-y growth rate compared with the previous year, while the CAGR in the observed period amounted to 21%. The following chart represents the share of the KPST and SKPF in total pension system assets in the period 2009-2013. As shown in Graph 6.16, the share of SKPF assets in total assets is negligible.

Graph 6.16 Kosovo: Assets Share of KPST and SKPF in Total Pension Fund Assets (%), 2009-2013



Source: Central Bank of the Republic of Kosovo, Annual Report.

[38] Data on the share of total assets managed by the SKPF exist as of 2009.

Pension funds are important investors in Kosovo's financial system. The following table presents the structure of KPST investments in the period 2010-2013. The structure of investments in 2009 was different, since there were no investments in shares. KPST investments were more concentrated on mutual funds (38.0% of total investments), whereas 23.7% of total KPST assets were invested in cash and bank deposits. Investments in bonds represented 14.2% of total assets, whereas the remainder belongs to other categories in 2009 (CBK, AR, 2009).

Table 6.10 Kosovo: Breakdown of KPST Investments, 2010-2013

	2010	2011	2012	2013
Shares	39.6%	35%	42%	34.31%
Kosovo government			0.20%	5.81%
Investment funds				17.53%
Loans trade		3.40%	2.90%	2.56%
Bonds related to inflation	8.90%	14.40%	15.20%	6.29%
CBK	9%	3.50%	2.20%	22.95%
Bonds	12.20%	10.20%	10.60%	10.55%
Other diversifications		17.30%	22.70%	
Money market	15%	10.80%		
Deposits in domestic banks	6.80%	5.90%	4.30%	
Loan market	8.60%			

Source: Central Bank of the Republic of Kosovo, Annual Report and Financial Stability Report.

Regarding the assets of the SKPF, the largest share (over 95%) in 2010 was invested in bonds and bank deposits, whereas the remaining was kept in cash, shares, etc. (CBK, AR, 2010). The SKPF investment structure was dominated by funds invested in bonds (about 75%) in 2011. The remainder of over 20% consists of investments in bank deposits. A relatively small part of assets under SKPF management were invested in stock markets and cash in 2011 (CBK, AR, 2011). The structure of SKPF assets during 2012 was dominated by investments in bonds and less by investments in deposits, shares and cash (CBK, AR, 2012). Investments abroad dominate the structure of SKPF assets. During 2013, 76.3% of total assets were invested abroad, of which 74.3% in bonds and 2% in cash. The remaining 23.7% represent investments in Kosovo, of which 23.4% of the assets are in treasury bonds of the Government of Kosovo (CBK, AR, 2013).

Both funds saw an increase of share price and investments return in 2013. The improvement in investment performance was due to the fact that conditions in international stock markets improved (the majority of Kosovo pension fund assets are invested abroad - 76.83% in 2013), (CBK, AR, 2013).

Private pension fund assets as a percentage of GDP are extremely small, only 0.1% on average in the period 2009-2013. The pension system represents a substantial share of total financial system assets (the second largest), as presented in Table 6.9. Pension funds, more precisely the KSPT, are a significant driver of total growth in the financial system.

6.3.1.2.3 Microfinance Institutions

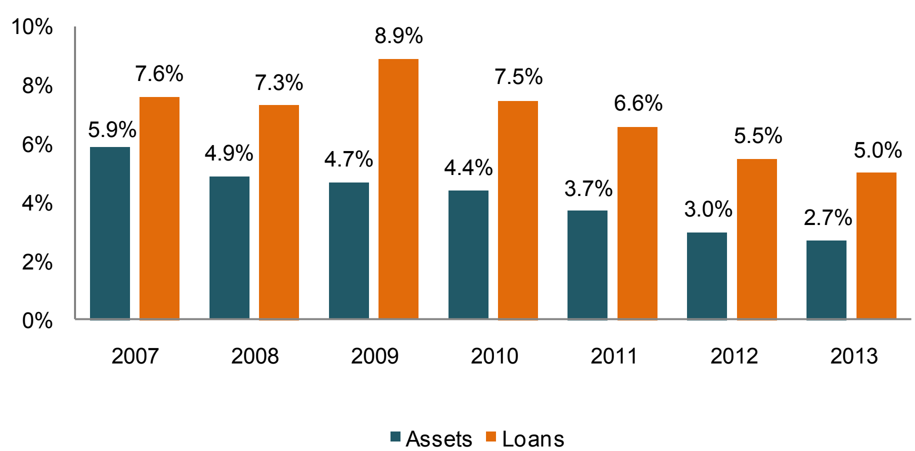
> "The main constraints are the Loan Limit Restriction of up to EUR 25,000, and the inability to take deposits (cheap funds)."
>
> MFI

A microfinance institution is a legal entity organized as either an NGO under the NGO Law or as a joint-stock company under the Law on Business Organizations, whose primary business is to provide loans and a limited number of financial services to micro and small legal entities, low-income households and low-income persons (Law on Banks, Microfinance Institutions and Non-Bank Financial Institutions, Law No. 04/L-093). Microfinance institutions (MFIs) play an important role in crediting the Kosovo economy. They lend to households, small businesses and agro businesses. These institutions are not allowed to take deposits; credits from abroad are their main source of financing. They received additional funding support from their NGO sponsor and other financial institutions, such as the EBRD, IFC, and European Fund for Southeast Europe, (Ministry of Trade and Industry, 2012).

> "It takes one year on average for a case to be treated by the Court of the Republic of Kosovo. However, we expect that the processing time of cases will accelerate with the introduction of private executers in the middle of this year."
>
> MFI

The MFI share in total financial sector assets was decreasing, reaching a minimum of 2.7% in 2013. The decline is mainly attributed to the reduction of loans, which represent the main category within the total assets of MFIs.

Graph 6.17 Kosovo: MFI Assets and Loans Share of Total Financial System (in %), 2007-2013



Source: Central Bank of the Republic of Kosovo, Financial Stability Report and Annual Report.

Note: Data for assets in 2007 refer to the share of other financial corporation assets as % of total financial sector assets, as stated in the annual report of 2007.

The interest rates of these institutions are much higher than those charged by banks. Their main argument rests in the fact that these institutions cannot accept deposits, making the collection of financial resources more costly.

> "To lower the default rate of microfinance institution debtors, MFIs need to make a deeper assessment or analysis of the client's creditworthiness, make a proper credit decision, and persistently monitor the client's business and activities."
>
> MFI

Microfinance institutions are regulated and supervised by the CBK. In accordance with the Amended Rule XIV on the Licensing and Supervision of Microfinance Institutions Authorized Under Sections 3, 6, and 7 of UNMIK Regulation 1999/21 (adopted as of February 7, 2007) part of banking provisions, such as assets classification, liquidity reserves, etc., also applies to MFIs. In addition, regulation stipulated by the CBK comprises policies on credit risk management, effective interest rate and its disclosure, limitation of real estate holdings, limitation of loan value, and other policies related to internal control and auditing and external auditing and reporting.

The investment policy of pension funds is stipulated by Rule 9 on Investment of Pension Assets (adopted as of July 25, 2002).

6.3.1.3 Other Non-Bank Financial Institutions

This chapter gives a short overview of other non-bank financial institutions that are either nonexistent or insignificant in Kosovo's financial system.

There are two **leasing companies** operating in Kosovo's financial system, Raiffeisen Leasing LLC and Factor Leasing SHPK. The leasing sector is undeveloped in Kosovo.

Investment funds do not exist in Kosovo. The legal framework and lack of developed financial market in Kosovo neither support nor protect the activities of such institution. There are no legal restrictions that obligate foreign investors or investment funds to invest in private companies in Kosovo, meaning that the investment fund would also have better legal protection if registered as fund abroad (DEED, 2013). The Diaspora Engagement for Economic Development (DEED) project is exploring the possibility of establishing a diaspora-targeted investment fund for investment opportunities in the Kosovo's private sector.[39] Remittances constitute a significant share in GDP, despite a decreasing trend caused by economic downturn in the last few years. Remittances reached 16% of GDP in 2013. Estimates show that only 1% of remittances is invested. Remittances can be used as a source of investments in order to improve economic growth and reduce unemployment (DEED, 2013).

Factoring companies are not present on the market, although some banks do lend against receivables. There is no formal structure or legal process to support lending against invoices (Ministry of Trade and Industry, 2012).

There is no **stock exchange** operating in Kosovo's financial sector.

6.3.2 Concluding Remarks

The Kosovo financial system's share in GDP increased in the period 2008-2013, peaking at almost 80% in 2013. The financial system is bank-centered with a share of banking assets in total financial sector assets of 72%. The share of commercial bank assets share was decreasing, due to light improvement in the performance of other financial institutions operating in Kosovo. Apart from commercial banks, pension funds and MFIs have significant roles in the financial system. The MFI loan supply and market share decreased in last two years, comprising only 3% of total financial sector assets. MFIs are registered as NGOs, and they are not allowed to take deposits. There is constant lobbying from MFIs and their association to

[39] Diaspora-targeted Investment Fund

change the Law on Banks, Microfinance Institutions and Non-Bank Financial Institutions. Pension funds have a significant share in total financial sector assets, 22% in 2013. The KPST has a dominant role in managing pension fund assets, whereas the SKPF (a voluntary private pension fund) has a negligible share, 0.6% of total pension fund assets in 2013. Both funds invest the largest part of their assets abroad. Non-life insurance, although experiencing significant growth in last two years, still remains an undeveloped segment of the insurance market and total financial sector. Only two leasing companies are operating in Kosovo; the leasing sector can be characterized as completely undeveloped.

Investment funds could improve the performance of the financial sector, especially through diaspora investments. Remittances have an impressive share of GDP (16% in 2013). In contrast to the financial sector data, the insurance sector share in GDP is no more than 2.5% in the covered period, and the share of remittances is as much as that of pension system assets. There are initiatives to open emigration-investment funds, in order to stimulate remittance inflow to contribute investments in Kosovo (not to be wasted as consumption).[40] Kosovo does not have a stock exchange, nor are factoring companies present in Kosovo's financial system.

Table 6.11 Kosovo: Summary of Financial Institutions and Their Legal Framework

Institution	Supervisory Authority	Legislation	Ability to take deposits
Banks	CBK	Law on Banks, Microfinance Institutions and Non-Bank Financial Institutions, Law No. 04/L-093, Official Gazette of the Republic of Kosovo, No. 11, May 11 2012, Pristina	Yes
Insurance	CBK	No Law Regulation No. 2001/25 "On Licensing, Supervision and Regulation of Insurance Companies and Insurance" Intermediaries, UNMIK, October 5, 2001 Other Regulations defined by CBK[41]	
Pension funds	CBK	Law No. 04/L-101 on Pension Funds of Kosovo, Official Gazette of the Republic of Kosovo, No. 10, May 8, 2012, Pristina	
Leasing	CBK	Law No. 03/L-103 on Leasing, 2009	

[40] The Diaspora Engagement for Economic Development has made significant efforts to establish this fund.
[41] Not available in English.

Institution	Supervisory Authority	Legislation	Ability to take deposits
Microfinance institutions	CBK	Law on Banks, Microfinance Institutions and Non-Bank Financial Institutions, Law No. 04/L-093, Official Gazette of the Republic of Kosovo, No. 11, May 11, 2012, Pristina Amended Rule XIV on the Licensing and Supervision of Microfinance Institutions Authorized Under Sections 3, 6 and 7 of UNMIK Regulation 1999/21, Central Banking Authority of Kosovo, 2007	Yes[42]

6.4 Macedonia

6.4.1 Financial Sector Overview

The financial system consists of depository financial institutions and non-depository financial institutions. Depositary financial institutions are banks and savings houses. Non-depositary financial institutions are: insurance companies, insurance brokers, insurance agents, leasing companies, pension funds, pension fund management companies, brokerage companies, open-end investment funds, private investment funds, private equity fund management companies, and financial companies.[43] Private investment fund and private equity fund management companies have no obligation to provide data on the value of their assets and net assets. In accordance with the Law on Supervision of Insurance, insurance brokerage companies and insurance agents are not required to submit financial reports to the Insurance Supervision Agency (NBRM, FSR, 2012). Those categories are not analyzed separately in this report. The detail overview will be presented for financial system categories that have a significant share and influence.

Table 6.12 presents financial system assets by segment, expressed as a percentage of total financial sector assets and GDP. The financial system is bank-centered with the share of banking assets in total financial sector assets around 90% in the covered period.

[42] Law on Banks, Microfinance Institutions and Non-Bank Financial Institutions, Article 91: MFIs cannot take deposits without being previously approved by the CBK, and cannot collect deposits greater than a minimum of 50% of their excess capital or EUR 125,000.
[43] In line with the categorization defined by National Bank of Macedonia, FSR, 2012.

Table 6.12 Macedonia: Breakdown of Financial Sector Assets

Financial Sector Assets Breakdown (% of Total Financial Sector Assets)

	2007	2008	2009	2010	2011	2012	2013
Banking system assets	90.9%	89.5%	89.0%	89.3%	88.6%	88.5%	87.7%
Insurance assets	4.5%	4.3%	4.0%	3.5%	3.5%	3.3%	3.3%
Private pension fund assets	1.4%	1.9%	3.0%	3.8%	4.4%	5.5%	6.6%
Mutual funds assets	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.2%
Leasing assets	2.0%	3.1%	2.8%	2.5%	2.5%	1.7%	1.4%
Savings houses assets	1.2%	1.2%	1.1%	0.9%	0.8%	0.7%	0.7%
Financial companies assets	0.0%	0.0%	0.0%	0.0%	0.2%	0.2%	0.2%

Financial Sector Assets Breakdown (% of GDP)

	2007	2008	2009	2010	2011	2012	2013
GDP (EUR m)	5,966	6,724	6,693	7,063	7,587	7,460	7,690
Banking system assets	61.0%	60.4%	65.3%	70.3%	71.0%	76.9%	78.1%
Insurance assets	3.0%	2.9%	3.0%	2.8%	2.8%	2.8%	2.9%
Private pension fund assets	0.9%	1.3%	2.2%	3.0%	3.6%	4.8%	5.9%
Mutual funds assets	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.2%
Leasing assets	1.4%	2.1%	2.1%	1.9%	2.0%	1.5%	1.3%
Savings houses assets	0.8%	0.8%	0.8%	0.7%	0.7%	0.6%	0.6%
Financial companies assets	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.2%
Total financial sector assets	67.0%	67.5%	73.4%	78.7%	80.1%	86.9%	89.1%

Source: National Bank of Macedonia, Financial Stability Report and IMF data for GDP.

Notes: Data on factoring assets are not available separately. They are included in banking assets and financial companies' assets. Mutual funds comprise open-end investment funds and Investment fund management companies, excluding private investment funds.

The significance of financial sector assets as a percentage of GDP increased in the covered period, reaching 89% in 2013. The second rank by share in total financial sector assets and GDP was held by insurance assets and private pension assets, with nearly the same share.

This chapter is divided into the following main subsections: depository financial institutions (6.4.1.1) and non-depositary financial institutions (6.4.1.2).

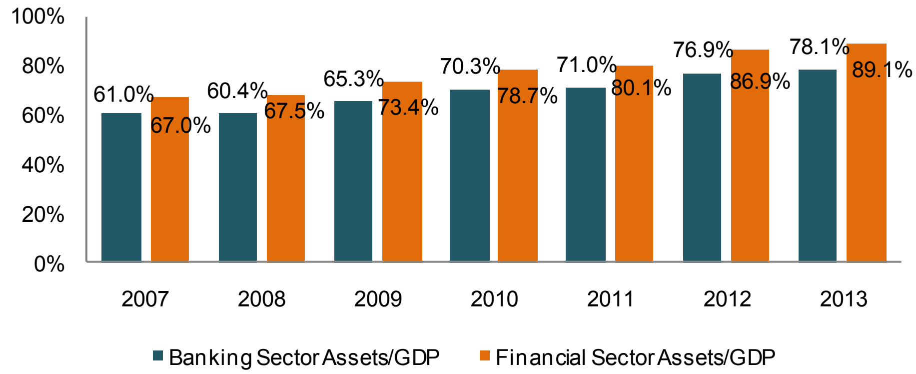
6.4.1.1 Depository Financial Institutions

The chapter is divided into two categories analyzed separately: banks (6.4.1.1.1) and savings associations (6.4.1.1.2).

6.4.1.1.1 Banks

Macedonia's financial system is significantly bank-centered, although the share of bank assets as a percentage of total financial sector assets was decreasing during the covered period, from 91% at the end of 2007 to 88% at the end of 2013. The CAGR was almost 9%, since banking system assets were constantly increasing in the period 2007-2013. The highest increase of banking sector assets was in 2010, with a 14% y-o-y growth rate. Graph 6.18 presents the share of financial sector assets and banking sector assets as a percentage of GDP in the period 2007-2013.

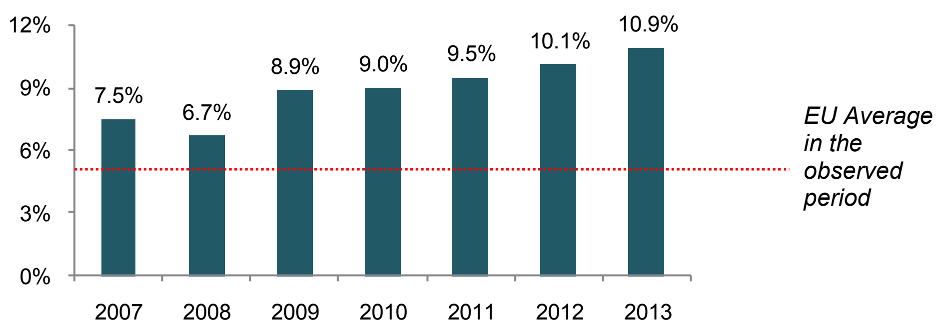
Graph 6.18 Macedonia: Financial Sector Assets and Banking System Assets as % of GDP, 2007-2013



Source: National Bank of the Republic of Macedonia, Financial Stability Report.

Since 2009, the ratio of NPL to gross loans has been constantly increasing, reaching almost 11% in 2013, as presented in Graph 6.19.

Graph 6.19 Macedonia: NPLs as % of Total Loans, 2007-2013



Source: World Bank database.

The share of NPL in total loans for the household sector was 6.4% at the end of 2013 (a decrease of 0.7 pp compared with the previous year), and for the enterprise and other clients sector amounted to 15.2% (an increase of 2.3 pp compared with the previous year) (NBRM database).

New regulation on credit risk management was implemented on December 1, 2013. The banks should attempt to restructure the customers' liabilities when they first observe their financial difficulties, without waiting for them to receive

"In general, more relaxed standards for the loans approved in the pre-crisis period, accompanied by a weak (mainly point-in-time) credit analysis that neglected the "through-the-cycle" behavior of the clients, were the most important drivers of NPL growth at the time of the global financial crisis' main impact in our country.

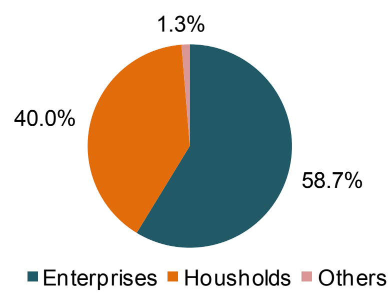
However, in some banks, NPLs have continued to grow even in the post-crisis period, even in conditions of relatively favorable movements in the domestic economy and assumed lowered systematic risk. The latter should indicate that the most recent bad credit decisions are mainly of an idiosyncratic nature. This shows that systematic risk still persists in the economy and that the corporate sector has not fully recovered from the crisis, which in turn could suggest that the solid economic growth in the country is concentrated and delivered by a relatively small number of companies that do not bring any substantial positive effects on the credit portfolio quality (these are large companies of foreign origin, seated in our technological-industrial zones, that have started their activities recently)."

NBRM

the non-performing status. This should reduce the NPL ratio in the short run. However, the medium term impact is twofold. NPLs may increase if the practice focuses on the recognition of expected credit risk losses in the aftermath only (NBRM, Report on the Risks in the Banking system, 2013).

The structure of loans by sector remained almost unchanged in the covered period, around 60% of total loans belonged to enterprises, whereas around 40% of loans were household loans. The "other sector" category had a negligible share of less than 1%, which increased over two years, amounting to 1.5% at the end of 2012. Graph 6.20 represents the structure of loans at the end of 2013.

Graph 6.20 Macedonia: Lending Activity by Sector (2013)



Source: National Bank of the Republic of Macedonia, database, 2013.

The maturity structure of loans changed slightly in the observed period. The share of short-term loans amounted to 30% in 2007. Their share was decreasing during the covered period, amounting to 22% at the end of 2013, whereas the remaining 78% of total loans were long-term.[44]

6.4.1.1.2 Savings Houses

Saving houses have a rather small share in the total financial sector. These institutions collect denar deposits from households, and lend to individuals and legal entities. “Their importance declined further in 2013. At the beginning of the year, amendments to the Banking Law were passed, allowing the savings houses to transform into a bank or financial company (without conducting a liquidation procedure) or to make a status change for the acquisition of a savings house by a bank. On the basis of this new legislation, over the year three savings houses were transformed into financial companies,

> “For further development of the non-banking financial institutions that accept public deposits, it is necessary to:
>
> ✓ Urgently modernize financial activities of savings houses, enabling them to offer new products (involvement in part of the payment system for physical persons, money transfers for pension funds, payment of utilities bills, mobile banking and participation in debit and credit card system)
> ✓ Change the restriction so that savings houses can accept savings greater than twice the amount of capital and borrow money from domestic and international legal entities
> ✓ Oversee the possibility of development of a legal framework for credit unions as non-bank financial institutions that accept public deposit."
>
> Saving House in Macedonia

[44] Past due loans and NPLs are excluded from maturity structure, although the NBRM also takes them into consideration when analyzing maturity structure of loans.

bringing the total number of savings houses down to four," as stated in the FSR (2013). Their share in total financial sector assets declined from 1.2% to 0.7%, while their share in GDP amounted to 1%. Savings houses must comply with almost the same procedure as banks. The further decrease in the number of these institutions, as well as their share in both financial sector assets and GDP, could be expected due to the change in the Banking Law and strong competition from banks.

Savings houses are faced with extremely high competition from banks. The Law on Banking regulates savings houses in Article 172, where it states that almost the same rules are valid for savings houses as for banks. Savings houses have to obey the same macro prudential norms for capital adequacy as banks do. The savings houses may collect natural persons' deposits up to a maximum of double the amount of their own funds, which is a binding constraint for their development. The capital adequacy ratio is high, amounting to 43.1% in 2013. It was even higher in 2012, at 51.9% (NBRM, FSR 2012 and 2013). This high solvency results from the structure of their funding sources, as they mostly operate with their own capital. Due to their role in the financial system, as well as the high capitalization ratio in comparison with their operational risks, savings houses are not a systemic risk to financial stability.

The regulatory framework could potentially be changed in a way to ensure their survival. One of the possibilities is to relax the constraints in terms of saving houses acceptance of deposits only up to double amount of their own capital, if adequate regulation, supervision and deposit insurance are in place. This change would probably allow for their growth and potential increase in their importance for the financial system. However, it is important to be aware of the risks, as overly and unfounded relaxation of prudential norms may influence financial stability.

6.4.1.2 Non-Depositary Financial Institutions

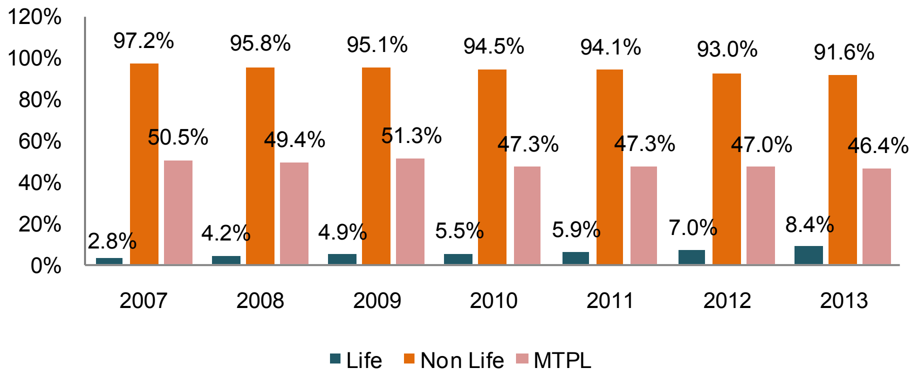
The two non-depositary financial institutions that have the largest share are private pension funds and insurance companies. These two categories will be analyzed in detail. Other companies are not a significant part of the financial system. The following categories of financial system are analyzed: insurance companies (6.4.1.2.1), leasing companies (6.4.1.2.2), investment funds (6.4.1.2.6), private voluntary pension funds (6.4.1.2.4), Macedonian stock exchange (6.4.1.2.7) and financial companies (6.4.1.2.8).

6.4.1.2.1 Insurance Companies

Assets of insurance companies were mostly increasing in the covered period. The CAGR was 4%, whereas the only year with a negative y-o-y growth rate was 2010 (-2%).

GWPs were mostly increasing in the covered period, but there was a sharp decline of 20% in 2011, which led to a negative CAGR amounting to 2%. The share of non-life insurance GWP in total GWP was dominant as presented in Graph 6.21, although the importance of life insurance GWP as a percentage of total GWP was increasing, reaching 8% in 2013. The most significant share of non-life insurance is motor third-party liability (MTPL) GWP. Their relative share decreased by 5 pp in the covered period, having a share in total GWP of 46% in 2013 (Insurance Supervision Agency data).

Graph 6.21 Macedonia: GWP Breakdown, 2007-2013



Source: Insurance Supervisory Agency, Reports.
Note: Data for 2007 are obtained from NBRM, FSR.

MTPL had a share of 52.3% of non-life GWP in 2013. The second place in the share of non-life GWP corresponded to property insurance at 20.4%; the third place went to motor vehicle all-risk (CASCO) at 11.2%; accidents were in the fourth place with a share of 8.4%; and other classes of non-life insurance accounted for 7.8% (ISA and NBRM internal calculations data).

Investments had a significant and increasing share in total assets. The share of investments in total assets was 18% in 2008, whereas in 2011 their share was 66%.[45] It is interesting to note that equity investments amounted to EUR 7.3 m in 2008, while debt investments amounted to EUR 0.3 m. Over the course of 2009, the structure of investment shifted significantly in favor of debt investment, which amounted to EUR 10.8 m, whereas equity investments amounted to EUR 3.3 m. The reason probably lies in the fact that the financial crisis influenced the way in which insurance companies invest, their trade-off between risk and return, which influences the choice between shares and bonds. Although investment in shares more than tripled in 2010, investment in debt remained dominant, reaching EUR 13.9 m.

Insurance penetration was small compared with EU countries. GWP as a percentage of GDP was around 2% in the period 2007-2009. It has decreased to 1% since 2010.

6.4.1.2.2 Private Pension Funds

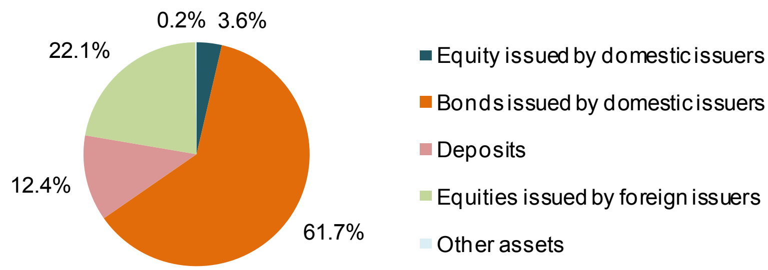
The share of private pension funds was constantly increasing in the covered period in both financial sector assets and GDP, as presented in Table 6.12. Pension fund assets as a percentage of total financial sector assets reached 7% in 2013, which is the second-largest category. As important investors of deposits in domestic banks, they have a significant role in financial stability. Not surprisingly, government bonds are predominant in the total investment share. Linkage between pension fund management companies and some domestic banks exists, stressing the importance to reputation risk (NBMR, FSR, 2013). Private pension fund assets consist of mandatory, fully funded private pension funds, voluntary fully funded private pension funds and pension fund management companies. We present the main findings concerning mandatory and voluntary fully funded private pension funds.

[45] The Insurance Supervision Agency published an annual report for 2009, 2010 and 2011.

6.4.1.2.3 Mandatory Pension Funds

Assets of mandatory pension funds amounted to EUR 436 m at the end of 2013, with a CAGR of 43% in the covered period. Graph 6.22 represents the structure of investments of mandatory pension funds.

Graph 6.22 Structure of Investment Assets of Mandatory Pension Funds (in %), 2013

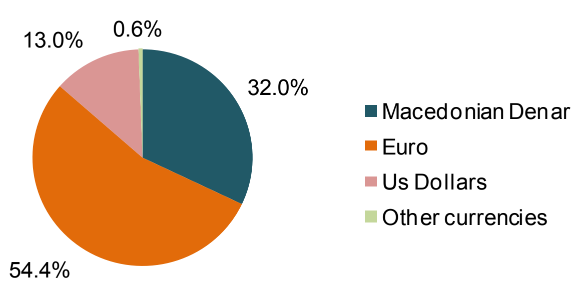


Source: National Bank of the Republic of Macedonia, Financial Stability Report for 2013.

Although there was an increase of investment in equities in 2013, mandatory pension funds still have a conservative policy towards risk, with the dominant share of bonds issued by domestic issuers accounting for almost 62% of total investment assets at the end of 2013. In the last few years, bonds issued by foreign issuers have had no share in total investments, with the exception of 2010, when their share amounted to 3%. Treasury bills have been a rather negligible component of investment assets in the last few years, amounting to 0.5% in 2012 (NBMR, FSR data).

It is important to note that the currency structure of investment has changed significantly since 2009. The currency of pension fund assets was predominantly in denars in 2007 and 2008, over 60%, whereas the assets in euros were around 30%, with a rather small share of other currencies. The structure changed in 2009, when the share of assets in euros amounted to 52.7% of total assets and the share of denar 46.4%. The share of denars declined even further in 2011, amounting to 27.9%. Shares in other currencies increased significantly in 2011, reaching 10.4%, due to an increase of dollars in the currency structure. Graph 6.23 represents the currency structure of the assets at the end of 2013.

Graph 6.23 Macedonia: Currency Structure of Mandatory Pension Fund Assets, 2013

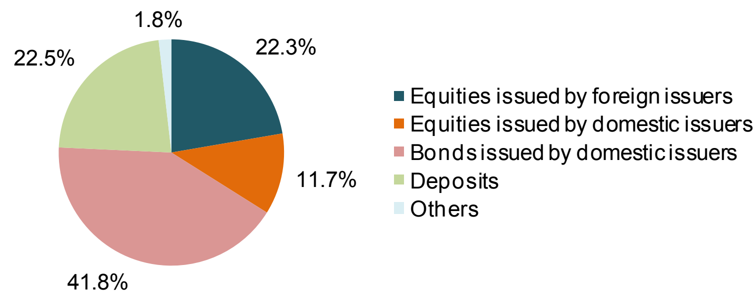


Source: National Bank of Republic of Macedonia, Financial Stability Report.

6.4.1.2.4 Voluntary Pension Funds

In the second half of 2009, the so-called third pillar of the reformed pension system, i.e., the voluntary fully funded pension insurance, started operating (NBRM, FSR, 2009). Total assets of voluntary pension funds increased by more than six times in the period 2010-2013, reaching EUR 5 m at the end of 2013. They invest a major portion of funds in low-risk instruments, such as government bonds and bank deposits. The structure of their assets is presented in Graph 6.24.

Graph 6.24 Macedonia: Structure of Investment Assets of Voluntary Pension Funds (in %), 2013



Source: National Bank of the Republic of Macedonia, Financial Stability Report for 2013.

The share of equities issued by foreign insurance increased significantly in 2013, reaching 22.3% at the end of year, which presents a significant increase compared with 2010 (4.6%).

The structure of both mandatory pension funds and voluntary pension funds was reflected in the high share of bonds issued by domestic issuers and deposits (64% and 74%, Graph 6.24 and Graph 6.22, respectively). Both types of funds had almost the same share of total assets invested into equities issued by foreign issuers (22% at the end of 2013). The general conclusion is that their investment decisions between risk and return were similar.

6.4.1.2.5 Leasing Companies

Leasing company assets had a negligible share in total financial sector assets, amounting to EUR 97 m at the end of 2013, which was 2% of total financial sector assets and 1% of GDP. A major growth in leasing assets was recorded in 2008, with an increase of 73%, but the y-o-y growth rate in the last two years was negative, 25% and 14%, respectively. The CAGR in the observed period was negative, as well (14%). Legal entities are still the dominant users of leasing, accounting for 78.9% of the total value of newly concluded contracts and 70.7% of the total value of active contracts (NBRM, FSR, 2013).

6.4.1.2.6 Investment Funds

Investment fund assets amounted to EUR 13 m at the end of 2013, constituting 0.1% of total financial sector assets. Although constantly increasing its share, with a CAGR of 46% in the covered period, their share in both financial sector assets and GDP was insignificant. The annual growth in the assets of investment funds was due to an increase in cash and deposits. The structure of assets of open-end investment funds changed significantly in 2013: cash and deposits amounted to 70.6% at the end of 2013, whereas at the end of 2011 and 2012, their share was less than 40% (NBRM, FSR, 2013). The majority of fund investments (77%) was invested in the country, whereas the rest comprised investments abroad. Investment funds have been operating for six years, but the supply of investment alternatives on the Macedonian financial market remains limited.

6.4.1.2.7 Macedonian Stock Exchange

Market capitalization of stocks and bonds amounted to EUR 1.670 m and EUR 108 m at the end of 2013, respectively. Total turnover amounted to EUR 53 m in the same year. The ratio of turnover to market capitalization has been even less than 0.1 since 2008. The y-o-y growth rate of market capitalization was mostly negative, except in 2010, when the annual growth rate was 10%. The sharpest decline in the covered period was recorded in 2008 (60%), which led to a negative CAGR of 16%. The share of stock market capitalization to GDP ranged between 20% and 30%, except in 2007, when the share was extremely high – 79% of GDP. The shares of bonds and shares of stocks in total market capitalization were 6% and 94% in 2013, respectively. Generally, the structure remained similar to previous years, with the dominant share of stocks in market capitalization, ranging between 85% and 94% in the covered period.

Capital market is still illiquid and unattractive. Uncertainty in the international financial market influenced the reduction of stock market investment. According to the amendments to the Law on Personal Income Tax of 2012, the provisions concerning the taxation of capital gains realized from the sale of securities shall not apply in the period from January 1, 2013 to December 31, 2015 (NBRM, FSR, 2013). This might prove an incentive to invest in securities.

6.4.1.2.8 Financial Companies

Financial companies are non-bank financial institutions conducting the following activities: crediting; issuing guarantees; factoring; consulting related to loan approval, issuance and administration of credit cards, factoring and guarantees; issuance and administration of credit cards; rental of movable and immovable property of third parties, including operating leasing. There are currently six financial companies operating in Macedonia.[46] Three of them have reported factoring as their activity. There is no specific law regulating factoring. They operate primarily according to the Law on Obligations. The more specific regulation on factoring activities is advisory, which will lead to more transparency and legal framework for its further development.

> "The regulation for these institutions should be unified, as some parts of the law are in conflict with other laws. The obligations law should provide special treatment for factoring and the process of transfer of receivables and all their rights. Courts should be educated regarding the implementation of these laws as well."
>
> Financial company

[46] As of September 15, 2014.

6.4.2 Concluding Remarks

The financial sector is dominated by banks, whose share in total financial sector assets was around 90% in the period 2007-2013. Insurance assets' share as a percentage of total financial sector assets was decreasing in the covered period. In 2007, insurance companies had the second-largest share in total financial sector assets, whereas at the end of 2013, they fell to third place. GWP as a percentage of GDP was 1% in 2013. This important indicator of insurance shows us that this sector is still undeveloped compared with EU standards. The life insurance share in total GWP was increasing and reached 8% in 2013. Private pension funds have had an important role in the financial sector since the beginning of the pension reform. The mandatory fully funded private pension funds represent the second pillar of the financial sector, with assets amounting to EUR 436 m at the end of 2013. Voluntary fully funded private pension funds, established in 2009, represent the third pillar in the pension scheme. Their assets were EUR 5 m at the end of 2013. Leasing companies and savings houses had a rather small share in total financial sector assets, 2% and 1%, respectively. Investment funds' share was approaching zero.

The majority of NBFIs have a negligible share in both total financial sector assets and GDP. It is important to note that, in spite of the banking system assets' enormous share of in total financial system assets, their share was slightly decreasing (2 pp in 2013 compared with 2007), which shows a modest increase of other NBFIs in the financial sector.

Remittances as a percentage of GDP were around 4% in the period 2007-2013, 3.7% in 2013.[47] That share is larger than the share of some non-bank financial institutions in GDP. The share of the insurance sector is 3%, placing this sector in third place in the financial assets structure. Remittances could be used as financial potential for the country.

Table 6.13 Macedonia: Summary of Financial Institutions and Their Legal Framework

Institution	Supervisory Authority	Legislation	Ability to take deposits
Banks	NBRM	Banking Law, Official Gazette of the Republic of Macedonia, Nos. 67/07, 90/09, 67/10 and 26/13	Yes
Insurance	ISA	Law on Supervision of Insurance, Official Gazette of the Republic of Macedonia, No. 27	
Private pension funds	MAPAS[48]	Law on Voluntary Fully Funded Pension Insurance	

[47] World Bank database.
[48] Agency for Supervision of Fully Funded Pension Insurance.

Institution	Supervisory Authority	Legislation	Ability to take deposits
Investment funds	Securities and Exchange Commission	Proposal to Pass a Law on Investment Funds, Official Gazette of the Republic of Macedonia, No.12.2009	
Leasing	Ministry of Finance	Law on Leasing, Official Gazette of the Republic of Macedonia, Nos. 4/2002, 49/2003, 13/2006 and 81/2008	
Savings houses	NBRM	Banking Law, Official Gazette of the Republic of Macedonia, Nos. 67/07, 90/09, 67/10 and 26/13 Decision on the Terms and the Manner of Operating Savings Houses, Official Gazette of the Republic of Macedonia, No. 79/2007	Yes
Financial companies	NBRM	Banking Law, Official Gazette of the Republic of Macedonia, Nos. 67/07, 90/09, 67/10 and 26/13	
Stock exchange	Securities and Exchange Commission	Law on Securities, Official Gazette of Republic of Macedonia, No.95/2005	

6.5 Serbia

6.5.1 Financial Sector Overview

The Serbian financial system consists of a banking system, non-bank financial institutions (insurance companies, voluntary pension funds and leasing companies)[49] and capital markets.[50] Although in the initial phase of development, factoring and microfinance institutions are presented.

Table 6.14. Serbia: Breakdown of Financial Sector Assets

Financial Sector Assets Breakdown (% of Total Financial Sector Assets)	2007	2008	2009	2010	2011	2012	2013
Banking system assets	94.2%	89.3%	90.8%	91.8%	92.4%	91.6%	91.3%
Insurance assets	0.0%	4.3%	4.2%	4.2%	4.4%	4.5%	4.7%
Private pension fund assets	0.2%	0.2%	0.3%	0.4%	0.4%	0.5%	0.6%
Mutual fund assets	0.2%	0.1%	0.0%	0.0%	0.0%	0.1%	0.0%
Factoring assets	0.0%	0.0%	0.0%	0.0%	0.0%	1.1%	1.0%
Leasing assets	5.4%	6.2%	4.7%	3.6%	2.8%	2.3%	0.0%

Financial Sector Assets Breakdown (% of GDP)	2007	2008	2009	2010	2011	2012	2013
GDP (EUR m)	28,570	32,410	28,853	27,666	31,447	29,650	31,995
Banking system assets	69.0%	61.9%	78.1%	86.8%	80.5%	85.4%	77.6%
Insurance assets	0.0%	3.0%	3.6%	4.0%	3.8%	4.2%	4.0%
Private pension fund assets	0.1%	0.2%	0.3%	0.3%	0.4%	0.5%	0.5%
Mutual fund assets	0.2%	0.1%	0.0%	0.0%	0.0%	0.1%	0.1%
Factoring assets	0.0%	0.0%	0.0%	0.0%	0.0%	1.0%	0.9%
Leasing assets	3.9%	4.3%	4.0%	3.4%	2.4%	2.1%	1.8%

Source: National Bank of Serbia, Financial Stability Report data, and IMF data for GDP.

The financial system is considerably bank-centered with a high share of banking assets in both total financial sector assets and GDP. The second-highest share in total financial sector assets belongs to the insurance sector, with the share of almost 5% at the end of 2013. Leasing assets accounted for 2% of total financial sector assets at the end of 2013, whereas other categories had a negligible share.

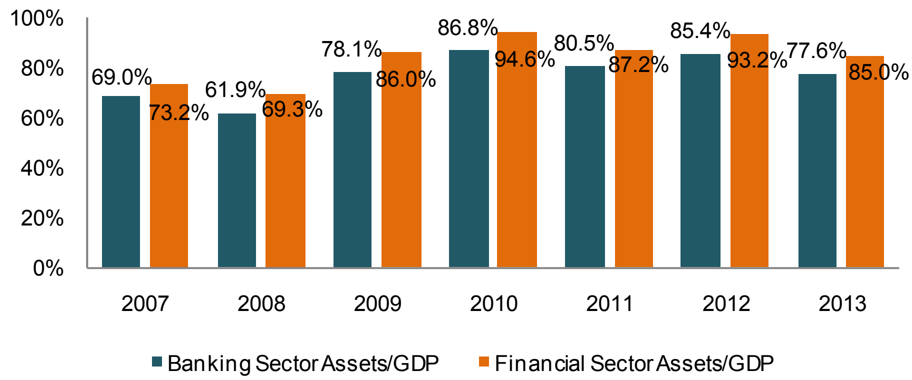
The section is divided into two subsections: banking system (6.5.1.1) and non-bank financial institutions (6.5.1.2).

6.5.1.1 Banking System

The financial system of Serbia is bank-centered, with the banking system assets accounting for 91.3% of total financial sector assets at the end of 2013. Banking assets' share in GDP amounted to 77.6% at the end of 2013. Graph 6.25 presents the share of financial sector assets and banking sector assets as a percentage of GDP in the period 2007-2013.

[49] Supervised by the National Bank of Serbia.
[50] Supervised by the Republic of Serbia Securities Commission.

Graph 6.25 Serbia: Financial Sector Assets and Banking Sector Assets as % of GDP, 2008-2013



Source: National Bank of Serbia database.

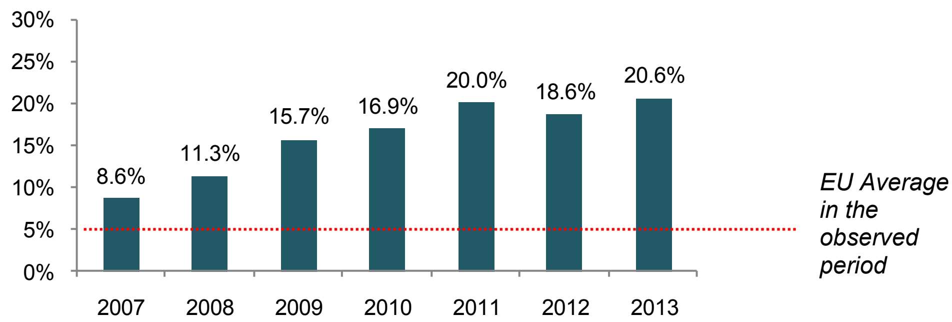
The difference between financial sector assets' and banking sector assets' share in GDP ranged between 7 and 8 pp, except in 2007, when the difference was even smaller.

Credit risk is a very important determinant of financial stability, as analyzed largely through non-performing loan indicators. The NPL ratio was constantly increasing in the covered period, reaching almost 21% at the end of 2013, as presented at Graph 6.26. Two banks were de-licensed (Razvojna Banka Vojvodine and Privredna Banka Beograd), which led to the height of the NPL ratio in 2013. The de-licensing of Nova Agrobank was the main determinant of the NPL ratio in 2012. A portion of the NPL portfolio belonging to closed banks was taken by the Deposit Insurance Agency, and another portion was written off, which diminished the increasing trend of NPL growth. The share of NPLs in total corporate loans amounted to 24.5% at the end of 2013, whereas for the households sector it amounted to 10.8%. The increase in the NPL ratio was 5.3 pp for corporate and 0.7 pp for households at the end of 2013. Serbia had already had a high share of NPLs at the beginning of the crisis (11.3% at end of 2008, compared with peer countries' range between 3.1% in BiH and 6.7% in Macedonia). The NBS applies a rather conservative and rigorous definition of NPLs (NBS, FSR, 2012 and 2013).

"Bearing in mind that one of the state-owned banks that is up for privatization has attracted a significant amount of interest, and due to the fact that we recently issued a preliminary license for a greenfield investment, it would be fair to say that international investors see growth potential in the Serbian market. Primarily, the balance sheet of the majority of Serbian banks consists of traditional banking products, i.e., loans. Current economic expectations indicate gradual economic recovery, which should result in growth starting from 2016. What have been identified as key drivers of growth - investments and net exports - require additional funding. Due to the fact that capital markets are still underdeveloped in Serbia, bank lending is left as the primary solution. From that perspective, corporate sector lending should increase with the development of new export-oriented projects. At the same time our economic growth is somewhat tempered by decreased consumption, which was mostly financed by consumer credit in the previous period. Thus, gradual economic recovery should stimulate an increase in consumption and consequently a rise in consumer lending as well."

NBS

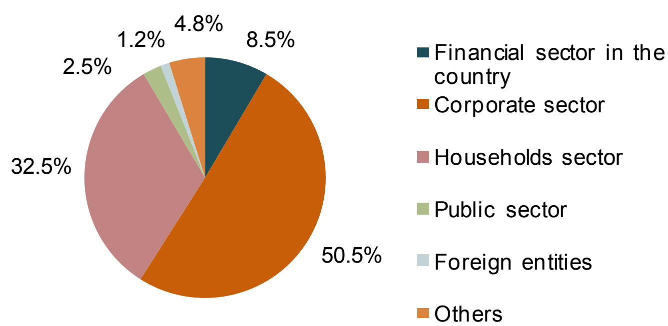
Graph 6.26 Serbia: NPL to Total Loans, 2007-2013



Source: World Bank database.

The largest share in loan maturity structure[51] belonged to long-term loans, 59% at the end of 2013, whereas short-term loans and medium-term loans had shares of 29% and 12%, respectively (NBS, Banking Sector in Serbia, 2013). A breakdown of loans by sector is presented in Graph 6.27.

Graph 6.27 Serbia: Lending Activity by Sector (2013)



Source: National Bank of Serbia, Banking Sector in Serbia Reports.

The loan sector structure was similar to previous years, except for 2009 and 2010, when lending to the public sector was significantly higher. The public sector share in total credits was 9.2% and 12.4% in 2009 and 2010, respectively; such tendencies are probably due to the fact that the financial crisis had extreme consequences in those two years.

6.5.1.2 Non-Bank Financial Institutions

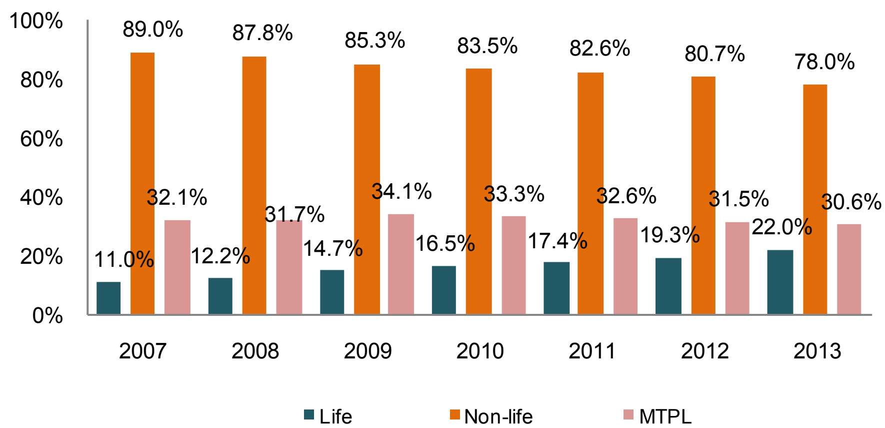
This section presents the main non-bank financial institutions operating in the Serbian financial system. The structure of the chapter is as follows: insurance sector (6.5.1.2.1), voluntary pension funds (6.5.1.2.2), leasing sector (6.5.1.2.3), Belgrade Stock Exchange (6.5.1.2.4), investment funds (6.5.1.2.5), microfinance institutions (6.5.1.2.6) and factoring (6.5.1.2.7).

[51] The categories excluded from total loans are loans due, no set term and no remaining maturity.

6.5.1.2.1 Insurance Sector

Insurance assets amounted to EUR 1.291 m at the end of 2013, when their share in total financial sector assets reached 5%. Insurance assets were constantly increasing in the covered period. The CAGR was 6% for the period 2007-2013. The share of GWP as a percentage of GDP was 1.83% in 2013, which was far below EU standards. The total GWP was EUR 558 m in 2013, which presents a 3% y-o-y increase. The share of life, non-life and MTPL GWP is presented in Graph 6.28.

Graph 6.28 Serbia: GWP Breakdown, 2007-2013



Source: National Bank of Serbia, Financial Stability Report database.

A constant increase of the life insurance share in total GWP was observed in the covered period. MTPL accounted for the highest share of non-life GWP in the covered period. The property insurance GWP was 21.6% of total GWP in 2013 (the second-largest category of non-life insurance). The structure of GWP did not significantly change in the covered period (NBS database).

Property insurance against natural disasters should be developed in the Serbian market, due to the advantages that this type of insurance offers. Some of these advantages include the following: help to households in the form of significant financial support in the case of disaster; fast access to liquid funds in eliminating the consequences of natural disasters; and lower impact on operating results of enterprises in the case of disaster (NBS, FSR, 2013). This has become even more important since the devastating floods in the spring of 2014.

Crop insurance premiums in Serbia had a negligible share in both total premiums and non-life premiums during the covered period (2007-2013). The maximum share was recorded in 2013, amounting to 2.3% in total premiums and 3% in non-life premiums (NBS database). The reasons for such devastating statistics are numerous. The average the agricultural household is poor; non-urban areas had a poverty rate of 13.6%, high above the percentage in urban areas of 5.7% in 2010. Rural areas had been strongly affected by the crisis, so the total increase in poverty in Serbia was generated mostly by a sharp increase of rural area poverty. More than half of the employed in rural areas do not even pay obligatory personal income taxes and social contributions, which increases the probability of being at risk of poverty in the period of retirement.[52] The low and unpredictable income of agricultural workers, as well as high poverty rates, are one of the key reasons why crop insurance is underdeveloped. Crop insurance is used mostly by large agriculture and food companies. The government continuously supports the insurance of crops by a tax reimbursement of 40% of net paid premiums.[53] Legal entities, entrepreneurs and natural persons (commercial family husbandry) could be entitled to the reimbursement. Although the subsidy is high, there has been some estimation that only 3% of registered agricultural holdings insured their crops.[54] It is also worth mentioning Serbian insurance culture, which is at an extremely low level. There is not enough promotion regarding the importance of insurance in general, even less so agriculture insurance. It becomes a popular topic when drought, hail or flooding has already destroyed the entire agriculture production. Individual agricultural holdings have the perception that in the case of natural disasters the government is going to help them to recover their holdings. Nowadays, the government does not enough resources to support them. Traditional agriculture insurance is not valid for catastrophic disasters. The supply of crop insurance products is limited. There have been suggestions and regional cooperation (the Europa Re project) regarding the introduction of climate disaster insurance products (such as hail, earthquake and flood).

Insurance companies have a limited scope regarding the diversification of risks, because of the scarcity of securities traded.

“In the conditions of pronounced information asymmetry, insurance companies as investors in the Serbian financial market cannot realistically assess the risk of and expected returns on their investments. For this very reason they cannot play the important role of efficient investors of funds and stabilizers of the capital market. Naturally, the fact that the development of life insurance per se, as a form of savings, is at a low level should not be neglected either” Kočović, Rakonjac-Antić and Jovović (2011).

In the period 2007-2010, short-term financial investments dominated asset structure. The structure has changed significantly since 2011, when long-term financial investments became dominant. Long-term financial investments’ share in total assets was 42.5%, whereas short-term financial investments amounted to 18.4% at the end of 2013 (NBS, Insurance Sector in the Republic of Serbia, Annual Reports). The share of intangible investments, real estate, and investments in non-tradable securities and receivables in total assets of life and non-life companies is presented in Table 6.15.

Table 6.15 Serbia: The Share of Intangible Investments, Real Estate, and Investments in Non-Tradable Securities and Receivables in Total Assets of Life and Non-Life Companies, 2007-2013

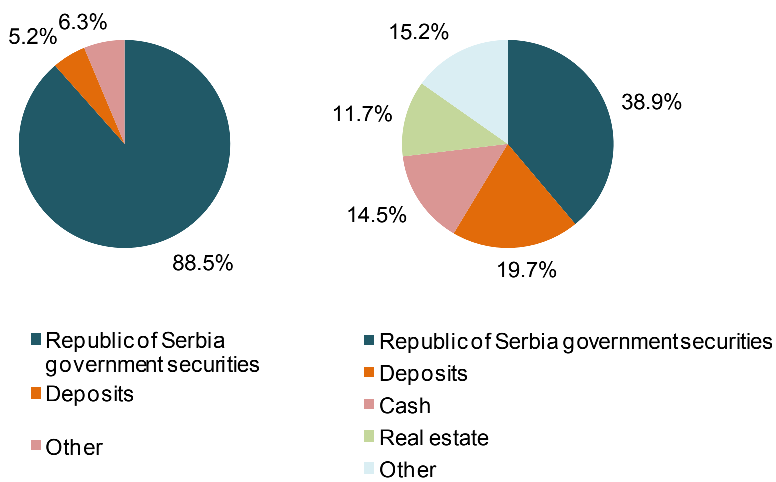
	2007	2008	2009	2010	2011	2012	2013
Non-life	38.62%	44.17%	39.31%	37.03%	38.09%	35%	30%
Life	15.62%	10.16%	10.66%	8.87%	8.01%	4.30%	3.80%

Source: National Bank of Serbia, Insurance Sector in the Republic of Serbia, Annual Reports.

52 For a detailed analysis of poverty in rural areas, as well as the recommendations for social inclusion and reduction of poverty, see First National Report on Social Inclusion and Reduction of Poverty in the Republic of Serbia 2011, and Draft Report for the Second National Report in 2014, Government of the Republic of Serbia publication.
53 Ministry of Agriculture and Environmental Protection.
54 Note: There are no official statistics regarding this topic.

The technical reserves structure is extremely important for the operation of insurance companies, since technical reserves are used to cover companies' obligations from concluded insurance contracts. Technical reserves structure is presented separately for life and non-life companies in Graph 6.29.

Graph 6.29 Serbia: Technical Reserves Structure for Life (left graph) and Non-Life (right graph) Companies, 2013



Source: National Bank of Serbia, Financial Stability Report, 2013.

As expected, investment strategy differs significantly depending on whether investors are life or non-life companies. Both types of companies invest the majority of technical reserves in domestic government bonds.

Kočović, Rakonjac-Antić and Jovović (2011) emphasize key reasons why Serbia is lagging behind developed countries in the insurance sector: an underdeveloped financial market; poor supply of financial instruments; pronounced information asymmetry; and insufficient financial capacity of companies due to the low degree of development of life insurance.

The Serbian insurance sector remained underdeveloped and substantially below the average for EU member states.

6.5.1.2.2 Voluntary Pension Funds

Voluntary pension funds were introduced in Serbia at the end of 2006. Due to the low level of living standards and economic crisis, the voluntary pension system remained undeveloped (NBS, FSR, 2013). Their assets were constantly increasing during the covered period, reaching EUR 172 m at the end of 2013, with a CAGR of 28%. Despite their increasing share in total financial sector assets, voluntary pension funds still have a negligible share in both total financial sector assets and GDP, amounting to 0.5% in both in 2013.

The funds' investment policy is rather conservative. The dominant share of assets is invested in government bonds and bank deposits, including transaction accounts, which accounted for 96% of total investments in 2013. Due to the high share of debt instruments in fund portfolios and bank deposits, most assets were exposed to interest rate risk. Voluntary pension funds are exposed to risk of investment concentration and liquidity of domestic financial instruments (NBS, FSR, 2013).

A favorable macroeconomic environment, development of domestic capital markets, and a rise in living standard are the preconditions for development of voluntary pension funds. Savings for old age through voluntary pension funds should be strongly promoted.

6.5.1.2.3 Leasing Sector

Leasing sector assets amounted to EUR 584 m as of the end of 2013. Their share in total financial sector assets and GDP was 2% and 1.8%, respectively, at the end of 2013. Leasing assets were constantly decreasing from 2009, after a y-o-y increase of 38% in 2008. The CAGR was negative and amounted to 10%.

Non-financial sector companies had a dominant role in investment structure by lessee at 85.6% in 2013, compared with 82.9% the year before (2012). The structure was mostly similar in previous years. In 2013 freight transport vehicles and buses and light vehicles had a dominant share in leasing structure by object, 34.9% and 24.8%, respectively, but the structure was similar to previous years.

There were 16 leasing companies operating in 2013; the number had remained unchanged in the previous two years. Most of them were established by banks, members of broker groups or other financial institutions. Porsche Leasing SCG d.o.o. Belgrade, founded by Porsche Bank AG, Salzburg, Austria, is specialized in financing Porsche Group products. LIPAKS d.o.o. Belgrade and Zastava Istrabenz Lizing d.o.o. were founded by non-financial entities (NBS, Report on Department for Financial Leasing in Serbia, Q3 2013).

Although the Law on Financial Leasing was changed in 2011, introducing the possibility to lease immovable property, it is rarely used. Interest rates, although lower than for housing loans, costs and tax treatment are more than discouraging for buying real estate property by leasing contract.

In 2013, long-term financial assets amounted to 0.1% of total assets, whereas short-term financial assets were 9.2% of total financial assets.

Financial lease investment was mostly financed from foreign borrowings. Foreign credit liabilities accounted for 79.2% of total liabilities, while financial lease investment accounted for 79.9% of total assets at the end of 2013 (NBS, Financial Leasing Supervision in Serbia).

6.5.1.2.4 Belgrade Stock Exchange

The securities currently traded at the Belgrade Stock Exchange are shares and bonds of the Republic of Serbia. In addition to these securities, the following market material is planned for trading: other debt securities, warrants on shares and bonds and other securities with the right to purchase shares or bonds, derivatives, certificates of deposit, and other financial instruments that can be traded at the Exchange by Law.[55] Not surprisingly, financial derivatives and forward contracts are not yet present on the Serbian SE. Currently banks offer private contracts such as forwards and FX swap transactions, giving their clients the possibility to manage FX risk. According to the Law on the National Bank of Serbia (NBS), the Executive Board of the NBS

[55] Belgrade Stock Exchange.

has issued the Decision on Terms and Conditions of Foreign Exchange Swap Trading between the National Bank of Serbia and Banks.[56]

> "The development of the capital market in Serbia depends on several factors. First of all, it is vital whether the government would decide to privatize some of the large state-owned companies by means of IPOs and thus admit the shares of large companies to trading on the stock exchange. Further on, it depends on the interest of foreign investors in takeovers of larger companies and banks listed on the stock exchange. In addition to this, the prospects for its development depend on the fact if a decision to list the state securities on the stock exchange would be made, thus promoting their secondary trading."
>
> Securities Commission

The total market capitalization of the Belgrade Stock Exchange was EUR 6.740 m at the end of 2013. The market capitalization of stocks and bonds amounted to EUR 5.791 m and EUR 949 m, respectively. The total turnover reached EUR 263 m. The y-o-y growth rate of both total turnover and market capitalization was mostly negative in the covered period, with a negative CAGR of 25% and 10%, respectively. The sharpest decline in the stock market was in 2008, when turnover shrank by 56%, whereas market capitalization went down by 36%. Stock market capitalization was constantly decreasing in the covered period. The CAGR was negative at 16%. The share of stock market capitalization as a percentage of GDP was 18% at the end of 2013.

Traded non-public debt was EUR 13 m at the end of 2013, with a negligible share of GDP, 0.04%. Currently, corporate bonds issuers include: Erste Bank a.d. Novi Sad and Societe Generale Banka Srbije a.d. Beograd, with bond maturity dates of November 9, 2014 and April 23, 2015, traded on MTP.[57]

> "The discrepancy arises from the fact that the value of total stock exchange transactions including shares and bonds account for not more than 1% of the total turnover, while OTC transactions make up 99% of the total turnover."
>
> Securities Commission

The corporate bonds market in Serbia is illiquid, risky and undeveloped. There are several reasons for the weak supply of corporate bonds in the Belgrade Stock Exchange. There is a general trade-off between investor protection and simple rules for the issuers. The new Law on Capital Markets (2011) is closer to the EU standards, but it is not appropriate for the emerging and illiquid capital markets. Detailed analyses of the corporate bonds market in Serbia lead us to the conclusion that the corporate bonds market is still in initial phase, with capacities that are virtually negligible. In terms of the real sector, issuance of corporate bonds is rare, and there is usually closed emission for a known investor who already has contacts and a prior arrangement with the company. This is actually an instrument to lend money to the pre-arranged client. Investing in corporate bonds in Serbia is still highly risky. Insurance companies are on the demand side for corporate bonds in general, but the data show that insurance companies prefer to invest in government bonds instead of corporate (as shown in section 6.5.1.2.1). That leads to further absorption of domestic savings by the government,

[56] National Bank of Serbia.
[57] Belgrade Stock Exchange.

thus reducing the scope for the private sector. High transaction costs characterize the Serbian stock market (Đulić and Ţivković, 2012).

6.5.1.2.5 Investment Funds

Investment fund[58] assets amounted to EUR 46 m at the end of 2013. Assets decreased during the crisis in 2008, 2009 and 2010. Since 2011, the y-o-y asset growth rate has been positive. Despite that, the CAGR was negative, amounting to 2%. Investment funds had a negligible share of around 0.1% in both total financial sector assets and GDP.

Raiffeisen Funds had the dominant share in the total assets of investment funds. At the end of 2013, Raiffeisen Cash, Raiffeisen Euro Cash and Raiffeisen World had asset shares in total investment fund assets of 46.4%, 28.6% and 10.9%, respectively, which adds up to 86% of total investment fund assets. We will briefly present investment strategies of these three investment funds in December 2013, since they are a representative sample.

Raiffeisen Cash invests at least 75% of its assets in cash deposits and short-term bonds (with maturity up to one year). This fund is suitable to rather conservative investors who prefer a stable and continual yield. The investment structure is as follows: 62.88% in term deposits, 26.63% in government coupon bonds, 7.23% in treasury bills, 3.12% in corporate bonds and 0.14% in money accounts. The currency structure is RSD (Raiffeisen Cash, 2013).

Raiffeisen Euro Cash invests at least 75% of its assets in money deposits and short-term bonds. The investments are suitable as protection from exchange rate oscillations. The structure of investments are as follows: deposits in EUR – 67.78%, treasury bills – 22.59%, government bonds in EUR – 6.48%, old foreign exchange savings – 2.49%, deposits in RSD – 0.65%, and money accounts – 0.01 RSD. The currency structure is mostly in EUR, 99.34% of total assets (Raiffeisen Euro Cash, 2013).

Raiffeisen World Fund invests mostly in stocks, with such investments accounting for more than 75% of its assets. The main goal of the fund is to realize high yields in the long run by investing in shares of foreign issuers, with the main focus on companies from the USA, the EU and Japan. The currency structure is the following: EUR – 43.24%, USD – 28.12%, and JPY – 13.02% (the first three positions) (Raiffeisen World Fund, 2013).

In addition to the above-mentioned, there were 11 investment funds at the end of 2013. Other investment funds had a mostly negligible share. Illirka Cash Dinar had an assets share of 4.4%, while all the others had a share of less than 3% at the end of 2013.

6.5.1.2.6 Microfinance Institutions

Currently, there are three microfinance institutions (MFIs) operating in Serbia: Agroinvest, Micro Development and Microfins (EMN,[59] 2014). Serbian banking law only allows banks to disburse loans. No specific regulations are given with regards to the provision of microfinancial services. It is necessary to build a legal framework for regulation and supervision of the microfinance institution in Serbia, which might contribute to economic growth (EMN, 2014). According to the information provided by the European Microfinance Network, the Ministry for Finance and the

[58] Investment fund refers to open investment funds.
[59] European Microfinance Network.

National Bank were clear on the fact that the non-banking financial sector should be non-deposit-taking, defined by a microcredit law and supervised by the Ministry of Finance.

6.5.1.2.7 Factoring

Factoring assets amounted to EUR 0.3 m at the end of 2013, making a negligible contribution to the total financial sector, both in terms of share in assets and share in GDP.

The Law on Factoring governs the activities of factoring companies (Official Gazette, No. 62/2013). The Ministry of Finance provides authorizations for performing factoring activity. Currently there are 10 companies authorized to provide factoring services.

Domestic factoring with recourse is still the dominant form of factoring in Serbia, as is characteristic of all the developing factoring industries. The Belgrade Chamber of Commerce conducts a survey in order to collect data on factoring.[60] Factoring turnover was EUR 679 m in 2013 (Belgrade Chamber of Commerce, 2014).

The foreign factoring share in total turnover was 5.5% in 2013, whereas domestic factoring dominated with 94.5% of total turnover. It is interesting to observe in which branches factoring is most present. In 2013, the largest shares in total turnover belonged to trade (22.93%), the food industry (15.85), the processing industry (8.16%) and construction (8.12%) (Belgrade Chamber of Commerce, 2014).

6.5.2 Concluding Remarks

The financial system of Serbia is bank-centered, with a high share (over 90%) of banking assets in total financial sector assets. Other components of the financial sector such as insurance, leasing, voluntary pension funds, investment funds, etc., have a rather small share. Insurance assets' share in total financial sector assets amounted to 5% in 2013, whereas leasing assets amounted 2%. Their share in GDP was even less, 4% and 1.8%, respectively. On the other hand, remittances as a percentage of GDP amounted to 7.3% in 2012.[61] This is important to emphasize, since remittances can be invested in the financial system of the domestic country, that is, in Serbia. Remittances are mostly used for current consumption of remittance-receiving families, and are rarely used for investments.

Private (voluntary) pension funds were founded in 2007, and while their assets were constantly increasing in the covered period, they still remained a small share of total financial sector, less than one percent. The stock market has similar characteristics as other emerging financial markets. Leasing assets were constantly decreasing from 2009, indicating that this sector was strongly hit by economic crisis. Investment funds also faced major consequences of the financial crisis.

Microfinance institutions are not currently governed by specific regulation. There are three MFIs operating in Serbia. The development of MFIs in the future is difficult to predict at this point. The

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[60] The following are factoring companies that filled out the questionnaire: companies - Faktoring, Finera Factoring, Jubmes Factor, Laiki Factors & Forfaiters, Prvi Faktor – Faktoring, Focus Factor and Real Factor; banks: Banca Intesa, Eurobanka AD, Komercijalna Banka, Raiffeisen Banka, Societe Generale Bank Serbia, OTP Banka Srbija and the Export Credit and Insurance Agency of the Republic of Serbia (AOFI). The data are based only on companies that gave the data to the Belgrade Chamber of Commerce.

[61] World Bank database.

factoring industry has become increasingly important. The National Bank of Serbia has collected data on factoring balance sheets since 2012. As in other emerging markets and developing countries, domestic factoring is dominant.

Despite the increase in their importance for overall financial market development, non-bank finance institutions are still a negligible part of the financial sector in comparison with the banking sector, but with the tendency to grow in future.

Table 6.16 Serbia: Summary of Financial Institutions and Their Legal Framework

Institution	Supervisory Authority	Legislation	Ability to take deposits
Banks	NBS	Law on Banks, Official Gazette of the Republic of Serbia, Nos. 107/2005 and 91/2010	Yes
Insurance	NBS	Insurance Law, Official Gazette of the Republic of Serbia, Nos. 55/2004, 70/2004, 61/2005, 61/2005–other related Laws and Regulations, 85/2005–other related Laws and Regulations 101/2007, 107/2009, 99/2011, 119/2012 and 116/2013	
Private pension funds	NBS	Law on Voluntary Pension Funds and Pension Schemes, Official Gazette of the Republic of Serbia, Nos. 85/2005 and 31/2011	
Investment funds	Republic of Serbia Securities Commission	Law on Investment Funds, Official Gazette of the Republic of Serbia, Nos. 46/2006, 51/2009, 31/2011 and 115/2014	
Factoring	Ministry of Finance	Law on Factoring, Official Gazette of the Republic of Serbia, No. 62/2013	
Leasing	NBS	Law on Financial Leasing, Official Gazette of the Republic of Serbia, Nos. 55/03, 61/05 and 31/2011	
Stock Exchange	Republic of Serbia Securities Commission	Law on Capital Market, Official Gazette of the Republic of Serbia, No. 31/2011	

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8 Table of Figures

9 Appendix

9.1 Explanatory Notes for Databases

- **Banking system assets** data refer to total assets (balance sheet total) including branches and subsidiaries of foreign banks, as of the end of period.
- **Stock market assets** data refer to total market capitalization of listed companies, as of the end of period.
- **Traded non-public debt** data refer to total market capitalization of traded corporate bonds, as of the end of period.
- **Insurance assets** data refer to total assets, as of the end of period (unless otherwise stated).
- **Private pension fund assets** data refer to total assets (balance sheet total), as of the end of period (unless otherwise stated).
- **Mutual fund assets** data refer to total assets (balance sheet total) of investment funds (a more detailed definition of investment funds is provided for each country).
- **Factoring volume** data refer to new contract total volume (turnover).
- **Other non-bank financial institutions asset** data refer to total assets (balance sheet total).

Legend:

CREF estimations, unless otherwise stated

9.2 Databases

9.2.1 Region

Table 9.1 Regional Aggregated Database (2007-2013)

Balkan	**EUR m**						
	2007	2008	2009	2010	2011	2012	2013
Banking system assets	40,878	43,296	46,063	48,999	52,163	54,196	54,828
Stock market capitalization	32,498	15,936	15,303	14,504	12,292	11,388	11,513
Traded non-public debt	0	2	2	1	0	17	17
Insurance assets	797	1,811	1,910	2,009	2,208	2,320	2,387
Private pension fund assets	379	395	608	806	984	1,250	1,550
Mutual fund assets	953	646	453	465	432	546	807
Factoring volume	0	0	35	45	45	0	0
Factoring assets	39	41	38	39	41	334	285
Leasing assets	1,948	2,383	2,074	1,590	1,461	1,262	1,118
Venture capital investments	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Venture capital assets	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Residual financing assets*	635	901	872	803	739	689	690
Total financial sector assets	**45,628**	**49,472**	**52,019**	**54,710**	**58,028**	**60,598**	**61,666**
GDP	56,983	64,365	60,494	60,673	66,114	64,800	68,081
Banking system assets/GDP	71.7%	67.3%	76.1%	80.8%	78.9%	83.6%	80.5%
Stock market capitalization/GDP	57.0%	24.8%	25.3%	23.9%	18.6%	17.6%	16.9%
Traded non-public debt/GDP	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Insurance assets/GDP	1.4%	2.8%	3.2%	3.3%	3.3%	3.6%	3.5%
Private pension fund assets/GDP	0.7%	0.6%	1.0%	1.3%	1.5%	1.9%	2.3%
Mutual fund assets/GDP	1.7%	1.0%	0.7%	0.8%	0.7%	0.8%	1.2%
Factoring volume/GDP	0.0%	0.0%	0.1%	0.1%	0.1%	0.0%	0.0%
Factoring assets/GDP	0.1%	0.1%	0.1%	0.1%	0.1%	0.5%	0.4%
Leasing assets/GDP	3.4%	3.7%	3.4%	2.6%	2.2%	1.9%	1.6%
Venture capital investments/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Venture capital assets/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Residual financing assets/GDP	1.1%	1.4%	1.4%	1.3%	1.1%	1.1%	1.0%
Total financial sector assets/GDP	80.1%	76.9%	86.0%	90.2%	87.8%	93.5%	90.6%

Notes: (*) Residual financing comprises other non-banking financial institutions operating in the Balkans (see tables by country)

Source: As stated in tables by country.

9.2.2 EU

Table 9.2 EU Database (2007-2013)

EU	EUR m							Sources and Notes
	2007	2008	2009	2010	2011	2012	2013	
Banking system assets	39,503,100	44,896,240	42,860,340	42,957,320	44,904,020	43,611,550	39,468,120	*Source: ECB*
Stock market capitalization	11,454,003	5,173,414	7,083,602	7,962,633	6,724,322	8,094,295	n/a	*Source: World Bank*
Traded non-public debt*	5,264,000	6,041,000	7,121,000	7,102,000	7,221,000	7,299,000	n/a	*Source: ECB*
Insurance assets	7,584,862	7,094,049	5,113,885	5,426,089	5,486,346	5,745,077	6,006,677	*Source: EIPOPA*
Private pension fund assets*	1,369,224	1,286,665	1,381,468	1,505,124	1,591,590	1,780,962	1,849,270	*Source: ECB*
Mutual fund assets*	n/a	4,467,099	5,435,055	6,302,363	6,236,977	7,193,704	7,951,384	*Source: ECB*
Factoring volume	877,210	845,368	827,514	989,953	1,140,449	1,207,318	1,259,343	*Source: Factor Chain International*
Factoring assets	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Leasing assets**	674,549	610,005	574,106	638,509	633,203	646,794	632,639	*Source: Leaserope*
Venture capital investments	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Venture capital assets	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Total financial sector assets	**49,131,735**	**58,354,058**	**55,364,854**	**56,829,405**	**58,852,136**	**58,977,087**	**55,908,090**	
EU GDP	12,582,066	12,670,916	11,909,285	12,467,757	12,824,830	13,083,559	13,185,836	*Source: IMF World Economic Outlook*
Euro Area GDP	9,052,594	9,271,664	8,927,149	9,194,031	9,439,951	9,511,160	9,602,940	*Source: IMF World Economic Outlook*
EU Leasing countries GDP	12,154,951	12,238,886	11,521,088	12,071,117	12,413,485	12,669,612	12,763,988	*Source: IMF World Economic Outlook*
Banking system assets/GDP	314.0%	354.3%	359.9%	344.5%	350.1%	333.3%	299.3%	
Stock market capitalization/GDP	91.0%	40.8%	59.5%	63.9%	52.4%	61.9%	n/a	
Traded non-public debt/GDP	58.1%	65.2%	79.8%	77.2%	76.5%	76.7%	n/a	
Insurance assets/GDP	60.3%	56.0%	42.9%	43.5%	42.8%	43.9%	45.6%	
Private pension fund assets/GDP	15.1%	13.9%	15.5%	16.4%	16.9%	18.7%	19.3%	
Mutual fund assets/GDP	n/a	48.2%	60.9%	68.5%	66.1%	75.6%	82.8%	
Factoring volume/GDP	7.0%	6.7%	6.9%	7.9%	8.9%	9.2%	9.6%	
Factoring assets/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Leasing assets/GDP	5.5%	5.0%	5.0%	5.3%	5.1%	5.1%	5.0%	
Venture capital investments/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Venture capital assets/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Total financial sector assets/GDP	**390.5%**	**460.5%**	**464.9%**	**455.8%**	**458.9%**	**450.8%**	**424.0%**	

Note: (*) Data refer to euro area (data for EU is not available); (**) Data refer to the group of 22 countries, that submitted their data to the Lease Europe association (Austria, Belgium, Bulgaria, Czech Republic, Germany, Denmark, Estonia, Spain, Finland, France, Greece, Hungary, Italy, Latvia, Netherlands, Poland, Portugal, Romania, Sweden, Slovakia and United Kingdom).
Estimations:
Data for pension funds for 2007 refer to 1Q 2008, given the absence of 2007 data.

Source: As stated within the table.

9.2.3 Albania

Table 9.3 Albania Database (2007-2013)

Albania	**EUR m**							Sources and Notes
	2007	2008	2009	2010	2011	2012	2013	
Banking system assets	6,089.3	6,726.6	6,422.5	7,126.6	8,059.0	9,470.0	9,674.2	*Source: BoA (SAR)*
Stock market capitalization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	*Note: No listed companies*
Traded non-public debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	*Note: No corporate bonds*
Insurance assets	109.5	125.2	117.6	127.1	136.8	145.3	151.4	*Source: BoA (FSR)*
Private pension fund assets	0.4	0.8	1.5	2.2	1.1	2.0	3.1	
Mutual fund assets	0.0	0.0	0.0	0.0	0.0	114.7	359.3	*Source: BoA (FSR)*
Factoring volume	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Factoring assets	0.0	0.0	0.0	0.1	0.7	1.6	1.0	*Source: BoA (FSR and SAR)*
Leasing assets	39.3	38.3	49.4	67.6	79.1	74.9	65.6	*Source: BoA (FSR and SAR), CREF research*
Venture capital investments	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Venture capital assets	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
SLA assets	50.4	61.3	63.5	69.8	70.6	75.7	73.3	
Microfinance institutions	0.0	0.0	0.0	2.2	2.9	2.5	2.5	*Source: BoA (FSR and SAR)*
Institutions licensed for lending assets	54.1	52.7	68.0	104.3	98.6	93.1	100.5	
Total financial sector assets	**6,343**	**7,005**	**6,723**	**7,500**	**8,449**	**9,980**	**10,431**	
GDP	7,806	8,623	8,506	8,829	9,108	9,470	9,581	*Source: IMF World Economic Outlook*
Banking system assets/GDP	78.0%	78.0%	75.5%	80.7%	88.5%	100.0%	101.0%	
Insurance assets/GDP	1.4%	1.5%	1.4%	1.4%	1.5%	1.5%	1.6%	
Private pension fund assets/GDP	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Mutual fund assets/GDP	0.0%	0.0%	0.0%	0.0%	0.0%	1.2%	3.8%	
Factoring volume/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Factoring assets/GDP	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Leasing assets/GDP	0.5%	0.4%	0.6%	0.8%	0.9%	0.8%	0.7%	
Venture capital investments/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Venture capital assets/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
SLA assets/GDP	0.6%	0.7%	0.7%	0.8%	0.8%	0.8%	0.8%	
Microfinance institutions assets/GDP	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Institutions licensed for lending assets/GDP	0.7%	0.6%	0.8%	1.2%	1.1%	1.0%	1.0%	
Total financial sector assets/GDP	81.3%	81.2%	79.0%	84.9%	92.8%	105.4%	108.9%	

Notes: Factoring institutions were licensed in 2010 and had only just started their activity prior to 2010; The first investment fund began operations in 2012 when the Albanian subsidiary of Raiffeisen Bank established an investment fund.

Source: As stated within the table.

9.2.4 Bosnia and Herzegovina

Table 9.4 Bosnia and Herzegovina Database (2007-2013)

Bosnia and Herzegovina	EUR m							Sources and Notes
	2007	2008	2009	2010	2011	2012	2013	
Banking system assets	10,006	10,643	10,537	10,439	10,735	10,832	11,262	*Source: FSR (CBBH)*
Stock market capitalization	11,491	5,577	5,300	5,229	3,892	3,904	4,052	*Source: SASE, BLSE and CREF estimates*
Traded non-public debt	0	2	2	1	0	3	3	*Source: SASE, BLSE and CREF estimates*
Insurance assets	436	455	481	481	551	600	586	*Source: FSR (CB)*
Private pension fund assets	0	0	0	0	0	0	0	*Note: Only "Pay as you go" system*
Mutual fund assets	901	626	445	454	414	407	390	*Source: FSR (CBBH)*
Factoring volume	n/a	n/a	35	45	45	n/a	n/a	*Source: Factor Chain International*
Factoring assets	39	41	38	39	40	41	n/a	*Source: Companies' financial reports, CREF estimates*
Leasing assets	705	822	724	380	392	366	305	*Source: FSR (CBBH)*
Venture capital investments	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Venture capital assets	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Microcredit institutions assets	484	620	556	438	379	346	341	*Source: FSR (CBBH)*
Total financial sector assets	**12,570**	**13,207**	**12,781**	**12,231**	**12,512**	**12,593**	**12,884**	
GDP	11,181	12,722	12,378	12,708	13,159	13,158	13,488	*Source: IMF World Economic Outlook*
Banking system assets/GDP	89.5%	83.7%	85.1%	82.1%	81.6%	82.3%	83.5%	
Stock market capitalization/GDP	102.8%	43.8%	42.8%	41.1%	29.6%	29.7%	30.0%	
Traded non-public debt/GDP	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Insurance assets/GDP	3.9%	3.6%	3.9%	3.8%	4.2%	4.6%	4.3%	
Private pension fund assets/GDP	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Mutual fund assets/GDP	8.1%	4.9%	3.6%	3.6%	3.1%	3.1%	2.9%	
Factoring volume/GDP	n/a	n/a	0.3%	0.4%	0.3%	n/a	n/a	
Factoring assets/GDP	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	n/a	
Leasing assets/GDP	6.3%	6.5%	5.8%	3.0%	3.0%	2.8%	2.3%	
Venture capital investments/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Venture capital assets/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Microcredit institutions assets/GDP	4.3%	4.9%	4.5%	3.4%	2.9%	2.6%	2.5%	
Total financial sector assets/GDP	**112.4%**	**103.8%**	**103.3%**	**96.2%**	**95.1%**	**95.7%**	**95.5%**	

Source: As stated within the table.

9.2.5 Kosovo

Table 9.5 Kosovo Database (2007-2013)

Kosovo	EUR m							Sources and Notes
	2007	2008	2009	2010	2011	2012	2013	
Banking system assets	1,435.0	1,808.0	2,205.0	2,455.0	2,660.0	2,830.0	3,060.0	*Source: CBK*
Stock market capitalization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Traded non-public debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Insurance assets	70.8	78.4	81.1	97.2	106.0	130.8	132.5	*Source: CBK*
Private pension fund assets	0.0	0.0	4.7	5.2	4.9	4.5	5.1	*Source: CBK*
Pension system assets*	286.0	256.3	380.9	493.7	593.3	745.0	918.7	*Source: CBK*
Mutual fund assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Factoring volume	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Factoring assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Leasing assets	0.0	0.0	0.0	67.6	79.1	74.9	65.6	*Source: CBK*
Venture capital investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Venture capital assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Microfinance institutions assets	0.0	110.5	131.6	140.8	127.1	115.8	112.9	*Source: CBK and CREF research*
Total financial sector assets	**1,792**	**2,253**	**2,803**	**3,260**	**3,570**	**3,901**	**4,295**	
GDP	3,461	3,885	4,064	4,406	4,813	5,061	5,327	*Source: IMF World Economic Outlook*
Banking system assets/GDP	41%	47%	54%	56%	55%	56%	57%	
Stock market capitalization/GDP	0%	0%	0%	0%	0%	0%	0%	
Traded non-public debt/GDP	0%	0%	0%	0%	0%	0%	0%	
Insurance assets/GDP	2%	2%	2%	2%	2%	3%	2%	
Private pension fund assets/GDP	0%	0%	0%	0%	0%	0%	0%	
Pension fund assets/GDP	8%	7%	9%	11%	12%	15%	17%	
Mutual fund assets/GDP	0%	0%	0%	0%	0%	0%	0%	
Factoring volume/GDP	0%	0%	0%	0%	0%	0%	0%	
Factoring assets/GDP	0%	0%	0%	0%	0%	0%	0%	
Leasing assets/GDP	0%	0%	0%	2%	2%	1%	1%	
Venture capital investments/GDP	0%	0%	0%	0%	0%	0%	0%	
Venture capital assets/GDP	0%	0%	0%	0%	0%	0%	0%	
Microfinance institutions assets/GDP	0%	3%	3%	3%	3%	2%	2%	
Total financial sector assets/GDP	**51.8%**	**58.0%**	**69.0%**	**74.0%**	**74.2%**	**77.1%**	**80.6%**	

Notes: (*) Pension system accounts for significant investor; data on assets of microfinance institutions for 2008-2010 are estimated.

Source: As stated within the table.

9.2.6 Macedonia

Table 9.6 Macedonia Database (2007-2013)

Macedonia	EUR m							Sources and Notes
	2007	2008	2009	2010	2011	2012	2013	
Banking system assets	3,636	4,062	4,368	4,964	5,385	5,738	6,007	*Source: MCB (FSR)*
Stock market capitalization	4,695	1,722	1,986	1,993	1,935	1,838	1,670	*Source: MSE reports*
Traded non-public debt	0	0	0	0	0	0	0	*Note: No corporate bonds*
Insurance assets	180	193	198	195	210	212	226	*Source: MCB (FSR)*
Private pension fund assets	54	86	148	210	270	355	451	*Source: MCB (FSR)*
Mutual fund assets	1	2	3	3	4	6	13	*Source: MCB (FSR)*
Factoring volume	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Factoring assets	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Leasing assets	81	140	140	138	151	113	97	*Source: MCB (FSR)*
Venture capital investments	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Venture capital assets	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Savings houses assets	47	56	53	49	51	46	47	*Source: MCB (FSR)*
Financial companies assets	0	0	0	0	9	10	12	*Source: MCB (FSR)*
Total financial sector assets	**4,000**	**4,538**	**4,910**	**5,557**	**6,081**	**6,480**	**6,853**	
GDP	5,966	6,724	6,693	7,063	7,587	7,460	7,690	*Source: IMF World Economic Outlook*
Banking system assets/GDP	61%	60%	65%	70%	71%	77%	78%	
Stock market capitalization/GDP	79%	26%	30%	28%	26%	25%	22%	
Traded non-public debt/GDP	0%	0%	0%	0%	0%	0%	0%	
Insurance assets/GDP	3%	3%	3%	3%	3%	3%	3%	
Private pension fund assets/GDP	1%	1%	2%	3%	4%	5%	6%	
Mutual fund assets/GDP	0%	0%	0%	0%	0%	0%	0%	
Factoring volume/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Factoring assets/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Leasing assets/GDP	1%	2%	2%	2%	2%	2%	1%	
Venture capital investments/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Venture capital assets/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Savings houses assets/GDP	1%	1%	1%	1%	1%	1%	1%	
Financial companies assets/GDP	0%	0%	0%	0%	0%	0%	0%	
Total financial sector assets/GDP	**67%**	**67%**	**73%**	**79%**	**80%**	**87%**	**89%**	

Notes: Data on factoring companies are not available separately; they have been included in the financial companies' assets and banking system assets.

Source: As stated within the table.

9.2.7 Serbia

Table 9.7 Serbia Database (2007-2013)

Serbia	EUR m							Notes and Sources
	2007	2008	2009	2010	2011	2012	2013	
Banking system assets	19,711	20,056	22,530	24,015	25,325	25,326	24,825	*Source: NBS (FSR)*
Stock market capitalization	16,312	8,636	8,018	7,282	6,464	5,647	5,791	*Source: Belgrade Stock Exchange data*
Traded non-public debt	0	0	0	0	0	13	13	*Source: Belgrade Stock Exchange data*
Insurance assets	0	959	1,032	1,109	1,204	1,231	1,291	*Source: NBS (FSR)*
Private pension fund assets	39	52	73	95	115	144	172	*Source: NBS (FSR)*
Mutual fund assets	51	18	5	7	13	19	46	*Source: NBS (FSR)*
Factoring volume	226	370	410	500	926	950.0	679.0	*Source: Factor Chain International*
Factoring assets	0	0	0	0	0	291.4	284.0	
Leasing assets	1,123	1,383	1,161	937	760	633	584	*Source: NBS (FSR)*
Venture capital investments	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Venture capital assets	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Total financial sector assets	20,924	22,469	24,802	26,163	27,417	27,645	27,203	
GDP	28,570	32,410	28,853	27,666	31,447	29,650	31,995	*Source: IMF World Economic Outlook*
Banking system assets/GDP	69.0%	61.9%	78.1%	86.8%	80.5%	85.4%	77.6%	
Stock market capitalization/GDP	57.1%	26.6%	27.8%	26.3%	20.6%	19.0%	18.1%	
Traded non-public debt/GDP	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Insurance assets/GDP	0.0%	3.0%	3.6%	4.0%	3.8%	4.2%	4.0%	
Private pension fund assets/GDP	0.1%	0.2%	0.3%	0.3%	0.4%	0.5%	0.5%	
Mutual fund assets/GDP	0.2%	0.1%	0.0%	0.0%	0.0%	0.1%	0.1%	
Factoring volume/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Factoring assets/GDP	0.0%	0.0%	0.0%	0.0%	0.0%	1.0%	0.9%	
Leasing assets/GDP	3.9%	4.3%	4.0%	3.4%	2.4%	2.1%	1.8%	
Venture capital investments/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Venture capital assets/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Total financial sector assets/GDP	73.2%	69.3%	86.0%	94.6%	87.2%	93.2%	85.0%	

Source: As stated within the table.

9.3 Exchange Rates

The following table shows currency exchange rates used for conversation of local currencies to euro.

Table 9.8 Exchange Rates (2007-2013)

Currency Exchange Rates	2007	2008	2009	2010	2011	2012	2013
USD/EUR (Average)	1.3705	1.4708	1.3948	1.3257	1.3920	1.2848	1.3281
RSD/EUR (End of period)	79.2362	88.6010	95.8888	105.4982	104.6409	113.7183	114.6421
MKD/EUR (End of period)	61.5076	61.7194	61.4791	61.5050	61.5050	61.5000	61.5113
ALL/EUR (End of period)	122	124	138	139	139	140	140
KM/EUR (Currency board)	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

Source: ECB for USD/EUR, National Bank of Serbia for RSD/EUR, Bank of Albania for ALL/EUR, National Bank of the Republic of Macedonia for MKD/EUR and Central Bank of Bosnia and Herzegovina for KM/EUR.