

Financial Stability – capacity building, credibility and systems for an effective regulatory: Role of CBK

Speech of Mr. Gani Gërguri

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Introduction

Good afternoon.

First of all I would like to congratulate your association for its 10-th anniversary and the enormous contribution in building accounting and auditing capacities in Kosovo.

At the same time I would like to thank you for your invitation that reflects your respect toward CBK's efforts. Both of our institutions are in partnership since the beginning and CBK as a guard for prudential use of SCAAK grants is proud to see your imposing growth. Than we are partners because CBK still has an important role on issues having to do with accounting and auditing standards of financial sector.

My presentation today is mainly focused on the role and responsibilities of the Central Bank of the Republic of Kosovo in preserving financial stability in Kosovo.

Central Bank Mandate

Because of individual specifics of different countries, all central banks in the world have completely the same structure and objectives. Some of the Central Banks are characterized by multi objectives (Federal Reserves of USA, Bank of Japan), while some others have only one main objective (e.g. European Central Bank), etc.

Anyway the common nominator on global level for a modern central bank is that its main function is the macro economical stability. This due to the fact that macro economical stability stands on its two main pillars: *monetary stability* and *financial stability*. Even in cases when financial stability is not explicitly attached to the central bank, people expect the central bank to perform this duty also. Remember commitments of the Bank of England, then those of FED about saving some of their banks that plunged into financial difficulty.

In our case, euroization has provided monetary stability, so CBK is assigned to maintain financial stability as its main duty and primary objective. After the last global financial crises, this objective is quickly turning under the umbrella of the majority of the central banks in the world.

In the context of the title of this panel let me briefly dwell on monetary stability, which is recognized as a prerequisite not only for financial stability, but also for the economic development of the country. In this case I just wanted to remind what has been highlighted by others before: the experience of undeveloped economies suggests to us that monetary stability contributes significantly to the economic development only if at the same time accompanied by significant improvement of governance, education and the efficient and effective legal system (property rights, enforcement of commercial contracts, etc..).

The unique role of CBK in maintaining financial stability

If we simplify the definition of financial stability within the implications that this objective derives to the role of the central bank, it appears that central banks have two main tasks associated to their objective for the maintenance of financial stability. This relates mainly to:

- *prevention of financial instability in one side; and*
- *managing the consequences of the unstable financial market on the other.*

In preventing financial instability, CBK is practically and legally responsible for the appropriate and sound formulation of rules and regulations of financial sector, than is responsible for the supervision of financial institutions and management of payment system in our country.

In this regard CBK is rare due to the fact that licences, regulates and supervises not only banks and insurance companies, but also any other entity that is included under the definition of a “financial institution”. Obviously, an arrangement of the type “*all in one*” demands from the CBK to continuously invest on **malty-profile** capacity building in guaranteeing an efficient and effective licensing, regulation and financial supervision.

While in *managing the consequences of the unstable financial market*, the majority of central banks have an entire arsenal of instruments such as the last instance lender, discount cashier, obligatory reserves and the right policy on interest rate, from all this, actually CBK posses only the obligatory reserve.

In these circumstances, the CBK is focused exclusively on **preventing financial instability** and it does this by adding continuous perimeter as well as the frequency of supervision of financial institutions.

Therefore, in these circumstances, the CBK is focused exclusively on **preventing financial instability** and it does this by continuously increasing the perimeter as well as the frequency of supervision of financial institutions.

Thus, in addition to mikroprudenciale supervision (of individual institutions) CBK is making encouraging steps in the field of makroprudenciale supervision also by stress-testing the stability of individual banks and the banking system as a whole towards the possible scenarios of the sources of financial instability that may come from other sectors of the economy. For this purpose, Early Warning Indicators are standardized and on monthly bases are distributed to decision-making bodies of the CBK. All these efforts are synthesized in the first publication of the Report on Financial Stability, which analyzes cohesion between proceedings in financial sector and those in the general environment. Building the capacity to illuminate this cohesion deeper is necessary especially for the need of defining clear and precise terms and systemic judge in case of eventual use of the Regulation (still being finalized) in cases of liquidity emergency. Only in such circumstances such a Regulation will be maximally in function of preventing financial instability, namely the prevention of the so-called "moral hazard" and the elimination of any excessive embrace of risk by bank's management.

The regulatory framework and supervisory capacity in view of financial stability in Kosovo

Regulatory and supervisory framework of the CBK has mainly being developed due to the permanent assistance of USAID, the IMF and World Bank. Built by international standards, this framework since in the beginning took into account the Kosovo specifics which resulted in soundness and stability of Kosovo's financial sector even during the global financial crisis.

Rules like the one of the ratio loan/deposits, then the restrictions on foreign exposure, requirements for capital adequacy, liquidity, etc., proved to be well defined instruments and powerful in ensuring financial stability in Kosovo (the latest data on soundness of the banking sector illustrate this stability: capital adequacy 18.1 percent, liquid assets to total assets 35.3 percent, the ratio loan/deposits of 78 percent, non-performing loans 6.2 percent, etc.).

Despite the so long mentioned stability, the CBK proactively continues to test the adequacy of its rate of patrol of financial sector as well as environmental quality within and outside the financial sector. Thus, after evaluation of compliance with the Basel Core Principles for Effective Banking Supervision (English: Basel Core Principles for Effective Banking Supervision Assessment), were identified areas that require updating of the regulatory and supervisory framework and on this basis are being reviewed with priority rules for capital, then rules for classification and provision of loans, corporate governance, new rules for

information technology systems, etc. In cooperation with the IMF and U.S. Treasury is prepared a draft law on commercial banks, microfinance institutions and other non-bank financial institutions, which clearly addresses some of the most important issues as sanitation actions, then strengthening of corporate governance requirements, consolidated supervision (supervision not only in the mother-daughter relationship, but also in the relation between banks and other entities related to business), the elimination of legislative uncertainties in the field of microfinance institutions and non-banking ones, etc.

In collaboration with the World Bank the new Law on Payment System is finalized, which clarifies the criteria for operators and other payment agent and installs the monitoring function of the payment system by the CBK. It is worth underlining here also the ongoing projects like:

- Common preparations with the Treasury (Ministry of Finance) for the operation of the market of securities: and
- Implementation of National Payments Strategy, with particular emphasis on the implementation of the RTGS (real time gross settlement) and the Labour Succession Plan - these crucial projects to ensure financial stability.

And, here is not the end of the review of regulatory framework. On the contrary, the financial sector is embarked on a comprehensive roentgen:

- Have already agreed for June World Bank mission in ROSC (English: Report on the Observance of Standards and Codes) for Corporate Governance, than for Credit/Debit Regime and Insolvency of the banking sector, and has just completed the ROSC Assessment Principles Basic Security for effective oversight of life and non-life insurance of insurance companies. Financial Sector Assessment Program (FSAP) required by many developed countries is already scheduled for the second quarter of 2012.

The roentgen is expected to:

- Calibrate accurately the soundness of financial sector (the ability of supervisors, policymakers and financial safety network to effectively respond to systemic tension) and;
- To assess development aspects of financial sector with special focus on examining the quality of the regulatory framework and financial infrastructure as well as examination of the financial sector contribute to the economical growth and development of our country.

It is also expected an extra examination to the issue of access to banking services and the development of local capital market - aspects that are very important especially for less developed countries and those with low income.

The regulatory frameworks do not regulate by themselves. Even the recent global crisis has shown that one of its causes was the failure of regulatory governance. Consequently, only the proper development of human resources profile and other capacities represents the best

guarantee that appropriate regulations will be designed and implemented in favour of preventing financial instability and therefore in favour of the economical growth and development.

Besides recruiting, developing and maintaining competent and credible profile of the staff of the CBK, and obviously the capacity building as the ones of your association and the one on Credit Registry that is taking place on the second floor right now in this hotel – also led by USAID, will enhance financial reporting and the transparency in the financial sector. This will further contribute to reducing information asymmetry in lending, which reduces the cost of credit and thus directly affects the growth and development of our country.

Thank you for your attention and good luck in this conference!