

## FOREIGN BANKS OPERATION IN KOSOVO

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**Abstract:** One of the most prominent events in the history of the Central Bank of Kosovo-CBK was the conversion to EURO (shifting from the Deutch marks DM to the EUR-euro currency). Although Kosovo is not member of the European Union, it has enjoyed the right to use the EUR currency. By doing so, Kosovo has benefited a monetary policy lead and monitored by the European Central Bank -ECB. This makes the financial system very secure and stable. Based on Law no. 03/L-209 on Central Bank of the Republic of Kosovo (CBK), its primary objective is to foster and to maintain a safe and sound financial system. CBK as a supervising and licensing mechanism of financial institutions supervises the following financial institutions: Banks, insurance companies, microfinance institutions, pension funds and non-bank financial institutions.

The banking system in Kosovo accounts for 85.5% of the financial system assets. In September 2017, the total assets of the banking system amounted to 3,811 million, whereas, loan share accounts for 2.4 million, respectively an increase of 10.2%. Deposits marked an increase to 9.2% of total amount of 3,046 Million. Current number of banks operating in Kosovo is 10, of which 8 are with foreign capital, while the number of employees in this sector amounts to 3,298.

Today, the sector is in the phase of evolving technology development with the tendency to shift from a traditional service to digital or electronic services such as e-banking, POS terminals, ATMs, online application for consumer loans and other electronic services. This strategy helps reduce overall business costs, contributes to the removal of physical money and promotes contemporary banking services that do not differ from the banking system of developed countries.

**Keywords:** Central Bank, financial system, banks, assets, services

### 1. HISTORY OF BANKS DEVELOPMENT IN KOSOVO

Following the end of war on 3 June 1999, or by Kumanovo agreement, based on Resolution 1244 (MTA, 1999), responsibility for Kosovo administration was vested to the United Nations Mission in Kosovo (UNMIK). Kosovo's Provisional Self-Government Institutions have been established by the UNMIK mission, representing the people of Kosovo and acting under United Nations mandate operating in Kosovo. Regardless of their democratic legitimacy, the powers of local institutions to express the will of the people in political decision-making processes were limited and subjected to the Special Representative of the Secretary-General (SRSG), this special representative held the main powers over the following issues: Coordination of Foreign Affairs, Justice, Public Order and Macroeconomic Developments.

The United Nations Interim Administration Mission in Kosovo (UNMIK) in close cooperation with the International Monetary Fund (IMF) assistance has issued the legal framework for the financial sector in Kosovo, which has been focused on building a sound legal, regulatory and supervisory framework and the provision of conditions for development of sound financial institutions. The Central Bank of Kosovo was established on 15 November 1999 by the United Nations Interim Administration Mission in Kosovo, pursuant to UNMIK Regulation.

The purpose behind its establishment was to contribute to strengthening the economy in Kosovo by providing an efficient payment system as well as a sound banking system. The purpose of the UNMIK authorities was initially to revive the payment system, because at that time there was no commercial banks established, and ultimately as another objective was "the efficient functioning of a banking system". The Banking and Payments Authority of Kosovo, at the same time, represents the root in establishing a financial sector of Kosovo. Like any other start, this institution managed well to cope with all these challenges successfully, developing and receiving additional functions, so on 24 August 2006, UNMIK issued a new regulation on the "Central Banking Authority of Kosovo"<sup>315</sup>. This institution was run mainly by international staff, but gradually the transfer of competencies to local staff was done by setting up professional cadres to lead this important institution to the financial sector.

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<sup>315</sup>Merovci, S. (2004): Tregjet dhe Instrumentet Financiare, Instrumentet Derivateve: Kontratat Forward, Futers, Opsionet, Marrëveshjet Repo. Prishtina, 2004

On June 15, 2008, with the entry into force of the Constitution of the Republic of Kosovo, Law no. 03/L-074 (revoked on 20 August 2010, and replaced by Law No. 03/L-209) on the Central Bank of the Republic of Kosovo-CBK, which defines the Central Bank of Kosovo as a public and independent institution reporting to the Assembly of Kosovo and provides it with full functional, operational and financial independence. Based on this legal framework, rules and regulations have been issued for the governance, supervision and monitoring of financial institutions. The provisions of that legal framework relied on best banking practices that were appropriate for the Kosovo environment as well as on Basel I agreement. This legal framework, with some changes and recent updates, was in effect until the end of April 2012, when the new law on banks, microfinance institutions and non-bank financial institutions was approved. The new law introduced a wide range of innovations. This law addressed some of the issues that were not specifically regulated by previous rules and regulations and addressed the improvement of capital and liquidity position of banks.

## 2. THE ROLE OF THE CENTRAL BANK

The CBK's objectives are now growing and prioritized, with the main objective being "promotion and maintenance of a stable and sound financial system":

1. The primary objective of the Central Bank is to foster and to maintain a stable financial system, including a safe, sound and efficient payment system.
2. An additional objective of the Central Bank, which is subordinated to the primary objective of the Central Bank, is to contribute to achieving and maintaining domestic price stability.
3. Central Bank shall support the general economic policies of the Government.
4. Central Bank acts in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources.

With the implementation of the new law, it is believed that it will promote a more sound and sustainable financial and banking sector by strengthening the governance of financial institutions, the regulatory capital for the banks that currently operate and those to enter the market, more accurate monitoring of capital positions and also the reduction of credit exposure to the level that reflects regulatory capital sustainability for banks operating in the Kosovo market. However, the implementation of this law will also be accompanied by constant changes in the Kosovo market, especially with local capital banks to respond to the stricter regulatory capital requirements. Whereas, for banks operating in Kosovo with international capital, most of the requirements of these laws and new regulations are already being implemented due to their obligations to the parent country operating under requirements of European Central Bank. The legal framework for banks, financial institutions and non-bank financial institutions of Kosovo, compared to legal frameworks with the countries of the region, cannot yet be considered as advanced although there has been continuous progress. In order to advance the competences of the BPAK regarding the regulation, licensing and control of financial institutions in Kosovo, Regulation No. 2001/24 on amending Regulation no. 1999/20. This regulation establishes the legal basis for licensing, supervision and regulation of insurance companies and intermediaries as well as pension funds. The status of the Central Bank of Kosovo (CBK) is defined in Articles 11 (2) and 140 of the Constitution of the Republic of Kosovo and in the Law No. 03/L-209 on Central Bank of Kosovo, which clearly defines competencies, objectives, tasks, relations with the state, relations with financial institutions and payment system functions, regulatory capital, organization and administration, financial statements and financial control.

The Central Bank of Kosovo acts pursuant to the following laws and regulations<sup>316</sup>:

- Law on the Central Bank of the Republic of Kosovo
- Law on Pensions in Kosovo
- Regulation on licensing, supervision and governing of banks
- Regulation on licensing, supervision and governing of insurance companies and insurance brokers
- Rule on Allowed Currency in Use in Kosovo
- Regulation on Payment Transactions, and
- Regulation on registration, licensing, supervision and governing of microfinance institutions

Then the following draft laws and regulations are put forward:

- Draft-law on Deposit Protection
- Draft-law on Banks

<sup>316</sup>Central Bank of Kosovo -CBK

- Draft-law on general insurance
- Draft-law on payment transactions, and
- Draft-law on compulsory motor liability insurance
- Regulation on the Capital Adequacy of Banks
- Regulation on Credit Risk Management
- Regulation on Liquidity Risk Management
- Regulation on Operational Risk Management
- Regulation on disclosure of information by banks
- Regulation on effective interest rate and publication requirements
- Regulation on Changes in Capital Accounts
- Regulation on Consolidated Supervision of Banking Groups, etc.

Kosovo's banking system is a relatively new sector which started to function at the end of 1999, whereas before this time Kosovo had no modern banking system in terms of providing financial intermediation based on market economy conditions. As the last country in the region that started the transition process, Kosovo continues to go through numerous challenges of economic recovery and consolidation of institutions to create conditions for the functioning of the market economy.

### 3. BANKING SYSTEM SPECIFICITIES

The banking sector in Kosovo has restored confidence, making this industry one of the most successful events of Kosovo's economy since the end of the war up to date. Kosovo's financial system covers the banking industry, the insurance industry, pension funds, microfinance institutions and non-bank financial institutions. The number of financial institutions has not marked any significant change from previous periods.

Financial Institutions in Kosovo	Number
Commercial banks	10
Insurance companies	13
Pension funds	2
Microfinance institutions	18
Financial intermediaries	40

Table 1. Number of financial institutions in 2017

The financial sector in Kosovo continues to be characterized with a satisfactory level and a steady stability even during 2017, although total financial sector assets grew at a slower pace compared to the following countries in the region: one can note that Serbia's banking sector has the highest share 92.7%, Albania with 90.0%, Macedonia with 88.5%, Bosnia and Herzegovina with 86.3%, Kosovo with 85.5%, Slovenia with 77.0%, and Croatia's lowest share with only 75.6 % in relation to total assets of the financial sector<sup>317</sup>.

Over the years, the financial intermediation cost has decreased, the largest number of banking products, the expansion of the banking network and the ease of access of customers to banking services. Kosovo's banking sector, by constantly introducing new technology, is developing compliant to modern banking trends, adapting to changing consumer behaviour towards banking services. The banking sector is also one of the main factors in stimulating the country's economic development.

Despite ongoing improvements, the cost of mediation in the banking system continues to be high. This has affected various factors related to both the banks themselves and the business environment. The Kosovo banking system throughout the period of operation has been characterized by a high level of stability stemming from the application of conservative lending policies by banks and conservative oversight by the regulator. This is explained by the fact

<sup>317</sup>World Economic Forum (2010): Redefining the Emerging Market Opportunity; Driving Growth through Financial Services Innovation

that the share of non-performing loans to the total credit portfolio of the banking sector is low and ranks Kosovo's banking sector among the sectors with the best loan portfolio quality in the region. Based on World Bank data on the level of interest rates on loans compared to the countries of the region, Kosovo has the highest interest rate.

Ensuring high deposit rates as a source of funding has made banks have a more stable source of funding and not rely on short-term demand, whose offer is usually more diverse and has higher funding costs, especially in times of economic and financial difficulties. Investments made by commercial banks in financial markets are mainly made in investments that are considered to have a high degree of security, both for the type of investment and the country where investments were made. Central Bank's capital serves as an important reserve against unexpected losses, therefore, requires careful asset management.

<b>Banking financial system in Kosovo</b>			
<b>Structure, Activities, Performance</b>	<b>September 2017</b>	<b>December 2016</b>	<b>December 2015</b>
<i>Number of Banks</i>	<b>10</b>	<b>10</b>	<b>10</b>
<i>Number of employees</i>	<b>3.298</b>	<b>3.375</b>	<b>3.375</b>
<i>Assets Value</i>	<b>3,811.40</b>	<b>3,363.80</b>	<b>3,387.30</b>
<i>Loans</i>	<b>2,407.20</b>	<b>2,230</b>	<b>2,019.40</b>
<i>Annual Growth Rate of Loans</i>	<b>10.20%</b>	<b>10.40%</b>	<b>7.30%</b>
<i>Deposits</i>	<b>3,046.90</b>	<b>2,897.90</b>	<b>2,701.40</b>
<i>Annual Growth Rate of Deposits</i>	<b>9.20%</b>	<b>7.20%</b>	<b>6.50%</b>
<i>Shareholder's Equity</i>	<b>456.30</b>	<b>420.7</b>	<b>393.80</b>
<i>Income</i>	<b>181.60</b>	<b>231.1</b>	<b>238.20%</b>
<i>Expenditures</i>	<b>112.50</b>	<b>155.6</b>	<b>143.50</b>
<i>Net Profit</i>	<b>69.90</b>	<b>75.5</b>	<b>94.70</b>
<i>Liquidity ratio</i>	<b>38.70%</b>	<b>41.50%</b>	<b>44.90%</b>
<i>Loan Loss provisions to nonperforming loans</i>	<b>139.90%</b>	<b>126.50%</b>	<b>115.10%</b>
<i>Interest rate</i>	<b>6.50%</b>	<b>7.20%</b>	<b>7.70%</b>

Table 2. Banking System, Performance (source, CBK annual reports)

#### 4. DIFFERENCES BETWEEN BANS IN KOSOVO

The banking sector of Kosovo consists of ten (10) commercial banks, 9 banks operate throughout the territory of Kosovo such as: Raiffeisen Bank - RBKO, Procredit Bank-PCB, NLB Bank, TEB Bank, Banka Kombëtare Tregtare - BKT, Banka Private e Binzesit- BPB, Banka Ekonomike-BEK, ISH Bankasi, Zirad Bank and Commercial Bank, which is located only in Serbian settlements. Three of the largest banks are branches of international banking groups coming from European Union countries such as Germany, Austria and Slovenia.

The banking system of Kosovo is characterized by a high share of foreign banks, which account for about 89.3% of total assets of this sector. It is noted that about 69% of the banking sector's asset structure in Kosovo comes from European Union countries, only 11% comes from Turkey, 11% of banking sector assets are from Kosovo and only 9% of banking sector assets belongs neighbouring countries such as Albania and Serbia<sup>318</sup>.

<sup>318</sup>Central Bank of Kosovo- CBK



Chart 1. Banking sector assets in Kosovo (Source Central Bank of Kosovo)

All commercial banks are private banks and only two of them are banks with local capital. In the case of Kosovo, there are several different characteristics in relation to other countries, for well-known reasons, that Kosovo's business immediately after the war first had the need for credit for infrastructure rebuilding, finance business activities and the need for reconstruction of the country. The main factors influencing the tightening of credit granting criteria are considered to be the general economic situation and particular industries as well as the risk associated with the collateral execution.

The distribution of loans by sectors remains unchanged from previous years, dominated by the services sector, accounting for 72.0% of total loans. The largest share of the services sector consists of loans to trading companies, followed by loans to the industry, energy and construction sector, accounting for 24.3% of total loans. Despite the fact that it is considered as a promoter for Kosovo's economic development, the agriculture sector continues to have a very low share, which accounts for 3.7% of total loans.

The financial statements structure and the statistical reports are in line with international financial reporting standards, the International Monetary Fund, the European Central Bank, Eurostat, etc. The most important and sustainable funding for the banking system in Kosovo continues to be customers deposits. The assets quality within the banking system continues to be under acceptable rates, however, in recent years their position is noted to be deteriorated.

## SUMMARY

The Central Bank of Kosovo, based on the regulation on capital adequacy, has determined the use Basic Indicator Approach as compulsory, but banks may also use other approaches, but such other approaches are subject to prior approval by the CBK. Commercial Banks have kept the capital adequacy ratio at a relatively high level in relation to the minimum requirements established by the CBK under the Capital Adequacy Regulation.

The performance of the banking system in Kosovo continues to be positive despite the unfavourable economic environment at global level. The banking system in the country although recorded a slowdown in income growth to assets ratio, again is considered stable.

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