



**DRAFT**

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## “Scoping of Problem” Document

### **Project:**

**Analysis of the alternatives on existence of Central Security Depository services to Albanian issuers and investors by comparing the “establish a new center” versus “buy the services” options of these services**

### **Section 1 Project information**

<b>PUBLIC-PRIVATE FINANCIAL SECTOR MODERNIZATION MATRIX</b>					
<b>Italian Banking Association CRITERIA</b>	<b>European Central Bank CRITERIA</b>				
	<i>Asymmetric information reduction</i>	<i>Completeness of the market</i>	<i>Increased opportunities to engage in financial transactions</i>	<i>Reduced transaction costs</i>	<i>Increased competition</i>
Business development					
Industry competitiveness				X	
Industry reputation					

#### **Short description of the context:**

There is no functioning stock market in Albania. There is a legal framework on the establishment and functioning of the stock exchange, but there are no dealings made in the market. There is one stock exchange licensed in Albania (the Tirana Stock Exchange). It has very limited trading activity and as a result the Albanian financial system is currently centered on banks while the equity market is remarkable underdeveloped. Nonetheless, there are active operators in the market, which create the demand and supply on securities.

The main securities supplier is Albanian Government issuing public debt securities. Companies are another important supplier issuing only ownership securities. Thus, shares of state companies are privatized to “strategic investors”, while private companies sell their shares in informal market. The demand for securities is committed generally by financial institutions such as commercial banks, brokerage houses (generally invest on government papers), insurance companies, pension funds as well as international financial institutions (i.e. IFC, EBRD, American Enterprise Fund etc. which invest in private company shares). Another important securities demander is the public, generally individuals, who invest their savings in T-Bills,

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and businesses who buy shares in informal market to “take-over” companies they privatized from the state.

All securities in Albania are dematerialized ones, and as such kept in “book-entry” form. Only privatization vouchers were in a physical form, as materialized securities. The financial instruments, which have been present in the Albanian securities market so far, are:

- T-Bills (3, 6, 12 month maturity)
- Government Bonds (2 years, 3 years, 5 years – fixed coupon and variable coupon and 7 years maturity)
- Privatization Vouchers
- Shares of Companies

**Stakeholder proposing the project: AFS, Ministry of Finance**

**Other Stakeholders involved (sponsors): Bank of Albania, Banks of second level, The Center of the share’s registration, Bourse of Tirana**

**Project objective:** The main objective of the PWG will be to produce a feasibility study that should contain a thorough analysis of the alternatives that would guarantee the existence of Central Security Depository services to Albanian issuers and investors by comparing the “establish a new center” versus “buy the services” options of these services. In more detailed terms the feasibility study shall duly considered all possible options, by not limiting itself in only examining the alternative of establishing an Albanian tailored Central Security Depository, but also the possibility to buy these services from another already established agency abroad, which have the appropriate experience and can ensure the same services at a lower cost, according to the standards of the EU’s countries. Both options shall carefully take into account important given facts in short and long-term perspective that will influence the success and/or failure of the to-be chosen alternative.

**Description of the project contribution toward financial modernization:**

The availability of CSD services will help the well functioning of the capital market, in general. Especially, it will create a higher efficiency regarding securities transactions; will create the appropriate guarantees regarding their ownership (clearing) and in the same time will enable the efficiency of the settlement for all securities types, especially of the dematerialized securities through the electronic system.

**Project Working Group:**

Albanian Association of Banks

Banks

Stock exchange

Securities market Operators

Investors

**The EU Better Regulation Approach**

<b>Steps</b>	<b>Purpose</b>
<b>Scoping of problem</b>	
1. Problem identification	To understand if a market/regulatory failure creates the case for regulatory intervention.
2. Definition of policy objectives	To identify the effects of the market /regulatory failure to the regulatory objectives.
3. “Do nothing” option	To identify and state the status quo.
4. Alternative policy options	To identify and state alternative policies (among them the “market solution”).

**Section 2:  
Scoping the problem****2.1. Problem identification****2.1.1. Background Information**

The central depository agency is a legal entity authorized for performing tasks related to the depository of dematerialized securities and the clearing and settlements of legal operations performed with securities.

The terms relating to the tasks of the central depository agency shall have the following meanings:

1. clearing is the comparison of information on concluded legal transactions in dematerialized securities, determination of deadlines for payments related to legal transactions and calculation of obligations to be paid,
2. settlement is the mediation and supervision of payment and/or transfer of securities associated with legal transactions in securities,
3. depository tasks are the corresponding entries in electronic records for the purpose of acquisition, transfer or termination of ownership, lien and other rights

from dematerialized securities.

*i. The need for the functions of a Central Depository*

In Albania, individual banks act as custodians. But there is not a central and/or unique depository.

For *companies shares* the Shares' Registration Center operates as licensed registrar. It was created as a joint stock company in 1996, and is a state-owned entity.

**Governmental securities** (G-Securities) are issued in book entry form and are transferable. Every transfer of property from the owner of the G-Securities to the purchaser must be registered, for the transfer to take effect.

The Bank of Albania maintains the registry of the first level, referred as the synthetic registry. Registrars licensed by the FSA (for example, Raiffeisen Bank and the INTESA SANPAOLO Bank and three other banks) maintain the registry of the second level, referred as the analytic registry.

The existence of several securities registrars is not considered as having a positive impact for the development of the market. There is a need for the existence of one central depository since it would assist in:

- Stimulating an active Stock Exchange;
- Increasing the number of long term debt instruments of the Albanian Government;
- Increasing the transactions with Albanian Government Securities by individuals and legal persons;
- Increasing the foreign investors' interesting, particularly foreign banks, on buying Albanian Government Securities;
- Increasing Cross-border transactions;

The experience of many countries that have established Central Depository institutions, and consulting with several foreign experts in this area, strongly supports the necessity of having a Central Securities Depository for:

- Registering all kind of securities in the same center, including the Government Securities;
- Completing the clearing and settlement of transactions with securities;
- Processing of the identification number of securities (ISIN);
- Other services to help securities issuers, etc.

On the other hand, there is growing awareness of obstacles to capital market development created by high clearing and settlement costs of low-volume national CSDs. In the interest of capital market deepening, particularly in the European Union, there is a well-advancing agenda, based on the so-called "Giovannini Reports", to promote consolidation of national CSDs. The ECB-driven T2S initiative is a powerful driver to create a single EU-wide CSD platform.

It is therefore necessary to cast our study in a rigorous "make" or "buy" decision of CSD services.

### **2.1.2. Market Analysis**

*General market:* Security market

*Specific segment:* Client services regarding the securities transaction, including the ownership and debt securities.

### **2.1.3. Legal framework**

The securities markets legislation in Albania is essentially entrusted in the Law Nr 9879, dated 21.02.2008 “On Securities”. The law regulates the types of securities, the conditions for their issuance, trading and registration procedures, requirements for brokers, the conditions for the organization of the public trading of securities, rules on protection of investors and the securities holders, the organization and functioning of securities registries and stock exchange<sup>1</sup>.

The securities market is supervised by the Albanian Financial Supervisory Authority (FSA). FSA was established by law no. 9572 dated 3.7.2006 and it replaced the Securities Commission. According to this framework, the FSA is mainly responsible for issuing and revoking<sup>2</sup> licenses of market operators, monitoring standards of transparency in public offerings of securities, keeping records in connection with market operators, determining licensing and operating requirements for securities brokers, and issuing rules<sup>3</sup> on the operation of the securities market. FSA is responsible for issuing and revoking licenses of the securities registrar.

#### **○ The establishment of the Registrar**

A company that wants to function as registrar shall fulfill some criteria that coincide with two phases:

- The FSA’s approval of the draft statute (Article of Association) of company;
- License’s provision.

The company’s draft statute shall have as exclusive object the its activity the functioning as securities registrar, and it shall be approved by the AFS, prior to the application nearby the National Center of Registration (NCR). After the statute’s approval, the company shall submit to FSA a written request on obtaining the license as registrar<sup>4</sup>. The fact that FAS has approved the company statute does not oblige FSA to issue the license as registrar. FSA examines all the documents that are attached to the request for obtaining the license<sup>5</sup> and has the right to verify *in situ* (at the place) the data stated by the applicant<sup>6</sup>. FSA shall decide within 30 days for the approval or refusal of the license’s request.

Registrar’s activity is supervised by the FSA, through mechanisms foreseen by law, for example, the registrar’s obligation to submit to FSA periodic reports and

<sup>1</sup> Article 1, Law Nr 9879, dated 21.02.2008 “On Securities”

<sup>2</sup> Article 13/2, Law No. 9572, Date 3.7.2006, “On the Financial Supervisory Authority”.

<sup>3</sup> Article 13/1, Law No. 9572, Date 3.7.2006, “On the Financial Supervisory Authority”.

<sup>4</sup> Article 129/2, Law No. 9879, date 21.2.2008 “On Securities”

<sup>5</sup> Article 130, Law “On Securities”, foresees a detailed list for the dokument to be submitted .

<sup>6</sup> Article 131, Law No. 9879, date 21.2.2008 “On Securities”

information regarding the activity's progress, based on procedures foreseen by the law "On the securities"<sup>7</sup>.

The registrar's directors in order to exercise such an assignment shall fulfill the criteria foreseen by article 136 of the law on "Securities" such as: the high education, expertise and experience in financial markets, etc.

The law "on Securities" foresees also the criteria of license's suspension and removal<sup>8</sup> and mainly ties those criteria with the start and interruption of the activity term; with the continuance of company's existence; or company's activity, despite the bankruptcy/liquidation procedure or the placement of the company under controlled administration; as well as with the disrespect of the legal requirements during the exercise of activity as registrar.

#### ○ **Registrar's functions**

The joint-stock company which is registered as a registrar shall have as an object of its activity the organization and administration of the securities data. The registrar's function is the securities' registration, through organizing methods/mechanisms on registry<sup>9</sup> holding which shall in all cases contain data as follows:

- Securities' ownership;
- The transaction performed with the securities;
- Pledging of securities as a guaranty (liens and or encumbrance, etc)<sup>10</sup>

A registrar can be licensed to register more than one security. In such a case next to the registrar's name is noted in brackets also the securities type for which it has been legally licensed. The register is nominated depending on the types of the securities.

In order to perform its functions, the registrar has the following duties:

1. To organize the registration of the transaction and of the respective changes, so that at in a timely fashion it can identify, data regarding the last security's owner and the terms leading to restriction of property rights on securities, such as liens and other kind of encumbrance upon them<sup>11</sup>;
2. To sign contract and to collaborate with the securities' issuers;
3. To ensure the confidentiality of the data recorded;
4. To perform other functions, which may be foreseen by the statute<sup>12</sup>.

The law also foresees that, if the registrar will offer clearing and settlement (payment/repayment) service, it is obliged to form a guaranty fund. Moreover,

<sup>7</sup> Article 136, Law "On Securities"

<sup>8</sup> Article 136 Law "On Securities"

<sup>9</sup> Article 126/1, 136 Law "On Securities"

<sup>10</sup> Article 123, Law "On Securities"

<sup>11</sup> Article 119/1, 139, Law "On Securities" and Art.1, Law No.8537, date18.10.1999 "On the liens and encumbrance"

<sup>12</sup> Article 126/2, Law "On Securities"

taking into account the role of the registrar, which in any case, does not enjoy any ownership on the securities for which it performs only the duty of data' and transactions' recording, the law foresees that the registrar can not lend and borrows securities<sup>13</sup>.

In order to have a full picture of the legal framework, besides the above-mentioned law "On securities" it is important to analyze also other law provisions i.e of the law No.9901, date 14.4.2008 "On entrepreneurs and companies" (LEC), Law No. 9723, date 3.5.2007 "On the national registration center" and the DCM No.112, date 19.2.1996 "On the establishment of the joint-stock company The center of the stocks registration".

The law "On entrepreneurs and companies" foresees the method of establishing the joint-stock companies (JSCs)<sup>14</sup> including the stocks' issuance and their transfer. According to LEC, the stock ownership is transferred at the moment of registration of the transaction at stocks' registry kept by the company, based on article 119 of the LEC. This article foresees: that "The joint-stocks company shall keep a specific Stocks' registry, in which the stocks' ownership is recorded. The following data shall be registered for each stock: shareholder's name and surname, or registered name, when he is a legal person, residence or head office address, stock's par value and date of registration". No stocks and right so acquired may be exercised against a person or a company prior to it registration in the special shares registry that the company keeps<sup>15</sup>. Thus, interpreting the two above mentioned provisions, we can conclude that the gain of ownership title is tied with the moment of registration of the stock's transfer, in the special stocks' register, kept by the company, which is different from the one kept by the NCR, and different from the one foreseen by the DCK no.112, date 19.2.1996, "On the establishment of the joint-stock company The Center of the Stocks Registration" and as well different from the one kept by the registrar, based on the law "On the securities".

- **Legal provisions regarding only the registration of the ownership titles, shares.**

Furthermore, according to the article 119/5 of the LEC, the above mentioned provisions do not interfere with the duty of the company to disclose the shareholders' list in accordance with article 43, paragraph 4 of the Law no.9723, date 3.5.2007 "On the national registration center". However, according to this point, the joint-stocks companies do not have the obligation to notify each stock's transfer, nearby the NCR.

Moreover, the joint-stocks company shall submit to NCR, an update list of shareholders, once a year, together with the balance-sheet.<sup>16</sup>

The register kept by the NCR, in the meaning given by LEC to the process of the shares' registration, does not reflect the transactions and does not aim to ensure the appropriate information regarding the stocks' ownership. Meanwhile, the specific register kept by the company itself has validation's function for stock's transfer of ownership and the lack of this registration according to this law, has as a

<sup>13</sup> Article 138/1,3, Law "On Securities".

<sup>14</sup> Article, 117, Law No.9901, date14.4.2008 "On entrepreneurs and companies"

<sup>15</sup> Article 117/2, 119/5 Law No.9901, date14.4.2008 "On entrepreneurs and companies"

<sup>16</sup> Article 43/4, Law No. 9723, datë 3.5.2007 "On the national registration center"

consequence the invalidity of the transaction.

Furthermore, the Albanian legal framework has foreseen with the DCK no.112 date 19.2.1996, the establishment of the Center of the Stock's Registration, which exercise its activity nearby the Ministry of Economy. This center operates as a state joint-stock company and has as a main function the effective and regular holding of the stocks' registration<sup>17</sup>, however, since the LEC does not foresee any obligation for the joint-stocks companies regarding the registration of their shares or respective transaction nearby this center, it seems that the function of this Center shall be further regulated taking into consideration the new legal framework.

#### **2.1.4. Stakeholders - Institutional framework**

##### **- *Financial Supervisory Authority***

FSA was established by law no. 9572 dated 3.7.2006 and it replaced the Securities Commission. According to this framework, the FSA is mainly responsible for issuing and revoking<sup>18</sup> licenses of market operators, monitoring standards of transparency in public offerings of securities, keeping records in connection with market operators, determining licensing and operating requirements for securities brokers, and issuing rules<sup>19</sup> on the operation of the securities market.

##### **- *Ministry of Finance***

It issues the government bonds, on behalf of the Albanian government.

##### **- *Bank of Albania***

Bank of Albania has the function of the government securities' trading, organization of the Treasury bonds' auction and keeping of the first level's register for these securities, referred as the analytic registers.

##### **- *Banks of second level***

Some of the banks of the second level perform registrar functions, by keeping the registry of the second level, referred as the analytic registry.

##### **- *Tirana Stock Exchange***

It is the only licensed by the FSA stock exchange in Albania. It has very limited trading activity.

##### **- *The Stock Registration Center***

SRC is established with the DCM No.112, date 19.2.1996, with the proposal of the Ministry of Finance and it is a state owned company. Its main activity's object is the effective and regular holding of stocks' registration, the assurance of the exact and timely transfer of the stocks' ownership and the necessary data processing of the shareholders accounts.

<sup>17</sup> DCM No.112, date 19.2.1996

<sup>18</sup> Article 13/2, Law No. 9572, Date 3.7.2006, "On the Financial Supervisory Authority".

<sup>19</sup> Article 13/1, Law No. 9572, Date 3.7.2006, "On the Financial Supervisory Authority".

## **2.2. Market/regulatory failure analysis (nature and evidence)**

The Albanian legal framework has not foreseen the existence of a Central Security Depository. The law on securities foresees the security's registration in a decentralized manner through the existence of various registrars, which operate as joint-stock companies. They have to be licensed for this activity by the FSA. The registrars can operate, according to their request, even for one or more than one security, which shall be specified by the license and by the register that they keep. In this framework, even the SRC itself can be considered as registrar for the ownership titles (stocks), but with a limited activity and not as a securities registrar, in terms of the law on securities. Article 13 of the law on securities, "Stock's electronic registration" foresees that for the securities electronic registration, one of the requested data is the stocks' registration's date nearby SRC. However, in any case since that SRC is a joint-stock company, it can apply to be licensed by FSA as a registrar, according to the provisions of the new law on securities, which allows the operation as a register also for only one type of security. Although SRC has as activity's object to hold efficiently and regularly the stocks' registration and the assurance of a timely stocks ownership's transfer and the respective data processing of the shareholders account, it seems that this role is not supported by the law "On entrepreneurs and companies", which creates a connection between the validity of the stock ownership's transfer with the respective transaction registration in the specific company's register. (Art. 117/2).

Moreover, taking into account the fact that new legislation will be required for potential establishment of a domestic CSD; this legal action would serve also the purpose of unifying and standardizing the terms used by different pieces of legislation regarding the securities' ownership and the ownership's evidence. In a more detailed manner the law "On securities" and the law "On entrepreneurs and companies", use the following terms on ownership: "stocks' holder" and "last stockholder", "holder" and "shareholder".

Furthermore, is important to stress the fact that the role of the registrar nowadays is played by commercial banks (for example, Raiffeisen Bank and the INTESA SANPAOLO Bank and three other banks), which hold analytical registers. However, this function seems to be in conflict with the role of registrar, because the Bank plays the role of the agent in the transaction operations and at the same time plays the role of the register in verifying the information, recording the transaction itself and providing the securities' ownership.

## **2.3. Policy Goal(s) threatened by the failure**

There is no Central Security Depository foreseen in the Albanian legal framework and there is no structure that has played or is planning to have similar functions as a CSD for the time being in Albania. However, the lack of this structure and/or service equivalent with the centralized administration of securities depository creates a very negative impact on the capital market development and financial stability due to:

1) lack of safety for the participants/investors, taking in consideration the need of securities to be deposited and registered only after being verified, which is realized

only through CSD existence.

2) lack of timely transactions in regard to settlements/payments;

3) lack of services provided in regard to dividends and securities interest distribution;

4) lack of guaranties to be placed upon securities (pledging liens and encumbrances) which are considered very important for financing activities of securities owners;

5) lack of possibilities in general for effectuating exchanges, loans, repurchases agreements etc.

All the above-mentioned downsides results in creating uncertainty for issuers and investors and emphasize the need to act properly for remedying the situation in order to encourage the capital market development in Albania. Moreover, the existence of a unique Central Security Depository would represent lower costs from the participating actors and investors than having different decentralized registrars.

Taking into consideration the benefits and positive effects of a CSD, the main objective of this project initiative would be to asses the possible alternative of establishing a new CSD structure in Albania, or having similar functions' services bought by already existing CSD structure.

## **2.4. “Do nothing” option**

**2.4.1. Possible medium-term (max 2 years) self – corrective market actions**  
(for example the mechanisms of the “do nothing” option will address the market/ legal framework’s failure)

The non-revision of the current regulatory framework will have as a consequence the malfunction of the transactions in the capital market and will bring a direct impact regarding the verification and the identification of the ownership titles, by resulting in a slow-down of the settlement (payment) process of the transaction made with the securities. The establishment of a newly structure of CSD or the purchasing of the services of a CSD represents also a possibility to correct the uncertainty created by the approval of the new legal regulatory framework such as the law on securities, the law on entrepreneurs and companies, or the DCM on the establishment of the stock registration center.

### **2.4.2. Impact of the “Do Nothing” option to the various stakeholders**

- **Impact on the investors:** The lack of a CSD forms an obstacle from the investors' perspective, because it doesn't offer the required guarantees to access capital market and perform the respective transactions. The same is valid also for the issuers especially the private. On the contrary, the existence of the central depository will serve as a basis to encourage the efficiency of the capital market in Albania and the engagement of more stakeholders and the public itself.

## 2.5. Alternative policy option(s)

### 2.5.1. Description of Option 1:

#### *“A domestic public-owned CSD”*

The establishment of e CSD nearby a state entity such as Bank of Albania that currently plays the role of the securities’ registrar for governmental securities is supported by the fact that BA has foreseen to undertake the initiative for the establishment of the electronic software regarding the registration of the government securities. In this framework, BA has planned to collaborate with the International Monetary Fund, during 2011 in order to establish this registrar, despite the fact of the establishment or not of a CSD.

It is important that all relevant issues are examined in this regard such as:

- the legal and operational possibilities of the BoA to undertake and play this role;
- other consequences that can impact current initiatives as the existence of the Central Registrar of Companies’ stocks
- the amount of securities and expected amount of transactions taking into account the current development in the governmental securities market (the new legal regulations on long term maturity Bonds and corporate bonds and issuance of Eurobonds

### 2.5.2. Description of Option 2:

#### *The establishment of a domestic privately-owned CSD*

Since the Albanian legal framework foresees that the registrars are organized as joint-stock company, it is important to take into consideration, similar criteria for the establishment of the CSD. In this framework, it can be foreseen that the state entities can participate with determined participation % (percentages) in the registrar (joint stock company).

In the framework of this alternative it is important to consider the following issues:

- The approach of MoF as the owner/administrator of governmental in this regard i.e. if they are confident to trust a private entity to register and keep all the records in regard to governmental securities.
- The amount of securities and expected amount of transactions especially in the perspective of a cost versus profit approach;
- The capacities (existed and to-be developed) of the private corporation serving a CSD in order to meet the required European standards so that the records and transaction are compatible with the one held in EU countries.
- The already existing Central Registrar of Companies’ stocks as a joint-stock company.

**2.5.3. Description of Option 3:**

*Buying CSD services from a highly competitive EU provider*

The third alternative of buying the services of a CSD from abroad, from a already existing company functioning as a CSD, shall be seen in the light of a cost-benefit analysis but also from the legal perspective, if the Albanian law allows this. Until now the majority of the stakeholders have seen this alternative with skepticism, because this may be the first time that this kind of duties are given to a non-Albanian entity. Thus for this alternative it is very important the duly consideration of the approach of MF, BA since the registrar plays the role of the securities' ownership certification, in analogy, the role of the Immovable Property Registration Office for the real estate property titles.

<b>Summary Problem Scoping</b>			
<b>Revising regulatory act on Execution of Procedures on Bank accounts</b>			
<b>Market failure</b>			
Asymmetric information	Market power	Positive externalities	Negative externalities
<b>(Existing) Regulatory failure</b>			
Regulation wrongly prescribed for the market	Regulations succeeded in addressing the failure; a different market failure (e.g. side effect)	Regulation made it worse	Regulation so far has failed to work; maybe in due course
X			