Project Information Document/ Identification/Concept Stage (PID)

Concept Stage | Date Prepared/Updated: 21-May-2019 | Report No: PIDC192119

BASIC INFORMATION

A. Basic Project Data

Project ID	Parent Project ID (if any)	Environmental and Social Risk Classification	Project Name
P171066		Low	Enhancing Capital Markets Supervision Capacities of The Albanian Financial Supervisory Authority Phase 2
Region	Country	Date PID Prepared	Estimated Date of Approval
EUROPE AND CENTRAL ASIA	Albania	21-May-2019	
Financing Instrument	Borrower(s)	Implementing Agency	
Investment Project Financing	Ministry of Finance and Economy	Albania Financial Supervisory Authority	

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	1.40
Total Financing	1.40
Financing Gap	0.00

DETAILS

Non-World Bank Group Financing	
Trust Funds	1.40
Swiss State Secretariat for Economic Affairs	1.40

B. Introduction and Context

Country Context

Albanian authorities are shifting their attention from strengthening stability and resilience of the financial sector into diversification and deepening of financial sector services. Following a set of comprehensive financial sector reforms during 2014-2017 focused on mitigating risks for the high level of NPLs, strengthening the resilience and stability of the banking sector, improving the safety net, enhancing the independence of the Albanian Financial Supervisory Authority (AFSA) and creating basic conditions for capital market supervision, the authorities are increasingly supporting measure to enhancing the contribution of the financial sector in the economy. By providing additional and alternative financial services, non-bank financial institutions (NBFIs) improve general system-wide access to finance. In particular, development of capital markets instruments and insurance services are key when it comes to supporting enterprise growth and ultimately economic growth. In this context, further upgrading AFSA's supervisory and regulatory capacities is crucial to contain risks and ensure a sound future development of the capital markets and insurance sectors.

Sectoral and Institutional Context

From virtually no significant capital market activities seven years ago, Albania has experienced sizable and positive development in some capital market segments while the insurance sector lags behind facing significant weaknesses. This raises prospects for meaningful development of capital markets and insurance sectors in the future, but also concerns about the ability of Albanian Financial Supervisory Authority (AFSA) to regulate and supervise these markets.

While the relatively newly established investment funds helped to diversify holdings of government securities in the financial system, their fast growth gives rise to potentially higher systemic risk in the country. The investment funds sector, emerging in 2012, has grown remarkably fast reaching EUR 586 million in net asset value at end September 2018. The number of investors in this market increased by 7 percent in 2017 but decreased with 7.5% during the first 9 months of 2018 to about 29,000 investors (only 6 are legal entities). There are currently five investment funds operating in the market with the largest accounting for 76 percent of market share. The market is mainly dominated by investments in government bonds (61.3 percent) inside and outside of Albania. There are two licensed fund management companies that manage both voluntary pension funds and investment funds and one that manages voluntary pension funds only. A new fund management company was licensed recently by AFSA. The lack of an established secondary market for government securities represents a key liquidity risk to the investment fund sector in the event many unit-holders simultaneously exercise their right to redeem their units.

Considering the rapid development of the investment fund sector since 2012, AFSA expects other capital market activities to emerge in the near to medium-term, especially with regards to the issuance of corporate bonds. There is no public issuance of securities other than government bonds and a limited (but increasing) volume of privately placed bonds and commercial papers. Several corporations have issued bonds, albeit through private offers, and market sources indicate increased interest on public issuance of corporate and municipal bonds. A new, private securities exchange in Albania has recently been licensed and has started its operations by mid-February 2018 focused on trading government debt for one year and will then move on to other assets. There is a need for a central securities depository for non-government securities – AFSA is currently assessing the institutional framework and options for its development. The Bank of Albania has a separate central depository, AFISaR, which clears and settles transactions in government securities. There are seventeen securities brokers, nine banks and post office who largely trade government bonds over-the-counter (OTC). The banks also act as custodians. Finally, there are two licensed investment advisers.

Relationship to CPF

The proposed second stage project is in line with the Country Partnership Framework (CPF) objective. Specifically, the proposed project supports the current CPF objective 1c: *Support improved financial stability*. Reducing NPLs, reviving credit growth, and strengthening bank and *non-bank prudential authorities* are essential for spurring growth, protecting the income of economic agents and increasing financial inclusion. Overall, strengthening the independence and capacities of financial regulators is the *sine qua non* for the maintenance of financial stability and further development of financial sector intermediation.

C. Project Development Objective(s)

Proposed Development Objective(s)

The development objective of the project is to support AFSA in implementing selected parts of its ambitious and far reaching Strategy for 2018-2022 by (i) strengthening its capacity to regulate and supervise the capital markets and to (ii) boost market development for capital markets products through innovation, introduction of new products and product distribution technologies.

Key Results

The proposed development objective is expected to achieve the following results. AFSA has further strengthened its capacity to supervise capital markets and support capital market development through:

1. Drafting and adoption of all implementing regulations following the approval of the new securities law;
2. Effective implementation of risk-based supervision of capital markets;
3. Strengthened capacity to enforce the new securities and investment funds laws;
4. Increased awareness and understanding of capital market activities;
5. Strengthened capacities of staff to understand, supervise and regulate technology driven developments.

D. Preliminary Description

Activities/Components

The assistance envisioned under this proposal aims to continue support for AFSA in strengthening its capacities to supervise the capital market activities. The technical assistance in this 2nd phase will build on, and complete the work carried under the 1st phase of SECO funded support (P153211). The following activities will be covered by the project:

Strengthening AFSA's regulatory and supervisory function

Component 1: Implementation support as regards to the newly adopted Securities Markets Law: A new Securities Markets Law, aligned with international standards and relevant EU Directives is currently being drafted with the envisaged adoption at the end of 2018 under the 1st phase of SECO funded support. Its adoption will results in the need to develop a suite of implementing regulations foreseen in the Law. AFSA's 5-year strategy provides for completion of the regulatory framework, in line with EU acquis, under the newly approved laws. The most important regulations are:

1. Licensing requirements including requirements for prudential capital and competence standards of securities firms (MiFID II definition) in particular criteria for assessment of capital markets qualifications and establishment of a regime of internationally recognised qualifications for capital markets participants;
2. Prospectus content requirements, aligned with the EU Prospectus Regulation;
3. Requirements for listed companies –there is a need to develop a framework governing listed companies covering elements such as transparency (EU Transparency Directive), public disclosure and regular and ad hoc reporting requirements, mergers and takeovers;
4. Conduct of business including corporate governance in order to implement the new law effectively and ensure that that capital market firms are properly governed; their clients are treated fairly and their rights protected;
5. Post-trade activities – a regulatory framework is needed to ensure that such activities, including clearing and settlement, are effectively regulated. Work will follow-on from the outputs of the CSD activities under the current phase.

Component 2: Further strengthen AFSA's risk based supervision. As per its strategy AFSA will maintain the focus on developing application of contemporary supervisory methods. To this aim, AFSA has identified the following areas that can be covered by the new SECO funded technical assistance:

1. The 1st phase of TA supported AFSA in building a framework for risked based supervision of asset management companies. Expanding on this previous work, AFSA should widen such supervision to other type of firms operating in capital markets. There is a need to develop prudential reporting

through the collection and analysis of financial data from licensed intermediaries, particularly in order to ensure that they apply the best international rules and practices in selling products, that customers receive the right information, and that these operators have adequate risk based capital and liquidity in place to protect against systemic risks.

2. Provision of advice to AFSA on the development of an enterprise risk management environment within AFSA including documenting of internal and external risks to its regulatory objectives. For AFSA's internal risks, linked to its internal audit and risk committee, there is a need to develop a risk register and for the AFSA's board to develop a risk appetite which can be clearly enunciated and conveyed to its employees and stakeholders. It is important that AFSA leads by example to its stakeholders including licensed firms in its commitment to good risk management practices.

Component 3: Development of AFSA's capacity to monitor and supervise securities markets. The strategy emphasises the need to increase AFSA's supervisory capacities through training of staff. AFSA staff is currently undergoing a thorough capital markets related training program during the 1st phase of SECO funded TA. The training plan for Phase 1 contains (i) a number of internal workshops covering topics of risk based supervision both of AFSA itself and market participants, investment fund supervision, development of AFSA as a regulator and typical regulatory board mandates, enforcement and the process of securities (particularly bond) issuance, (ii) study visits to other regulatory authorities in particular on strategic issues with senior counterparts as well as practical day to day supervisory issues, e.g. risk based supervision/analysis of reports, (iii) internationally recognized qualifications: Chartered Institute of Securities and Investment Operations Certificate ('IOC'), Chartered Financial Analyst courses and select tailored courses for senior management. The training support under Phase 1 will also help enable AFSA to create a sustainable internal training planning and delivery in the future through training of two staff (training unit) in the human resources directorate at the AFSA.

Despite this, as market activities grow and become more complex as well as legal and regulatory frameworks are further strengthened, there is a need to provide further capacity building support to AFSA. in particular in the areas of investigation and enforcement. While the focus of the Phase 1 training plan is predominantly on building up AFSA's regulatory and supervisory capacity more broadly, limited emphasis is placed on investigation and enforcement capacity (only one internal workshop on enforcement will be held in Phase 1), an issue which becomes more and more pressing with full adoption of the new securities legal framework, and market development:

1. *Development of inspection, investigation and enforcement capacity in relation to securities markets and investment funds*: the new securities law and new investment funds law will detail and strengthen AFSA powers to inspect, and investigate (or support investigation of) breaches as well as enforce compliance; support is needed through provision of ongoing advice to the supervision, legal and enforcement staff including, study visits to comparable but more advanced markets with a similar legal framework, drafting of an enforcement manual and on-the-job training in use of the manual to enable AFSA to develop its capacity to undertake investigations and effectively enforce securities and investment funds laws.

2. *Assistance in relation to improvement of Market Surveillance Systems* - The establishment of the privately run stock exchange will bring the need to develop market surveillance arrangements to detect and prevent market manipulation and market abuse, in order to protect investors and ensure the integrity of capital markets. Support will be provided to AFSA to develop its capacities to monitor and supervise the market and its participants.

1. *Hiring of peripatetic advisor(s) that will provide on-job regulatory and supervisory support and guidance to AFSA.* A senior advisor with experience in EU capital markets supervisory agencies will support AFSA management and staff in implementing its strategy in the areas of strengthening its regulatory and supervisory function and related capacity building. The timing of engagement of such advisor should be tailored to AFSA needs. Some support would be needed after the CIU law is passed and its implementing regulations issued. The intensity of involvement will increase with the passing of the capital markets law. The advisor is expected to work together with the AFSA staff and management to:

1. Ensure that all deliverables and outputs are functional and guide AFSA through their implementation.
2. Advise the AFSA management and staff on day-to-day policy and supervisory and enforcement decisions related to investment fund industry, capital market, as well as bond market.
3. Deliver on-job practical training with regard to supervision of the investment funds following entering in force of the new risk-based funds supervision methodology prepared during Phase 1.
4. Advise the AFSA management in understanding global industry challenges and developments, especially related to EU markets and regulations, and making better use of AFSA membership in the international regulatory associations.
5. Carry other advisory tasks as dictated by market developments or trends.

Support AFSA in its Capital Market Development Efforts

Component 4: AFSA has committed in its strategy to work to promote market development. Apart from measures to develop a sound regulatory and supervisory environment, AFSA highlights the need to enhance awareness and financial education activities with the purpose of increasing investors trust in the system and consumer protection as well as dealing with challenges and opportunities stemming from rapid technological developments (Fintech). AFSA's strategy incorporates the strategy and action plan it approved in 2017 for Increasing Consumer/Investor Confidence in the Markets under AFSA's Supervision. This component will support AFSA in implementing few select activities related to awareness raising and financial education targeting potential groups of issuers and investors. Support will be provided in the design of the activities that a) will targets a particular area based on well-grounded prioritization with respect to potential impact; b) are designed to achieve an identifiable and sustainable outcome. The Technical Assistance sought will be such as to add value that could not be realized by AFSA without access to external expertise.

Secondly, support will be provided to AFSA to address opportunities and challenges from increased use of technology by entities operating in the market. A technical note will be prepared by an external expert focused on assessing the challenges and opportunities stemming from rapid technological developments with the aim to strengthen capacities of AFSA's staff in supervising and regulating technology driven developments, as well as address current or near-term emerging needs.

Environmental and Social Standards Relevance

E. Relevant Standards

ESS Standards		Relevance
ESS 1	Assessment and Management of Environmental and Social Risks and Impacts	Relevant
ESS 10	Stakeholder Engagement and Information Disclosure	Relevant
ESS 2	Labor and Working Conditions	Relevant
ESS 3	Resource Efficiency and Pollution Prevention and Management	Not Currently Relevant
ESS 4	Community Health and Safety	Not Currently Relevant
ESS 5	Land Acquisition, Restrictions on Land Use and Involuntary Resettlement	Not Currently Relevant
ESS 6	Biodiversity Conservation and Sustainable Management of Living Natural Resources	Not Currently Relevant
ESS 7	Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities	Not Currently Relevant
ESS 8	Cultural Heritage	Not Currently Relevant
ESS 9	Financial Intermediaries	Not Currently Relevant

Legal Operational Policies

Safeguard Policies	Triggered	Explanation (Optional)
Projects on International Waterways OP 7.50	No	The project scope does not involve any physical activities, impacts both direct and indirect on any water bodies or international waterways.
Projects in Disputed Areas OP 7.60	No	None.

Summary of Screening of Environmental and Social Risks and Impacts

There are no identified direct or indirect environmental impacts of the project activities. There are no activities with a physical footprint identified, nor are there activities that could lead to specific actions that could have an associated environmental impact. There is a possibility to also integrate environmental awareness within the capacity building program for the AFSA staff aimed at recognizing the market development through technological development, but this depends on the actual scope of the capacity building program itself.

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