

Supervising the Albanian financial system

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INTRODUCTION

This work aims to give a general idea about the Albanian financial system architecture and supervision methodology. That's why I start writing about the unknown and unstudied Albanian financial history. Then I continue describing the Albanian actual financial structure. The authorities that supervise this market and its health, compared with the Italian financial system. I conclude by expressing some ideas of mine, regarding the future of this economic sector in Albania.

HISTORY OF THE ALBANIAN FINANCIAL SYSTEM

Talking about a complex system like that of financial markets is always difficult, especially if what we study is the implementation of the international best practice (*Statement of Best Practice*) and the legislation in line with that of the countries with a tradition in the financial field. We can't begin such a study without putting to uncover the historical roots of this system in Albania and its development over the years and the most important steps through which it has passed. Although, history this isn't our main research objective.

The institutions history in each country has its own peculiarities. In Albania, we can speak of banking and financial activity since 1839, when Ottoman bank branches were operating in the Albanian territories.¹ During this period, on proposals of economists, jurists² and literary,³ ideas for the creation of a national central bank, were proposed, which among other functions has also the issue of the currency in Albania (*Albanian Franco*). Albania exists as an independent nation, since November 1912. Before that day, because of the Ottoman occupation it was impossible to have a real state organization on the territory. Population came out from the occupation underdeveloped, compared to neighbour countries. Economy was inexistent and the standards of living were below the poverty line. However it should be noticed that the independence was accompanied with the establishment of an independent government who raised hopes for the future. This led to a serious interest of foreign

¹ AA.VV., *History of the Albanian Central Bank*, Tirana, 2003, P.8

² G. Guga, *The Albania of the two Vilajet. Appoint on morphology and anthropology of Albania region. It's trade relations with Italy and Austria*, Venice, 1909, cit. Various authors, *History of the Albanian Central Bank*. Tirana, 2003, P.10

³ An example is the work of the author Sami Frasheri, one of the main writes of the late '800. Sami Frasheri, *Shqiperia c'ka qene, c'eshte e c'do te behet*, Tirane, 1978

capital to plan major investment in the country.⁴ During the first decades of the twentieth century, Albania had a great development, but still remaining far from other European states. In fact, the first act signed to design the central bank, made on October 4, of 1913, signed by the Albanian Prime Minister, *Ismail Qemali* with *K.Pitner & O.Pollack* (representing Austria's "*Vine-Banke Ferrin*") with *P.Fenoli & G.Ansbaher* (representatives of the *Italian Commercial Bank*, based in Milan), was a first vague attempt. The agreement intended to provide an equitable distribution of shares between the two banks that were participating in the capital. The framework defined in the Agreement, in addition, recognized the exclusive right to this bank to issue notes and to play the role of main actor in the field of bank credit. Essentially it was a monopoly itself. The life of this first Bank, was very short, as it was swept away, along with the Albanian government, by the Great War.

Between 1921 and 1924, Albania was in a chaotic situation. Into the country continued to circulate "*coins of different values and backgrounds such as Turkish Coins, Italian Lire, Belgian Francs and Swiss and Austrian Corona, Greek Drachma, French Francs, Serbian Dinars, British sterling...*"⁵

In this situation, Albania made a formal request for help to the League of Nations for some financial experts, who were supposed to estimate the investment opportunities in the country.⁶ Shortly after the request, arrived in Albania *A.Calmes*, and immediately after him came *I.D.Hunger*. These experts, after estimating the wealth of the country, recommended the establishment of a National Bank with primary task to control the national currency. After various proposals concerning the establishment of the National Bank of Albania, the *League of Nations* choose the project that established a stock ownership (5 million francs in gold) divided to different participants such as *England, France & Italy* with 25% each, *Belgium* with 5%, *Albania* with 10%, and other countries in the limit of 10%.⁷ This idea seemed really interesting to the Italian government who was the first to move, based on the decisions taken in Paris (1921) that "recognized a de facto Italian protectorate over Albania."⁸ In March 1925 an agreement was made between the *Albanian Government* and the *Italian Genoa Credit*. This was the first step in implementing the cooperation between the Albanian Government and the Italians, who were accepted to be in a position of prominence, as

⁴ On the issue should be pointed out that scholars have arrived to the same conclusions. See: I. Fishta, *Monetary and credit System in Albania (1925-1944)*, UT Press, Tirane, 1971; G. DI NARDI, *Public Finances of Albania's economy*, Padova, 1941

⁵ I.MONTANELLI, *Shqiperia nje dhe njemije. Homerit ka qene ne Shkoder*, Tirane, 2004, P.106

⁶ K. KRISAFI, *Bank of Albania, from it's creation until the end of World War II*, in *Economicus*, UET Press, Tirana, 2008, P.130

⁷ I. Fishta, *Intervention of foreign capital and its enslavement consequences on Albania (1925-1944)*, Tirana, 1979, P.19-20

⁸ B.J.FISCHER, *King Zog, trying to stabilize Albania*, Cabej MCM, 1996, P.98

they were funding the government through the SVEA.⁹ The agreement was a constitutive program, which also included the division of the shareholdings of the various investors who would be part of the foundation. Among these were the “*Italian Commercial Bank*”, “*Banca Nazionale di Credito*”, “*Banco di Roma*”, “*Zadruga Bank of Belgrade*”, etc. Initial investment in social capital including natural persons, both Italian and Albanian In Rome, on September 2, 1925, by the presence of *Italian, Albanian and Serbian* government representatives, was subscribed the capital share of the Albanian National Bank. Also there was appointed the first board of directors (8 persons, of whom only one was Albanian).¹⁰ The National Bank of Albania was a public institution of law. In addition, for the resolution of conflicts with third parties, the bank was subject to the jurisdiction of the Albanian courts. During the Second World War the invaders choose an inflationary policy and the Bank was ruled completely by their control. In this period, the number of operators acting on the market expanded greatly. It is also important to mention the opening of a “*Banca Nazionale del Lavoro*” branch, which soon became a strong competitor of the National Bank of Albania, and the “*Banco di Napoli*”. In the years that followed, during the Nazi occupation, all the country's resources were put at the service of the war. Banks (especially the National Bank) were forced to "finance" the war of the Germans. This led to a total depletion of the reserves, which ended with the sacking of the State Treasury and all the gold reserves found in branches on October 30, 1944. The end of the war found Albania totally destroyed and robbed of its gold reserve¹¹ and proprieties. At the end of war the Communist Party created it a provisory government. The new government decided to repeal the Convention of March 1925, to seizure the shares of National Bank of Albania and their transition in state property. Because the communist ideology commands that private property of a public entity, is found in conflict with the national interest.¹² This day was also approved the Organic Law "*On Bank of Albania*", which established the functions of the bank and its role in the market. It was clear that for a second time, this bank would be the cornerstone and the point of reference for the whole financial sector.¹³

In 1965, after the experience gained in the first two decades of existence of the bank,

⁹ A company that was exclusively established to finance the Albanian government in it's affairs. SVEA-*Society for the Economic Development of Albania*, formed in April 1925

¹⁰ Cfr. AA.VV., *History of the Albanian Central Bank*, Tirana, 2003

¹¹ The case of the gold reserve of the Albanian state lasted many years after the end of the conflict. Seized from the Germans by the British was never returned to the Albanian state in retaliation against the incident of the Corfu Channel, where a British navy ship lost 17 men by underwater mines, blaming the Albanians for not informing them of the mined areas. On the case and the process in general cf. BIMAL N. PATEL, *The World Court Reference Guide-Judgments, advisory opinions and orders of the Permanent Court of International Justice and International Court of Justice* (1922-2000), Law International, 2000, p. 219

¹² Special law of January 13, 1945

¹³ In December 1944 there were implemented new laws to guarantee a strictly state economy. The foreign debt was cancelled, and the property of foreigners was confiscated. Also the property of the Albanians who had not contributed to the war was nationalized as all the water sources.

a new law was passed regulating the organization, the functions, the rights and the duties of the Albanian State Bank.¹⁴ This law represents a step backward in the history of the banking market in Albania, encouraging a closed economy and centralized. Even the subsequent amendments to the law¹⁵ made profound detachment from the Bank's supervisory role in the market since there was no real market. After the interruption of the relations with China in April 1978, the leaders chose *autarky*. But the galloping growth of population and the lack of production led to the failure of their strategy. In 1990, the companies are divided into small independent units and state subsidiary was replaced by long-term bank loans. In 1991, the deficiencies lead to the system collapse. The change from a centrally planned economy to a free market economy brought many changes, among which we identify the abandonment of that false sense of security regarding the future. The new government began working on drafting a new *Civil Code*, a *Commercial Code*, and a *Law on the Enterprises*, the *New Banking Law*, *Tax*, *Labour* and *Social Security*. The Albanian Government, helped by the IMF and World Bank, developed a new banking law that provided a two-tier banking system, governed by a Central Bank. Was thus created by the reorganization of the State Bank, the Bank of Albania that is responsible for managing the domestic currency and the supervision of credit institutions. This reform also gave birth to three second-tier banks, supervised by the central bank: -Savings Bank -Bank for Agricultural Development -Commercial Bank of Albania (which allocated all foreign transactions of the old state bank)

In the mid 90' watching the country's economic development and its potential growth, were taken some initiatives to establish and develop a financial capital market. This market was supposed to help the privatization process undertaken by the state at that time. Was so adopted in 1996 the law n.8080¹⁶, which regulated the entire securities field, starting by the Supervising Authority, the Market, Markets Participants and Single Tradable Securities. Thus was founded, the Supervising Authority KLV¹⁷, and the Tirana Stock Exchange, the first capital market in Albania. The Tirana Stock Exchange was initially established as a department of the Bank of Albania. It functioned as a market for the exchange of the government securities. Also in 1995 the law n.7979¹⁸ was passed. This law regulates the form and operating of the Mutual Investment Funds. On March 96 were passed two new laws¹⁹ regarding the Albanian banking system repealing those of '92.

¹⁴ Law n.4021 of 23.06.1965, "Mbi Banken e Shtetit Shqiptar"

¹⁵ D.lgs.5529 of 25.02.1977, "Mbi Banken e Shtetit Shqiptar" modified d.lgs.6882 of 28/04/1984

¹⁶ Law n.8080 "For financial instruments"

¹⁷ Securities Commission (KLV) -The supervisory authority in the capital market

¹⁸ Law n.7979 "For the investment funds"

The activity of a second level bank instead, is regulated by the law n.8365.²⁰ This law has been subject to several changes. The last change was made the 2006 Law n.9662.²¹

In 1997, the parliament also approved the Law n.8215²², designed to prevent the recurrence of pyramid schemes (*Ponzi schemes*) in Albania.

During the 1995 -1996, planning to help the ongoing privatization of public property process was conceived a legislation that gave life to an entire series of institutions that should work with the privatization voucher. As first expressed in 1996 the law n.8080 gave life to the supervisory authority in the capital market, KLV. In 1995 Parliament adopted the Law n.7943²³, which regulated the pension fund market and the supervisory authority in this market, IIPPS²⁴. Moreover, it created the QRA, the central register of shares.

On 10 August 2006 was approved the law n.9572²⁵ that gave birth to the supervisory authority on the financial system AMF. This authority unifies the functions initially exercised by the:-Commission of the securities value KLV;-Inspectorate of private institutions of supplementary pensions IIPPS;-Supervisory Authority on the insurance system AMS. Law n.9572 also prescribes the establishment of the " Counsellor Group for Financial Stability GKSF. This group is composed by:

- Minister of Finance;
- Governor of the Bank of Albania;
- President of the Board of Directors of AMF...

GKSF is designed as an adviser unit which:-Assists in the developing policies shared by the three institutions;-Ensures the exchange of information among members of the group;-Assists the Albanian financial market by maintaining stability and development inside it and improve the control on market participants.

¹⁹ Law n.8075 of 22.02.1996, "*For the banking system in Albania*" and Law n.8076 of 22.04.1996, "*For the Bank of Albania*"

²⁰ Law n.8365 "*For banks in the Republic of Albania*"

²¹ Law n.9662, 18.12.2006 "*For the banks in the Republic of Albania*"

²² Law n.8215 "*For the control of legal persons non-banks that collect deposits from the public*"

²³ Law n.7943 "*For supplementary pension institutions and private pensions*"²⁴

²⁴ IIPPS -*Inspectorate of private institutions of supplementary pensions*²⁵

²⁵ Law n.9572 "*For the Supervisory Authority on the financial system (AMF)*"

THE ACTUAL ALBANIAN FINANCIAL SYSTEM

The Albanian financial system is actually supervised by two different and independent authorities. The Central Bank of Albania plays the role of the supervisor on the banking system. While AMF, is the non-banking system supervisor. Those two authorities, are part of deep institutional reform implemented in Albania in the framework of the European integration. The key reforms in the Eastern Europe countries for the future years are, 1) modernizing the regulatory framework and strengthening the regulatory capabilities in line with the Basel core principles for an effective surveillance, 2) ensuring the adaptation of the Europe Union laws on the principle of monitoring regarding the host country, 3) facilitating the market entrance and consolidation through the European financial services companies, 4) implementing specific regulations governing the transition process, especially the rapid credit growth and high exposure to currency risk,²⁶ 5) strengthening the fight against money laundering and financial crime.²⁷

Law No 8269 regulates the Albanian banking system²⁸. Article 3 of this law states: *The Bank of Albania stimulates and supports the development of the regime and the currency system, the domestic financial market, the payments system and helps in improving the monetary and creditor in support of stability and economic developments in the country.* In accordance with its rules and within the powers defined by this Act, Bank of Albania is an independent authority. According to the law n.8269 this institution responds only to the Parliament, through semi-annual reports. The principal organ of Bank of Albania is the

Executive Council, which works in the implementation of laws and regulations governing the Albanian banking system. The banking sector is the most developed of the Albanian financial system. After 1997, the attention of the Albanian authorities and international authorities were concentrated in developing the banking system and not in the capital one. The Albanian financial system actually is dominated by commercial banks, which provide more than 90% of the assets on this market.²⁹ All these banks are commercial banks, specialized in collecting deposits and in granting trade and consumer credit. There is a unified practice among all these banks. They invest the remaining not granted deposits in public debt securities. This practice is forced by the lack of investment alternatives on the domestic market. As the other Eastern

²⁶ 80% of loans in Albania are named or indexed on foreign currency (mostly in euros). The exposure of the financial system on foreign currency increases the risk of exposure to external shocks and makes it difficult for the monetary authorities to make adjustments on the exchange rate

²⁷ European Commission, World Bank – *Financial sector restructuring and regional integration in the western Balkans.*

²⁸ Law n.8269, 23.12.1997 "For the Bank of Albania"

²⁹ Elis Tarelli -*Banks and banking activity in view of the new law "On Banks in the Republic of Albania"*

countries, Albanian banking system has experienced significant foreign investments. Data tells that the participation of foreign capital in the credit market has grown from 20.7% in 1998 to almost 88% in 2006. The origin of capital was mainly European and specifically Italian, Austrian and Greek. Groups that have entered the Albanian banking market are serious and important to their origin countries. For example we can mention the Austrian group *Raiffaisen*, the *Intesa-San Paolo* of Italy and the Greek *Piraeus Bank*. The government response to the global markets crisis regarding the banking sector was implemented with the law 10106 of 30.03.2009 "For some changes on law no.8873 of 23.03.2002, "On deposit insurance" with whom governmental Agency for Deposit Insurance raised the fee for deposits from a maximum of 350,000 Lek to 2,500,000 Lek³⁰. In this way, Government gave a strong signal of confidence to the depositors. The minimum guaranteed before, was very low in response to a possible bank panic. The introduction of the Agency in 2002 coincides with the deposits crisis in Albania due to misinformation³¹. The Agency for Deposit Insurance was introduced into the Albanian legislation by the law no. 8873 of 23/03/2002 "On Deposit Insurance". This Agency is an independent public institution³², following the model of other Central and Eastern Europe countries³³.

Instead the Albanian capital market doesn't go beyond the investment in securities issued by the state. This year, for the first time were issued government bonds with five years to maturity.³⁴ We include in the Albanian Capital Market all those subjects regulated and supervised by AMF. These subjects are, the capital markets, the private pensions, the insurance market and the people who operate in there. AMF is an authority created in the recent years (2006) by the union of three previous supervising authorities, which had limited powers. The new authority opted for an function based vigilance, modelled as the French non-banking supervisor, with the idea of supervision integration³⁵. So, there is a single authority for the whole capital market that supervises in a prudential way. The Authority's main task is to control the financial market and the entities involved in it following the model of other supervisory authorities in other European countries. Another primary task is to protect the investor and the consumer, diversifying classes of investors and brokers through the MiFiD

³⁰ Within this threshold join the largest number of depositors, about 90%. They have to insure their deposits even if banks fail. Source: official website of the Agency for Deposit Insurance <http://www.dia.org.al/default.shtml>

³¹ S. Sheqeri -*The Albanian banking system shocks and policies of the Bank of Albania* in discussion Materials 2003, Bank of Albania, Tirana, 2003, pp. 19-20

³² Albania has opted for an independent agency not incorporated into the Bank of Albania. For more information on the agency see: N. KALLFA, *Aspekte juridik te veprimtarise bankare*, USAID project, Tirane, 2002.

³³ N. Kallfa, *Legal aspects of banking activity*, USAID project, Tirana, 2002, p.139

³⁴ Bank of Albania - 2006 Annual Report, p.106

³⁵ So says F. Vella on regulatory developments on supervisory authorities in the Italian law. "Integration" as the tendency to reorganize the functions of supervision and "backward" in the sense of abandoning a requirement for a prudential supervision that enhances the autonomy of the operators in their ability to auto discipline. F. VELLA, *Supervisors: not just a matter of architecture in companies and investors: growth, protection, interest*, ads GDMOSCO, F. VELLA, Milan, Giuffrè Ed, 2008, p. 170

directive.³⁶ In addition, the Financial Supervisory Authority has the duty to promote and stimulate the securities market in Albania. This way a developed and healthy market will be created and then integrated with other regulated markets in the Balkans and Europe. AMF is an independent authority that regulates and supervises the activity of individuals and legal entities operating in the Albanian financial market. The directing office is the *Executive Council*, composed of 7 members, appointed by the Parliament, to whom the authority reports twice per year. Lately the Albanian capital market is taking a more appropriate form.³⁷ Authorities are working on fulfilling the legislative framework that regulates this sector. Actually there is an interbank market, which works as primary and secondary market for government debt. Within this market banks and individuals can invest their capital. There is also a regulated market of securities different from debt, Tirana Stock Exchange. AMF has prepared a law draft on corporation securities and local government debt. The adoption of this law will bring more equity and information on the market. Also it increases the diversity of securities on the market. The law on local government debt was approved in February 2008³⁸. AMF has also written down another law draft on Investment Funds, which replaces the Law n.7979³⁹. The old law is no more suited to the prospects of the Albanian financial system.

A COMPARATIVE OVERVIEW WITH THE ITALIAN LAW

Studying the Albanian financial supervisory authorities is relatively interesting. I think it was interesting to see the procedure followed by the institutions of this young country. It was also interesting to see its way toward a state of democracy for the creation of a free capital market initially and the reorganization of the supervisory authorities later. We also saw that the adopted models and rules are the best on the field. Singular is the creation of the AMF unifying governmental agencies that initially supervised based on different subjects. In addition, singular is also the creation, of an independent central bank that is entrusted of drafting and implementation of monetary policy.

Starting from these observations, but with the premise that in Albania this plant has grown on a virgin field, we look to the supervisory authorities in Italy from a structural point of view. Regarding the banking supervision we can notice differences between the authorities. Other differences can also be noticed in the direct link that exists

³⁶ Directive 2004/39/EC, effective from 1 November 2007 "*Markets and Financial Instruments' Directive*". This directive is the most important in the context of the Action Plan of the financial instruments of the European Commission.

³⁷ Arjon Gjondedaj -*The future of the Albanian financial system*, n.20 Monitor (397) Albania 2009

³⁸ L. 9869, 4 February 2008 "*Per huamarrjen e qeverisjes Vendore*"

³⁹ Law n.7979 of 26.07.1995 "*On Mutual Investment Funds*"

between political power and the central Bank. As we firstly saw Bank of Albania is an independent authority that responds only to the parliament. While in Italy the high vigilance on banking activity is a matter for the Inter-ministerial Committee for Credit and Savings under the *Consolidated Bank Law* (Testo Unico Bancario TUB). The committee approves, the principles and the criteria of the banking supervision on Bank of Italy's proposal. The Committee is composed of several ministers such as the Economics and Finance, International Trade, Infrastructure, Transport and so on. In the meetings participates also the Governor. There are differences also regarding the bank ownership. For example, Bank of Albania shares are totally owned by the State while in Italy the shareholder is divided between different bank groups, insurance companies or public institutions, which approve the budget and appoint the members of the *Bank's Superior Council*.

This choice was made intending to ensure the independence from the political power of *Bank of Italy*. This choice is risky enough since the banks shareholders are the subjects supervised by her. So it is impossible not to see the conflict of interest in this whole situation. The shareholders participate in the nomination of the Governor but in an advisory role.

Here we have to open parenthesis on the law 262 of 28 December 2005 on the protection of savings. This law profoundly changed the institutional framework of Bank of Italy. Among the many innovations that the law brought, we have to mention the obligation for the shareholder to transfer their owned shares at the state property. We can still express that after all these normative changes into the Italian law there is still a difference. In Albania all the shares are owned by the Treasury but in Italy it is admitted the possibility that some of the shares can be on the hands of other public bodies. We have seen that Bank of Albania has to establish and apply independently the monetary policy. For Bank of Italy things are different. The European Central Bank, according to the parameters established in Maastricht, draws monetary policy firstly at the European level. Then Bank of Italy applies the monetary policy. Actually, after the reform that brought in 2005 the law on savings, we can notice differences regarding the figure of the Governor, who no longer enjoys a mandate for life into Italian. Apart this differences in office duration, the rest regarding the skills and the role is almost the same as before.

We can conclude arguing about the differences between the central banks giving importance to the fact that, basically, whatever the structural differences between the institutions are, and due also to historical peculiarities that characterized the two countries; the two central banks are getting standardized to the model of the European Central Bank.

In the field of financial market supervision, however, we can notice deeper differences through the institutions. To a single supervisor authority in Albania for all three

markets, there are various authorities in Italy. We can list the Consob, the Covip, Isvap and in addition the antitrust that concerns to ensure competition in the markets. In Italy these authorities supervise markets divided by *subjects* and not by *purpose*. To this non ideal control systems in Italy compensates the close collaboration between the authorities provided by law 262 of 2005 on savings. The law thus leaves the matter in the autonomous cooperation among the supervisors. We made a structurally comparison, because on what belongs to the functions, the operations performed and the principles on which the two systems are inspired, are quite similar. Now we can notice a harmonization of the legislation on the markets, especially with the performance of the tasks of harmonization of the legislation on which the Albanian authorities are required by their commitments to the European Union. It is important to notice the task of Italy to introduce MiFID in its legislation and the voluntary implementation of this directive by the Albanian authorities.

FUTURE PROSPECST

We just have to say in conclusion of this paper that all the regulatory reforms implemented in Albania, are part of the policy of the regulatory authorities and their commitments made with the communitarian committee and international supervisors to perform their duties following the best international principles generally shared.

Their work in these last years was not limited to mere observation of the inspection tasks, which are their natural tasks, but it went further. In line with the development of the country's economy, the authority's worked in promoting the financial markets, especially the securities market, placed outside the banking sector. Sector this one that is and will remain for a long time the main sector of the Albanian financial system in which companies will rely on investments.

It is believed that the development of new markets will give breath to the business by making third parties capital available.

To conclude this argument we can only hope that the new legislative reforms will be in perspective of the communitarian law and that the Albanians market will be an effective part of the wider European markets.

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