

**BANK OF ALBANIA
SUPERVISORY DEPARTMENT**

ADVISORY

ON

REGULATORY BANK CAPITAL,

Approved by Supervisory Council Decision No. 57, date 05/05/1999 and changed on
Supervisory Council Decision No. 40 date 16.05.2001

CHAPTER I

GENERAL

1. This Advisory is issued pursuant to Law No. 8269, date 23/12/1997 "On Bank of Albania" and Law No. 8365, date 02/07/1998 "On Banks in the Republic of Albania."
2. Entities subject to this Advisory are banks and branches of foreign banks that exercise banking activities in the Republic of Albania.
3. The purpose of this Advisory is to define the calculation method of Regulatory Capital of banks in order to cover credit risk.
4. Definition: Credit Risk shall mean the negative effect to a bank's capital due to default of the counterpart (or third parties).

CHAPTER II

REGULATORY CAPITAL FOR CREDIT RISK COVERING

1. Regulatory Bank Capital is composed of Base Capital and Additional Capital 2. Elements of regulatory capital are:

- 2.1. Base Capital is composed of two groups:

- 2.1. 1. Elements that are added (A)

- Subscribed Capital
- Reserves (besides the re-evaluation reserves)
- Primes of emissions and mergers (merging, blending)
- Undistributed profits (carried over)
- Profits at the end of the fiscal year (as defined in section 5 below)
- Profits of the current year (as defined in section 4.1. below)
- Credit re-evaluation differences

- 2.1. 2. Elements that are subtracted (B)

- Unpaid Subscribed Capital
- Nominal value of bank shares in bank's possession (redeemed or unissued shares)
- Undistributed losses (carried over)

- Losses during the Fiscal Period
- Debt re-evaluation differences
- Intangible fixed assets

Total of Base Capital is equal to $C = [(A)-(B)]$

2.2. Elements of Additional Capital

2.2.1. Additional Capital is composed of these elements (J):

- Re-evaluation Reserves
- General Reserves (as defined in section 6 below)
- Subordinated Liabilities:
 - i) Hybrid Instruments (as defined in section 8.1 below)
 - ii) Time Subordinated Liabilities (as defined in section 8.2 below)

2.2.2. LIMITATIONS

Elements of Additional Capital have the following limitation when included in the calculation of the regulatory capital.

2.2.2.1. The Total of Additional Capital should not be greater than 100% of the Total of Base Capital.

2.2.2.2. The Total of Time Subordinated Liabilities, that are a part of Additional Capital, should be no greater than 50% of the Total of Base Capital.

3. The Regulatory Capital is calculated by subtracting from the amount of Base Capital and Additional Capital, as calculated in section 2 (above), the following elements:

3.1. Participation and Subordinated Rights in banks and other financial institutions (P)

(i) Participation in banks and other financial institutions with an amount greater than 10% of their capital or less than 10% of their capital but which plays an important role in the decision making process of such institutions. Subordinated Rights in the same institutions would be added to the Participation.

(ii) The total amount of participation in the bank and in other financial institutions, that don't meet the above mentioned conditions, along with other Subordinated Rights in the same banks and institutions, after they are decreased by 10%, for example: $[10\% \times (C+J)]$.

3.2. Guarantees given to the Mutual Guarantee Fund according to conditions defined by the Bank of Albania (Q).

THE TOTAL AMOUNT OF REGULATORY CAPITAL IS $[C+J-(P+Q)]$.

4. INTERMEDIATE RESULTS

Intermediate Result shall mean the earnings or loss in every fiscal period' except the fiscal period at the end of the year.

4.1. Earnings of the Fiscal Period shall be included in the total amount of the Regulatory Capital, calculated as above, as an element of the Base Capital if the following conditions are met at the same time:

4.1.1 If it is calculated after a full accounting of all expenses of the corresponding period, including here the amortization expenses and expenses for provisions.

4.1.2. If it is calculated as a net earning after subtracting projected income tax and projected dividends.

4.1.3. After it is verified by the Control Committee of the Bank and its authorized accounting expert. .

4.2. Losses during the Fiscal Period, for business and supervision reasons, regardless of the fiscal year in which it occurred, shall be included in the total amount of Regulatory Capital as an element of the Base Capital, which is calculated as shown above.

5. FISCAL YEAR END EARNINGS

For the purpose of this Advisory, Fiscal Year End Earnings shall mean the earnings of the fiscal period at the end of each year, which is not distributed until the moment that Regulatory Capital is reported and it will be included in the Base Capital after it is decreased by the amount of dividends projected to be distributed.

6. GENERAL RESERVES

General Reserves shall mean elements that fulfil the following conditions:

6.1 They are freely used to cover unidentified risks related to banking activities and do not reflect a reduction in the value of assets.

6.2. Appear in bank accounting books.

6.3. The amount is determined by bank directors and it is verified by the Bank Control Committee and its authorized accounting expert.

7. SUBORDINATED LIABILITIES

Subordinated Liabilities are defined as **"assets that originate from the emission of Subordinated Titles or Loans, with maturity time or not, which's payment is made after the payment of other liabilities."** Their classification depends on the "subordinated" condition and not from the emission method (title or loan) or the maturity criteria (with or without maturity dates).

In accounting, they will be entered as a credit of account 56 "Subordinated Liabilities" and as a debit of account 112 "Central Banks", or as a debit of account 131 "Liquid account with Banks ..." or as a debit of account 271; Transactions with Clients", depending on counterparts.

8. TYPES OF SUBORDINATED LIABILITIES

8.1 Hybrid instruments:

- are uninsured, subordinated and fully paid,
- paid only on the initiative of the debtor and upon approval of the Bank of Albania;
- Contract terms foresee the possibility of extending the payment time of interest in case that entities included in this regulation are working at a loss;
- Contract terms foresee that payments of principal and interest may be used to recover losses, without making these entities stop their activity.
- are included in the Regulatory Capital only for collected amounts.

8.2. Time Subordinated Liabilities:

- In case the contract foresees a certain maturity date, the initial maturity date should be no less than 5 years.
- If the contract does not foresee a certain maturity date, liabilities may be paid after a 5 year notice is given.
- In no cases is prepayment allowed, unless it is done without the approval of the Bank of Albania.
- Payments are not used to cover losses.
- Only amounts actually collected are included in the regulatory capital, after they are progressively deducted by 20% for the last 5 years before the maturity date.

8.3. The Bank of Albania gives approval only in cases when all of following conditions are fulfilled at the same time:

8.3.1. Entities subject to this Advisory are profitable,

8.3.2. Any payment of principal and interest of instruments, defined in paragraphs 8.1.and 8.2., does not reduce the capital adequacy under the limits defined by the Bank of Albania.

9. REPORTING PERIOD

Regulatory Capital is reported every month to the Bank of Albania, Supervisory Department.

10. REPORTING METHOD

Reporting of regulatory capital is done based on the following form, which is part of the reporting system.

11. This Advisory takes effect on 01/06/1999.

Chairman of the Advisory Council

Shkelqim Cani

REPORTING FORM
(Regulatory Capital for covering credit risk)

Bank Name
Reporting Period
Reporting Date
Prepared by (Name, Last Name, Signature)
Director (Name, Last Name, Signature)

in thousands lek

The Base Capital	Acc. No.	Amount
-------------------------	-----------------	---------------

I. Elements that are added to (A):

- | | | |
|--|-----------|--|
| 1. Subscribed Capital | 5711 | |
| 2. Reserves (other than the re-evaluation capital) | 5731,5733 | |
| | 5734 | |
| 3. Primes of emissions and mergers | 572 | |
| 4. Undistributed earnings (carried over) | 577 (P) | |
| 5. Fiscal Year End Earnings | 578(P) | |
| 6. Earnings during the Fiscal Period | 578(P) | |
| 7. Credit re-evaluation differences | 574(P) | |

Subtotal A= (1f2+3+4+5+6+7)		A
-----------------------------	--	---

II. Elements that are subtracted (B)

- | | | |
|---|---------|--|
| 1. Unpaid Subscribed Capital | 5712 | |
| 2. Nominal value of bank shares in
bank's possession (redeemed or unissued shares) | | |
| 3. Undistributed losses (carried over) | 577(-P) | |
| 4. Losses during Fiscal Period | 578(-P) | |
| 5. Debt re-evaluation differences (negative) | 574(-P) | |
| 6. Intangible fixed assets | 531 | |

Subtotal B= (1+2+3+4+5+6)		B
---------------------------	--	---

Total of Base Capital C= (A-B)		C
--------------------------------	--	---

ADDITIONAL CAPITAL

m. Elements of Content (J):

- | | | |
|----------------------------------|------|----|
| 1. Re-evaluation Reserves | 5732 | EA |
| 2. General Reserves | | EB |
| 3. Hybrid Instruments | 56 | EC |
| 4. Time Subordinated Liabilities | 56 | F |

If $F \leq C/2$, then $G=F$	G
If $F > C/2$ then $G=C/2$	G
Limited Subtotal $H = (EA+EB+EC+G)$	H
First Limitation: If $H \leq C$, then $J=H$	J
Second Limitation: If $H > C$, then $J=C$	J
The Total of Additional Capital prior to deductions (J)	J

IV. Elements that are subtracted (P+Q)

1. Pinion in Banks and financial institutions (P):	
-- Participation over 10% in their capital or under 10%, which plays an important role in them and adding to it Subordinated Rights in the same bank or financial institution.	K
-- Participation amount, that does not meet the above conditions along with other Subordinated Rights in the same bank or financial institution is reduced by 10% of Its Own Funds (C+J)	L
For Example $M = (C+J) * 10\%$	M
Retained after the above reduction: $N = (L-M)$ if positive	N
Subtotal $P = (K+N)$	P
2. Guarantees given to Mutual Guarantee Fund according to conditions set by Central Bank	Q
Subtotal of the subtracted amount is (P+Q)	P+Q

Summarized Calculation of the Base Capital and Additional Capital after deductions of No. IV

1. If $J \leq (P+Q)$ then:	
Additional Capital after the subtraction $JA=0$	JA
Base Capital $CA = C+J-(P+Q)$	CA
2. If $J > (P+Q)$ then:	
Additional Capital after the subtraction $JA = J-(P+Q)$	JA
Base Capital $CA = C$	CA

Total of Base Capital and Additional Capital: $E = (JA+CA)$ **E**

Deductions according to proper regulations

- Regulation on "Credit risk management" approved on decision No.13 of the Supervisory Council of the Bank of Albania dated 21.02.2001.
- Regulation "On participation of the bank and foreign bank branches in the capital of trade associations" approved on decision No.107 dated 03.11.1999 of the Supervisory Council of the Bank of Albania.

- Regulation “On the amount and the complement of the minimum initial capital on licensed bank activities and licensed foreign bank branches” approved on decision No.51 dated 22.04.1999 of the Supervisory Council of the Bank of Albania.

The total amount of base capital and additional capital after subtractions (E) E