ESSAYS ON REGULATION AND SUPERVISION

Regulation and Supervision of Albania's Microfinance Industry

Building Supervisory Capacity for Credit Unions and MFIs

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ABOUT THE SERIES

The *Essays on Regulation and Supervision* series has been commissioned for the Microfinance Regulation and Supervision Resource Center, funded by the Consultative Group to Assist the Poor (CGAP) and implemented by the IRIS Center. These essays are intended to provide additional insights and perspectives on the experiences of microfinance institutions, regulators, donors, and others regarding specific microfinance legal and regulatory environments.

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Introduction

SINCE ITS BEGINNINGS in the early 1990s, microfinance has been an essential part of the development and economic environment of Albania. With donor support and with a firm commitment from the government throughout the period, microfinance has developed and consolidated into a recognized and established part of the financial market. Microfinance institutions (MFIs) entered Albania in the early and mid 1990s with ease--some as NGOs and some as quasi-governmental agencies all free of state supervision. By the time state supervision came under discussion in the late 1990s there was a solid core of MFIs operating in Albania.

MFIs have retained high levels of loan repayment during the period, despite a number of social and economic crises, most infamously the 'pyramid savings schemes' collapse of 1997, when up to 50% of the population lost their savings. MFIs maintained their small but sound base even when crises in loan repayments led to the collapse of one major state owned bank and, in 1998, a moratorium on lending in another.

This healthy state of operations has, from the MFI point of view, been the cornerstone of discussions with the state authority for regulation and supervision of banking activity, the Bank of Albania (BoA)[1]. With strong repayment levels MFIs have been able to negotiate from a position of strength in order to obtain a regulatory and supervisory system suitable to their needs.

Bank of Albania, while it is reassured by consistently high levels of loan repayment, points out however that MFIs have been slow to achieve an optimal scale of operations and full sustainability. They are still donor dependent, either through direct subsidies or through access to funds at below market rates.

1. Note that under Albanian Law, savings collection and lending are defined as banking activity. This forms the basis for empowering BoA to regulate and supervise all actors engaged in these activities.

Overview of Microfinance Development

THE FOLLOWING TABLE gives a brief overview of the microfinance actors in Albania today, together with a comment on the level of regulation and supervision in force today for each sector.

Table 1: Albania's Microfinance Industry

Type	Institution	No.	No. of Clients	Savings	Active Lending	Level of Reg./Sup.[1]
1	Unions/Savings and Credit Associations[2]	2 Unions (with 120 member SCAs)	14,000	$3m	$10m	High
2	MFIs under BoA Regulation[3]	1	4,000	NA	$4m	High
3	MFIs with BoA recognition but not under regulation	2	7,000	NA	$24m	Low
4	MFI operating with NGO status	2	1,500	NA	$2m	None
MFI Total		**7 MFIs**	**26,500**	**$3m**	**$40m**	
5	Commercial Banks with microfinance portfolio	3	8,000 est.	NA	$10m	Medium
Total		**10**	**34,500**		**$50m**	

[1] Level of regulation and supervised analyzed according to the frequency and detail of off-site reports to BoA and the percentage of micro-loan contracts BoA inspectors examine during in-site inspections.

[2] Note that Credit Unions in Albania are known as Savings & Credit Associations (SCA) and their National Federations are known as Unions of SCAs (Union).

[3] For more information about recognized versus regulated MFIs, see below

Over a period of 13 years, microfinance activity in Albania has reached over 2% of the population, or an estimated 6% of households, in over 80% of the regions of the country. Average loan size per borrower has also surpassed the expectations of all MFIs. Since 1998 it has risen from $300 to $1,400 in rural areas and from $1,800 to over $3,000 in urban areas.

Development of Microfinance Regulation and Supervision and Effects on Practitioners

THE FIRST DEVELOPMENTS of state regulation and supervision of microfinance activity took place in 1998, stimulated by World Bank encouragement and the inclusion of a component for improvement of the legal and regulatory environment in the World Bank's Albanian Micro credit Project (1999 to 2004). This project aimed to transform the two implementing bodies of the existing Urban and Rural Micro credit Projects from quasi-governmental institutions into one independent MFI for the urban areas and one Union of SCAs with a network of member SCAs for the rural areas. These institutions would then be independently owned and appropriate for state regulation and supervision.

The distinction between deposit taking and non-deposit taking MFIs was made immediately. The only deposit taking MFIs are SCAs and their Unions

The first major collaboration between state, donor and beneficiaries was in the redrafting of the Law for SCAs. A long process of discussion between the Ministry of Finance, BoA, World Bank, other donors, and the beneficiary projects themselves led to the redrafting of the 1996 Law for SCAs. The new Law for SCAs of 2001 maintained the essential member-owned and non-profit status of SCAs, defined their organizational structure, described their core operations and added two new key elements:

- Delegation of licensing, regulation and supervision authority to BoA

- Acknowledgement of the monitoring and financial role of the Union for its member SCAs.

On the basis of this solid 'stand alone' Law for SCAs, the BoA issued Licensing and Supervisory Regulations for SCAs in 2002, enabling a rapid growth in SCAs, much of which came from the transformation of already existing village credit schemes.

A specific law was not formulated for other types of MFIs, primarily because they may not collect deposits. In the years 2001 and 2002, BoA granted exemptions from dispositions of the Banking Law to the two largest of these MFIs (type 3 in Table 1 above). This exemption allows the MFIs to conduct their activity, and obliges them to send quarterly balance sheets and loan portfolio analyses to BoA. Critically, the exemption letter did not mention regular inspection of these MFIs by BoA, and no inspections of these MFIs have taken place. Satisfactory inspection would be difficult for BoA inspectors since these MFIs are not subject to any specific BoA regulation.

In these years however, BoA did work on the development of regulations suitable for MFIs. In 2003 it updated its Licensing Regulation for Non-Banking Financial Institutions (NBFI), which foresees a wide variety of financial activity such as lending, money transfers, foreign exchange, safe facilities and issue of guarantees; deposit collection is not allowed under this regulation.

The key requirement for an MFI to obtain a NBFI license is a minimum capital of $1 million[2]. (This amount is 5 times the minimum capital for a NBFI which does not lend to clients). This requirement presents a difficulty for currently active MFIs because this capital must be in cash on the date of application. Capital in use as loan portfolio, or commitment from a donor, is not accepted. This cash requirement (maintained in an escrow account) has discouraged active MFIs from registering under this regulation. To date just one MFI (Mountain Area Finance Fund) has become licensed under the regulation, and has been subject to BoA reporting and inspection. Four of the five significant

2. The exchange rate used throughout is $1 = 100 Albanian Leke

MFIs active at the moment have not registered. The regulation has served mainly to allow money transfer agencies to license and operate.

Two of the four un-regulated MFIs (Besa Foundation and Albanian Micro credit Partnership) are still the subjects of the 2001/2002 exemption, and as such send at least their financial statements to BoA. The other two (Building Futures and For the Future Foundation) are registered as Non-Profit Organizations (NPOs) under the Law for Non–Profit Organizations of 2001.

It is a source of concern to BoA that any MFI would not report to it on its lending activity. It is highly unlikely that BoA will issue further exemptions, since these exemptions were foreseen as temporary measures pending the introduction of the 2003 Regulation for NBFIs. The scale of operations of these MFIs, however, is very small and it is unlikely that they will fulfill the minimum capital requirement in the near future.

Taxation status also influences the process. The four non-regulated MFIs enjoy a non-profit status and have no tax liability. Registration as a NBFI would change that status. It must be assumed then that assumption of a tax liability is a major disincentive for MFIs to come under BoA regulation at this time or in the future. Tax on the profit of banking activity is 25%.

Should the fact that four of the five significant MFIs active in 2005 have not applied for licenses under the regulation be of concern to BoA? Insofar as there are no deposits at risk there is a strong case to say that there is no need for concern. Insofar as these MFIs have a large share of the loan market in Albania (over 10% of all active borrowers), however, there is a strong argument for BoA supervision of this section of the market.

Strengths and Weaknesses of the Current Regulatory and Supervisory Systems

UNDERSTANDING the regulatory and supervisory system for microfinance requires analyzing its impacts on both the savings and credit associations (SCAs) and the MFIs.

The main strengths of the SCA regulatory and supervisory system are:

- The representative and financial role which Unions of SCAs have for member SCAs. Unions monitor SCA activity and report to BoA on the operations of their member SCAs. They may also provide some of the key support services which the SCAs need, such as liquidity management. The BoA is satisfied that Unions have the infrastructure and HR in place to manage networks of small SCAs that are scattered over the country. It is inconceivable that BoA would directly license and supervise 120 SCAs, were they not members of Unions. Supervision, inspection and communication would be too expensive.

- Capitalization requirements are low enough to allow SCAs to become established and commence activity 'from zero'. The primary 'capital to lending' ratio of 8% is low enough to allow SCAs to begin their activity by:

    - Seeking reasonably low levels of capital contributions from members (normally 2 to 4% of the value of the loan the member seeks).

    - Collecting savings from members at very low interest rates for the first few years.

This minimum capital requirement does not rise as the SCA matures, an issue which BoA is to examine in the near future.

This system encourages 'bottom up' or grass roots development of SCAs with solid principles of sustainability from the beginning. This would be impossible if BoA had imposed a high minimum capital requirement or an excessively high 'capital to lending' or 'capital to assets' requirement. Such requirements would oblige SCAs to either find generous donors to input capital, or to persuade members to input high levels of capital, which is not plausible since, under the non-profit status of SCAs, capital is not remunerated.

It should be pointed out that, against the low capitalization requirement, the provisioning requirements for late loans are very high, thereby obliging non-performing SCAs to have high levels of capital to fund necessary provisions.

The main weakness of the system may well be the flip side of the strengths described above.

- BoA has entrusted Unions with the monitoring of their member SCAs and with communication from SCAs to BoA. This is effective only as long as the Union is acting in the best interest of all parties. The owners of the Union are the SCAs themselves however, hence the system is to a large degree one of self regulation. This type of supervision is inevitably weaker when the subject experiences difficulties, and especially when the subject is reluctant to disclose those difficulties.

- The system is designed to allow SCAs to progress from the 'bottom up' by building capital incrementally. This is very suitable for the case of classic Credit Union growth through members' savings, where growth is usually incremental. However the major part of the Albanian SCA system (albeit declining) is financed by large amounts of donor funds. BoA regulation has allowed SCAs to gain access to these funds with the low capitalization requirements and with capital that is not institutional (e.g. member contributions which are redeemable on the member's departure). The danger exists that, in order to allow the SCA to access large donor loans, the capital base may be created artificially and may just as easily disappear in the future.

The strengths of the Regulation for Non-Banking Institutions, as it relates to microfinance, include:

- a high minimum capital requirement ($1 million), which is 20% of the minimum capital required for a banking license in Albania. This will certainly ensure that only well financed organizations consider microfinance in the future.

- a minimum capital leverage ratio of 10%. This is low enough to allow MFIs to access considerable levels of funding if they can convince donors/lenders of the quality of their operations.

The regulation is weak, however, in the area of risk distribution:

- The maximum single loan size permitted is 10% of gross loans. Currently this permits the one MFI licensed as a NBFI to make a single loan in excess of $400,000. (The said MFI has not done so, but has made large loans by MFI standards.) This begs the basic question: what is microfinance? An answer or definition is not to be found in Albanian law or regulation.

- Regarding minimum capital requirements we have seen above the futility of a large entry threshold for BoA licensing, when there is no restriction to NGOs, legal persons or individuals lending funds to others. The high threshold simply keeps these lenders out of the state supervisory system.

Development of BoA Capacity to Regulate and Supervise MFIs.

BANK OF ALBANIA, with encouragement from the World Bank, began microfinance regulation and supervision in 1998. Its first step was to commit two experienced specialists from its supervisory department staff to be interlocutors with the MFIs and to move the process forward. The BoA Supervisory Department contains three sub-departments:

- Licensing and Regulation (from which one specialist was engaged)

- Off-site analysis

- On-site inspections (from which one specialist was engaged).

The regulation and supervision of the non-deposit taking MFIs has taken up relatively little energy. It has involved analysis of the reports of the three MFIs with formal status with BoA (either through the 2003 regulation or the exemptions issued by BoA), with just two one-site inspections carried out.

BoA has been comfortable with these MFIs which consistently show high and improving loan repayment rates and still have very high levels of capitalization (all of them over 30% of assets). It is aware, however, that most of this capital is seed capital received from donors and is foreseen as the capital base for a much higher level of assets in the future.

For deposit taking MFIs (SCAs and their Unions) the investment of BoA time has been much greater. Both BoA specialists were intensely involved in the consultative process of redrafting the Law of SCAs, which was approved in 2001. Subsequently they led the internal BoA process of drafting and approving the SCA Licensing and Supervisory Regulations of 2002. This work also involved a long consultation with the Unions of SCAs.

With the base of the regulations in place, the day to day work of SCA supervision and inspection began. Extra capacity within BoA was needed then to carry out a large volume of work:

- A total of two Unions and their 130 member SCAs have each been approved individually for licenses.

- Each SCA reports to BoA four times per year. SCAs report to BoA through their Unions.

- Inspections are time consuming as SCAs are situated in rural areas, often very far away from the capital.

- A system of electronic reporting has not been developed yet to enable BoA to receive reports on disk and process them quickly on a suitable software system.

To achieve the minimum level of supervision considered necessary BoA has involved up to six other supervisory staff at different times, plus the considerable energy of an analyst from the Statistics department. It has achieved on an annual basis:

- Statistical analysis of all of the quarterly reports from the SCAs and Unions.

- One full inspection of each Union annually, plus inspections of about 10% of member SCAs annually.

The burden of this work then is heavy, and would seem to be out of all proportion with the level of financial activity (approximately $14 million in assets, or less than 1% of the total assets that BoA supervises) especially when compared to the limited resources that BoA has to cover the whole spectrum of banking activity in Albania. SCA supervision is estimated to have taken up over 5% of Supervisory Dept. resources throughout those years.

This commitment is justified however as BoA emphasizes that

- Any type of non-banking deposit collection in Albania requires close attention, given the catastrophe of the 'pyramid savings schemes' collapse of 1997. BoA is quick to remind readers that these schemes were outside of its supervisory system and it was therefore powerless to prevent their growth and subsequent collapse.

- BoA personnel have received, with donor support, the benefit of a wide range of training and capacity building during this process. Staff have traveled to see first hand the Credit Mutuel system of France and the Irish Credit Union system. They have also participated in the Annual Conferences of the Micro Finance Centre for Eastern Europe and New Independent States.

- BoA has also received the benefit of an in-house consultancy financed by the microfinance donor.

This travel, networking, training and consultancy has created an enthusiasm for microfinance and helped BoA to see this sector as one with enormous growth potential, which if managed and supervised well, can benefit a large proportion of the population.

The Supervisory Dept. and consultants agree with the current policy of maintaining microfinance regulation and supervision within the overall work program and staffing structure of the Department. They consider this superior to the formulation of a separate microfinance unit or department for the following reasons:

- BoA specialists are reluctant to work solely in the area of microfinance. Few, if any, would be happy to leave their roles in banking supervision, as they see greater career prospects there. A system where specialists embrace both banking and microfinance supervision is more appealing to staff.

- Many of the MFIs have the long term aim of achieving full banking status. They conduct much of their discussion with the BoA microfinance supervisors on the possibility of achieving this. Therefore it is highly desirable that these supervisors be up to date on the current banking environment as well as the microfinance environment

- Banks have entered the microfinance market and may become the largest actors in this market in the next few years. Therefore there will be a significant overlap between supervision of Banking and microfinance activity.

BoA is pleased then that it built a solid base of expertise and experience in microfinance within its Supervision department. It is also pleased with the high level of communication that it maintains with regulated entities. This is vital given the relative youth of the MFIs and the rate at which the MFIs experience growth and change.

Among the MFIs, the SCAs and their Unions are quick to point out the huge level of time and energy that they have put into the regulatory and supervisory process with BoA and the considerable reporting demands made of them. They envy the way in which the other non-deposit MFIs may operate free from BoA restrictions (e.g. loans in foreign currency, much larger loan sizes) and with fewer reporting requirements.

It should be noted that the difference in the level of energy devoted to the process and the greater severity of the regulation on SCAs and their Unions is not due solely to the fact that they are allowed to collect deposits. Much of the discussion and energy has been necessary because of the SCA co-operative structure of ownership and organization, which is a challenge to Albanians in the aftermath of the Communist system, which abused and distorted many of the fundamental concepts of democratic organization, co-operation and volunteerism.

It is also of note that BoA does not recover any of the cost of supervision of microfinance, nor indeed of banking activity. The idea that the BoA Supervisory Department evolve into a separate institution from BoA (which also has responsibility for Monetary Policy, Treasury etc.) has been discussed from time to time but no concrete proposals have emerged. Should this evolution ever take place it is likely that MFIs will be required to cover the cost of supervision.

The Advent of Commercial Banks in the Microfinance Market

THE LATEST DEVELOPMENT in the evolution of microfinance in Albania has been the advent of commercial banks into the market for small loans.

ProCredit Bank, which has operations across Southeast Europe, has been the leader in this field, not surprisingly since its Albanian roots are in the development field. Other banks have followed suit. The recent entry of Raiffeisen Bank to Albania through its purchase of the state-owned Savings Bank is most significant, since it has a nationwide network and over 50% of the deposit market at this point. It professes its determination to serve the micro loan market.

Current information is not very satisfactory, however, since micro-lending includes both lending for small business and for consumer purposes. At the moment banks informally consider micro-lending as loans of $10,000 and less, an amount much lower than the maximum loan of the MFIs.

It will be very important for BoA to acquire accurate information on the nature of the portfolio of the small loans of commercial banks in order to distinguish between microfinance loans, and other types such as consumer loans, housing loans and overdrafts.

BoA must pay very close attention to the development of the small loans market, and in particular the advent of consumer credit on a massive scale, which we can expect in the next few years. By way of example, commercial banks are now on the verge of capturing a huge market of state employees, because the state sector is transforming all its wage payments systems from cash to bank transfer, thereby obliging each employee to open a bank account. The competition to secure these accounts is fierce, to the point that some banks are offering employees high overdraft facilities (in some cases up to 3 months salary) on opening of an account. This is a disturbing development in a country with little experience of bank accounts and of credit.

BoA strategy of developing its microfinance supervisory staff within its banking supervision personnel should pay dividends here, as it is vital that BoA understand in depth the strategy of commercial banks to develop the microfinance market. BoA inspectors, as they inspect MFIs one month and commercial banks the next, are gaining invaluable insights in the different cultures of the institutions, their different strategies and the level and quality of service they provide to their clients. While it is natural and to be expected that individual inspectors may consider one system to be superior to another, what is most important is that the merits of both are recognized and that BoA ensure that each system works within a well regulated and supervised system.

Likely Developments in Microfinance over the Next Five Years

IN ORDER TO try to predict what the developments in microfinance may be over the next few years, it is necessary to revisit and review some core principles of microfinance and consider the attitude of MFIs and BoA in the context of these principles.

All Albanian MFIs, with the exception of a small number of urban based SCAs, proclaim that they exist to fund the development of micro-business in Albania, and for no other reason.

It is clear however that consumer lending is an area of huge growth and one that cannot be ignored by MFIs.

- The same clients who have micro-businesses will seek consumer loans, and may prefer to use their MFI than the bank.

- Strong arguments can be made for the economic benefits of loans for education, training etc., even though they are not connected to micro-business.

- MFIs may already concede that a certain proportion of their lending to clients is already being used for consumer purposes, in spite of what is written on the application form.

Therefore we may expect a shift in lending policy and the development of new products among the MFIs.

The housing market cannot be ignored either since the cost of purchasing, building or renovating a house is still very much in the range of micro-loans (with the exception of the capital city) and the ownership of a family home is a very important part of Albanian culture.

MFIs define themselves by the level of loan that they lend to the client. With the exception of one MFI, loan limits have stayed under $30,000 and average loan size has stayed at a fraction of that. This is not due to BoA regulation but rather to MFI credit policy. This policy may be reviewed when many of the clients consolidate their businesses and seek much larger loans from the MFIs in order to progress from micro-business to Small and medium enterprises (SME).

In short MFIs may find themselves with a great demand from clients for larger loans and for loans for other purposes. It will be emotionally painful and economically risky to turn these clients away in the direction of the banks. BoA has not curtailed the potential of MFIs to offer new products. It has not yet foreseen reporting of new products in its reporting system, however. It would be wise to do so in order to ensure that it is aware at all times of the nature of the loan portfolio of the MFIs, in terms of loan size and purpose. Significant and rapid change in the nature of the portfolio of an MFI would naturally worry BoA. It would seek to assure itself that the MFI had a clear strategy and policies for this change.

Of course MFI credit policy will also be dictated to a great degree by the level of funds the MFIs have at their disposal and the sources of these funds. While five of the seven MFIs profess sustainability at this point, the fact remains that they still operate largely with their own capital and with the funds of donor/lenders at below market rates. It must be assumed that these lenders will maintain their funding only in order to sustain microfinance in the traditional sense of micro-business funding. MFIs have begun to borrow from commercial lenders at market rates, but this has been a slow process.

Rapid expansion and development of new products and large loans, to serve a rapidly growing demand, will only be made possible by the collection of local deposits. For the MFIs which are not SCAs, the only route to such funds is through a banking license.

The first such MFI to formulate its strategic plan for transformation to banking status is the Mountain Area Finance Fund. Central to achievement of the objective however are the expansion of operations into new regions of Albania (into the 'territory' of other MFIs) and the merger or takeover of other MFIs (in order to achieve the necessary scale and to solve the territorial competition problem). It remains to be seen if this initiative will be pursued and succeed, and if other MFIs will agree to merge.

Among the SCAs a series of mergers are already taking place. It is almost certain that the two Unions of SCAs will reduce the total number of member SCAs from 120 village SCAs at this time to less than 50 regional SCAs over two to three years. As well as affecting a financial restructuring, these mergers are also of cultural significance: as few as four years ago, neighboring villages would not work with one another to establish SCAs but SCA development has brought these villages closer together.

Sixteen different banks and seven MFIs currently operate in Albania. There is a strong body of opinion that Albania is oversupplied with providers, although its population is still of course underserved. BoA may soon raise the requirements for entry into the banking market and may take measures to prohibit the arrival of new NGOs to carry out unregulated microfinance activity.

An increase in the minimum capital requirement for a banking license would seem reasonable to discourage the arrival or establishment of more small banks. It would seem unfair however that such a measure might prohibit an individual MFI or conglomerate of MFIs from transforming to banking status in order to better serve their established client and regional base. Allowing capital requirements to be met by existing loan portfolio, or fixed assets, as well as simply by cash, would also be of great help to MFIs which are currently active and using existing funds to maximum benefit.

Measures to prevent the arrival of new NGOs in microfinance would appear very sensible to all of the current MFIs, to BoA staff, to commentators in the capital city and in regions well served by MFIs. The struggling inhabitants of the many regions still not served by MFIs and the development community would strongly disagree with such an embargo on new initiatives, however. They are still crying out for the provision of low cost credit to poor people (note that most MFI loans are at rates of over 20% APR and must be fully secured).

BoA, in addition to seeking the compliance of each MFI with its regulations, strongly supports the development of key supports to the financial sector and the inclusion of MFIs in these initiatives:

- MFIs are not participants in the national deposit insurance scheme. BoA awaits proposals from SCAs as to whether they would be better served by setting up their own deposit insurance scheme, or by seeking entry to the national scheme which serves the banks.

- There is no Credit Information Bureau (CIB) in Albania at either the banking or microfinance level. BoA has expressed its support for such a scheme and urged the industry to proceed with its development. MFIs have expressed their desire to form their own CIB, separate to the banking sector. Any such bureau would also form links with the state data bases of the tens of thousands of loan defaulters of state banks from the 1990s.

In January 2005, the seven MFIs established a national representative organization to pursue issues of common interest such as those above. BoA welcomes this innovation as one which will work to support the industry, to access more funds for microfinance, to maintain a clear definition of microfinance in Albania and a clear identity for MFIs, and to facilitate more discussion with BoA on issues of regulation and supervision. Both BoA and MFIs agree that their relations are healthiest when MFIs bring their proposals for expansion and change to BoA in a consistent and clear fashion and thereby allow BoA to foresee the necessary regulation and supervisory regimes to facilitate and control this development.

Conclusion

The concern of BoA is the security of the deposits of Albanian citizens, the soundness of the MFIs under its supervision and the stability of the financial market. In this regard it can be pleased with its progress: the bulk of microfinance activity is being reported to BoA: approximately 50% of the activity is directly inspected by BoA and there are ongoing discussions with the MFIs not fully incorporated into the system. The main issue of concern is the slowness of the MFIs to request licenses under the 2003 NBFI regulation, a situation due in part to BoA acceptance of their current status. The BoA Supervisory Dept. has integrated microfinance supervision into its overall Bank Supervision program with relative ease, although licensing of all MFIs under regulation would put a strain on its resources.

The MFIs and their donors may be pleased with their progress in the difficult first 13 years of market economy in Albania, especially considering the unstable political environment and the failures of state controlled banking in the first half of this period.

Further reform should begin with the needs of the clients. The financial needs of the ordinary Albanian has changed beyond all expectation since the beginning of MFI activity. The average Albanian has more resources at his disposal and requires a variety of financial services, both for personal and business on purposes. He does not distinguish between MFIs and other sources of finance, indeed often he does not distinguish between his business needs and personal needs. MFIs must develop strategies to ensure that it can cater for all his financial needs, business, family and housing. These strategies are necessary to ensure not just the expansion of the MFIs but their very survival in the face of a rapidly growing banking sector.

BoA has so far actively encouraged MFI development, through its exemptions and regulations for MFIs. The single greatest issue at this point is the issue of sourcing funds and in particular local deposits. If MFIs embrace the concepts and scale of banking then they will proceed to banking status. Some may not wish to take this route; if they do not, however, they will need to bring innovative proposals to BoA to enable a sound supervisory and reporting system for a wider variety and higher scale of financial services.

The challenge for BoA and MFIs to enable this discussion and formulate a vision for the industry is made greater by the likely withdrawal of donors as they complete their commitments to Albanian microfinance and as the MFIs achieve sustainability.

The establishment of the representative body for MFIs is an important step, which should facilitate the formulation of an industry strategy, discussions between industry and the state and the sourcing of resources for the industry. The state and BoA in particular, should welcome this initiative. It will enable the best possible dialogue.

The client or consumer should not be neglected by the industry or the state in the formulation of the microfinance and credit industry. There is unfortunately little or no consumer representation in the financial and microfinance sector. This is a concern given that the Albanian consumer has little experience with credit. The development of a variety of MFIs and banks has ensured competition which is in the interest of the consumer. Nevertheless the consumer remains vulnerable to high costs, to unclear or misleading advertising of costs and to breaches of client confidentiality.

BoA for its part needs to maintain its commitment of resources to this sector, to exploit all opportunities within the country and abroad to build the capacity of its microfinance specialists and to maintain its close links with the Ministry of Finance, which has the capacity to effect new legislation in this sector. Finally, far away as it may yet appear to be, all of this activity will come within the remit of EU directives once Albania comes closer to EU membership. Now is the time to evaluate the entire microfinance system in the context of the EU, membership of which is now the goal for Albania, its institutions, businesses and citizens.