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# Functions of Central Bank of Kosovo and the need for their advancement

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## **Abstract**

Central Bank of the Republic of Kosova (CBK), was established in June 2008, and is the successor of the Authority of Banking and Payments of Kosovo and the Central Banking Authority of Kosovo.

Main Functions of the Central Bank of Kosovo are:

- Drafting and implementation of monetary policy,
- Regulation and supervision of the banking system,
- Bank of the Government,
- Management of foreign exchange and gold reserves.

Central Bank acts as the Banker, Fiscal Agent, and Economic Adviser to Government. Developing an efficient and safe system for domestic payments is a primary function of the CBK. Creating of Electronic System for Interbank Clearing (SEKN) in 2001, first as a system of interbank payments was a major step forward in terms of facilitating the operations of domestic payments through the banking system. SEKN remains the only system of interbank payments since then, but has been raised significantly functionally in recent years, especially in 2008, aiming at modernizing and enriching ways of conducting transactions. Specifically, in 2008, was passed in web technology platform and developed the Direct Debit scheme.

Facilitating the exchange of information between lending institutions is a crucial and target commitment of the CBK in order to develop interbank infrastructure for credit market advancement and promotion of financial stability.

**Key words:** Central Bank, Functions, Banking, Kosovo.

**Jel code:** E5, E58, E52, E42

## Introduction

Under the Law on Central Bank of Kosovo Article 1, Central Bank of the Republic of Kosova (CBK), the successor of the Authority of Banking and Payments of Kosovo and the Central Banking Authority of Kosovo, was established in June 2008, with the approval of the Law no. 03/L-074 for "Central Bank of the Republic of Kosovo" approved by the Kosovo Assembly.<sup>1</sup>

Approval of the Constitution of the Republic of Kosovo transformed the Central Banking Authority of Kosovo in the Central Bank of the Republic of Kosovo, thus meeting the institutional framework for more efficient financial sector and economy. With this, it was the transfer of all powers to local authorities and achievements in this area were numerous.

Central Bank of Kosovo (CBK) provides services for government institutions, financial institutions and the public; services that are offered by a common central bank, with the exception of credit or provision of temporary liquidity since CBK is not the issuing bank. Currency used in the Republic of Kosovo is the euro.<sup>2</sup>

Central Bank of the Republic of Kosovo is independent legal entity with full powers as a legal person under the applicable law in Kosovo, and responds to the Assembly.

Central Bank of Kosovo, is senior financial institution, which licenses and performs supervision of the banking sector, insurance companies, and pension funds both state and private.

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The main objectives of the Central Bank of Kosovo under the applicable law are:<sup>3</sup>

1. Price stability (maintain low inflation and stable prices);
2. Economic growth;
3. Senior Employment;
4. Financial stability;
5. The stability of interest rates;
6. The stability of foreign exchange rate markets.

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<sup>1</sup> BQK, (2008): *Ligji mbi bankën Qëndrore të Kosovës fq.1*

<sup>2</sup> BQK, (2008): *Raporti Vjetor i BQK 2008*

<sup>3</sup> BQK, (2008): *Ligji mbi bankën Qëndrore të Kosovës fq.1*

Central Bank acts as the:

- Banker,
- Fiscal Agent, and
- Economic Adviser to Government.

Central Bank must be independent, and have legal and real independence based on the law of the CBK. Apart of legal and real independence, the CBK also should have:

- Political independence;
- Economic independence;
- Independence in policymaking;
- Instrumental independence; and
- Independence of staff.

Political independence, means legal independence from political interference. Economic independence, means legal independence from government interference. Independence in policy making, means that CBK is independent of drafting policy itself. Instrumental independence means that the CBK is independent in pursuing its own policy and undertake action in performing monetary policy. The independence of the staff means the ability of the CBK to select and appoint staff of the central bank.<sup>4</sup>

The Central Bank has the following specific powers:<sup>5</sup>

- To recommend to Parliament and Government policy guidance in areas under its responsibility;
- To establish and implement measures for transactions settlement systems of local and foreign currencies in Kosovo;
- To supervise and regulate the fees;
- To own and operate one or more payments systems;
- To act as fiscal agent of the Ministry of Economy and Finance;
- Maintain currency deposits of banks, the Ministry of Economy and Finance and other public entities;
- Ensure adequate supply of banknotes and coins for the settlement of cash transactions;
- To maintain treasury for safe keeping of currency and securities;
- To license, supervise and regulate financial institutions;
- To conduct regular analysis of economic and monetary economy in Kosovo, to make public the results and make proposals and measures to Parliament and Government

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<sup>4</sup> Sulo Haderi, (2007): “Paraja, bankat, dhe tregjet financiare”, Shoqata e kërkimeve shkencore sociale-ekonomike (AGAFER), Botimi 3.

<sup>5</sup> [www.bqk-kos.org-funksionet dhe përgjegjësitë](http://www.bqk-kos.org-funksionet-dhe-përgjegjësitë)

- To supervise and regulate dealers in foreign exchange, broker-dealers and mutual funds;
- To approve the external auditors of financial institutions;
- To set accounting standards for financial institutions in Kosovo in accordance with international financial reporting standards.

In the context of the organizational structure of the Central Bank of Kosovo also operate many departments and directorates which have particular importance in the functioning of the CBK as senior financial institution. Especially Directorate for Financial Management which deals with the foreign investments, deposits and securities, (Front Office, Middle Office, Secondary Office, and Back Office or Support Office), then the collection research and analysis of statistical data, (Directorate of Analysis and Statistics), Interbank payment system (interbank clearing), and the evidence of making loans of all commercial banks. Within CBK also operates financial supervision of commercial banks, insurance companies and pension funds. There is also Directorate of Internal Audit who makes regular audits based on the work plan approved by the Board the CBK.

### **Asset Management**

Central Bank of Kosovo (CBK) based on the Law on Central Bank of the Republic of Kosovo No.03/L-074, Section 6, is authorized to act as fiscal agent of the Ministry of Economy and Finance and to offer advice on financial requirements of this Ministry, while by the Law on Public Financial Management and Accountability No.03/L-048, Section 7, Central Bank of Kosovo (CBK) is authorized to invest Government funds. This form of financial investment enables return on investment, by interest paid on lending funds which are then deposited in the Kosovo Consolidated Budget.

In practice, the deposited funds mainly belonging to government institutions, where the Ministry of Economy and Finance (budgetary resources) is among the main depositors of the Central Bank of the Republic of Kosovo (CBK), the Kosovo Privatization Agency (AKP) (income from the privatization process) and financial reserves (mandatory liquid reserves). Also, the Central Bank of Kosovo (CBK) is charged with managing the funds deposited by public agencies, financial institutions, and donor organizations.

Until December 31, 2008, total assets managed by CBK were over 1 billion euros; from this, deposits of the Ministry of Economy and Finance and the relevant entity were around 470 million euros (44 % of the total), the Kosovo Privatization Agency (PAK) 403 million (38 %) and financial institutions 197 million euros (18 %). Investment policy is approved by the governing board of the Central Bank of the Republic of Kosovo (CBK), and implemented by the bank management, respectively implemented by the Department of Asset Management. Because a large portion of funds that are managed by CBK are public funds, which have to be returned for a short term, special focus was given to safety, liquidity and return on investment.

Central Bank of Kosovo (CBK) invests funds in money market instruments. During 2008, the process of fund investment has encountered in changing the investment strategy due to the global financial crisis. Asset Management Department during this period was concentrated in

investing funds with shorter time, with maturities up to one year according to the Investment Policy of the Central Bank of the Republic of Kosovo (CBK) in investments with shorter time limits, on bank deposits and in securities with maturities of no more than three months. Particular attention during this period was given to distribution (diversification) of risk, where the largest concentration of invested assets were carried out with the Central Banks of the European Union States which cooperate with the Central Bank of the Republic of Kosovo (CBK).

All investment processes were performed with banks that have a high rating (AAA and AA or equivalent). The investment of funds presented in euro currency, or in bank deposits were 49 percent at the end of 2008, or in government securities 51 percent at the end of 2008, with a maturity of no more than three months and a high degree of investment (AAA and AA or equivalent). Amounts of invested funds for each correspondent bank and to countries where investments take place are limited strictly based on the decision of the board of CBK. Compliance with the rules of domestic investment is working on a daily basis, until all activities are separate from (back office) and reported to the Governor.

Support Office (back office) performs all functions relating to the admission of documents prepared by the Front Office and Middle Office pertaining to the investment of deposits of funds to CBK, the Treasury investment securities. Support Office performs all transactions dealing with CBK clients transfers such as commercial banks, Ministry of Finance, Treasury, EULEX, Pension Trust, NEA etc.

These transfers of CBK clients are performed through the correspondent banks abroad, which are: Commerz Bank, Deutsche Bundes Bank, RZB, Banque de France, etc..

Analysis of risks and asset management functions audit are done on regular basis. Deposits taken by the Central Bank of Kosovo (CBK) were paid based on the interest rate of the European Central Bank (ECB) and the current value which is based on Interest Rate Policy of the Central Bank of the Republic of Kosovo (CBK). Treasury deposits and deposits from other Government institutions of the Republic of Kosovo, together with KPA deposits constitute the largest overall deposits held in accounts in the books of the CBK.

On December 31, 2008, deposits of the Treasury and other government institutions amounted from 470 million euros. During the year, the KPA deposits increased as a result of new privatizations, reaching a total of 405.9 million euros at the end of the year.

Based on the analysis done for the interest rates paid to CBK by correspondent banks for deposits and investment securities CBK, one can conclude that the interest rates paid to CBK on time deposits and investment securities from the period before the global financial crisis (recession 2008), until the end of 2009, has been highly inconstant and followed by a drastic decrease.

Decrease in interest rates for time deposits and investments in securities have oscillated from 4.5% -5%, the minimum rate of pay in early 2008, up to 0.15% - 0.25%, depending on the bank where they were time limited. CBK has deposited and invested its funds in the following banks:

- Deutsche bundes bank (investment in securities);
- Commerz Bank;
- Banque de France;
- Svenska bank
- Raiffeisen Bank, etc..

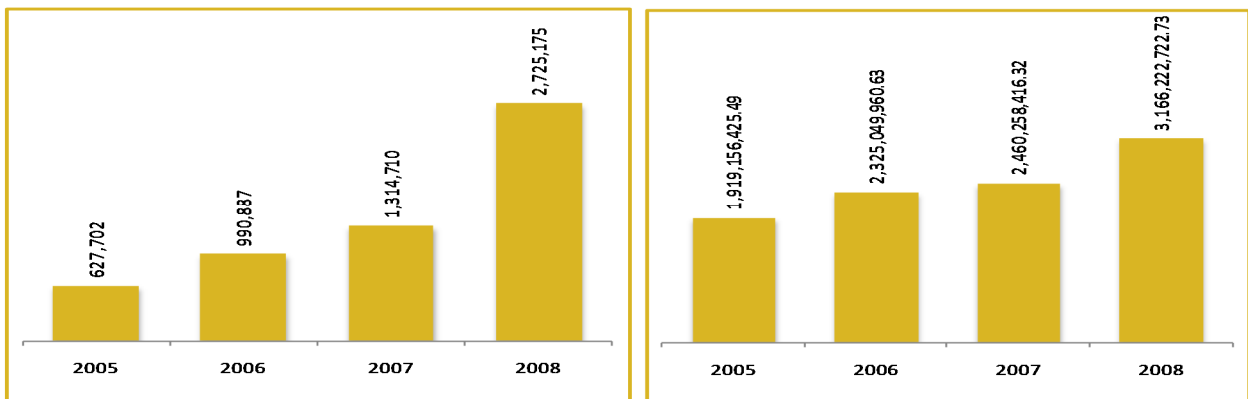
The interest rates paid to CBK by banks above, on invested funds in these banks, prior to the recession were 4.5-5% with a continuous tendency to decrease and finally collapse rapidly from month to months, until it has reached rate of 0.15% -0.20% for funds invested, and which can be seen from the documentation of investments made by the CBK. Despite the fact that thoughts that the financial crisis has had no negative impact on Kosovo economy, reducing the tearing of these interest rates is reflected negatively in the revenue of the CBK, for reasons that we had a reduction of income from interest.

### Interbank Payment System

Developing an efficient and safe system for domestic payments is a primary function of the CBK. Creating of Electronic System for Interbank Clearing (SEKN) in 2001, first as a system of interbank payments was a major step forward in terms of facilitating the operations of domestic payments through the banking system. SEKN remains the only system of interbank payments since then, but has been raised significantly functionally in recent years, especially in 2008, aiming at modernizing and enriching ways of conducting transactions. Specifically, in 2008, was passed in web technology platform and developed the Direct Debit scheme.

As is seen in Figure 1, in the 2008, annual growth in the volume as well as the value of SEKN transactions was visible. About 2.7 million transactions worth a total of 3.16 billion euros were channeled through SEKN. Compared to SEKN transactions in the previous year, the volume of transactions rose by 107.2 percent, and value of transactions rose by 28.7 percent.

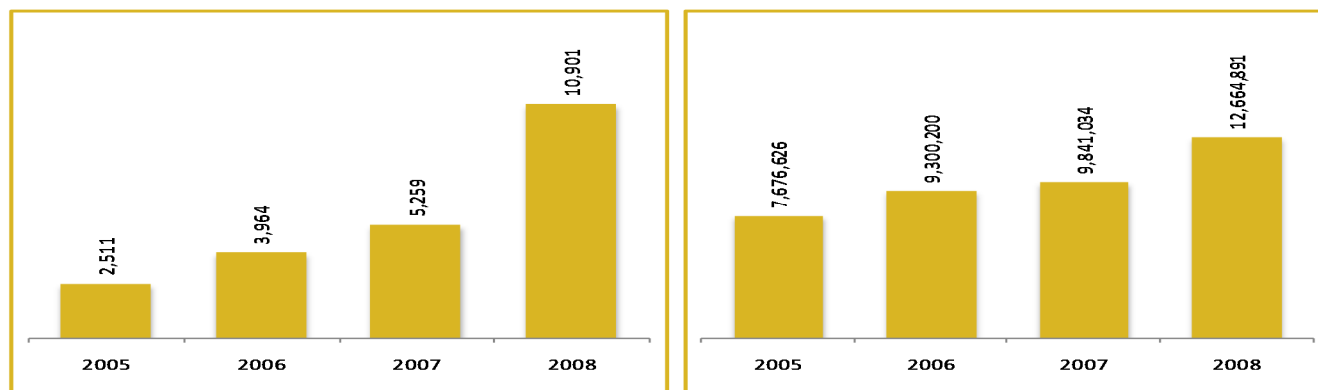
Figure 1 Annual volume and value of SEKN transactions



Source: BQK, (2008): Raport i vjetor i BQK 2008.

Significant growth SEKN transactions can be seen from the average daily data. Daily value of SEKN transactions in 2008 was about 12.7 million, compared with about 9.8 million in 2007. Then, the volume of daily SEKN transactions in 2008 was approximately 10.9 thousand, compared to about 5.3 thousand transactions in 2007.

Figure 2 Average daily volume and value of SEKN transactions



Source: BQK, (2008): Raporti vjetor i BQK 2008.

There are several types of SEKN transactions: priority - individual and mass, Kos-Giro, regular - the individual, and regular - massive. Comparative levels of volumes and values for 2008 and 2007 are presented in the regular payments. Regular payments constitute about 90 percent of SEKN transactions and were channeled through SEKN or individual transactions (one-to-one) or as mass transactions (one-to-many or many-to-one). They are processed through regular clearing sessions and settled on a net basis. During 2008, the CBK sent through SEKN on behalf of their clients over 135.5 thousand orders.

### Credit Registry

Facilitating the exchange of information between lending institutions is a crucial and target commitment of the CBK in order to develop interbank infrastructure for credit market advancement and promotion of financial stability. Credit Registry of Kosovo (CRK) is a modern technological and telecommunications system developed by the CBK in order to exchange credit information on borrowers and lenders, and related credit applicants. Even the borrowers and applicants for credit as credit subjects can provide relevant personal information. CRK is designed as an internet based application and can be accessed directly and in real time by lending institutions and credit entities, but can only access relevant information through CBK.

### Directorate of Economic Analysis and Statistics

Directorate for Statistics Research presents one of the main pillars of the CBK, and has made significant achievements related to monetary and financial statistics in 2008, that is considered as meeting the standards for the publication of statistics in the IMF, respectively International



Financial Statistics. Besides the statistics of other states, this will result in the publication of monetary and financial statistics of Kosovo in IMF publications.

Implementation of this project is expected to occur after completion of the process on Kosovo's membership in this organization. Regarding the external sector statistics, since February 2008 is also implemented new version of International Transaction Reporting System, which has expanded significantly the number of companies surveyed and increased interagency cooperation within the Committee on Statistics and Foreign Trade. All this has contributed to improving the quality of balance of payments statistics that have been published annually since 2006.

In the context of external sector statistics in 2009 the main objective is to draft and publish these statistics on a quarterly basis, according to international standards on frequency statistics for balance of payments. During the year 2008 were also prepared analyses of economic developments in Kosovo, with particular emphasis on the financial sector and balance of payments, which were published in periodicals and non-periodical publications of the CBK. For the first time in 2008, was developed 'stress-test' analysis for banking sector through which assessed the vulnerability of the banking sector to potential shocks to the economy. Through this analysis, was estimated liquidity risk, credit risk and interest rate risk. In addition, there have been performed a number of internal analyses that aimed to help and support the decision making process in the CBK and the general economic policies.

Compiled economic analyses and statistics are published in the CBK publications, such as the Monthly Statistical Bulletin, Bulletin of the Balance of Payments, Financial Sector Bulletin, Annual Report of the CBK (certain parts), etc.. In 2008, research and statistical activities at the CBK were performed within the Department of Economic Analysis and Statistics, which consisted of the Department of Economic Analysis and Statistics Department.

Since January 2009, Directorate of Economic Analysis and Statistics Office has been promoted to Chief Economist Office made by the Department of Economic Analysis and Statistics Directorate. Economic Analysis Directorate, along with Financial Sector Analysis Unit and Publications Unit was added Macroeconomic Analysis Unit, while the Department of Statistics comprises the Monetary and Financial Statistics and the Statistical Unit of the External Sector.

## **Conclusion**

1. Central Bank of Kosovo acts as Banker, Fiscal Agent, and Economic Adviser to Government.
2. Despite the recent financial crisis, Kosovo's financial sector remained stable and steady, increasing deposits and loans.
3. There was drastic decrease in interest rates for time deposits and securities invested by the CBK, in its correspondent banks abroad.
4. Any balance of net income generated will be transferred to the Ministry of Economy Finance, as revenue to the budget, and if any net loss, it will be covered by the general reserve account or the capital;

5. Lack of Swift code represents the main challenge of the CBK, because payments to and from abroad create large financial losses incurred in the absence of swift code;
6. Every year CBK is subject to audit performed by extern companies such as Deloitte Touch, KPMG, etc.;
7. The Governing Board consists of five members: four non-executive directors and Governor. Director of Treasury is one of the non-executive directors;
8. The capital and general reserve accounts will be at least equivalent to five percent of the total loan balance of all accounts maintained on the books of the CBK  
CBK capital is not subject to mortgage.

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[www.bqk-kos.org-funksionet dhe përgjegjësitë](http://www.bqk-kos.org-funksionet_dhe_pergjegjesite)