

# *Efficiency of collateral execution in Albania*

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## **Abstract**

Banking sector in Albania even if resulted with profit, has a raising level of non performing loans by reaching at 18.8% of total portfolio as of December 2011 compared to 14% as by the end of December 2010. The financial crisis has its own impact worldwide as well in Albania however the paper will be focused on the local factors that characterized the increased non performing loan portfolio and the difficulties during its recovery process such as the efficiency of collateral execution. A special attention will be paid to the functioning of the private Bailiff Offices. They have started to operate as a need since the process of collateral execution in Albania was the longest in the region. As a conclusion the paper will presents the strategy of Albanian banks for year 2012 with regards to the efficiency of collateral execution for non performing loan and the challenges of Private Bailiff in this process.

*Key Words:* Non performing portfolio, collateral, bailiff, repossession.

*JEL classification:* G01, G21

# 1 Introduction

Year 2011 in Albania was characterized by a distressed economic and political environment, especially political crisis deteriorated during January 2011. Economic crisis has started since 2009 by affecting some macro indicators as inflation, unemployment rate and remittances. The natural decrease of remittances in the Albanian economy has been pushed along by the economic crisis that has affected neighbourhood countries, where the number of Albanian emigrants is higher

The sector that indicated growth during 2010 – 2011 is the Industry, while Post Telecommunication and Construction decreased. Construction which remains non performing loan driver since the beginning of crisis has low chances to recover in 2012. Difficult development occurred during 2011 in the Gas Trade activity considering the “virgin naphtha” scandal and seizure of one of the main Gas Station by Bailiff. Still there is a high level of uncollectible or delayed receivables from government toward private companies. No improvement are estimated, as 2012 state budget is the lowest in the last years, while public debt is very close to 60%.

Legal environment is very difficult and in almost all the cases under execution process there is at least a claim from the debtors to suspend bailiff actions delaying the whole process. Another concern is the considerable difference between the collateral price evaluated by external evaluation companies before loan disbursement and the collateral value evaluated by Bailiff Office.

In Albania there is a very low market potential for purchase of collaterals especially during auctions period. In specific cases potential buyers prefer to purchase assets under the bank ownership and not in bailiff auction to avoid conflicts with the debtor. Another concern has been the lack of Credit Bureau until 2008 by exposing the banks toward an increasing credit risk especially for customers highly leveraged previously. Starting from November 2010 in the Credit Bureau is reported as well customers for 5 other credit institutions.

For the unsecured personal loan there are different reasons of delinquency related more to individuals living affecting the non performing loan in early and late stage. The main reasons are related to the increase of living expenses, delay in salary credit, no knowledge of the debt (fraud), customer unwilling to pay or being abroad.

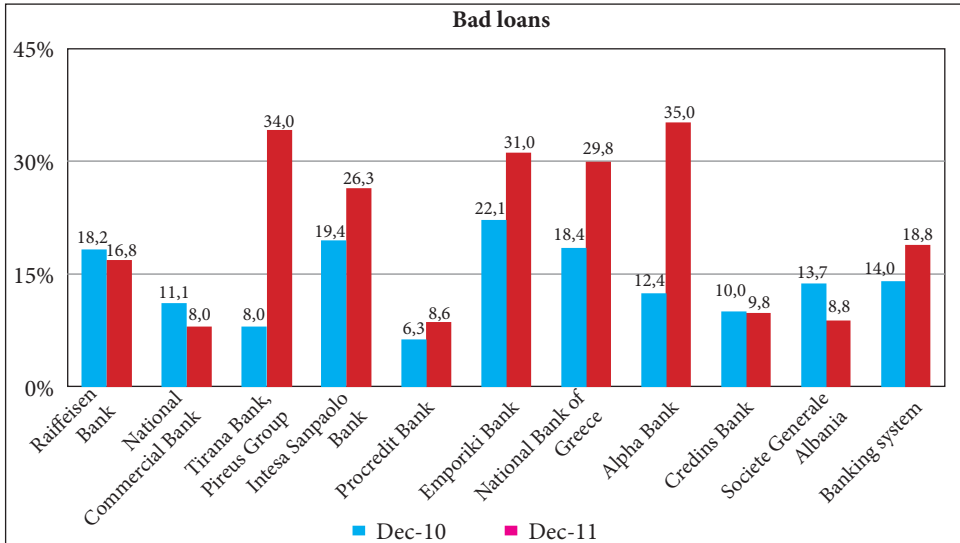


FIGURE 6.1 — *Bad loans December '10 and December '11.*

## 2 A brief overview of the approaches on collateral

Collateral or the property pledged, in order to be sold by the bank when the client does not repay the loan, should be considered as a way to encourage businesses and individuals to pay off the loan. There is always space to be exploited in order to close the loan repayment obligations of businesses without going to the enforcement of collateral. Of course, there will always be some businesses and individuals who have exhausted all possibilities for such a conclusion. What should be avoided is the problem of cold treatment by the banks, as they are in the same line with the businesses on which they believed by giving credit. There is no reason for the banks to see the credit problem without taking into consideration the touch of their profit. If the client has failed, the bank has failed as well.

A bad loan from a business was not created today, but is created in those years, when banks have reaped profits over 20%. This means that, as enjoyed higher profits when lending activity was in good quality so must face the problems arising from the bad loans and not intended to transmit any loss to the customer when problems occur. It is easy for the bank to avoid a loss today by charging all losses to the client, but that, directly or indirectly, will influence the banking system and economy in the near future.

Not every business that shows difficulties in repaying bank loans must be seen as having mismanaged the funds given by banks. Banks are not allowed that in conditions of crisis like this last one, to take panic and apply more stringent techniques, adding problems for affected businesses. If the bank goes without hesitation in enforcement of

collateral, then it is a blow to the Albanian business and indirect damage to the banks in general for the whole economy. As bad loans during the past two years has been increasing and currently has caught double-digit levels, the analysis of this problem should start from the source of the problem. During the recent financial crisis in the U.S., one of the main causes was the mismanagement of the banks. Their managers effectively increased lending activity beyond market potential, with the sole intent to benefit from increased rewards from the credit volume (Leskaj B, 2011).

### 3 Key steps in bailiff process in Albania

Albanian banking system estimates approximately 150 million EUR property pledged as collateral, which can not be sold due to lengthy procedures and often speculative taking place in the courts. Block of these collaterals increase the risk of lending money and consequently, the willingness of banks to give loans.

Once the bank selects the “Exit Strategy” with the customer mainly when he is 180 days past due, prepares the file to be send to court and deposit the court request. After receiving the court decision within 30 days the bank notifies in written the customer for the court decision obtained. A 10 days period is needed to send the court decision to the debtor to increase the pressure. If the debtor does not react within 5-6 days, the file is sent to Bailiff office. The deposit procedure lasts only one day. Bailiff notifies the debtor for voluntary execution. Execution procedure starts after 15 days.

Bailiff starts forced execution if no agreement is reached between Bank & debtor (conservative sequestration starts with debtor/co-debtor/ personal guarantor’s bank accounts, movable& immovable collaterals, and other properties).

An independent appraiser is appointed by Bailiff to perform evaluation of the respective collateral. In case the evaluation is accepted by both Bank & debtor, Bailiff proceeds with appointment of auction date.

1st auction property is generally discounted by 20% of the agreed initial price.

In case of not successful auction, Bailiff proceeds with the next round of auction.

2nd auction property is generally discounted by an additional 20% of the first auction value.

In case of not successful auction, Bailiff submits a notification to the Bank proposing to take over ownership of the collateral.

Bank has to notify back Bailiff within 5 days either accept ownership of collateral with the discounted value of the second auction against reduction of exposure with respective value, or refuse ownership of the collateral, which means releasing all sequestrations.

The bank still has the collateral registered in its favor and legal right to claim on it but must restart Bailiff procedures from the beginning, including all costs.

The law permits to the debtor, the right to claim in Court at any stage and for any action during Bailiff procedures delaying the process..

## 4 Main concerns during the collateral execution process in the Public Bailiff

Throughout last year the prolonged lack of liquidity faced by the businesses put banks in front of increasing difficulties in collecting the loans given to them. After using all the methods of debt collection and having exhausted all other options to keep the borrower business active, banks are obliged to undertake the process of compulsory execution of collateral a crucial process to maintain a healthy banking system and especially to protect depositor's money.

In many cases, negotiations between banks and customers have resulted in the restructuring of loans, to give a greater breath of business performance.

Naturally, there have been cases of complete inability of borrowers to repay their obligations, cases which have ended in court proceedings until the execution of the mortgage.

It is this phenomenon - the execution of the collateral - which has been a concern for the banking industry. This process has encountered many obstacles. But what is more evident is the fact that the obstacles to the execution of collateral are not related to the market of immovable / movable properties but rather to regulatory and organizational issues as well to the law enforcement.

Problems come out at the time of execution with the ownership of properties that are used as collateral, problems for which the banks were not aware and followed from other inconveniences as:

- There are inaccuracies in the registration system of real estate and lack of information in the ownership files;
- Extension of compulsory execution proceedings;
- Suspension of enforcement actions by the court, not meeting the legal criteria up to the ignoring of the bank arguments;
- Banks are not called as third-party, violating the principle of a due legal process. The court takes a decision without the presence of the credit party (bank), and consequently, without examining the damage done to this party, violating the principle of equality of arms and extending for months suspension of enforcement process;
- Furthermore, is noted that the possibilities of suspending proceedings increase with increasing amounts that are in process of execution;
- Another claim by the banking industry is related to the court decisions.

Significant delays in issuing execution orders lead to overcome the legal terms in the trial of cases.

Unfortunately, it is observed that delays in the trial have pushed debtors in failing to paying the loan, favoring borrowers with problems.

Apart from the problems encountered in the courts, there are a number of issues encountered during enforcement procedures.

- Fictional setting of seizure or possession of the item;
- Speculative price reducing of the item, to damage the interests of the creditor;
- Lack of procedures for real estate, built without planning permission;
- Lack of transparency and ensuring integrity of a process for items in execution

Once private enforcement system was established, many bankrupt borrowers have discovered the claim manner in the court for the assessment of their property evaluation conducted by private Bailiff. Given that the aim of debtors is delaying the execution time, no matter if the evaluation conducted by bailiffs is high or low. The value of collateral is determined once at the time of taking loan, but in recent years, commercial value of many properties has fallen. Borrowers have the opportunity to actually complain to the court for the amount of property valuation and the court must enter in a process where an independent expert determines the performance of alternative assessment. Even if this procedure ends, the borrower has the right to appeal to the Court of Appeal. Here, banks have to wait one to two years until the Court of Appeals find the time to review the claim. With this legal scheme, collateral execution is postponed for several years, during which the bank expects to recover its money.

Bankrupt borrowers who choose to cause delays in execution of collateral are also lost because penalties and interests are accrued by the banks up to the selling property. Consequently, the borrower's financial situation continues to deteriorate. Meanwhile, banks increase their risk provisions, to cover possible losses from bad loans and therefore, the economy slows.

According to banks, there is a high correlation between the value of collateral and cases where the courts decide in favor of the borrower, which costs a shadow of suspicion for corruption in the justice system. This means that the higher the value of collateral, the higher is the probability that the court will order the suspension of execution.

Various arguments are used by the court for suspension of enforcement actions such as: the debtor declares that he has not taken notice that at the time of notification has been ill in hospital etc.

Thus, by banks has been noticed that the borrower is suing the bailiff, and the bank is notified on the suspension of the execution only after the court decision has become "fait accompli".

## 5 Banks' responsibility on the collateral accepted

Collateral execution process for many loans granted, especially to businesses, has highlighted the quality of collateral accepted by banks. So, the banks have agreed to accept collateral which are located in peripheral areas or in villages, with a reference price highly inflated. Thus, different surface land in village centers, were accepted for collateral against the high price per square meter. To find buyers at such a crisis time is always difficult and auctions organized for sale of such properties have consistently failed.

During recent years, Albania has had numerous cases where different businesses have put as loan collateral not appropriate properties as for example basements declared with a "perspective to be convert in pub", stores without windows or land in remote areas of the country, which, though having a nominal value, can not be sold. During 2004-2007, banks were under increasing lending fever, and did not think of the quality of properties that received collateral. Recently is pointed out the fact that the banks have often performed procedural errors used by customers to suspend the execution.

In the case of collateral that has trouble running, is not simply the responsibility of the courts, the responsibility of enforcement, but it must be seen the way of accepting the collateral. In many cases it was found that the collateral received had legal uncertainty. Banks often have accepted as collateral constructions without permission, which has further complicated the recovery process. According to a unified decision of the Constitutional Court, legally constructions without permission do not exist, but the legalization process has provided a semi legal status, while the debtor can pass from nonentity to status "in the legalization process," according to the interest of the moment, effectively blocking the execution.

## 6 Economic impact of the collateral execution

The economic impact derived from the failure to execute in time the collateral is significant. Total outstanding liability from debtors who are in the process of executing the collateral amounts to approximately 20 billion LEK. Although the value of the collateral is nearly 2 times higher than the value of the liability, and more than sufficient to liquidate these obligations, uncertainty and delays in the execution system makes the compensation for the banks a harder target to catch.

Performance indicators of the banking system are also affected by the absence of rapid execution of collateral. Bad loans have risen sharply the past two years, and a significant role in this indication has played the inability of banks to withdraw guarantees, which would enable them to write off the bad loans that will be compensate with the collateral value, thus improving the indicators. Beyond that the cost of funding in some sectors has increased, as it is increased the reluctance of banks to borrow more real economy.

Over all the impact on the trust is among the most important. An uncertainty of banks to execute on time and quality of credit guarantee, it is likely to become more conservative on their approach lending. At the same time problems in the execution of collateral creates difficulties in terms of generating sufficient liquidity to flow from this execution.

## 7 Why the Private Bailiff was a need in Albania?

The low performance of the Public Bailiff service mainly related to delays in the conduct of proceedings and accuracy of tracking the legal deadlines during enforcement process lead the need for a fundamental improvement of the service of bailiffs' offices. The reports (Surveys) of prestigious international institutions show that the duration of the collateral execution process in Albania was among the longest in the region, often reaching up to 12 months from the time of application for compulsory execution.

The old service gaps was not related only with state delay in the completion of execution but also the organization of auctions and the announcement of the acts directed to the parties in a execution procedure, making the whole execution process move back in courts after the claim of one of the parties. The suspension or resumption of procedures extends the execution even more. Initiative of the Ministry of Justice to adopt privatization reform in enforcement service is based on the advanced practice of some countries, especially those using the legal system of Common Law (mainly U.S. and UK).

After the reform, which started two years ago, the law on Private Bailiff Service was approved and added to state bailiff service also the private bailiff. Until now, are completed two exams for taking the title and the licensing of private enforcement agents and are allowed to open their office 63 private enforcement agent. Transparency and reduction of corruption was an imperative need for the creation of private bailiff service. Also increasing pressure from banks community in Albania, due to continuous increase in recent years of bad credit, brought the need for improved bailiff service. The introduction of private service that is based on the promotion of private bailiffs from the profit that comes from paying the bailiff fee is expected to change the service in terms of quality, efficiency and execution speed. Another need for the creation of this service is the reduction of budget expenditures and reducing the workload of the State Bailiff.

## 8 Private Bailiff efficiency during collateral execution process

According to official data from Tirana Bailiff's Office out of 1200 loan files only 5-10% of them are treated by the state (only loan files of National Commercial Bank - BKT). Over 90% of loans sent to Bailiff are secured by collateral. As by Bailiff feedback consumer loans (without collateral) are more problematic.



Strong competition between the two services and public dissatisfaction over the state service has made the commitment of private bailiffs to be even bigger and becoming a success story. Like the other free professions as lawyer or notary, private bailiffs compete to find customers and bring as many of them being so driven to improve the quality of service. Also National Chamber of Private Bailiffs has concluded cooperation agreements with the State Police and the Central Office of Real Estate. Good relationship and cooperation with these institutions quickly helped substantially faster execution of executive titles.

Another opportunity of private Bailiff for the execution of executive titles is that specialized people investigate and find the debtor's financial resources, investigation which has left much to be desired when provided by state Bailiff. Private Bailiff assumes responsibility for the execution of court decisions that would also mean that both the creditor and the debtor will face a credible private service because no one would oblige the citizen or entity to go to this or that Bailiff. Private Bailiff and creditor relationship is in the position of business & taxpayers, meaning that this relation is subject of offer – demand and if the incomes are not realized the business will go bankrupt. The concept of allowing simultaneously both state and private Bailiff makes the creditor free to choose according to his belief and without restrictions require enforcement by a private or state agents as well as a private enforcement is free to accept or not an issue to execute. Currently the data received from the Chamber of Private Bailiff shows that 80% of the creditors are directed to the Private Bailiff, although tariffs set by law to be paid in the private service is higher than in that state.

In the first year of operation of private bailiff collateral execution performance is satisfactory and has a progressive increase. Out of 80% of cases that have applied for execution at private Bailiff are executed in a relatively short time, the rest from 15% to 20% is executed after completion of judicial processes. From the loan files of 2011 handled by private bailiffs in 60% of the auctions the collaterals are repossessed from the Banks. In 25% of cases the collateral is purchased by third parties and in 15% of cases the collateral is turned back to the debtor (in case of sale failure) as the Bank has no interest to take the collateral towards the credit.

The experience has shown the need for independence of this service. The collateral execution, in case of its realization by the private enforcement service offers a parallel system to the state Bailiff by adding value in terms of speed, de-bureaucratization, efficiency and competitiveness. This practice is followed today in some European countries to avoid and minimize problems that exhibit the auction procedures in collateral assigned for banks credit.

## 9 Challenges that should affront the Private Bailiff

Bailiffs have encountered many difficulties for the compulsory execution of collateral, a process essential to the execution of executive titles. By law, the process of collateral compulsory execution begins after the bailiff has used all other means of

notification for collection of debt.

Key issues in the compulsory execution of collateral remain the inaccuracies in the records of Registering Office of Real Estates of the Republic of Albania. The registers of the properties are held manually by creating difficulties in the identification of real estate under debtor ownership and leaves room for many inaccuracies and overlapping properties. These inaccuracies adversely affect the execution of mandatory collateral.

Another problem is the way of providing information required by the bailiff, by Registering Office of Real Estates. Bailiff officers for execution of judgments should stand in long queues with other citizens in order to be provided with the acts required by Registering Office of Real Estates. This procedure weakens the efficiency of execution of the collateral. Another reason which increases the difficulties is that Registering Office of Real Estates response in most of the cases does not meet the legal deadline. For this problem the National Chamber of Judicial Private Bailiffs has complained in Central Office of Real Estates and recently an agreement is in place to improve cooperation.

Other challenges Private Bailiff should face are:

Improving the resistance of executive actions and shorten the execution process in court. It is a fact that most of the enforcement procedures are attacked in court. In many cases, the court has led to delay in executing the litigation bringing consequences for the creditor. The juridical doctrine rightly states that “A claim against the decision of the court which issues the execution order should not be allowed, as it is aimed the delay of the execution”. Control of the court should rely only on cases that the order issued containing a prescribed right or if in the order is made an extensive interpretation of the contents of executive title. Both cases serve the debtor’s right to be protected by executive title objection as provided in section 609 of the Code of Civil Procedure. During the challenge phase of enforcement actions, the court need only to assess the abovementioned cases without entering in the base of the relationship creditor - debtor.

Executive titles expansion. Executive title stands as a prerequisite for any forceful execution. In banking relationships are introduced services offered to the Albanian client such as overdraft or credit cards. Execution of the right acquired recognizes the development and refinement of the law and as such must necessarily find the same standard of legal regulation.

Increase access to parties in the implementation of enforceable titles, through the notice and posting of list of bailiffs. Publication of state and private Bailiffs nomination list simplifies procedures for determination of bailiffs by the creditor, avoid monopolies that can be created and increase competitiveness of service delivery.

## 10 Conclusion

The issue of collateral is a public issue. Banks are private companies but operate in a market entirely specific and sensitive. Banks manage the deposits of citizens.

And when it comes to execute the collateral, it is not to protect the interests of bank capital, of a private business, but has a wide impact on public interest to protect the deposits of citizens. If Albania was unharmed during the period of global economic crisis, this was because the banking system was safe and there was no need for budget intervention, otherwise Albania would have suffered, perhaps even worse as some economies of the largest countries in the region. So when it comes to enforcement of collateral, it is about to guarantee customers deposits, the depositors confidence and is in interest of not only to citizens, but to the business as well to maintain a reliable system where individual deposits are in safe.

Bank of Albania, as the central banking institution in the country, should play a more active role in creating a sustainable climate. This institution also has a duty to analyze the real reasons of the problems associated with banks bad loans. One of the sources for leading to bad loans is the mismanagement. Also, there is no doubt that some of them are due to “corruption” of loan officers who have handled with loan portfolio and sometimes up to bank management. Many loans are approved despite they did not meet the approval criteria for the only purpose of achieving the targets set. Bank of Albania, of course, should be aware of these problems and take measures to minimize them in the future. In the policies of this institution, it is important the relationship between the lenders (banks) and borrowers (businesses and individuals) should be characterized by transparency, flexibility and long-term relationships.

While banks’ policies should avoid rigid and strict practices, and become more dynamic and appropriate for economy stages.

Also they should improve the quality and quantity of the existing portfolio and to focus in targeted industries, i.e. Hydro Power Projects Financing, infrastructural Projects, Production and trading, to increase the profitability margins by focusing in fees and commissions and non-interest incomes. Banks should be more conservative during collateral acceptance as collateral Execution is a painful process for the bank which requires a lot of efforts, time, expenses and risks. Restarting the execution process, may not provide value added for the bank.

Liberalization of bailiff services is value added in terms of speeding up, simplifying, increasing quality and efficiency of enforcement services due to competition. Banks are expecting now the transparency missing, rapid implementation of court decisions and minimized corruption cases. This is the big challenge for the Private Bailiff.

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