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DRAFT FOR DISCUSSION

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PART 1

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EXECUTIVE SUMMARY

This report provides an overview of the South-Eastern European (SEE) countries’ financial service industries over the period 2002-2019 as well as an insight into the implications of the coronavirus COVID-19 pandemic for the countries’ economies and their financial industries. It is mainly based on the individual countries’ reports officially launched by their relevant national institutions, such as central banks and financial supervisory authorities, and the survey of the banking and insurance associations. Its first part contains a comparative analysis of the SEE region countries’ macroeconomic indicators, elaboration of the banks’ and insurers’ businesses key specifics (plus the other financial institutions), and then implications of the pandemic for the SEE economies (with detecting the most vulnerable areas), the financial institutions’ responses (with special focus on the SMEs), and prospect and challenges of the financial institutions in post-COVID economies. Detailed reports of the particular countries’ financial service industries can be found in the second part of the report.

In order to halt spread of the coronavirus COVID-19 and protect lives of their citizens, the SEE governments have taken a wide range of measures, such as protection of their fragile health systems by purchasing additional medical equipment and medicine, transforming medical centres into specialised COVID-19 centres, etc. The governments also introduced various restrictions to airports and borders, educational institutions, restaurants, shops, bans on large gatherings, instatement of curfews, etc. These containment measures impacted on the SEE economies in different ways; for example, due to the pausing numerous social and economic activities, they drove up to decreases in domestic demand and supply; the decrease in demand and disruptions in supply chains, which affected almost all industries starting from pharmaceutical to automotive, diminished the SEE region countries’ exports, etc.

To the unprecedented shock of COVID-19, with the intention of protecting economic prosperity, the governments of the SEE countries responded rapidly through the instruments of the monetary and fiscal policies. Their central banks cut the policy rates to maintain liquidity of banks and non-bank financial institutions, which in turn had to ease the burden on companies and individuals caused by the health emergency. Moreover, the regional governments gave financial supports to the health sectors for purchasing medical equipment, approved fiscal stimulus packages in order to support companies through temporarily subsiding wages of their employees, and provide social assistance benefits to unemployed individuals as well as the most vulnerable households. However, the economic relief (support) packages will lead to fiscal deficits and accumulations of debts in the SEE countries. The scope of the wage subsidy support varied greatly across the SEE region countries. No SEE country limited support to specific sectors, but some countries offered more favourable terms to tourism, transport companies, agriculture sector, etc.

Since the financial service industry in SEE the region is highly bank-centric, the financial soundness of the banking sector has critically importance for the industry as well as real economy, their stability and growth. The SEE countries have had relatively high capital adequacy and also liquidity profile in their banking sectors. The resilience of the banking sectors has been strengthening by wide implementation of Basel III capital requirements. Although reductions of NPLs ratio have been reported across almost all SEE countries, by those with previously higher starting ratio in particular, NPLs have remained unevenly distributed.
The scope of the bank measures during the pandemic crisis varied across the SEE countries. Some central banks cut its key policy rate and took different actions to provide additional liquidity for the banking sectors and economies. In most countries, banks were prevented to pay dividends as well as bonuses in order to boost their capital bases. Soon after the pandemic outbreak, temporary deferred principal repayment arrangements for a certain period of time (mostly three or six months), according to the application by companies and/or individuals, were given. In many cases, special relief measures towards SMEs were taken, such as credit schemes with government guarantees as well as outstanding loans to stimulate credit demand, or loan restructuring as well as loan refinancing to ease debt burden for SMEs, etc. Banks are taking advantage of the flexibility in aspects of Basel III regulatory framework to deal with the crisis. Although there are early warnings of the deterioration in the banks’ asset quality, this is not yet reflected in the NPL ratio due to moratoria approved across many SEE countries for 2020 and even 2021. The impact on the credit risk exposure, however, could be offset by higher growth of total loans because deposit potentials have not been materially affected by the pandemic. But operational risk exposure could be grown due to recently wide reliance on IT usage and ongoing digital transformation.

A key determinant of the SEE insurance markets is undoubtedly its general underdevelopment compared to the IE members, especially taking into account Turkey’s great contribution. Various criteria indicate on a primordial stage in the insurance culture development of the SEE region. Nonetheless, there is a great potential for the growth of the (re)insurance undertakings, especially those related to life and other non-life insurance. The COVID-19 crisis has influenced the insurance industry mainly through insurers' investments and to a lesser extent on claims. Exceptionally, significant consequences of the crisis have felt by the life insurers, or in the life insurance line of business, due to massive layoffs, business shutdowns, salary cuts or, in general, uncertainties about future economic conditions. As regards claims payments, implications have recorded for an increased number of cases of business cessation, unemployment, and deaths.

When it comes to the other financial institutions in the SEE region countries, there is a wide range of different types, such as investment funds, voluntary pension funds, leasing companies, micro-credit organizations (or microfinance institutions), credit unions, etc., but their investment potentials are far below the banks’. The ongoing crisis has impacted on the other relevant financial institutions in terms of imposed lockdowns and temporarily pauses of their activities. In coming years these institutions could face deterioration in the granted loans as well as lower returns on the investments in the financial markets.

During the pandemic the financial service industry found itself at a turning point on its path to more comprehensive digital transformation. Since the pandemic outbreak, banks as well as insurers have continued with their businesses without any disruptions due to the fact that they have used models based on on-line communication in their organizational hierarchies to more extent and very quickly adapted themselves to the changed customer behaviour, which in some lines of business has resulted in reducing operating costs and rationalizing expenditure. The special issue is related to the other financial institutions’ limited capabilities for digital transformation. It seems that providing financial services nowadays require an intensive application of the new ways of business and the customers (particularly millennials) responded very positively. Even when all physical distancing and mobility restrictions are lifted, customers are more likely to continue using digital channels of accessing financial services.
INTRODUCTION

The following report is the sixth issued based on the contribution provided by several banking and insurance associations, central banks and other supervisory authorities from 13 Eastern European countries and will be presented at the 2021 Trieste Eastern Europe Investment Forum. (The zero report was made in 2015, but with focus only on the insurance sector.)

In Part I of this report we will shortly present the basic performances of the main segments of the financial service industry in the countries of South-Eastern Europe, plus Ukraine. Special focus will be on macroeconomic environment of the Region, considering trends and the most important consequences of the COVID-19 pandemic.

The entire Report, Part I and Part II, with individual country reports of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Greece, Kosovo, Montenegro, North Macedonia, Romania, Serbia, Slovenia, Turkey, and Ukraine, will be available at our web page shortly (https://www.febaf.it).

Trieste’s Forum, as a permanent venue and opportunity to strengthening dialogue and cooperation among the financial communities of the area, promotes the development of local, national, and regional markets. It aims at relaunching infrastructure and SME financing, integrating capital markets, and above all supporting stability employment and growth in the Region and in wider Europe.

The program of this year has been reviewed considering the recent events related to health and economic emergency. We are strongly committed to give a positive sign of continuity holding FeBAF’s Forum even in this unprecedented season.

Modern developed and sophisticated banking and insurance sectors are required for encouraging domestic production, innovation, investments, and trade. Banks, moreover, channeling funds and their other typical financial intermediary activities in the initial years of transition in these countries, relied on relatively low expertise and made up a tiny share of economic activity.

On the other side, insurance companies reduced the investment risk faced by private sector companies and the state. Insurance thereby facilitates access and reduces costs of raising the capital needed by firms, particularly small and medium-sized ones. This is especially important in emerging markets, as a shortage of capital, and particularly in this tragic season, is common there and represents one of the major disincentives to investment and economic growth. By reducing the investment risk, insurance can also encourage companies to think more long-term and increase their risk absorption capacity.

This document aims to stimulate a debate among all participants and stakeholders. After the discussion, we plan to publish a book with short extracts from speakers’ remarks, as we do every year.

Franco Delneri

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PART I: FINANCIAL SERVICE INDUSTRY IN SOUTHEAST-EASTERN EUROPE – OBSERVED TRENDS AND COVID-19 PANDEMIC IMPLICATIONS

Safet Kozarevic

In the first part of this report it is highlighted the macroeconomic environment of the South-Eastern European (SEE) countries, that is, Albania, Bosnia and Herzegovina (BiH), Bulgaria, Croatia, Greece, Kosovo, Montenegro, North Macedonia, Romania, Serbia, Slovenia, Turkey, and Ukraine, as well as the most important consequences of the coronavirus COVID-19 pandemic impacting these countries. Also, the basic features of banking and insurance businesses (plus specifics of the other relevant, existing financial institutions) in these countries, in terms of the observed trends and the most important repercussions of the pandemic, are discussed. With respect to the ongoing pandemic, and the subsequent recession, special attention in this part is focused on the implications of the coronavirus COVID-19 pandemic crisis for the SEE economies and identifying the most vulnerable areas.

Moreover, the financial institutions' responses to the pandemic crisis in the SEE region countries (particularly when it comes to the SMEs) are considered. Based on using contemporary reference literature, this part is ending with the prospects and challenges of the financial institutions in the post-COVID economies.

It should be pointed out at the start that the data for this part, and the report in general, was mainly collected from the officially launched reports and via the survey of banking and insurance associations, central banks, national statistics offices, and financial supervisory authorities in the SEE countries. The database for a multi-year period (starting in 2002) provides the insight into trends, that is, long-term dynamics of the economies, especially financial service industries, of the SEE region countries.


In this section it is briefly overviewed key macroeconomic indicators of the SEE countries in order to situate the research issue, i.e., their financial structures, in a wider context – European in particular. Although their comparative analysis over the period 2002-2019 provides an insight into the trends, a special accent is put on notable changes in the macroeconomic environment in 2019 compared to the previous year.

From Figure 1, which shows the trends of the total population for each SEE country, it can be noticed a kind of continuity of the population reduction (that is, depopulation) in almost all

2 The author of PART I is Safet Kozarevic, PhD, Professor at Faculty of Economics, University of Tuzla.

3 In spite of the fact that, from a geographic perspective, Ukraine is not a part of the SEE region, this (extended) survey includes data for that country.
countries covered by the survey except Turkey. In addition, Montenegro registered stagnation regarding its total population, while Slovenia and North Macedonia faced a small increase in the population in 2019 (for 19 thousands and one thousand, respectively). However, it should be noted that the data for Ukraine is dating back to 2007.

![Figure 1. Total population of the SEE countries over the period 2002-2019 (in thousands)](image)

As mentioned above, unlike other SEE countries Turkey continued its population growth over the observed period, reaching 82,6 million in 2019. The total population of the SEE region for the corresponding year was 185,6 million and it was 36,0% of the EU-28 population,\(^4\) which reached 514,9 million (additionally, the same percentage was noted in 2018 compared to the previous year).\(^5\)

It should be underlined that, given their EU membership, Greece, Slovenia, Bulgaria, Romania, and Croatia, the total populations of these countries are included in both the SEE and the EU populations. In 2019 Turkey’s contribution to the SEE population was 44,5%, while in 2018 and 2017, for example, it was 44,0% and 43,6%, respectively, which supports the thesis of the continued growth of its population. Thanks primarily to the growth of the Turkish population, the total population of the SEE region increased by 2,2% since 2007.

Compared to the previous year, in 2019 the total population in the SEE region grew by only 0,4%, slightly decreasing in most of the countries. There is a wide range of arguments by which could be

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\(^4\) Since the United Kingdom withdrew from the EU on January 31, 2020, in this survey it is used data for EU-28 instead of currently EU-27.

explained the ongoing trend of depopulation in the region; for example, demographic aging, persistence of high unemployment, corruption, consequential migrations to the Western European countries, etc. Nonetheless, the current coronavirus COVID-19 pandemic crisis has slowed down emigration from the SEE countries. According to the latest UN migration report, entitled “International Migration 2020 Highlights”, due to the pandemic global migration has slowed by nearly 30%.6

When it comes to the total nominal GDP of the SEE, it was EUR 1.501,3 billion in 2019 and it increased by 6,6% compared to 2018. Since 2007 the drops were recorded in 2009, by 8,7%, and 2014, by 4,2%, compared to the previous years. The data related to the total GDP of the particular SEE countries over the period 2002-2019 is presented in Figure 2.

![Figure 2. Total GDP of the SEE countries over the period 2002-2019 (EUR millions)](image)

As can be seen from Figure 2, Turkey continuously has a largest single share in the SEE GDP, whose GDP in 2019, approx. EUR 680 billion, counted of 45,3% of the SEE GDP for that year. The respective Turkey's share slightly declined compared to 2018 (47,1%) and still does not reach the level of 2015 (55,6%).

In a broader context, if we compare the SEE GDP of EUR 1.501,3 billion to the EU GDP in 2019, of EUR 16.491,9 billion, we can draw a conclusion that the SEE countries generate only 9,1% of the EU GDP, a little more than in year before (8,8%).

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As far as the real GDP growth is concerned, during the past three consecutive years (2017-2019) all SEE countries registered positive real GDP growth rate, ranging from 0,9% in Turkey to 4,9% in Kosovo in 2019. Figure 3 illustrates the real GDP growth rates of the particular SEE countries from 2002 to 2019, with the exception of Ukraine, which data is dating back to 2007.

![Figure 3. Real GDP growth of the SEE countries over the period 2002-2019 (%)](image)

As mentioned above, the highest rate of real GDP growth in 2019 was registered in Kosovo (4,9%), followed by Serbia (4,2%) as well as Montenegro and Romania (both 4,1%) and then Bulgaria (3,7%) as well as North Macedonia, Slovenia, and Ukraine (3,2% each), whereas other countries recorded the rate of real GDP growth between 2% and 3%. Only Turkey had the rate less than 2% (i.e., 0,9%) for various reasons such as: domestic demand contribution continued to recover further in fourth quarter of 2019, whereas deterioration in net exports deepened more; GDP growth was underpinned by a positive contribution from net exports at 2,3%, while domestic demand dragged down 1,4% mainly due to the sluggish recovery in investments; on the sectorial side, the recovery in industry and services sectors accelerated, while construction sector recovered somehow but it still continued to display a negative growth rate, etc. Additionally, among the SEE countries, in the recent years Turkey noted the largest drop in the rate of real GDP growth, e.g., from 7,5% in 2017 to 3,0% in 2018 and then 0,9% in 2019.

In order to make comparison, an average real GDP growth rate in the EU was 1,5% in 2019, which was lower than the rate achieved in 2018, of 2,0%. There were several reasons for this lower

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growth rate, such as weakening the international trade due to the trade war between the USA and China, as it reached its peak at the end of 2019, consequences of Brexit, high level of public debt of some member state (Greece, Italy, Portugal, Belgium, etc.). According to the International Monetary Fund (IMF), the global real GDP growth rate of 2.9% in 2019 was the lowest since the global financial crisis outbreak in 2008. As a result of the coronavirus COVID-19 pandemic crisis, the global economy is projected to contract sharply by 3% in 2020, much more than during the global financial crisis.\textsuperscript{8}

When it comes to an average GDP per capita for the SEE region in 2019, it was EUR 8.090 and rose by 6.2% compared to 2018. Figure 4 indicates EUR amounts of GDP per capita for particular SEE countries over the period 2002-2019.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure4.png}
\caption{GDP per capita of the SEE countries over the period 2002-2019 (EUR)}
\end{figure}

The GDP per capita for the SEE region was continuously far below the EU average of EUR 32.030; in other words, approx. four times smaller than the EU average. Nonetheless, whereas the EU GDP per capita increased by 3.2% (the same rate like in the previous period, i.e., 2018 compared to 2017), the GDP per capita in the SEE region increased by 6.2% in 2019 compared to the previous year (the latter rate was negative, of 2.6% in the previous period).

When the SEE countries are considering more specifically, it can be stated that Slovenia was repeatedly the SEE country with the highest GDP per capita reaching 72.3% of the EU average in 2019 (alternatively, in absolute terms, Slovenian GDP per capita was EUR 23,165). Ukraine was

the poorest among the observed countries, with GDP per capita EUR 3.583, by 34.9\% higher than in 2018, but still the second lowest in Europe (after Moldova and before Kosovo).

In addition, except Slovenia, like in the previous year, Greece (EUR 17.102), Croatia (EUR 13.343), and Romania (EUR 11.509) were the countries with GDP per capita above EUR 10.000. On the contrary, like Ukraine, Kosovo (EUR 3.986) and Albania (EUR 4.781) also had the amounts below EUR 5.000. Bulgaria (EUR 8.678), Turkey (EUR 8.234), Montenegro (EUR 7.959), Serbia (EUR 6.619), North Macedonia (EUR 5.398), and BiH (EUR 5.168) were the countries “in the middle”, with GDP per capita between EUR 5.000 and 10.000, as shown in Figure 4. Furthermore, Bulgaria and Romania had the lowest level of GDP per capita in the EU in 2019 (27.1\% and 35.9\% of the EU average, respectively).

It is clear that there are huge differences among the SEE region countries as concerns the level of their economic development. The countries such as Greece (since 1981), Slovenia (2004), Romania (2007), Bulgaria (2007), and Croatia (2013) are the EU member states and they are trying to be more competitive members, while other eight countries find themselves at various stages of the EU integration process; more precisely, Turkey (as of 1999), North Macedonia (2005), Montenegro (2010), Serbia (2012), and Albania (2014) are candidate countries for the EU membership, while BiH (2003) and Kosovo (2013, but five EU member states not recognizing its independence) are potential candidate countries for the membership. Recently, Ukraine has announced that it will apply for the EU membership in 2024. However, the progress in the EU integration process depends on not only economic but also political issues. There are still many structural reforms related to business climate and governance that need to be implemented; for example, improvement of the legal framework (“rule of law”), reduction of the informal (shadow) economy and elimination of corruption, tax administration transformation, improvement of corporate governance in public enterprises, improvement of the conditions and removal of barriers to trade, energy sector transition towards renewable sources, etc. Thanks to the trend of economic growth, foreign direct investments (FDI), as a source of economic activity, in the SEE countries boosted from June 2018 to May 2019, especially for those countries making efforts to join the EU. For example, the Western Balkan countries (or WB6), that is, Albania, BiH, Kosovo, Montenegro, North Macedonia, and Serbia, achieved their highest greenfield FDI inflows in a decade in 2018, attracting 147 greenfield FDI projects, mostly by Serbia. Despite WB6 countries attracting significantly less greenfield FDI projects than their counterparts in Central, Eastern, and Western Europe, the SEE region performs very well relative to its share of global GDP.\(^9\) Most of the FDIs in the SEE region is a result of interregional cooperation, whereas other investors come from the EU, China, the Middle East, and the Russian Federation. From the interregional perspective, the largest investor in the region is Turkey. The foreign investors are mainly interested in energetic and financial sectors, but there is also an increasing interest in the manufacturing industry, such as automotive industry and organic food and beverages production, as well as infrastructure, tourism, etc.

Due to the fact that some SEE countries’ economies are still underdeveloped, or essentially far behind the EU member states economies, one of the main economic issue the SEE region countries face is permanently high unemployment rate, as shown in Figure 5.

Hence, all WB6 countries are suffering from high unemployment, ranging from 25.7% in Kosovo to 10.4% in Serbia in 2019. However, because of intensified emigration before the coronavirus COVID-19 pandemic as well as the presence of the informal economy, some have doubts about these official statistics meaning that they reflect real picture of unemployment in the WB6.

In spite of substantial decrease in unemployment, Kosovo had the highest unemployment rate in Europe in 2019 (conversely, Czech Republic had the lowest unemployment rate of 2.0%). North Macedonia and Greece followed it with 17.3% unemployment rate both. Greece was the country with the highest unemployment rate in the EU as well as eurozone. Apart from WB6 and Greece, among other SEE countries Turkey also had high unemployment rate, at 13.7%. On the contrary, the SEE country with the lowest unemployment rate repeatedly was Romania, at 3.9%. For comparison, an average unemployment rate in the EU was 6.3% in 2019.

The situation regarding the unemployment in most of the SEE region countries is even worse if we consider young people’s unemployment. While the SEE countries with the highest general unemployment rates, Kosovo, North Macedonia, and Greece, had youth unemployment rates around 55%, 48%, and 33%, respectively; youth unemployment rate in the EU was around 14.2% in 2019 (e.g. among the EU member states Czech Republic had also the lowest youth unemployment rate of 5.1%). Therefore, the migration trend of the young, unemployed, and well-educated population to the EU is becoming more evident and, consequently, a major threat for the SEE region countries in the future, as the EU labour market opens. Also, working-age population is decreasing as the result of unfavourable demographics and, thus, many SEE region countries have unfavourable relationship between the number of employees and retired individuals. This creates additional difficulties to their social pension and health insurance systems.
As illustrated in Figure 6, inflation rates in the SEE countries ranged from 0,3% to 3,8% in 2019 (no case of deflation was noted over the past three consecutive years). The exceptions were Turkey and Ukraine, with the inflation rates as high as 11,8% and 7,9%, respectively. However, both countries recorded decreases in the rate of inflation compared to 2018, by 8,5 i 3 percentage points, respectively.

Figure 6. Average annual inflation rate of the SEE countries over the period 2002-2019 (%)

The lowest inflation rate, of 0,3%, was repeatedly recorded in Greece, as the Economic and Monetary Union (EMU) member since 2001. It was followed by BiH that implemented a currency board arrangement in 1997 (firstly based on DEM as anchor currency and since 2002 on EUR), with the inflation rate of 0,6%. For comparison, an average inflation rate in the EU was 1,5% in 2019, declining by 0,4 percentage points compared to the previous year.

Figure 7 represents the changes in EUR amounts of the average net month salary for particular SEE countries from 2007 to 2019, except for Turkey due to missing data.
In 2019 the highest average net salary was recorded in Greece, of EUR 1.161, followed by Slovenia, of EUR 1.134. In contrast, the lowest average net salary was recorded in Ukraine, of EUR 397. For the purpose of comparison, in Germany, as one of the leading EU economies, average net salary in the same year was around EUR 1.890, that is, 4.8 times higher than Ukrainian. Nonetheless, all SEE countries registered increases in average net salary in 2019 compared to the previous years.

Furthermore, as already known, the World Health Organization announced the coronavirus COVID-19 (or SARS-CoV-2) pandemic on March 11, 2020. The term "pandemic" does not reflect the severity or mortality rate of a disease, but its geographical spreading. Due to both the worlds' population growth (around 7.8 billion) and higher than ever global mobility of people, for a couple of months the rapid spread of the virus became noticeable worldwide, prompting governments to act quickly in order to combat the pandemic. Physical distancing requirements, mandatory quarantine, lockdowns (national or city-level), and shutdown of nonessential businesses became common preventative actions for most countries. From an economic standpoint, these actions were unprecedented, just as the emergence and transmission of the coronavirus COVID-19 were exceptional. According to the Worldometer's report, at the time of this writing, the pandemic affected 219 countries and territories across the globe, which reported a total of 140,558,460 confirmed cases and a death toll of 3,012,991 deaths.10 For these reasons the coronavirus COVID-19 pandemic can be characterized as "the largest public health crisis in living memory".11

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As far as the SEE countries are concerned, in order to halt spread of the virus and protect lives of their citizens, since March 11, 2020, the governments have taken miscellaneous measures starting from protection of their fragile health systems by purchasing additional medical equipment and medicine, and then transforming medical centres into specialised COVID-19 centres as well as concert and sport arenas into temporary hospitals. Also, the governments introduced various restrictions to airports and borders, educational institutions, restaurants, shops, and gyms, domestic travel as well as bans on large gatherings and instatement of curfews. These containment measures generally impacted on the SEE economies in the following ways:\textsuperscript{12}

- Due to the pausing or reducing numerous social and economic activities, they drove up to decreases in domestic demand and supply.

- The decrease in demand and disruptions in supply chains, which affected almost all industries starting from pharmaceutical to automotive, diminished the SEE region countries’ exports. Those SEE countries that had manufacturing sectors more integrated into the global supply chains (e.g. Bulgaria, Romania, Serbia, North Macedonia, Turkey, etc.)\textsuperscript{13} and had higher contributions in terms of value-added and employment beared the greatest cost of the pandemic in the short run. According to some views, this could lead to a localization of supply chains in long run (“localization over globalization”\textsuperscript{14}).

- A deceleration of both public and private investments as a consequence of, for example, a reduction in FDI, could be expected, which would further slow economic growth; that is, inhibit creating jobs and attracting new technologies and innovations. In the World Investment Report 2020, the United Nations Conference on Trade and Development (UNCTAD) projected a dramatic fall in global foreign investments by up to 40\% in 2020, with a further decrease by 5-10\% in 2021 and recovery in 2022.\textsuperscript{15}

- The containment measures significantly reduced global travelling and, consequently, tourism activities, which are critically important for those SEE countries where tourism revenues exceed 20\% of the GDP, such as Montenegro (33\%), Croatia (25\%), Albania (22\%), and Greece (22\%).\textsuperscript{16}


The level of the GDP of the SEE countries such as Kosovo, Montenegro, BiH, Albania, Serbia, Bulgaria, Romania, and North Macedonia greatly depends on the inflow of remittances (e.g. for several countries remittances account for around 10% of GDP; moreover, according to the World Migration Report 2020, among the top 20 countries in the world by emigration in 2019, from the SEE region countries were included BiH, Albania, and North Macedonia). However, because of travel restrictions and increased unemployment, linked to the economic downturn in the EU (which is the main source of remittances for the SEE region), the remittances decreased. The World Bank (WB) estimated a global drop in the inflow of remittances by 20% in 2020.

More detailed implications of the pandemic for SEE economies as well as the reactions of the governments and financial institutions are presented later in this part of the report.


PHENOMENON OF BANK CENTRICITY

This phenomenon refers to the fact that the financial service industries of all SEE countries are dominated by commercial banks. In other words, banks have been playing an essential role in economic stability and development of the SEE countries for a long period of time. As key financial intermediaries in these countries, bank basically are collecting deposits and lending to households, businesses, and governments, facilitating the flows of funds from surplus transactors to deficit transactors in the economies. Well-functioning banking sector accelerate economic growth, whereas poorly functioning banking sector is an impediment to economic progress and aggravate poverty.

The following data on the SEE countries’ banking sectors was collected from the official reports of their relevant national supervisory institutions and with support of central banks and banking associations of some countries. After a concise introduction to the regulatory framework, a comparative analysis of the banking sector parameters among these countries, as well as between this group of countries and developed part of Europe, is done.

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17 Considering the fact that remittances represent “financial or in-kind transfer made by migrants directly to families or communities in their countries of origin”, more data on remittances can be found in the International Organization for Migration (IOM) yearly reports. Abovementioned data was taken from the latest officially launched report at the time of this writing, that is: IOM. World Migration Report 2020. 2019. Retrieved from: https://publications.iom.int/system/files/pdf/wmr_2020.pdf, Accessed: January 12, 2021.


BANK REGULATORY FRAMEWORK

Despite the fact that the observed countries (except Ukraine) belong to the same geographical region, South-East Europe, they are hardly comparable due to various levels of the economic development, their political and historical background and, particularly, different relations to the EU. As already discussed, some SEE countries are the EU member states, while others are at various stages of the process of accession. Also, SEE countries have different monetary policy regimes implemented. For example, while Bulgaria and BiH have currency board arrangements, Kosovo and Montenegro have unilateral use of the euro; or since 2001 Greece and 2007 Slovenia have been the EMU(19) members; further, Croatia and North Macedonia apply flexible but managed monetary policy regimes, etc. However, despite this diversity the main goal of the central banks remains unique – maintenance of monetary and financial stability. Furthermore, the banking supervision is generally assigned to the central banks. Exceptions are BiH, where the entities' agencies (that is, the Banking Agency of the Federation BiH and the Banking Agency of Republic of Srpska) supervise the bank activities, and Turkey, where the Banking Regulation and Supervision Agency (BRSA) is in charge of supervision of banking sector.

As far as designing bank legal and institutional framework in all SEE countries is concerned, the Basel Committee on Banking Supervision (BSBC) documents and the EU directives serve as the basic guidelines. The SEE countries that are the EU member states fully implemented Basel III (Capital Requirements Directive IV/Capital Requirements Regulation - CRD IV/CRR package) until the beginning of 2019, whereas the SEE countries that are non-EU member states (including Ukraine) are still at the various stages of the process of adopting Basel III standards. For example, in the case of Albania and Kosovo, in the process of the implementation of Basel III much need to be done. In BiH, Basel III standards regarding capital, capital adequacy, leverage, internal governance were implemented in 2017, while liquidity coverage ratio was implemented in 2019. In 2017 in Serbia and then in 2018 in North Macedonia, banks successfully met the challenges of complying with the requirements that are related to the capital components of Basel III. Montenegro adopted Basel III requirements in 2020. Turkey’s banking regulatory and supervisory framework is in line with international standards. In conjunction with the IMF, the WB, the European Commission (EC), and other international financial institutions, Ukraine also works on implementation Basel III standards and the EU laws.

It needs to be underlined that implementation of the Basel standards is a dynamic process, leading to continuous revisions and suggestions. Future changes of this regulatory framework will be a result of the EU further improvement of the CRD/CRR regulatory package. In 2019 the EU ambassadors endorsed the full package of risk-reduction measures, which represented a more robust framework to regulate and supervise banks aimed at reducing risks in the EU banking sector. The package involved enhancing the framework for the resolution of banks, strengthening capital requirements for lenders, and improving banks’ lending capacity and giving them a larger role in capital markets as well as a framework for information-sharing among regulators responsible for supervision and resolution of cross-border lenders. It also introduced changes aimed at improving cooperation between competent authorities on matters related to supervision of anti-money laundering activities.

According to a new report of the BCBS, banks and regulators are taking advantage of the flexibility in aspects of Basel III regulatory regime to deal with the COVID-19 pandemic crisis (e.g. bank using buffers to combat COVID-19 fallout). While various countries have continued to make progress on
implementing Basel III standards, efforts have also been somewhat disrupted by the pandemic. However, the BCBS is developing plans to restart implementation assessments that have been halted due to the pandemic, with the goal of completing its reviews by the end of 2022. Moreover, it is expected from BCBS to focus its future agenda more on emerging risks to the financial service industry, including the ongoing digital transformation in banking and climate-related financial risk.\textsuperscript{20} 

COMPARATIVE ANALYSIS OF THE BANKING SECTOR PARAMETERS

As shown in Figure 8, the size of the banking sector relative to GDP, in terms of total banks’ assets as percentage of GDP, in individual SEE countries indicates great importance of banks for the SEE’s economies. For that reason it is of vital importance to assess the stability and resilience of the banking sector and to identify the most sensitive areas.

![Figure 8. Total banks' assets as % of GDP in 2019](image)

The total banks’ assets as a percentage of GDP in the SEE region countries was 93,0% in 2019 (in absolute terms, EUR 1.396,8 billion). When it comes to individual SEE countries, Greece continuously had the largest share of banks’ assets in GDP (168,6%), whereas Ukraine and Romania registered the lowest share of banks’ assets in GDP in 2019 (49,8% and 50,4%, respectively). Apart from Greece, other SEE countries with the share of banks’ assets in GDP above the region average in 2019, of 93,0%, were Croatia (105,8%), Turkey (97,3%), Bulgaria (96,2%), and Montenegro (93,8%). For comparison purposes, total banks’ assets in relation to the EU GDP

\textsuperscript{20} In April 2020 BCBS launched the report entitled „Climate-related financial risks: a survey on current initiatives“. For more details see: https://www.bis.org/bcbs/publ/d502.pdf.
was 298.9% in 2019; in other words, it was 3.2 times higher compared to the SEE region’s average, but like in the SEE region it differed significantly among the EU member countries.\textsuperscript{21}

Since 2012 the size of the banking sector prevalently increased in the SEE countries such as Albania, BiH, Bulgaria, Croatia, Kosovo, Montenegro, North Macedonia, Romania, and Serbia; thus, exceptions were Greece, Slovenia, Turkey, and Ukraine, as illustrated in Figure 9. As far as the amount of total assets held by the EU banks is concerned, it expanded in 2019 after few years of consecutive contraction, reaching EUR 49.300 billion (hence, 35.3 times higher than the SEE region countries’ bank assets), but the expansion came basically from gain in the total assets in the euro area countries (of 4.6%).

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure9.png}
\caption{Total banks’ assets over the period 2012-2019}
\end{figure}

In 2019 all SEE countries except Turkey recorded increases in their banks’ assets in comparison to 2018. It ranged from 3.0% in Albania and 4.2% in Croatia to 13.7% in Kosovo and 24.5% in Ukraine. Interestingly, in 2019 Greece for the first time in the observed period registered an increase in the amount of total banks’ assets, of 5.9%. In spite of the recording slight increases in the amount of total banks’ assets for past three consecutive years, in the case of Slovenia and Ukraine, it is still below the level in 2012. When it comes to Turkey, after the drop of the size of the banking sector in 2017, it continued to record decreases, e.g. of 3.1% in 2019 compared to 2018; nonetheless, contrary to Slovenia and Ukraine (as well as Greece, of course), it is still above the level in 2012.

As represented in Figure 10, the number of banks per SEE country varied from 10 in Kosovo to 75 in Ukraine in 2019.

The number of banks in the SEE region continuously dropped since 2012 (from 510 to 358), primarily because of Ukraine, where it dropped from 176 to 75, Greece, from 52 to 35, as well as Croatia, from 31 to 20. Similarly to the SEE region, the EU faced a downward trend in the number of credit institutions, which started in 2009 and continued ten years after, with the number falling to 5,981 in 2019 (but, like in the SEE region, the number differed significantly among the EU member states). The decline, however, is the slightest (-107 units) since the trend started.\textsuperscript{22} In both region, SEE and the EU, consolidation in the banking sector continues helping to reduce overcapacity and aiming to enhance profitability.

The size of banks, measured as average assets per bank, also varied significantly among the SEE countries in 2019, traditionally from the lowest level in Montenegro, EUR 354,2 million, to the highest in Turkey, EUR 12,478,5 million (see Figure 11). While this size increased in the case of Montenegro by 20,5%, in Turkey it rose by 7,2% in 2019 compared to the previous year.

\textsuperscript{22} The data for the EU is taken from the website: https://www.ebf.eu/facts-and-figures/structure-of-the-banking-sector/#:~:text=Number%20of%20credit%20institutions,units)%20since%20the%20trend%20started., Accessed: April 17, 2021.
The average assets per bank in the SEE region countries in 2019 was EUR 3,901.7 million (total bank’ assets in the SEE region countries, EUR 1,396.8 billion, divided to the overall number of banks, 358), by 5.1% more than in 2018. In order to make comparison, the average assets per credit institution in the EU in 2019 was EUR 8,242.8 million (total bank’ assets in the SEE region countries, EUR 49.300 billion, divided to the overall number of credit institutions, 5,981), that is, 2.1 times higher than the SEE region average.

If we compare the size of banks measured as average assets per bank in 2019 to 2012 (see Figure 12), we can notice that the average assets per bank was at a bit lower level only in Turkey.
Since 2012 the average assets per bank increased significantly in BiH (of 94,1%), primarily due to consolidation in the banking sector and the financial service industry extremely being bank-centric. BiH was followed by Albania (89,9%), Croatia (73,4%), Bulgaria (71,8%), Serbia (68,8%), North Macedonia (66,3%), Ukraine (64,5%), Romania (60,2%), and Kosovo (51,3%). In other countries it increased by less than 50% (in Montenegro, by 38,7%; Slovenia, by 20,9%, and Greece, only by 4,1%). Turkey’s decrease in the average assets per bank was 3,9% in 2019 compared to the beginning of the observed period of time.

In 2019 the market concentration measured as the share of five largest banks in the total banking assets, shown in Figure 13 for individual SEE countries, was the highest in Greece (97,3%), although the share was much lower in 2012 (79%), but showing this upward tendency since 2013 (94,0%). Greece was followed by Croatia, with the share of 80,5%, and BiH, with 77,7%.

Figure 12. Average assets per bank over the period 2012-2019
Figure 13. Market share of five largest banks in 2019 (%)

Note: An asterisk in the chart mean that the data for five largest banks was not available and, therefore, the data for three largest banks was used.

On the contrary, the lowest market concentration in 2019 was reported in Serbia (53,4%). Due to missing data, for Kosovo was used the share of three largest banks in the total banks’ assets.

Figure 14 reveals that inasmuch as we observe the market share of the largest bank, it was the highest in Greece (29,5%), followed by Ukraine (27,8%), Croatia (27,3%), Albania (27,2%), and BiH (26,8%).
The other SEE countries had the share of the largest bank around 20%. The lowest share was noted in Turkey (15.5%) and Serbia (15.9%).

Figure 15 shows that in all countries except Ukraine and Turkey, there was a high share of foreign ownership in the total banking assets. It varied from 61.4% in Slovenia to 90.2% in Croatia.

Note: An asterisk in the chart refers to the data for the year 2015 and two asterisks to data for the year 2018.
As far as Ukraine and Turkey are concerned, their banking sectors were dominated by domestic banks (more precisely, 27.2% and 28.0% of the total assets were held by domestic banks, respectively). Due to missing data, the presented share for Greece referred to 2015 and for Slovenia referred to 2018.

Furthermore, the structure of banks’ assets per individual SEE country in 2019 is presented in Figure 16.

As can be concluded from Figure 16, in all SEE countries net loans undoubtedly had the highest share in the banks’ assets. That could be expected to some extent bearing in mind the underdevelopment of the SEE financial markets and, as a consequence, the banking orientation to a conservative (core business) approach, in terms of operating in a sphere of attracting deposits and lending money. However, the exception was Ukraine, where net loans participated almost like other assets (that is, assets different from net loans, government bonds, cash funds, and/or fixed assets).

On the other side, Figure 17 illustrates the structure of total banks’ liabilities for individual SEE countries in 2019.
In spite of quite different forms of reporting, we can conclude that in almost all SEE countries “households and corporation deposits” traditionally had the highest share in total banks’ liabilities. Only Ukraine had almost equal share of both “households and corporation” and “government deposits” (around 27% each).

Regarding the maturity structure of deposits in 2019, there was a mismatch across almost all countries, as we can see in Figure 18.
While Albania and BiH had almost the same share of short-term and long-term deposits (47.6%:52.4%, and 53.0%:47.0%, respectively), the share of short-term deposits in other countries was much or less higher than the share of long-term deposits (only Albania recorded slightly more long-term deposits in the banking sector in relation to short-term deposits). The highest share of short-term deposits in total deposits was recorded in Ukraine (97.9%), followed by Turkey (95.6%), Serbia (93.0%), and Romania (92.2%). In other SEE countries the share of short-term deposits varied from 56.9% (Croatia) to 83.8% (Montenegro).

As far as the maturity structure of loans in 2019 is concerned, the share of long-term loans was significantly higher than the share of short-term loans in all countries except Romania (Figure 19).
In Romania, the share of short-term loans (97.5%) was much higher than the share of long-term loans (2.5%), similarly to the structure of deposits by maturity. The highest share of long-term loans in total loans was noted in Croatia (87.7%), followed by Kosovo (85.9%), North Macedonia (83.0%), Montenegro (82.3%), Greece (80.4%), Serbia (79.5%), BiH (78.0%), and then Bulgaria (75.1%), Albania (68.7%), and Ukraine (64.1%), which indicated to much or less mismatch between maturity structure of deposits and loans in those countries. The exception was Turkey, which registered relatively balanced shares of short-term and long-term loans (46.7%:53.3%).

The currency structure of deposits in 2019, shown in Figure 20, reflects presence of a major part of deposits (around 50% or more) in the local/domestic currency, including Montenegro, where euro is local currency although the country is not a part of the euro area. The exception was Serbia, with the higher share of euro-denominated deposits (59.3%) than deposits in dinar (35.2%).

Figure 19. **Maturity structure of loans in 2019 (%)**

In Romania, the share of short-term loans (97.5%) was much higher than the share of long-term loans (2.5%), similarly to the structure of deposits by maturity. The highest share of long-term loans in total loans was noted in Croatia (87.7%), followed by Kosovo (85.9%), North Macedonia (83.0%), Montenegro (82.3%), Greece (80.4%), Serbia (79.5%), BiH (78.0%), and then Bulgaria (75.1%), Albania (68.7%), and Ukraine (64.1%), which indicated to much or less mismatch between maturity structure of deposits and loans in those countries. The exception was Turkey, which registered relatively balanced shares of short-term and long-term loans (46.7%:53.3%).

The currency structure of deposits in 2019, shown in Figure 20, reflects presence of a major part of deposits (around 50% or more) in the local/domestic currency, including Montenegro, where euro is local currency although the country is not a part of the euro area. The exception was Serbia, with the higher share of euro-denominated deposits (59.3%) than deposits in dinar (35.2%).
For some countries, such as Kosovo, North Macedonia, and Turkey, deposits in euros were included in “deposits in other currencies”. Also, official data on currency structure of deposits as well as loans for Slovenia, which became a member of the eurozone on January 1, 2007, was not available.

As far as the currency structure of loans in 2019 is concerned, shown in Figure 21, we can notice that loans in the local currency were dominating in the loan currency structure, including Montenegro, where euro is local currency. Only countries with the shares of loans in the local currency less than 50% were Serbia, Croatia, and BiH (more precisely, with the shares of 31.4%, 42.8%, and 47.7%, respectively).
While the highest share of loans in euros, where euro is not local currency, was registered in Serbia (68.1%), the highest share of loans in other currencies different from euro was recorded in Ukraine (31.6%). Like for deposits, data on Turkey’s currency structure of loans contained local and other currencies, without separation of euro currency. As mentioned above, the data for Slovenia was not available.

Furthermore, taking the main features of the banking sectors into consideration, capital adequacy ratio at first (see Figure 22), we can notice that the capital adequacy ratio in the SEE countries in 2019 varied from the lowest recorded level of 15.9% in Kosovo to the highest level of 24.8% in Serbia. Even the lowest level was far above the international standard of 8% (applied in the SEE countries that are the EU member states as well as Turkey and North Macedonia), or the minimum rates required by national legislatives (e.g. 10% in Montenegro and Ukraine, or 12% in Albania, BiH, Serbia, and Kosovo).

**Figure 21. Currency structure of loans in 2019 (%)**
Figure 22. Capital adequacy rate in 2019 (%)

From 2012 to 2019 movements in the ratio showed a stagnancy or even positive trend, for example in Slovenia, where it increased from 11.9% in 2012 to 18.2% in 2019, and Greece, where it increased from 9.7% in 2012 to 17.3% in 2019. However, a rare decrease was recorded in Ukraine, where the ratio dropped from 18.1% in 2012 to 12.3% in 2015 and then continued to increase to 19.7% in 2019, which was far from the minimum of 10% set by the National Bank of Ukraine. When it comes to country with the lowest recorded rate in 2019, Kosovo, it faced a drop from 17.2% in 2012 to 15.9% in 2019, but the regulatory minimum set by the Central Bank of the Republic of Kosovo is 12%. In order to make comparison, the total capital of the banks in the EU continued to show a positive trend, reaching 18.9% in June 2019 up from 9.1% in June 2012, or 9.7% at the end of 2012.23

As far as non-performing loans (NPLs) are concerned, the highest ratio of NPLs was repeatedly recorded in Ukraine, of 48.4%, followed by Greece, of 40.3% (see Figure 23). In Greece, the ratio of NPLs in total loans increased significantly from 31.3% in 2012 to 48.5% in 2016, and then fell in 2017 to 47.2%, 2018 to 45.4%, and 2019 to 40.3%. In regard to Ukraine, the NPL ratio steadily increased since 2012, from 8.9% in 2012 to 52.9% in 2018, and then fell to 48.4% in 2019.

In Serbia, Albania, Romania, and Bulgaria the ratio of NPLs decreased from 2012 level of 18.6%, 22.5%, 18.2%, and 16.6%, respectively, to 2019 level of 4.1%, 8.4%, 4.1%, and 6.5%, respectively. In other countries such as Montenegro, Croatia, BiH and North Macedonia the ratio also decreased, but in smaller range (from 14.0%, 13.9%, 13.5% and 10.5%, respectively, to 4.7%, 5.5%, 7.4%, and 4.8%, respectively). Only Turkey was recorded an increase of the NPL ratio from 2.9% in 2012 to 5.3% in 2019. The lowest NPL ratio in 2019, 2.0% and 2.2%, was recorded in Kosovo and Slovenia, respectively.

As it is well-known, during the global financial crisis 2007-2009 was seen a strong uptake in NPLs in banks’ balance sheets, leaving policymakers worldwide concerned by this challenge. This trend was exacerbated for some countries by the 2011 European sovereign debt crisis, particularly in the SEE region, resulting in an EU-wide peak NPL ratio of 7.5% in 2012. However, NPL ratio trajectories point to a significant decline across the EU which can be mostly attributed to NPL sales and securitizations. In 2019 the ratio for the EU stood below the world average of 6.5%, at 3.1%, which suggests that NPLs are no longer a specific European problem.24

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24 The world average of NPLs as a percentage of all bank loans for 2019 was based on 119 countries, with the highest value in San Marino, 61.7%, followed by Equatorial Guinea and then Ukraine and Greece. The lowest value of NPLs was registered in Monaco, 0.2% (https://www.theglobaleconomy.com/rankings/nonperforming_loans/, Accessed: April 19, 2021). The EU average of NPLs ratio at the end of 2019 was taken from the European Banking Authority’s (EBA’s) report entitled “Risk Assessment of the European Banking System” (https://www.eba.europa.eu/sites/default/documents/files/document_library/Risk%20Analysis%20and%20Data/Risk%20Assessment%20Reports/2020/December%202020/961060/Risk%20Assessment_Report_December_2020.pdf, Accessed: April 19, 2021).
As shown in Figure 24, return on equity (ROE), a key indicator by which can be assessed banking sector’s attractiveness for investors, was positive in banking sectors of all SEE countries in 2019.

The highest ROE in 2019 was registered in Ukraine (34.8%), followed by Kosovo (18.9%), and Albania (13.5%). Interestingly, after five consecutive years of negative or zero ROE, in 2019 Greek banking sector recorded ROE of 0.7%, which was the lowest in the region. In other countries ROE varied from 8.7% (Montenegro) to 12.3% (Slovenia). For comparison, with the ECB maintaining its ultra-low interest rates throughout 2019, profitability remained a key challenge facing European banks, although the ROE has been slowly recovering. The ROE of the EU banks was 5.4% in 2019, down from 6.1% in 2018, after up from 5.8% in 2017. It is still far from the 10.6% registered in the outset of the financial crisis (the highest recorded since 2007 was the one in 2018).

Moreover, while the difference between the highest (Ukraine) and the lowest (Greece) ROE in the SEE region was 34.1 percentage points, that difference in the EU, that is, between the highest in Hungary, of 16%, and the lowest, Greece, was 15.3 percentage points in 2019. The ROE across the EU countries diverged after 2007, signaling growing fragmentation, especially across the eurozone. After reaching a peak in 2013 (25.8%), the dispersion around the average ROE has substantially decreased falling to 8.3% in 2014, 7.4% in 2015, 5.7% in 2016, 5.1% in 2017, 3.5% in 2018 and further to 4.0% in 2019, but less than 4.5% seen in 2007 before deviation started.25

As Figures 25 and 26 illustrate, like in the previous years, in 2019 Ukraine and Romania registered the highest both ratio of liquid assets to total assets (54.2% and 43.8%, respectively) and ratio of

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liquid assets to short-term financial liabilities (94.4% and 240.0%, respectively), which were far above the observed group’s average (around 28.6% and 65.4%).

On the contrary, liquid to total assets were repeatedly the lowest in Slovenia (14.0%), followed by Croatia (14.7%), Bulgaria (15.9%), and Turkey (16.7%). For other countries it was higher than 20%. The lowest liquid assets to short-term financial liabilities in 2019 were noted in Turkey (25.1%), followed by Montenegro (27.1%), and Bulgaria (29.81%). For other countries the latter ratio was at least 44.4%.

However, in this liquidity analysis were included only countries with available data; in other words, Serbia (missing data on ratio of liquid assets to short-term financial liabilities), Slovenia (missing data on ratio of liquid assets to short-term financial liabilities), and Kosovo (missing data on both liquidity ratios) were excluded. Also, bearing in mind that liquidity issues were highlighted in post-financial crisis regulatory framework, Basel III, introducing liquidity coverage ratio (LCR), which requires banks to maintain minimum amounts of liquid assets to withstand cash outflows over a 30-day horizon, as well as net stable funding ratio (NSFR), which is defined as the ratio between the amount of stable funding available and the amount of stable funding required; it can be expected further improvement in this field of the SEE banking businesses. As of January 1, 2019, the minimum LCR required for internationally active banks is 100%. Basel III requires NSFR to be equal to at least 100% on an ongoing basis. The latter ratio measures, in fact, a bank’s medium and long term resilience, whereas the objective of LCR is to promote short-term resilience.
Summa summarum, since the financial service industry in SEE the region is highly bank-centric, the financial soundness of the banking sector has extreme importance for the industry as well as real economy, their stability and growth. As we can conclude from the charts, the SEE countries have had relatively high capital adequacy and also liquidity profile in their banking sectors. The resilience of the banking sectors has been strengthening by wide implementation of Basel III capital requirements. Although reductions of NPLs ratio have been reported across almost all SEE countries, predominantly by those with higher starting ratio, NPLs have remained unevenly distributed (from 2.0% in Kosovo and 2.2% in Slovenia to 48.4% in Ukraine, followed by Greece, with 40.3%).

According to the BCBS, banks are taking advantage of the flexibility in aspects of Basel III regulatory framework to deal with the ongoing COVID-19 pandemic crisis. Although there are early warnings of the deterioration in the banks’ asset quality, this is not yet reflected in the NPL ratio due to moratoria approved across many SEE countries for 2020 and even 2021. A retrospective analysis, especially official data on 2022, will reveal the real impact of the pandemic crisis on the quality of banks’ assets in the SEE region countries. However, the impact on the credit risk exposure could be offset by higher growth of total loans because deposit potentials have not been materially affected by the pandemic. But operational risk exposure could be grown due to recently wide reliance on IT usage and ongoing digital transformation. It is discussed later in the text.
DIVERSITY OF THE INSURANCE INDUSTRY

In this section a comparative analysis among the observed 13 countries’ insurance markets is conducted by using different parameters, as well as their comparison to the parameters for the Insurance Europe (IE), or the European (re)insurance federation, which represents the developed part of the European insurance market. The data on insurance markets of the SEE countries was collected from the official reports of the countries' relevant national supervisory institutions and with support of certain insurance associations. In order to illustrate the trends, it is used the data from the reports since 2002, but descriptive analysis was focused on 2019 compared to the previous year, and a deep market review is presented.

Moreover, in Part II a detailed report of particular SEE countries’ insurance markets indicators is provided. The main market indicators for all countries, as well as the other relevant data necessary for a comparative analysis for 2019, was collected from their annual reports published by the relevant national institutions, as mentioned above. Regarding the functioning of the SEE region insurance markets in 2019, it can be asserted that all markets continued to grow as in the previous years.

CHALLENGES OF RISK-BASED INSURANCE REGULATION

In 2016 new regulatory regime, that is, Solvency II, started to apply in the EU insurance and reinsurance businesses. As it is known, similar to Basel II and then Basel III in banking, Solvency II is based on a structure of following three pillars: (a) risk evaluation (i.e., quantitative requirements), (b) risk management (i.e., qualitative requirements or supervisory review process), and (c) transparency of risk (i.e., market discipline via disclosure requirements). Bearing in mind at least six-year transition period, implementation of Solvency II did not cause many issues for most of the EU member states, in spite of a significant change of their legal and institutional framework. However, the SEE countries that are non-EU member states (including Ukraine) are still implementing regulatory regime Solvency I and their insurance markets are taking the appropriate steps in the preparation for Solvency II. Some of them are focusing on further liberalization of motor third-party liability (MTPL) insurance, a key line of the insurance business, while others are struggling with plenty of burdens, trying to provide a better supervision process and improve market discipline.

In recent years the SEE countries that are the EU members continued to focus on further meeting Solvency II requirements and establishing the related reporting process. The other SEE countries continued to improve the regulation regarding MTPL insurance as well as popularize risk management practices in the insurance undertakings, but MTPL liberalisation is still waiting to be implemented in couple of countries, while the others already overcome consequences of that process. Throughout the process of joining the EU, SEE countries that are non-EU member states will have the opportunity to use the technical support and projects to establish the EU's Solvency II regime. But, generally speaking, most SEE countries did not make noticeable preparations for the new regulatory regime in their insurance sectors. Unlike in the developed part of Europe, insurance is still not perceived as an important factor of financial stability as well as economic development in these countries.

Due to the fact that the insurance sector was hit by coronavirus COVID-19 pandemic less than the other sectors, there were no significant changes in the regulation (e.g. like in the case of the banks and Basel III, insurers were encouraged to use of flexibility within the Solvency II). Many
insurance supervisors took regulatory actions to ensure business continuity and flexible treatment of policyholders. Of course, public trust in supervisory authorities is extremely important to mitigate any potential run on insurers.

THE INSURANCE MARKETS OVERVIEW

The comparative analysis among the SEE countries’ insurance markets as well as their comparison to the IE members reveals a diversity concerning various criteria. It should be underlined at the start that the outlook of the SEE region insurance industry would be much less remarkable without Turkey’s contribution.

In 2016 the SEE region insurance market reached the largest growth since 2012, at the rate of 11,1%. In 2017 it decreased by 1,5% and further fell by 2,7% in 2018. These drops were mostly caused by similar changes of Turkish market. Nonetheless, the total insurance premium of the SEE region countries was EUR 26.896 million in 2019 and it grew by 11,7% compared to the previous year, which represents the new record in the premium level since 2012. Due to the Turkey’s significant share in the premium, it can be assumed that its premium increased simultaneously, which was the case – at the rate of 13,0%. For comparison, the total insurance premium of the IE members was EUR 1.254,3 billion in 2019 and it registered a decline by 2,9% compared to 2018, after it increased by 5,7% in 2018 and also rose by 2% in 2017 compared to the previous year. Because of the introduction of Solvency II framework, it is obvious that the comparability of the IE members’ data with those of the years before 2016 is not plausible due to the changes in the methodology of data collection. To put things in a perspective, the total insurance premium of the IE members in 2019 was 46,6 times higher than the premium of the SEE countries. Because of the recent changes in both insurance premium volumes (SEE and IE), the spread between them became a bit smaller compared to the previous year (53,6). In other words, from the perspective of the insurance premium volume, the SEE insurance markets rose from the level of 1,9% of the share in the Insurance Europe members’ premium in 2018 to the share of 2,1%, in 2019. The latter indicate on, among others, a primordial stage in the insurance culture development of the SEE region.

As Figure 27 suggests, the total insurance premium of the SEE region in 2019 increased because the country with the largest contribution to the region insurance landscape, that is, Turkey, recorded premium growth.
The total premium volume of Turkey was EUR 10.900 million, or 40,5% of the SEE insurance premium, in 2019. As mentioned above, it rose by 13,0% compared to 2018, after the decline of 14,7% in 2018 compared to the previous year. Apart from the latter, since 2002 Turkey's insurance premium declined in 2004 by 25,1%, 2014 by 6,8%, and 2017 by 6,7% compared to the previous year. The reason for the decreases in the last two years was a high rate of inflation since the premium amounts in the Turkish lira were increasing for both respective years. Hence, it can be stated that the increase in 2019 stopped the opposite tendency over the past two-year period. When it comes to the region country with the lowest insurance premium, in 2019 it was traditionally Montenegro, as the country with the smallest population, with the premium of EUR 95 million (for four million euros less than Kosovo, as the country with the second smallest premium). All countries except Turkey registered a four-year continuity of premium increase.

Whereas by Figure 28, it can be illuminated the trends in insurance penetration (that is, in the share of insurance premium in GDP), Figure 29 refers to the insurance density (or, descriptively, the insurance premium per capita) for individual SEE countries. An average insurance penetration for the region slightly increased from the level of 1,7%, which was recorded in 2018 as well as 2017, to the level of 1,8% in 2019. Insurance density of the SEE region also followed the trend of the total insurance premium in 2019. Namely, insurance density for the region in 2019 was EUR 144,9 and it was by 11,3% higher compared to 2018, after a drop of 2,4% in 2018 compared to 2017. In the IE members in 2019, insurance penetration was 7,1% (four times higher than in the
SEE region) and insurance density was EUR 2.085,0 (14.4 times higher than in the SEE region). Both parameters, the insurance penetration and the insurance density, slightly declined in the case of the IE members in 2019 compared to the previous year – from 7.55% and EUR 2.163,5, respectively.

As Figure 28 reveals, the largest level of insurance penetration was expectedly noted in Slovenia (5.2%) and that is the closest to the IE average (7.1%, as mentioned earlier). Insurance penetration in other SEE countries ranged from 1.0% in Romania to 2.6% in Croatia.
Also, Slovenia had by far the best indicator of insurance density (EUR 1.205,1), shown in Figure 29. All other countries of the region, except Greece (EUR 414,3), Croatia (EUR 347,6), and Bulgaria (EUR 214,2), continued to have features of poor insurance markets with insurance density around EUR 150 or less (for example, EUR 152,3 in Montenegro, fifth largest penetration, and the lowest in Ukraine, only EUR 47,7).

When it comes to the structure of insurance premium of the SEE insurers, a situation with life insurance changed slightly, in a positive way. More precisely, the average share of life insurance in total premium of the SEE region was 23,9% in 2019, while it was 22,3% and 22,8% in two previous years, respectively. Simultaneously, as far as the insurance premium structure of the IE members, a situation with life insurance was slightly diminished. The average share of life insurance in the total premium in 2019 was 55,8%, while in 2018 it was 58,3% and in 2017 it was 57,9%.

Figure 30 suggests that the largest share of life insurance in 2019 was registered, as usual, in Greece, of 49,5% (by 3,2% more than in previous year).
Additionally, Slovenia (30,0%), Croatia (29,3%), Serbia (23,3%), Romania (20,5%), and BiH (20,8%) were the countries, among the remaining ones, that had the share of life insurance around 20%, that is, a fifth of the premium, or more. The country with the smallest share of the life insurance in the total premium in 2019 stayed Kosovo (3,5%), but with a slow improvement since the data about its insurance premium was collecting.

The further details about insurance markets of the SEE region in 2019 confirm diversity among the countries regarding different criteria. Through the following figures, specific market indicators are analysed, starting with the market size data that is shown in Figure 31.
The total premium of EUR 26.896 million in 2019, where Turkey’s contribution was EUR 10.900 million or, in relative terms, 40.5%, made the SEE region as one of the least developed parts of Europe as regards insurance. Like in the previous four years, apart from Turkey, Greece (EUR 4.444 million), Slovenia (EUR 2.517 million), and Romania (EUR 2.314 million) were the only countries with the amount of the insurance premium above EUR 2.000 million in 2019. Among the other countries, Ukraine was exception because it reached the insurance premium amount around EUR 2.000 million (i.e., EUR 2.006 million) in 2019, the first time since 2013. Nonetheless, considering the volume of the SEE economies, banking sectors as their inherent parts in particular, one of the mutual characteristics refers to a serious potential for insurance market growth in future.

The total number of insurance and reinsurance undertakings conducting business in the IE members was 3.202 in 2019, whereas Figure 32 reveals that this parameter for the selected 13 markets of the SEE regions was 540.
With only 2.1% of the share in the Insurance Europe members’ premium, having the share of 16.9% in the total number of companies operating there suggests that most countries of the SEE region had a disproportionately large number of companies in a relation to the market’s premium. As shown in Figure 33, this is most evident in Kosovo, the country with the smallest average premium per company, where an average premium per company was EUR 7.7 million, 24.3 times less than in Turkey, as the country with the largest average premium per company (EUR 184.8 million), and, especially, the IE members, 51.5 times (EUR 392.0 million). Or, although Ukraine generated only 7.5% of the total insurance premium in the SEE region, with overall 233 insurance companies it participated with 43.1% in the total number of companies operating on the observed 13 markets.
The average premium per company for the observed markets in 2019 was EUR 50.0 million, that is 7.9 times less than the average premium of the IE. Except Turkey (EUR 184.8 million), only Slovenia had an average premium per company above EUR 100 million (precisely, EUR 132.5 million). Bearing in mind the upcoming regulatory requirements set by Solvency II for the SEE countries that are non-EU member states (including Ukraine), the latter parameter indicates that further mergers and acquisitions or even liquidation of the insurance undertakings can be expected.

The selected indicators of the market concentration are shown in Figures 34-37 (the data for Kosovo was not available). Figure 34 illustrates that in 2019 Montenegro continued to have the highest market share of the largest company (35.0%), which is the successor of the monopolistic state company that existed in the earlier country’s economic and political system.
Figure 34. Market share of the largest company on the SEE insurance markets in 2019 (%)

With regard to the criterion of the market share of the largest company, Montenegro was followed by Serbia (26,4%), Slovenia (26,2%), Croatia (25,9%), and Albania (24,1%), while in other countries the largest insurance company covered between 4,3% (Ukraine) and 17,3% (Romania) of the market. For comparison, average market share of the largest company in the IE members was 8,0% in 2019.

Furthermore, Figures 35 and 36 refer to market shares of three and five largest companies, respectively.
It can be noticed that in all analysed countries three largest companies covered more than 25% (a quarter of the market or more), and five largest companies covered more than 35% of the total markets (around a third of the market or more). The only exception was Ukraine as regards both parameters.
More precisely, the parameters linked to the market share of the three and five largest companies in the case of Ukraine were 11.8% and 18.3%, respectively. These shares were far less than the SEE average shares, 38.1% and 47.1%, respectively.

The participation of small companies in the markets can be approximated by the number of companies with market share less than 3%, as shown in Figure 37.

![Figure 37. Number of companies with market share less than 3% on the SEE insurance markets in 2019](image)

The total number of companies with the market share less than 3% in the observed countries was 402. Ukraine had the largest number of these companies (228), followed by Turkey (49) and Greece (40). The number of these companies declined over the last years as a consequence of mergers and acquisitions as well as bankruptcies caused by the global financial crisis and subsequent recession.

In 2019 the average share of the largest company for the 12 observed markets of the SEE region was 14.4%, while the average share of the three and five largest companies was 38.1% and 47.1%, respectively, as mentioned before. In order to make comparison to the IE member states, the average share of the largest company in the last ones was 8.0%, as also already mentioned. The parameters regarding the three and five largest companies were 20.1% and 26.8%, respectively. Therefore, the selected indicators of the market concentration for the SEE region and their comparison to the IE members point to more concentrated insurance markets in the SEE region than in the developed part of the Europe.

Figure 38 represents the structure of the insurers according to the type of insurance they were focused on.
From the Figure 38, it can be noticed well-known dominance of nonlife insurers (386) over life and composite insurers (96 and 54, respectively). Exceptions were Slovenia and Croatia, where composite insurers had a prevalence. However, a composite type of insurers is prohibited in some countries; in other words, life and nonlife insurance have to be separated. As a consequence, it is easier for small domestic insurers to conduct their activities in the nonlife than life insurance lines of business. That is why the life insurance business on the SEE insurance markets is mostly “in the hands” of the insurers that come from the EU. Additionally, on the one hand, a low level of capacity competition of the domestic companies in life insurance business forced them to focus on less profitable – nonlife insurance business. On the other hand, efficiency of foreign insurers was reduced by the lack of insurance culture and predominant interest of the insurers in auto insurance, especially in mandatory MTPL insurance.

Figure 39 illustrates the shares of life, MTPL, and other types of nonlife insurance on the selected markets in 2019.
The share of life insurance in the total premium of the SEE insurance markets was 24.0%, while MTPL covered 25.3% and other nonlife 51.4%. More analytically, a high share of MTPL insurance on the market was evident in Albania (63.9%) and Kosovo (58.0%), and BiH (49.7%), while a contribution of the MTPL to the total premium in the other SEE countries was less than 50%, as it can be seen from Figure 40.

Figure 39. *Share of life, MTPL and other types of nonlife insurance premium on the SEE insurance markets in 2019*

<table>
<thead>
<tr>
<th>Country</th>
<th>Share of Life (%)</th>
<th>Share of MTPL (%)</th>
<th>Share of Other (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>6.9</td>
<td>63.9</td>
<td>29.1</td>
</tr>
<tr>
<td>BiH</td>
<td>20.8</td>
<td>29.0</td>
<td>50.2</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>17.1</td>
<td>45.4</td>
<td>37.4</td>
</tr>
<tr>
<td>Croatia</td>
<td>31.8</td>
<td>49.5</td>
<td>18.7</td>
</tr>
<tr>
<td>Greece</td>
<td>19.3</td>
<td>58.0</td>
<td>22.7</td>
</tr>
<tr>
<td>Kosovo</td>
<td>4.5</td>
<td>40.1</td>
<td>55.4</td>
</tr>
<tr>
<td>Montenegro</td>
<td>18.1</td>
<td>43.4</td>
<td>38.5</td>
</tr>
<tr>
<td>North Macedonia</td>
<td>17.3</td>
<td>39.4</td>
<td>43.2</td>
</tr>
<tr>
<td>Romania</td>
<td>20.5</td>
<td>43.8</td>
<td>35.7</td>
</tr>
<tr>
<td>Serbia</td>
<td>23.3</td>
<td>59.1</td>
<td>17.6</td>
</tr>
<tr>
<td>Slovenia</td>
<td>30.0</td>
<td>56.6</td>
<td>13.4</td>
</tr>
<tr>
<td>Turkey</td>
<td>16.4</td>
<td>79.9</td>
<td>1.7</td>
</tr>
<tr>
<td>Ukraine</td>
<td>8.7</td>
<td>10.9</td>
<td>80.2</td>
</tr>
</tbody>
</table>
For the purpose of comparison, an average share of the MTPL insurance in the total premium of the IE members was only 4.9% and the share of the other nonlife insurance was 39.3% in 2019. The share of life insurance in the total premium of the Insurance Europe was the highest, of 55.8%, as mentioned at structure of the insurance premium.

The final figures regarding the introductory (general) considerations of the SEE insurance markets represent the numbers and market share of companies with the majority of domestic and foreign ownership for the seven countries with available data – BiH, Croatia, Kosovo, Montenegro, North Macedonia, Serbia, and Turkey. Except in BiH and Kosovo, foreign insurers were prevalent in the observed markets (see Figure 41).
However, when it comes to the foreign insurers, there were many examples of insurers from one SEE country, such as Slovenia and Croatia, operating on the markets of other countries of the region, like BiH, etc.

Considering the market share of the companies with majority of domestic and foreign ownership, it can be stated that in 2019 the foreign insurers continued to participate with more than 50% in the total premium in the observed markets with the available data – BiH, North Macedonia, Serbia as well as Turkey (see Figure 42). The largest market share of foreign insurers was repeatedly registered in North Macedonia, where foreign insurers covered 88,4% of the market.

Figure 41. Number of companies with majority of domestic and foreign ownership on the SEE insurance markets in 2019
On the whole, or taking into consideration all aforementioned about the SEE insurance markets, one could gain a knowledge and understanding of similarities as well as differences among SEE insurance markets. A key determinant of the markets is undoubtedly its general underdevelopment compared to the IE member states (relatively 2,1% in terms of the insurance premium of the IE), especially because of the predominantly contribution of one single country – Turkey. Nonetheless, based on data regarding the SEE banking sectors’ assets size as well as the deposit potential, it is clear that there is a great potential for the growth of the (re)insurance undertakings, especially those related to life and other non-life insurance.

The COVID-19 crisis has influenced the insurance industry mainly through insurers’ investments and to a lesser extent on claims. Considering that MTPL is dominant, which is mandatory, so the crisis have had no significant impact on this the SEE insurers’ line of business. They have continued with their business operations without any disruptions, but significant consequences of the crisis have felt by the life insurers, or in the life insurance line of business, due to massive layoffs, business shutdowns, salary cuts or, in general, uncertainties about future economic conditions. When it comes to claims payments, significant implications have recorded for an increased number of cases of business cessation, unemployment, and deaths (e.g. health insurers are likely to experience a significant number of claims related to COVID-19, but this will be mitigated by deferral of nonurgent medical procedures). Therefore, it could be expected lower level of the insurers’ profitability in coming years compared to the previous period. A decrease in profitability in life insurance will be higher than in non-life insurance. Also, from the aspect of digitalization, insurance companies have used models based on on-line communication in their organizational hierarchies to more extent and very quickly adapted themselves to the changed customer behaviour; in other words, the insurers have adapted their business models to ongoing
changes in the environment caused by the pandemic, which in some lines of business has resulted in reducing operating costs and rationalizing expenditure.

* * * * *

OTHER RELEVANT FINANCIAL INSTITUTIONS IN THE FINANCIAL SERVICE INDUSTRIES

Based on the previously mentioned reports related to the banks and/or insurance companies, the contributions of the other relevant, existing financial institutions to the financial service industries in all SEE region countries, except Greece and Ukraine (for which overall data was not available), over the period 2007-2019 can be illustrated as shown in Figure 43.

![Figure 43](image)

Figure 43. Contributions of the other relevant financial institutions to the financial service industries over the period 2007-2019 (%)

The shares of the other financial institutions on the most selected markets were increased or relatively stable. Only BiH was continuously showing a downward trend.
It should be emphasized that the following more detailed data on the other financial institutions in the SEE countries’ financial service industries was collected from the official reports published by their relevant national supervisory institutions for 2019. The PART II of this report includes the segments related to these institutions consisting of data for several recent years.

However, since the reporting on the individual countries’ level for these institutions is not well organized and data is not well structured, like in case of the banks and the insurance companies, for some countries there is missing data for 2019 or before. For that reason below it is presented a descriptive overview of other relevant financial institutions by each country (starting from the country with the largest to the country with the smallest share and, then, Greece and Ukraine), in order to shed some lights on this part of the industries, though much smaller than banking part. In fact, it will be highlighted specifics of other financial intermediaries and the range of their activities in particular SEE financial service industries.

Pension funds, micro-credit organizations, and leasing companies, as other relevant financial institutions in Kosovo, participated with a share of near a third of the Kosovo financial structure (31,6%) in 2019, slightly up from the previous year (30,9%) and it was the highest share of other relevant financial institution in the SEE countries’ financial structures. “Kosovo Pension Savings Trust” (“Trusti”) was established in August 2002 to administer and manage mandatory and voluntary pension contributions of Kosovo employers and is supervised by the Central Bank of Kosovo (CBK). Since 2008, there were two pension fund management companies – “Trusti”, with an exclusive mandate to administer compulsory pension contributions (second pillar), and the “Slovenian Kosovo Pension Fund”, licensed also by the CBK to administer only voluntary pension contributions of Kosovo employers and is supervised by the Central Bank of Kosovo (CBK). Pension funds mostly invested abroad (84,7%). In 2019 the pension sector was characterized by an accelerated annual growth of assets of 17,0%, so that the total value of its assets reached EUR 2,0 billion. The vast majority of microfinance institutions in Kosovo has non-governmental organization (NGO) status. They are supervised by the CBK. The leasing sector is at early stage of development and the Raiffeisen Leasing Kosovo is still the only financial institution that offered this kind of financial services in the country. The main activity of this leasing company is to provide financial leasing for vehicles, equipment or machinery as well as real estate.

In 2019 slightly more than a quarter of the financial service industry (26,5%) in Croatia was made up of other relevant financial institutions, such as pension and investment funds, credit unions, and leasing companies. The share slightly up from the previous year (25,3%). Since 2002 the Croatian pension insurance system has based on individual capitalized savings, i.e., the establishment and management of mandatory and voluntary pension funds (known as pension insurance pillar 2 and 3). In 2019 there were 12 mandatory pension fund, which belonged to the one of the three categories (A, B or C), and 28 voluntary pension funds, which were functioning as open-end (8) and, more frequently, closed-end type of investment funds (20). In the same year mandatory pension funds invested 98,7% of their assets in securities and deposits, out of which the most in domestic government bonds (83,0%). Also, while voluntary open-end investment funds had 93,2% of the investment structure in securities and deposits (out of which 54,2% in domestic government bonds), voluntary closed-end funds had 93,6% in the same items (out of which 48,6% in domestic government bonds). There were 131 investment funds of two types in Croatia in 2019 – 96 open-ended investment funds with public offering (UCITS) and 35 alternative investment funds. UCITS funds predominantly invested in government bonds (74,3%), then deposits (9,5%), shares and global depositary receipts (8,6%), UCITS funds (3,5%), money market
instruments (3.4%), and corporate bonds (0.7%). With regards to the country of the origin of issuers, these funds continued to invest the most in domestic securities (74.1% in 2019). Moreover, credit unions nowadays play the role of micro-credit organisations in Croatia. As a result of the initiative of nine credit unions, the Croatian credit unions association was established on July 1, 2011, in order to achieve mutual interests. Further, at the end of 2019 leasing operations in Croatia were carried out by 14 leasing companies, compared to 16 companies in 2018. The majority of leasing companies in Croatia belong to the group of financial institutions and they traditionally offer financial as well as operational leasing services/products. In 2019 the most of the leasing contracts repeatedly referred to financial leasing of passenger cars, commercial vehicles, plants, machinery, transport machines, and equipment. The most frequent users of leasing products were non-financial institutions, that is, companies.

When it comes to Romania, 21.8% (slightly more than a fifth) of the assets in the financial industry were possessed by other relevant financial institutions in 2019, a bit more than in the previous year (20.6%). Continuously there were 17 pension funds, out of which 10 voluntary and seven mandatory, which functioned on the market. They invested 61.1% of the assets in government securities. Apart from pension funds, 159 investment funds operated in Romania in 2019, out of which 135 were open-end and 24 were closed-end. The number of the non-bank financial institutions in the General Register increased from 177 in 2016 to 183 in 2017, then decreased to 178 in 2018 and dropped marginally to 177 in 2019. Their primary activities were multiple lending activities, more precisely, 86.4% of the non-bank financial institutions’ activities in 2019.

The share of other relevant financial institutions in the financial service industry of Bulgaria was significantly lower than in Croatia, at the level of 17.5% in 2019 and slightly increased compared to 2018 (16.7%), after a drop compared to 2017 (17.2%). Similar to abovementioned countries, in 2015 Bulgaria adopted the WB three-pillar model with a mandatory state pillar, a mandatory funded pillar, and a voluntary supplementary third pillar. The supplementary pension insurance was implemented by participation in mandatory universal and/or professional pension funds, supplementary voluntary pension funds, and/or supplementary voluntary pension funds with occupational schemes, which were established and managed by pension insurance companies licensed by the Financial Supervision Commission. At the end of 2019, the structure of the pension insurance market remained unchanged compared to the previous period (2016-2018), in terms of the number of licensed pension companies (9) and the number of pension funds (28). They invested dominantly in debt securities, issued or guaranteed by the EU member states or by their central banks (59.3%). As far as Bulgarian investment funds are concerned, they can be classified into two broad groups – resident and non-resident. Regarding the investment funds’ portfolio structure, it is interesting that the funds mainly invested in shares and other equity (40.7%), then securities other than shares (35.2%), and then deposits (12.3%) and other investment funds’ shares/units (10.7%). Furthermore, in the portfolio of Bulgarian leasing companies the highest share had loans (85.5%), followed by “other assets” different from shares and other securities (14.0%). Much more leasing contracts were financial (94.9%) than operational (5.1%), on the observed four-year continuity. The object of both type of leasing contracts were usually cars, transport and commercial vehicles as well as machinery and industrial equipment.

In North Macedonia 15.1% of the assets in the financial service industry referred to other relevant financial institutions in 2019, which was a slight increase from 13.9% registered in the previous year. The fully funded pension insurance included three pension companies. The
companies managed three mandatory pension funds and two voluntary pension funds. They mostly invested in bonds of domestic issuers. Further, investment funds continued to have small contribution among institutional investors (that is, 1.3%, whereas the pension funds had the share of 11.5%, and the insurance companies contributed with 3.5%). In 2019 there were five investment funds management companies operating in Macedonian economy managing 16 open-end funds (and no closed-end fund). The existing funds invested the highest share, 39.5%, of the assets in deposits. In 2019 the number of leasing companies was seven and it did not change compared to the previous years. Unlike the years after 2008, when the scope of activities of this sector was continuously decreasing, the total assets of the leasing companies increased by 19.9% in 2017, by 24.9% in 2018, and then by 14.3% in 2019. All companies were with 100% foreign capital but the leasing market was still underdeveloped. The largest volume of outstanding leasing contracts was for non-financial corporations, but almost all were for vehicle financing and only one leasing company provided equipment leasing. Also, there were two saving houses and 19 financial companies on the market, relatively small according to the volume of their activities. Most of the growth of the financial companies’ activities arose from lending to individuals.

When we analyse the financial structure of Slovenia, we can notice that 11.3% of the structure was related to other financial institutions in 2019, which remained relatively stable compared to the previous years. The "First Pension Fund" (PPS) represents a special type of a pension fund designed to cover for payments of pension annuities from insurance policies under supplementary pension insurance and is managed by "Modra Zavarovalnica" d.d., which activities are defined by the law and the Company's Articles of Association. Regarding the investment funds, at the end of 2019, five management companies operated, which managed six umbrella funds with 99 sub-funds and one mutual funds. The Leasing Committee, established as a leasing office within the Bank Association, represents the leasing industry in Slovenia. Related to the leasing activities, there were relevant trends in 2017 such as the sale of the portfolios of the leasing companies, the sale of certain leasing companies, the specialisation of the member institutions, the changes in business models, etc. As it was the case in the previous years, in 2019 the leasing business grew in the segment of automotive and equipment financing.

In Albania the share of other relevant financial institutions in the overall assets circulated in the financial industry was 8.8% in 2019 and it slightly went up compared to the 2018 (7.8%). There were three voluntary pension funds and they invested mostly in government securities (e.g. treasury bonds and bills). Also, six investments funds operated on the market. According to the official data, in 2019 they invested 66.8% of their assets in government bonds, 14.2% in treasury bills, 10.3% in cash and cash equivalents, 4.2% in other investments, 1.1% in corporate bonds, and 0.2% in other assets. In 2016 through the mergers, by absorption, the process of the reorganization of 98 existing saving and loans associations finished. At the end of 2017 there were 13 saving and loans associations and one union savings and loan associations and no new licenses were granted until 2019, when one new saving and loans association was licenced. Micro-credit organizations (or microfinance institutions) as well as leasing companies operated on Albanian financial market. Regarding the object of the leasing, in 2019 the leasing portfolio was dominated by financing for personal transport vehicles (40.9%) and working transport vehicles (20.4%). The leasing sector registered the highest growth to EUR 93.5 million in this year.

The contribution of other relevant financial institutions in Turkey's financial service industry was equal to the Albanian share, 8.8%, and it went up from 7.5% in 2018. The number of active pension funds was 408, which were managed by 17 pension companies. At the end of 2019 total amount
of the pension funds’ assets reached 2.8% of the GDP. Insurance and Private Pension Regulation and Supervision Agency was established in 2019, to conduct duties regarding the regulation and supervision of the insurance and private pension sectors. Moreover, in 2019 on the market operated 482 investments funds. The funds mostly invested in private sector debt securities. Also, there were 23 leasing companies on the market in 2019. While the share of financial leasing receivables (net) in the aggregate leasing companies balance-sheet was 83.3%, a main object of the leasing contracts were real estate (23.6%), followed by “other machines and equipment”, and “heavy equipment and construction machinery” (20.9% and 12.3%, respectively). However, the supply of microfinance services in Turkey was still very limited, both in terms of the numbers of citizens served and the range of services offered.

In BiH the share of other relevant financial institutions financial system was 5.9% in 2019 and it was showing a downward trend since the outset of the global financial crisis 2008. Despite the entities’ strategies for pension reforms created in conjunction with the WB experts and adopted in 2007, the pension fund reform in BiH is still not over and in practice it has actually been stopped. However, in 2017 the first voluntary pension fund management company was founded and the first voluntary pension fund (“European Voluntary Pension Fund”) started to operate. Regarding the investment funds, until the end of 2018 all closed-end investment funds in Republic of Srpska were transformed in open-end investment funds and their owners became owners of the new open-end investment funds. Thus, six investment companies operated in this BiH entity in 2019 and managed by 19 open-end investment funds. Also, there were eight closed-end and eight open-end investment funds in the Federation of BiH in 2019. The micro-credit sector of BiH has played a significant role in reducing poverty and supporting the development of entrepreneurship among the socially vulnerable parts of the population, which have no access to financial resources at traditional banks. The results achieved for the period since the establishment of the micro-credit sector rank BiH among the countries of the world that have gone further in the development of this area of financial offer. In 2019 on the BiH market 27 micro-credit organizations were functioning, out of which 14 operated as micro-credit companies and 13 as micro-credit foundations. They invested mostly in the net loans (in Federation BiH 79.9% of their assets and 81.1% in Republic of Srpska). When we consider the portfolio of five BiH leasing companies, whose registry offices are in the Federation BiH, 88% of all arrangements were financial and 12% operational leasing. The object of the leasing were mainly passenger vehicles and vehicles for business purposes and, consequently, the users were mainly individuals and legal entities. There also were eight brokerage houses in the financial service industry of BiH in 2019.

When it comes to Serbia’s financial service industry, we can state that the role of the third group of financial institutions – other relevant financial institutions – has still not been recognized. Only 3.3% was the share of other relevant financial institutions in Serbian financial structure in 2019 and it stayed relatively unchanged compared to the previous year (3.1%). The pension reform finished in 2006, since then only voluntary pension funds have been operating. Four companies managed seven voluntary pension funds, one custody bank, five intermediary banks, and one intermediary insurance undertaking. As far as the investment structure of the pension funds is concerned, they invested 78.2% of their assets in the government debt securities in 2019. Besides, there were two types of investment funds on the market – (a) open-end investment funds with public offering and (b) alternative investment funds. In total, 18 investment funds on the market in 2019 mostly invested in short-term and cash deposits (70.3%), more in domestic currency (58.0%) than euro (42.0%). Micro-credits in Serbian financial system are approved exclusively by
banks, and money control is carried out by UNHCR donors and tax authorities. Moreover, 17 financial leasing companies existed on the market and their financing of commercial vehicles, minibuses, and buses continued to account for the largest share (39.9%), followed by the financing of passenger vehicles (36.5%). Other lease assets had a share less than 10.0%.

As in the case of Serbia, Montenegrin sector of other relevant financial institutions is still underdeveloped. Its contribution was only 3.0% in 2019. Since 2002 it has been relatively stable or even in decline, except a slight increase in 2018 compared to 2017 (from 2.4% to 3.1%). Two voluntary pension funds operated in Montenegro but in 2019 the Capital Market Commission of Montenegro ordered the court liquidation of both of them. Four closed-end and three open-end funds operated in the industry of the investment funds. They invested 80.6% of their assets in securities. Seven micro-credit organizations invested 66.4% of the assets in loans, out of which 95.5% to loan to citizens. Moreover, in 2019 only two leasing companies continued to conduct their businesses, out of four in previous years.

Although in Greece there are also three pillars of the pension system, the first pillar on the social security accounts for more than 99% of its whole system. Voluntary occupational and private pension plans existed in 2019, but they still were of minor importance. Greek UCITS included two basic types of collective investment undertakings – (a) mutual funds and (b) variable capital investment companies. Both fund types were open-end. According to type, in 2019 out of 327 mutual funds, 102 were bond, 80 funds of funds, 78 equity, 45 balanced, 13 specialized, nine variable net asset value money market, and three money market. The existing Banking Law requires a minimum capital of EUR 18 million to carry out financial or credit activities. A partnership with a licensed bank is required by all legal entities such as NGOs (including associations, foundations, etc.) that are interested in serving the micro-credit market. Among other relevant financial institutions, in 2019 in Greece operated leasing as well as factoring companies.

Other relevant financial institutions in Ukraine involve pension funds, investment funds, credit unions as well as leasing companies. Pension reform was introduced in October 2017. This reform has been one of the IMF’s key demands for Ukraine in order to release an USD 8.4 billion tranche of finance, part of its USD 17.5 billion loan program. However, according to a survey, 49% of Ukrainians do not support the pension reform. In 2019, 1,326 investment funds operated on the market and 38.1% of their assets was invested in corporate bonds, followed by equities (32.7%) and promissory notes (21.8%). Like in Turkey, microfinance in Ukraine is not developed and the microfinance segment is mostly served by banks or credit unions, though NGOs are present on the market. Credit unions are the main non-bank financial institutions serving the financial needs of small and medium enterprises. The overall size of the credit union segment is very small, relative to the financial system. Similarly, the leasing market has been developing slowly. In 2000, the overall contribution of the leasing assets was registered at the level of 1.0% (the lowest in Europe). Vehicles (cars, trucks, LCV) were still the main subject of leasing in Ukraine, comprising more than 70% of all items leased during 2017. Ukrainian leasing market is rebuilding slowly after a sharp drop of 42% in leasing agreements in 2015. Lessors were mostly interested in the leasing of equipment that is highly liquid and can be easily repossessed and resold. At the end of September 2019, 337 credit unions operated in Ukraine. In 2020 all credit unions closed on government orders in response to the COVID-19 pandemic. Banks and insurance companies were allowed to remain open, but credit unions were forced to close because they do not offer on-line
financial services. In a report on the situation, the World Council of Credit Unions highlighted the poor state of digital infrastructure in the Ukrainian credit union industry.

On the whole, considering the other financial institutions in the SEE countries’ financial structures in 2019 we can conclude that there was a wide spectrum of various types of financial institutions other than banks and (re)insurance companies, such as investment funds and voluntary pension funds, leasing companies, micro-credit organizations (or microfinance institutions), credit unions, saving and loans associations, brokerage houses, factoring companies, etc. Their share(s) ranged from 3,0% in Montenegro and 3,1% in Serbia to 31,6% in Croatia, followed by Kosovo (26,5%) and Romania (21,8%). Knowing the fact about bank centricity of the financial service industries, as we could assume, the investment potentials of other relevant financial institutions in the SEE region countries are still extremely below the banks. As in the case of banks and insurers, the ongoing COVID-19 crisis has impacted on the other relevant financial institutions in terms of imposed lockdowns and temporarily pauses of their activities. The special issue is related to their limited capabilities for digital transformation. Also, in coming years the other relevant financial institutions could face deterioration in granted loans (they also approved moratoria in the outbreak of the pandemic crisis) as well as lower returns on investments in the financial markets.

**IMPLICATIONS OF CORONAVIRUS COVID-19 PANDEMIC CRISIS FOR THE SEE ECONOMIES AND THE MOST VULNERABLE AREAS**

To the unprecedented circumstances, with the intention of protecting economic prosperity, the governments of the SEE countries (i.e., policy-makers and decision-takers in these governments) responded rapidly through the instruments of the monetary and fiscal policies. Their central banks cut the policy rates to maintain liquidity of banks and non-bank financial institutions, which in turn had to ease the burden on companies and individuals caused by the health emergency. Moreover, the regional governments gave financial supports to the health sectors for purchasing medical equipment, approved fiscal stimulus packages in order to support companies through temporarily subsiding wages (salaries) of their employees, and provide social assistance benefits to unemployed individuals as well as the most vulnerable households.26 However, the economic relief (support) packages will lead to fiscal deficits and accumulations of debts in the SEE countries, which rose from the global financial crisis in 2008 to 2016 and started to drop thereafter, but generally still not reaching the pre-crisis level (see Figure 44).

Although the events that triggered the pandemic crisis and the global financial crisis (i.e. the subprime meltdown) were completely different, these crises share many similarities; for example, they both required massive public financial interventions. As demonstrated by the global financial crisis, strong government interventions are needed to prompt economic recovery. This new course of action in 2008 came after years of austerity measures, balanced budget initiatives, tax cuts, etc. In other words, Keynesian ideas were rediscovered. Another important lesson from the global financial crisis that can help the governments to manage the novel crisis was that national public policies are vulnerable to external events (or decisions occurring elsewhere). The


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governments must be prepared to work collaboratively with other governments (international, national, and subnational) and various other stakeholders in an uncertain environment.  

As shown in Figure 44, the general government gross debt (as percent of GDP) across the SEE region countries in 2019 ranged from 17.5% in Kosovo and 18.6% in Bulgaria to 79.3% in Montenegro and even 180.9% in Greece. The SEE average debt-to-GDP ratio (57.6%) was still pretty below the EU average (79.2%).

A sector of the SEE economies most affected by the coronavirus COVID-19 pandemic crisis is tourism (especially small tourism businesses), where employment has declined remarkably.  

Tourism covers, of course, a wide range of industries such as transport and tour operators (aviation, cruise, railways, tour operators), accommodation and food service (hotels, shared accommodation platform economy, holiday resort, restaurants), and other sectors (business, meetings, and events travel; culture, sports, and entertainment; tour guides; travel technology

Figure 44. General government gross debt (% of GDP) over the period 2002-2019


28 According to the United Nations World Tourism Organization, due to restrictions on travel, low consumer confidence, and a global fight the novel virus, international tourist arrivals fell by 72% over the first ten months of 2020, which is worst year recorded in the history of tourism. More details can be found on: https://www.unwto.org/taxonomy/term/347, Accessed: December 26, 2020.
After tourism, given the high influence by the pandemic, come transport, manufacturing, construction, real estate activities, and wholesale and retail trade. In the second quarter of 2020 around 139,000 workers lost their jobs in the WB6, half of them in Albania and Serbia. A number of layoffs would be even bigger without wage subsidy programs (schemes) implemented. Details about these programs across the SEE region are contained in Table 1.

Table 1. Wage subsidy programs in the SEE countries during the pandemic crisis

<table>
<thead>
<tr>
<th>Country</th>
<th>Specifics of the wage subsidy program</th>
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<tbody>
<tr>
<td>Albania</td>
<td>The initial wage subsidy program was for the small businesses and the self-employed and then was expanded to over 75,000 business and self-employed that together had 170,000 employees. The total cost was EUR 76 million. A credit guarantee scheme (EUR 85 million) was introduced for SMEs to pay three months of wages (100% coverage with the interest paid by the government), which enabled local banks to issue loans totalling EUR 53 million for wages to 550 companies, benefiting approx. 46,000 employees.</td>
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<tr>
<td>BiH</td>
<td>Given the high level of fiscal decentralization, BiH had several different programs at subnational levels. Complete data is not available, but for April through June 2020, BiH spent an estimated EUR 70 million on wage subsidy programs, supporting over 460,000 employees – more than a half of the registered employment. The amount per worker ranged from EUR 101 (half of the minimum wage if laid off due to restrictions) to EUR 203 (if forbidden to work by the government).</td>
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<tr>
<td>Bulgaria</td>
<td>The key government support measures include as follows: „60/40 wage subsidy“, financial support for the tourism sector (approved employers received a monthly fixed wage subsidy approx. EUR 145 per employee), the project &quot;Employment for You&quot;, miscellaneous social security measures, and miscellaneous financial support for the agriculture sector. Under the 60/40 wage subsidy measure was paid out approx. EUR 320,47 million, which preserved 250,000 jobs. Under the 80/20 measure, for hotels, restaurants, tourism, and transport jobs, was paid out approx. EUR 11,76 million, which preserved 24,858 jobs. With regard to targeted assistance for families with children studying remotely, there were 40,000 applications and 23,520 families were approved. The term of the measure 60/40, introduced by the State of Emergency Act, was extended to September 2020, and for some sectors – until the end of 2020. For the transport sector, the measure will reach a ratio of 80/20.</td>
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<tr>
<td>Croatia</td>
<td>Job retention was immediately characterized as one of the government’s main goals. The measures for reducing the rate of unemployment caused by the COVID-19 pandemic included the following: subsidized wages for employees in affected sectors; the discontinuation of existing employment and self-employment subsidies to secure additional funds to preserve employment in affected sectors; and the extension of subsidies for permanent seasonal workers. In practice, for most Croatian employers this meant compensation of wage costs in the amount of approx. EUR 530 per employee for April and May 2020. The subsidy for March 2020 was approx. EUR 430 per employee, which was the minimum wage in Croatia, while the second package of measures brought an upgrade. Further, the state also covered wage contributions up to approx. EUR 195. The projected cost of these measures for April and May 2020 was approx. EUR 1.100 million. Subsidized salaries were used for 480,000 employees.</td>
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<tr>
<td>Greece</td>
<td>Greece was one of several countries in Europe adopting job-retention approaches that experienced similar trends in the early months of the crisis. Many furloughed workers in Greece may have continued to be counted as “employed” but were, in fact, not working – even though measured employment in Greece fell by only 3% in the second quarter of 2020, working hours declined by 19%. Greece introduced a temporary STW scheme (Syn-Ergasia) effective from June 15, 2020, to October 15, 2020. The scheme was available for employers who experienced at least 20% loss in revenues during the</td>
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month(s) prior to the participation. The European Commission approved EUR 500 million Greek scheme to support self-employed individuals, including self-employed managers of small companies in sectors affected by the coronavirus outbreak.

<table>
<thead>
<tr>
<th>Country</th>
<th>Details</th>
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<tbody>
<tr>
<td>Kosovo</td>
<td>Subsidies covered private sector wages for two months at a net of EUR 170 per month with additional subsidies for pension contributions for the same period. Informal employees registered for the first time received EUR 130 per month. Employees in essential businesses like food retailers, pharmacies, and bakeries received bonuses of EUR 100 per month for two months. More than 130,000 employees received wage subsidies since the pandemic outbreak.</td>
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<tr>
<td>Montenegro</td>
<td>Wage subsidies ranged from 100% of the gross minimum wage for closed sectors during lockdown and for tourism to 50% for the other sectors. They were in place for April and May 2020, and later extended for closed sectors (100%), tourism (70%), hospitality, and transport (50%) until September 2020. The subsidies also covered 50% of the gross minimum wage for employees in quarantine or isolation and parents taking care of children under 7, and 70% of the gross minimum wage for six months for newly formal employees. The subsidy programs supported over 64,000 employees.</td>
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<tr>
<td>North Macedonia</td>
<td>The wage subsidy was EUR 235 per employee (the net national minimum wage) for April-June 2020. Only companies whose revenues were down at least 30% were eligible. Companies in tourism, hospitality, and transport also received subsidies of 50% of social contributions. The subsidy benefited approx. 20,000 companies (1/3 of all active companies) with 130,000 employees (1/3 of all private sector employees). The total cost was about EUR 80 million (or approx. 0.7% of the GDP).</td>
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<tr>
<td>Romania</td>
<td>Romania received a loan of EUR 400 million from the WB to reduce the socio-economic impacts of the coronavirus. Employees of the companies that recorded losses of at least 25% due to the COVID-19 pandemic received 75% of their basic wage during technical unemployment. The government provided subsidies worth EUR 200,000 to companies that changed their activities to start producing sanitary products, such as masks and disinfectants.</td>
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<tr>
<td>Serbia</td>
<td>Provided wage subsidy coverage for five months (May-September 2020) at a minimum of EUR 255 for the first three months and 60% of that (or EUR 155) thereafter. Approximately one million employees benefitted (or approx. 37% of the total employment). The total cost was EUR 1,130 million (or approx. 2.4% of the GDP). In addition, during 2021 the government has decided to pay 50% of the minimal wage for three months to all private firms.</td>
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<td>Slovenia</td>
<td>During 2020 the Slovenian government announced seven mitigation measures in response to COVID-19 (so-called PKP1, PKP2, etc.), estimated approx. EUR 7,000 million. In total, over 2 million users were intended. It turned out that the government helped to save 150,000 to 200,000 jobs in the economy. Additionally, it helped 51,500 sole proprietors, partners, cultural workers, and farmers. Assistance was provided to high school and university students, pensioners, the self-employed, farmers, large families and, of course, the economy and healthcare.</td>
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<tr>
<td>Turkey</td>
<td>In March 2020, the Turkish government announced an approx. EUR 11.070 million economic shield plan to help businesses ride out the economic storm caused by the COVID-19 pandemic. The plan introduced a set of new measures ranging from tax cuts and payment deferrals for tax liabilities of businesses, to increase minimum pension payouts. Apart from these measures, certain financial support measures were also announced by various the government entities to aid struggling businesses. Further economic stimulus actions followed to ensure the provision of sufficient liquidity to the markets by Turkish banks. Moreover, a complementary budget of approx. EUR 222 million was earmarked for families in need, while approx. EUR 775.2 million was earmarked in support for workers with minimum wage.</td>
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<tr>
<td>Ukraine</td>
<td>The government created a temporary stand-alone budgetary program under the Ministry of Finance to fight the pandemic. This program allowed for a greater flexibility in the reallocation of funds to quickly accommodate changing priorities. Several measures were introduced to support business. Parliament adopted legislation increasing the thresholds for the simplified taxation regime. A holiday was introduced for SMEs for the payment of social security contributions until May 31, 2020 (which did not impact the accrual of their pensionable service). To support households, parliament adopted legislation that allowed households to deduct the expense of COVID-19...</td>
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As illustrated in Table 1, the scope of the wage subsidy support varied greatly across the SEE region countries. Eligibility criteria ranged from companies forbidden to work by government (like in BiH) and those whose revenues went down at least 20% (like in Greece) to sole proprietors, cultural workers, farmers, etc. (like in Slovenia). The subsidy per employee varied from EUR 120 to EUR 530 depending on the country’s ability to secure fiscal space. No SEE country limited support to specific sectors, but Bulgaria, Montenegro, Albania, and North Macedonia offered more favourable terms to tourism, transport companies, and/or agriculture sector.


medicine from the calculation of personal income tax. The government introduced a one-off pension increase to low-income pensioners of approx. EUR 37,8 in April, 2020, and a regular monthly EUR 18,9 pension top-up for retirees aged 80 years or more (incorporating seniors 75+ with approx. EUR 15,1 top up starting July, 2021). In preparing for the January 2021 lockdown, the legislature supported a set of measures to prop up small businesses. If certain conditions are met (e.g. a history of contribution to the pension system is in place), eligible entrepreneurs can count on approx. EUR 302,8 in a one-off state aid and a single tax holidays through December, 2020-May, 2021. Employers affected by a lockdown can be reimbursed from the budget the amount equal to an average monthly payment of the social security, which they have been making on behalf of their employees in the ten months of 2020. Also, tax debts (up to approx. EUR 114,7) were written off. Penalties charged on overdue taxes were forgiven if the principle was paid. Introduction of the “remote work” regime, partial unemployment benefits, preferential state loans for the payment of salaries to retain staff.
Since one of the main regional governments’ goal was preserving employment, in Serbia, for example, companies that had fired more than 10% of their employees were ineligible, while in North Macedonia, for example, those that received support had to retain workers for two additional months. In some countries wage subsidy programs were complemented by development bank “soft” loans for paying wages, other countries offered support to cover social security contributions. Montenegro and Kosovo, for example, provided wage subsidies for newly registered employees in order to stimulate business and job formalization. It should be clear that there are no quick fixes for the problems caused by the pandemic as well as that the support programs for companies will need to be prolonged beyond the end of the COVID-19 pandemic. Some experts suggest five-year (or even seven-year) timescale of recovery and resilience programs, but it is still early to discuss what comes after this pandemic. Targets must be defined and performance measures laid down in governance systems to ensure public money is spent appropriately and transparently.

For the SEE region countries in 2020, the IMF forecasted more severe recession (“history's first deliberate ‘lockdown recession’”30) than the 2008 recession. The SEE economies should contract by 6%, with national estimates ranging from a low of 3% in Serbia to highs of 9% in Croatia as well as Montenegro, and 10% in Greece. For other SEE countries, the IMF estimated a decrease of 4% of GDP in both Bulgaria and North Macedonia; 5% in each Albania, Kosovo, Romania, and Turkey; 6,5% in BiH, 6,7% in Slovenia, and 7,7% in Ukraine.31

It should be emphasized at this point that fragility of the SEE region countries economies in the time of the coronavirus COVID-19 pandemic was deteriorated for several reasons.32 The first reason was the high pre-existing (i.e. pre-pandemic) unemployment rate. As illustrated earlier, in 2019 unemployment rates in Greece and the WB6 averaged in the high teens (compared to the EU-28 average of 6,3%), with youth unemployment twice that level (in comparison to the EU-28 average of 14,2%). The pandemic crisis will exacerbate this situation as businesses go bankrupt and more workers are laid offs. The second reason was several tourist-dependent countries as mentioned above. The third one was broad reliance on remittances as a safety net. Fourthly, and last, although the public revenues sharply fell, the regional governments adopted economic relief packages to help companies, households, and individuals get through the pandemic crisis, which put pressure on regional budget balances and debts.

Therefore, rebuilding budget and debt stability has to be a high priority across the SEE region in the new post-COVID-19 normality. There is no question that the governments will win a fight the COVID-19, but in many aspects the region, as the world itself, will no longer be the same.

FINANCIAL INSTITUTIONS’ RESPONSES TO CORONAVIRUS COVID-19 PANDEMIC CRISIS IN THE SEE REGION COUNTRIES, WITH SPECIAL FOCUS ON SMEs

The main impact of the coronavirus COVID-19 pandemic crisis on SEE region countries’ banking in the short run implied a drop in loan demand. For example, over the first months of the pandemic, people were living in some sort of (physical) isolation, which made their consumption sluggish, and credit card loans declined significantly. Tertiary sector, especially its micro and SMEs, struggled for survival during this period of time. Nevertheless, rising loan demand of health industry, such as companies producing protective equipment (e.g. respirators, surgical masks, face visors, etc.), and demand for “new consumer” loans related to e-commerce, on-line education, and procurement of office as well as sport equipment, partially alleviated downward trend in consumption.

Furthermore, under the influence of the pandemic, bank nonperforming loan ratio is likely to rise. The higher proportion of tertiary sector loans, the higher credit risk banks face. Also, interest margin in banking narrowed. It was a consequence of several influencing factors. For example, the cost of bank liabilities increased because the pandemic generally slowed down the inflows of household and enterprises deposits; the short-term loan demand drop affected bank loan bargaining power and the loan interest rates, etc.

As far as the long-term pandemic impact on banking sector is concerned, it depends on the future development of the pandemic, that is, (a) how long the virus will spread, (b) how long before the vaccine becomes widely effective, and (c) how effective policy-makers will be in mitigating the damage to our physical and economic health and well-being. The longer the pandemic lasts, the higher the credit risk which banks are exposed to. The pandemic could raise systemic risk in global banking on a higher level.

In addition to banks, the changed business conditions influenced the insurance companies in the SEE countries. They had to improve their services and direct their businesses as much as possible towards modern technological solutions. Although in previous years digital (cashless) business stood out as one of the priorities in the business of financial institutions, the insurers noted that during the pandemic the improvement of on-line services became a struggle for bare survival. Insurance companies focused on digital sales channels (as a supplement to the sales network through insurance agents or distributors), which was the biggest change in the insurance business since the pandemic outbreak. Due to the uncertain situation, clients became more interested in life and health insurance policies that cover the risk of the coronavirus disease, but sales did not increase significantly. Of all types of insurance, the biggest drop in 2020 was in travel insurance policies because citizens travelled less. Life insurance market was also hit by 2020 economic downturn, and global premiums are projected to decline by 4,5% due to rising unemployment and lower purchasing power.

In Table 2 are summarized the basic measures that central as well as commercial banks in the SEE countries took during their struggle against the pandemic. Banks play, of course, a crucial role in

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33 Because of changes in consumption behaviour, even the economies of countries which did not officially adopt "lockdown" measures were impacted (Bedford, J. et al. COVID-19 futures: a framework for exploring medium and long-term impacts. Study, pp. 7. DOI: 10.2139/ssrn.3678593).
making funds available and function as a “transmission mechanism” to support near-frozen SEE economies. Whether they behave as “the doctors of the economies” remains to be seen.

Table 2. Bank measures in the SEE countries during the pandemic crisis

<table>
<thead>
<tr>
<th>Country</th>
<th>Specificities of the bank measures</th>
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<tbody>
<tr>
<td>Albania</td>
<td>On March 25, 2020, the Bank of Albania (BoA) cut its key policy rate - the weekly repo-by 50 bps to a new historic minimum of 0.5%. To address the liquidity bottlenecks of companies and individuals, the BoA extended a temporary suspension of requirements for loan classifications and provisioning to August 31, 2020, enabling clients to ask banks to defer loan installments without penalties. Additionally, to urge the use of Internet banking and reduce the number of people requiring services in bank premises, the BoA waived the commissions for transfers in local currency. The BoA suspended dividend distribution for banks until end-2020 in order to boost capital and support lending during this period.</td>
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<tr>
<td>BiH</td>
<td>The monetary policy response to the COVID-19 pandemic was successful in stabilizing BiH financial markets. The banking agencies announced a six-month loan repayment moratorium for restructuring credit arrangements for individuals and legal entities, which were found to have aggravated circumstances for loans repayments due to COVID-19. The initial decision was adopted in March 2020, moratoria six months, grace period 6 months. The new decision was adopted in September 2020, six months moratoria, 12 months grace period – the clients had the opportunity to apply for measures until December 31, 2020. The banking agencies instructed banks to track clients and exposure portfolios affected by COVID-19. Banks were also instructed to consider additional customer relief, including reviewing current fees for services and avoiding charging fees to handle exposure modifications. All banks were ordered not to pay dividends or bonuses. The decision on bonuses payment was suspended in September 2020. In March 2021, the decision was amended and clients could apply for moratoria with expiration date June 20, 2021 and grace period December 31, 2021.</td>
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<tr>
<td>Bulgaria</td>
<td>The first thing the Bulgaria National Bank (BNB) implemented in 2020 was the capitalization of the previous year profit in the banking system (approx. 1.4% of 2019 GDP). Furthermore, it could be mentioned increase in liquidity of the banking system by EUR 3.6 billion (or approx. 6% of 2019 GDP) by reducing foreign exposures of commercial banks, and cancellation of the increase of the countercyclical capital buffer planned for 2020 and 2021 with effect amounting to EUR 0.4 billion, or approx. 0.6% of 2019 GDP. The BNB implemented agreement on a moratorium on bank loan payments for up to six months but no later than March, 2021, with deadline for requests set at end-September, 2020.</td>
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<tr>
<td>Croatia</td>
<td>The Croatian National Bank (CNB) provided additional liquidity, supported the government securities market, and temporarily eased the regulatory burden on banks. Moreover, the European Central Bank (ECB) and the CNB agreed on a EUR 2.000 million swap line. The agreement was in place until the end of June, 2021. A moratorium for three months on obligations to banks was introduced. Banks would not apply enforcement measures during this period. The Croatian Banking Association agreed to defer repayment of loans to the tourism sector until the end of June, 2021. Depending on clients’ possibilities and needs, regular interest may have been paid for the duration of the moratorium, according to the existing payment schedule, or the loan maturity may have been extended to adapt monthly loan instalments to clients’ possibilities and cash inflow.</td>
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<table>
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<tr>
<th>Country</th>
<th>Measures Taken</th>
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<tr>
<td>Greece</td>
<td>The loan moratorium measures put in place by banks and servicers, coupled with the flexibility announced by the supervisory authorities, implied that the impact of the pandemic on the quality of the banks’ loan books was limited on 2020. The moratoria were applicable for debtors affected by the coronavirus outbreak and applied to interest payments for business, and principal and/or interest for individuals. In that regard, moratoria granted represented above 10% of the banks’ total loan portfolio and 14% of all performing loans (moratoria granted to SMEs accounted for 20% of performing loans). In terms of allocation of the moratoria granted across different asset classes, 59% of moratoria was granted to households (mainly for collateralized residential loans) and 41% of moratoria granted to companies (of which 26% to SMEs). The two schemes implemented by the Hellenic Development Bank, i.e. a guarantee scheme and the interest subsidy scheme for new corporate loans, co-financed by the Hellenic Development Bank (TEPIX II), were particularly successful in attracting strong demand. The guarantee scheme consisted of two tranches of EUR 1.000 million of guarantees each, aiming to leverage EUR 7.000 million of loans. Until the beginning of July, 2020, EUR 3.100 million of loans were approved under the first tranche, corresponding to 4.406 SME loans (EUR 1.300 million) and 270 large corporate loans (EUR 1.800 million), while actual disbursements were expected to gradually pick up throughout the summer, 2020. The TEPIX II scheme was also successful in attracting demand via a new sub-product (aimed at providing support to companies affected by the coronavirus outbreak). As a result, the scheme mobilized 12.783 loans worth EUR 1.800 million (EUR 1.400 million of which related to the new sub-product) and has recently expanded by EUR 180 million, aiming to leverage another EUR 800 million of new loans, to cover the demand in excess of the initial envelope. Payment-related aspects, such as: (a) several extensions of payment provided for post-dated cheques at maturity, (b) the increase of card-based payment contactless (i.e., without the use of the PIN code) limit from EUR 25 to 50 conducted at POS terminals by consumers, and (c) the continuous encouragement of the use of electronic payments vis-à-vis cash and cheques.</td>
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<td>Kosovo</td>
<td>The Central Bank of Kosovo (CBK) together with the Kosovo Banking Association decided to allow banks to suspend payments of loan instalments for businesses and individuals for three months, which was ended in June, 2020. Another decision was taken by CBK in June, 2020, by which banks were allowed to make loan restructuring for up to one year and the process of application was until the end of September, 2020. The CBK will apply regulatory forbearance on loan provisions and capital requirements on reprogrammed loans. In February, 2021, CBK issued another Guideline on Loan Restructuring due to COVID-19, which allowed banks to restructure loans for up to 9 months. For banking clients who did not benefit from previous restructuring banks could restructure the loans for up to 9 months while those who restructured their loans previously but for less than 9 months, they could restructure for the period of difference in order to reach a total of 9 months. The deadline for applications was until March 31, 2021.</td>
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<tr>
<td>Montenegro</td>
<td>On October 22, 2020, the Central Bank of Montenegro (CBCG) announced a new package of support measures, aimed at helping the most affected citizens. The CBCG introduced a six-month moratorium on the repayment of loans for citizens who lost their jobs after March 31, 2020, due to the COVID-19 crisis and did not delay the repayment of their loans by more than 90 days before end-2019, and whose loans were not classified as non-performing by end-2019. Other measures included a loan restructuring for citizens whose wages were fallen by at least 10% due to the pandemic, and a change in the amount of demand deposits included in the calculation of due liabilities (20% instead of 30%).</td>
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<tr>
<td>North Macedonia</td>
<td>The National Bank of the Republic of North Macedonia (NBRNM) cut its policy rate twice since the start of the crisis by a cumulative 50 bps to 1,5%. The fees for withdrawing and returning cash to the NBRNM’s central vault was abolished to minimize any risk of transmitting the virus infection by coins and bills. In addition, the NBRM reduced by 60% the amount of CB bills offered to banks, thus providing additional liquidity to the economy. With the amendments of the regulation on credit risk management, the NBRNM has enabled banks to alter the contractual terms of the existing performing loans to households and non-financial legal entities (for example, by providing</td>
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moratoria on loan payments), without considering those loans as foreborne exposures. This option was provided on a temporary basis, from March to September 2020.

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<th>Country</th>
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<td>Romania</td>
<td>The National Bank of Romania (NBR) adopted a package of measures aimed at mitigating the negative effects of the crisis generated by the coronavirus COVID-19 pandemic on the households and companies. The following measures were taken: (a) monetary policy measures; (b) measures to increase the flexibility of the legislative framework so that banks and non-bank financial institutions could help individuals and companies with outstanding loans; (c) measures regarding the bank resolution - to postpone the deadline for collecting the annual contributions to the bank resolution fund for 2020 by three months, with the possibility of extension to up to six months, to delay the reporting deadlines of some information on resolution planning; (d) operational measures - to ensure the smooth functioning of payment and settlement systems underlying payments in the domestic currency, so that commercial and financial transactions can be performed under normal conditions, the NBR will provide banks with continuous cash flows for all operations, including liquidity for ATMs. The ECB set up a EUR repo line with the NBR bank worth a maximum of EUR 4.500 million. It was initially agreed that the repo line would remain in place until end-2020, but it was extended until the end of June, 2021.</td>
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<tr>
<td>Serbia</td>
<td>In March 2020, the National Bank of Serbia (NBS) adopted the first moratorium on debt payments. In June 2020, the NBS adopted the regulation for facilitating access to loans for first home buyers (in the case of first home buyers, banks may approve a mortgage loan to a natural person provided that the amount of the loan does not exceed 90% of the value of the property mortgaged - exception from the general limit of 80%). In July 2020, the NBS adopted regulations to facilitate repayment of household loans approved by 18 March 2020, having in mind possible deterioration in the financial position of citizens who took out consumer loans, cash or other loans, before the extraordinary circumstances brought on by the COVID-19 pandemic. Banks were encouraged to offer to borrowers refinancing or change of the maturity date of the last instalment of consumer, cash and other loans (except housing loans and current account overdrafts) approved by 18 March 2020 for additional two years relative to the current repayment regime. In August, 2020, the NBS adopted a new set of temporary measures through 2021 intended to provide easier access to housing loans for individuals. These measures include the possibility of earlier approval of mortgages before construction was completed, the possibility of extending mortgage repayment periods up to 5 years, and a temporary relaxation of the approval procedure for short-term RSD loans up to a certain amount. This regulation allowed banks to grant a loan of up to RSD 90,000 to a natural person who does not receive his/her wage or pension via an account with that bank, with the maturity of up to two years, and to accept, as relevant evidence of employment and wage or pension of the borrower in the past three months, the signed statement on such facts issued by such borrower under full criminal and material liability. Banks will be able to apply the adopted set of measures until end-2021. In November, 2020, the NBS announced additional FX-purchase swap auctions and securities purchase repo auctions on a weekly basis to provide liquidity to the system. In December, 2020, the NBS adopted new measures to support debtors (companies and households) affected by the pandemic. These measures envisage rescheduling and refinancing of bank loans and a six-month grace period with extension of repayment terms.</td>
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<tr>
<td>Slovenia</td>
<td>The Bank of Slovenia (BoS) extended all ECB measures to all banks and savings banks in Slovenia. Furthermore, the BoS restricted profit distribution at banks and savings banks and reduced the maximum level of allowed bank account fees, with higher reduction for the more disadvantaged groups. The BoS allowed banks to temporarily exclude income declines caused by the pandemic when calculating creditworthiness.</td>
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<tr>
<td>Turkey</td>
<td>In addition to rate cuts, the authorities took steps to inject liquidity in the economy. The primary goal was to sustain credit flow to cash strapped businesses and thereby also try and preserve financial stability. In that regard, the Central Bank of the Republic of Turkey (CBRT) implemented unconventional liquidity support due to COVID-19. Besides lowering the policy rates and liquidity injection, other important steps included:</td>
</tr>
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</table>
In order to support the economy during the quarantine, the National Bank of Ukraine (NBU) eased monetary policy by cutting the key policy rate by 200 bps down to 6% starting from June 12, 2020. The NBU modified the operational design of monetary policy implementation to provide banks with more liquidity management flexibility: the frequency of liquidity tenders was doubled (from bi-weekly to weekly), two-week certificates of deposit became one-week certificates, and short-term refinancing loans (which previously had a maximum maturity of 14 days) were issued for a period of up to three months. Further, the NBU modified the calculation of reserve requirements (effective on April 11, 2020) so as to free up some more domestic currency liquidity. The NBU adopted a regulation that facilitates restructuring of loans to borrowers facing financial difficulties due to impact of the COVID-19. Penalties on clients not servicing loans during the period starting on March 1, 2020, and until 30 days after the quarantine finishes should not apply if there were reasonable grounds.

As Table 2 shows, the scope of the bank measures also varied across the SEE countries. Some central banks cut its key police rate and took miscellaneous actions to provide additional liquidity for the banking sectors and economies. In most countries, banks were prevented to pay dividends as well as bonuses in order to boost their capital bases. Soon after the pandemic outbreak, temporary deferred principal repayment arrangements for a certain period of time (mostly three or six months), according to the application by companies and/or individuals, were given. In many cases, special relief measures towards SMEs were taken, such as credit schemes with government guarantees as well as outstanding loans to stimulate credit demand, or loan restructuring as well as loan refinancing to ease debt burden for SMEs, etc. As elsewhere in the world, bearing in mind existing obstacles in accessing capital, SMEs in the SEE region countries’ economies “need to be supported through special credit lines, reduced interest rates on loans, deferred repayments, and establishment of long-term credit systems”.35

Supporting SMEs in response to COVID-19 in the short run required fast and well-coordinated support that combined financial measures to address their cash-flow problems and avoid bankruptcies. However, structural policy measures36 by the region’s policy-makers need to involve the following:

- Step-up efforts on SMEs digital transformation, in terms of adoption of teleworking and ICT technologies, especially digital payment options, and protection via cybersecurity

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practices. From cybersecurity experts' point of view, all enterprises, regardless of their size, need to protect sensitive data (i.e. enterprise-wide information that could impact business decisions, reputation, and operations if exposed). The most exposed enterprises are those that do not give priority to cybersecurity. Passwords are a weak link that can be resolved by using multi-factor authentication when possible and securing passwords. The best way to protect passwords is to prevent employees from choosing weak passwords.

- Embed the green agenda into new support initiatives, e.g. eligibility for grants, subsidies, and “soft” loans can be tied to increased environmental performance and to introduction of green business models by SMEs. It would help the transition of the SMEs sector to more efficient and carbon-free economy in order to comply with the EU requirements. Moreover, there is growing investor demand for green products.

- Support and leverage innovative start-ups in the fight against COVID-19, e.g. new programs can be rolled out incentivising start-ups to develop innovative products and/or services intended to overcome the economic, health, and societal effects of the pandemic. For example, today there are opportunities for start-ups that introduce innovations in telemedicine, remote personal care, medical equipment, home delivery, food processing, teleworking, on-line education, contact tracing, etc. Policy-makers should therefore tackle short-term challenges (in terms of support existing start-ups' short-term financial needs with minimal bureaucracy, and help secure jobs and incomes of their workers), but also and importantly foster the ability of start-ups to grasp new business opportunities, reducing barriers to entrepreneurship, providing the right incentives, and boosting entrepreneurial potential.

- Encourage SMEs uptake of e-commerce to facilitate their entry into new markets and expand their customer base. According to the Organization for Economic Co-operation and Development (OECD), in 2018 the EU average percentage of the SMEs selling on-line was 17%. While Serbia and BiH, for example, had the percentage higher than the EU average, 26% and 21%, respectively, the lowest percentage of the SMEs selling on-line in the Western Balkans region and Turkey (WBT) had North Macedonia, 3%.

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37 In this context, it could be illustrative an anecdote that comes from developer Dick Anagnost. Mr. Anagnost said: „When my hair care products shut down because there was no demand, we converted our lines and made hand sanitizers and disinfectants. We started creating new products we would not normally sell.” He added: „As you evolve, you reconfigure and change the business model to meet the new normal. Those are the people who are going to survive and become successful.” See: Solomon, D. Surviving the COVID Economy. Business NH Magazine, 37(11), November 2020, pp. 35-36.


- Continue enhancing insolvency regimes, in terms of further efforts that will be needed to reduce the time and cost of bankruptcy by simplifying proceedings and increasing the use of out-of-court settlement systems. For example, in WBT, Montenegro continues to be the leader as a result of its efforts to bring its bankruptcy regulation closer to the international standards. However, second chance policies for failed entrepreneurs are generally still absent in the SEE region and the region’s governments provide no dedicated training or information on restarting a business after failure.40

As far as the tourism sector is concerned, in addition to aforementioned measures, the region’s governments need to foster stronger collaboration with tourism sector representatives in order to implement sound and sustainable tourism recovery measures (e.g. through loans, tax holidays, or postponements, guarantee schemes, staycation vouchers, etc.). Also, the governments need to develop health and safety guidelines in the hospitality sector as well as promote domestic tourism. Governments need to ensure that the sector will be ready to resume and keep on innovating and transforming. For example, tourism business and destinations need to adjust their offer to respond to changing travel behaviour.

PROSPECTS AND CHALLENGES OF THE FINANCIAL INSTITUTIONS IN THE POST-COVID ECONOMIES

The year 2020 was a year like no other in modern history and 2021 will be a time of great uncertainty, particularly regarding efficiency of the vaccine against COVID-19 disease and how the pandemic has been changing human behaviour.41 According to the IMF, the global economy should grow by around 5.8% in 2021. As far as the SEE countries are concerned, the IMF estimated growth at the rate of 9% in Albania, 5% in BiH, 6% in Bulgaria, 4.9% in Croatia, 5.1% in Greece, 7.5% in Kosovo, 6.5% in Montenegro, 7% in North Macedonia, 3.8% in Romania, 7.6% in Serbia, 5.2% in Slovenia, 5% in Turkey, and 3.6% in Ukraine.42 The WB predicted that the total output of the WB6 region loss due to the pandemic crisis would be fully recovered in 2022.43 Of course, the

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41 For example, the ongoing pandemic increased a sense of fear and insecurity among people due to probable job and pay loss. However, there is no such thing as a “vaccine for fear and economic insecurity” or vaccine for environmental degradation (Dennis, M. J. The impact of COVID-19 on the world economy and higher education. Realities and Innovations, 24(9), 2020, p. 3. DOI: 10.1002/emt.30720).


uncertainty made economic forecasting more tentative; in other words, economic recovery prospects remain the subject of a high degree of uncertainty.44

Throughout the whole SEE region multilateral support of the international financial institutions, especially the IMF and the WB, and the EU will be essential in addressing immediate financial needs and closing gaps. In fact, dealing with the effects of the pandemic has already become a priority for the IMF.

The state of the COVID-19 pandemic imposes the need for structural reforms and solving problems that accompany these. For example, ongoing digitalization of economies brings a requirement for up-skilling and re-skilling. More general, post-pandemic world will bring with itself opportunities as well as huge challenges.

Unlike the pre-pandemic time, since the pandemic outbreak teleworking has become an imperative. New equipment was procured, a new work environment was created and new work schedules were made (in terms of work- and family-role adjustment). Therefore, providing financial services required an intensive application of the new ways of business (theoretically already known), and the customers (particularly millennials) responded very positively, as they did when booking hotel rooms or buying furniture, or shoes. This is why the following question is increasingly arises: "Why would a financial institution require a customer to visit its physical branch to complete an account opening, a loan application or buy an insurance policy?" In other words, financial services sector found itself at a turning point on its path to more comprehensive digital transformation. According to some views, 2020 made progress in boosting digitalization of financial services45 and accelerated the Fourth Industrial Revolution.

Nowadays there are numerous technologies that can help in the process of digital transformation of banking sector. A successful digital transformation strategy has to involve technologies that

44 Moreover, Ioannidis, Cripps, and Tanner found that epidemic forecasting has a dubious track-record, and its failures became more prominent with COVID-19. Poor data input, wrong modelling assumptions, high sensitivity of estimates, lack of incorporation of epidemiological features, poor past evidence on effects of available interventions, lack of transparency, errors, lack of determinacy, consideration of only one or a few dimensions of the problem at hand, lack of expertise in crucial disciplines, groupthink and bandwagon effects, and selective reporting are some of the causes of these failures (Ioannidis, J. P. A., Cripps, S., Tanner, M. A. Forecasting for COVID-19 has failed. Article in press, International Journal of Forecasting, 2020, pp. 1-16. DOI: 10.1016/j.ijforecast.2020.08.004).

45 In Gartner’s IT glossary, digitalization is “the use of digital technologies to change a business model and provide new revenue and value-producing opportunities; it is the process of moving to a digital business”. Digitization refers to the internal optimization of processes (such as work automation and paper minimization) and results in cost reductions. Although business leaders often use digitalization as an umbrella term for digital transformation, the terms are quite different. Digital transformation requires a much broader adoption of digital technology and cultural change. Digital transformation is more about people than it is about digital technology. It requires organizational changes that are customer-centric, backed by leadership, driven by radical challenges to corporate culture, and the leveraging of technologies that empower and enable employees. For more details, see: https://medium.com/@colleenchapco/digitization-digitalization-and-digital-transformation-whats-the-difference-eff1d002fbdf, Accessed: December 31, 2020.
bring the most value to both banks and their customers. Among the advanced technological solutions are the following:

1) Artificial intelligence (AI) and machine learning (ML). The integration of AI into bank business systems provides, on one hand, a completely new level of personalization of banking services and the possibility of adapting them to the end-user and, on the other hand, a more advanced approach to risk management, in terms of faster and more advanced risk assessment of transactions based on the analysis of former user behaviour. By processing a large amount of data through neural networks, user behaviour is recognized, or "learned", in order to provide a completely individualized bank approach to the user, which ultimately creates value-added. By anticipating the customer behaviour and needs, some services can be offered to them even if they might not require these services, because they do not know that the services exist at all.

2) Blockchain. With the most important features, such as transparency, decentralization, independence, and immutability (changeless), the application of blockchain technology in banking sector results in a better user interface, greater accuracy, transparent transactions, and makes data storage more secure. Also, a significant impact can be observed on the increasingly present cloud technologies, which makes them more decentralized.

3) Internet of things (IoT). By enabling data analysis in near real-time, the customer experience becomes more personal, thus achieving personalization of banking services. Additionally, IoT enables contactless payment, facilitated application of the authentication procedure, etc.

4) Cloud computing. It is a revolutionary concept that offers a new way to access personal data and applications, which are no longer located on the computer, but "in the cloud", which means the access to programs, records, and documentation from multiple devices at any time and from various locations.

The future of the digital transformation in banking (especially retail and investment banking) is de facto impressive and projected to transform bank image from traditional one to "synapses", and provide more services to the customers. The „synapses bank” connects its miscellaneous activities and partners in mutually beneficial ways, in much the same way that synapses connect neurons in a human brain. And in doing so, the „synapses bank”, like the human brain, forms a whole that is greater than the sum of its parts. When it comes to „synapses” in insurance, the digitization of insurance could change people lives in an even more profound way than digital transformation in payments or transformation in lending. In fact, it all relates to the basic production factor of insurance sector, that is risk first and foremost, and across the key function of the financial service sector. The „synapses” that could potentially happen in insurance could deliver the customers very relevant non-financial values: more information and intelligence on the customers’ lifestyle related risks, with more interconnected counterparts operating for customers’ extended health and augmented wellbeing; and with more opportunities to basically make sure what are not just covered on the potential negative outcomes, but that we are actually

46 More details see on: https://www.intellectsoft.net/blog/digital-transformation-in-banking/, Accessed: August 8, 2020
driving them down, even potentially eliminating them – as an economic incentive system is developed to guide and influence customers' behaviour and preferences, their basic needs and highest ambitions. The almost limitless possibilities to apply "synapses concept" to better insure almost every dimension of life brings incredible opportunities, but also a number of unanswered questions, and potentially few significant (un-insurable) risks.47

Insurance companies worldwide are already largely considering new ways to cover the risk of a pandemic in the future. However, pandemic risk represents a challenge for insurers because, by definition, it is global and potentially affects many individuals and economic sectors at once. This separates pandemic risk from insurable risks – from those that do not occur everywhere and all at once – because it prevents diversification mechanisms. In practical terms this means that although under well-defined circumstances it is possible to cover a limited number of insureds against pandemic risk; insurance of a very large group cannot rely solely on insurance principles and resources of the insurance industry alone. Pandemic risk therefore has its place among similar risks such as natural disasters or terrorism, which require partnerships between public bodies and the private insurance industry to find innovative solutions. It is important to note, however, that even natural disasters and terrorism do not share the same global nature that is inherent to pandemic risk because their potential losses are much lower and diversification can be achieved.

Furthermore, contemporary banking faces certain challenges that are difficult to overcome, such as competition from non-financial institutions (e.g. transfers via Facebook, Amazon, Apple, PayPal, etc.), limitations related to on-line payment service fees, and increasing investments in complementary technology that become of an urgent need. One very important aspect of the digital transformation in banking, as well as insurance, cannot be ignored, and that is the emergence of new risks generated by digitalization (e.g. credential stuffing, phishing attacks, malware and ransomware, malicious attacks on cloud providers, IoT exploitation, etc.) as well as systemic risk concerns. “Data sharing among banks, governments, industry chains, and relative departments needs to be established to strengthen the internal risk control of banks, focus on risk spillovers of system-important industries and system-fragile industries to the banking sector, and improve intelligent risk controls system.”48

Hence, below are given the key digital imperatives for banks:49

- A mobile device is the primary channel for accessing web applications. So banks should provide mobile friendly web or apps for mobile platforms.

- Digital banks are one of the emerging trends, wherein the banks provide branchless digital banks that solely rely on digital channels.


Increasing use of gamification concepts by rewarding banking customers for their on-line transactions and activities.

Money management tools (such as spend analyser, budget planner, debt analyser) and self-service tools are increasingly used in digital banks to aid customer decision making and minimize information clutter.

Digital payments and digital wallets are some of the features gaining momentum in digital banking channels.

Social banking that actively leverages social and collaboration features is one of the most popular features in the digital bank.

Optimized and simplified processes (such as 1-step registration, or a simplified customer acquisition process).

More general, there are several things that could help banks and non-bank financial institutions to digitally transform while also becoming more stable and more profitable. Financial institutions should:

- Take advantage of the dramatically increased availability of data and real-time information;
- Use AI and ML to build more organizational intelligence;
- Evolve a more inclusive, interconnecting intermediation model;
- Develop solutions that add value to the overall economic ecosystem rather than playing a zero-sum game, and
- Earn and trade on the trust that is central to the stability of the overall global financial service sector but that is often much more readily given to purely digital players.

When all physical distancing and mobility restrictions are lifted, people are more likely to continue using digital channels of accessing financial services. Banknotes and coins do not only help the grey economy and hence tax evasion, now their unhygienic character will also be given much more attention. There is no doubt that the ongoing pandemic will accelerate the trend of transition to digital finance, as one of the ways of building more digitised (contact-free) and resilient economies.

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According to the Global Risks Report 2021, "the most imminent threats – those that are most likely in the next two years – include employment and livelihood crisis, widespread youth disillusionment, digital inequality, economic stagnation, human-made environmental damage,

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erosion of societal cohesion, and terrorist attacks".\textsuperscript{52} Not only the coronavirus COVID-19 pandemics caused more than three million death cases until the time of this writing, but the economic and health impacts continue to have devastating consequences.

Apart from financial services industry, when it comes to real sector of the economy, noting like the COVID-19 pandemic forced the whole world to think about attracting equity into business. Public capital approved during the health emergency provided a bridge and private capital now needs to be mobilized. Some experts point out to the need for financial markets to be competitive, which means developing primary markets, raising the liquidity of secondary markets, and lowering transaction costs. Others see SMEs' dependence on bank loans as a major obstacle to recovery and growth. Namely, automatic application of rules related to loan quality (i.e. calendar provisioning) would have an extremely damaging impact on businesses. An outcome of the pandemic crisis will be an increase in business failures and the policy-makers and decision-takers need to prevent cascading bankruptcies. In a nutshell, reforms and sustainability have to be two main objectives in the post-COVID-19 "new normality".

Sustainable economic recovery requires a policy reset, although it is early to draw definitive lessons from the pandemic. Public policy should focus on areas such as new sustainable infrastructure, new technology, climate, and re-integration. The construction of the infrastructure will have a significant impact on GDP growth. With smarter spending, policy-makers should make more use of public-private partnerships and establish operational and regulatory frameworks to enable greater participation of financial institutions in the real sector of economy.

\textbf{REFERENCE LIST}


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43. Other on-line sources: