

Impact of the Capital Adequacy Framework Revisions

Qualitative Cost – Benefit Analysis

Bank of Albania is seeking to develop the regulatory framework on capital adequacy by improving the credit risk methodology and introducing the operational risk methodology for banks when calculating the capital requirements.

The Basel Committee on Banking Supervision for credit risk permits banks a choice between two broad methodologies for calculating their capital requirements, the Standardized Approach or the Internal Ratings-based Approach, while for operational risk, are proposed three methods: (i) the Basic Indicator Approach, (ii) the Standardized Approach and (iii) Advanced Measurement Approaches (AMA). For the operational risk banks are encouraged to move along from the spectrum of available approaches [starting from (i)] as they develop more sophisticated operational risk measurement systems and practices.

Given the current status of development of the banking activity and the directives of the Committee, Bank of Albania for credit risk methodology will update the current credit risk methodology with the latest guidelines as provided by the Basel Committee on Banking Supervision in the **Simplified Standardized Approach** and will introduce the **Basic Indicator Approach** on operational risk.

Regulated firms

| | Impact | Comments |
|--------------------------|---------------|---|
| Costs | Higher | |
| One-off | Higher | |
| Operational | + | The modifications in the CA framework will require training of the (i) technical staff (ii) high strategic management staff and potential revisions in the strategy |
| Infrastructure | + | |
| Accounting and reporting | + | The modification of the CA framework will require changes in the methodologies of calculation of capital requirements to credit and operational risks |
| Other | + | Some banks might need to add capital in order to comply with the increased capital adequacy requirements. Other extra costs related to the modification of the credit risk methodology and the first time implementation of the operation risk methodology |
| On going | Lower | |
| Human resources | + | Increased complexity in of the prudential reporting framework and in a better risk management will generate a growth in the time |

| | | |
|---|---|--|
| | | allocated to this activity. |
| | | |
| Benefits | Higher | |
| Additional products / additional business | = | No direct impact on the business strategy. |
| Cost saving / + revenues | +/= | Better coverage of banking activities - credit and operational risk with capital, with little effect on cost savings. |
| Equity requirements | =/+ | Banks will have to account for the operational risk. Some banks might have already considered operational risk, or more sophisticated credit risk methodologies for capital requirements, based on their parent bank / group requirements. For some of the banks, introducing the operational risk might ask for an increase in the capital. |
| Total impact | Higher costs and Higher benefits | Higher costs during the implementation process, and higher long run benefits |

Consumers

| | Impact | Comments |
|--------------------------|-----------------------------|--|
| Costs | Slightly lower costs | |
| Higher risks | - | Safer banking system, would reduce risk / increase protection for depositors and investors |
| Higher prices | +/= | The additional one off costs could be reflected on the prices (cost transfer from the banks), but no significant effect. |
| Lower quality of service | = | No direct effect |
| | | |
| Benefits | No effect | No direct effect |
| Better choice | = | |
| Price reduction | = | |
| Improved access | = | |
| Total impact | Lower costs | Lower costs as consequence of a better capitalized and hedged banking activity. |

Authorities

| | Impact | Comments |
|--------------|---------------|---|
| Costs | Higher | |
| One-off | + | Higher costs of the Banking Supervision Authority related to the drafting, enactment and implementation the modified regulations. |

| | | |
|---------------------------------|---|---|
| | | Higher costs related to the training of the supervisors and/or external assistance. |
| On going | + | |
| Direct | + | The supervision process will be more complex |
| Indirect | = | |
| | | |
| Benefits | Higher | |
| Statutory goals | ++ | The banking supervisory authority accomplishes its statutory obligations of ensuring the financial stability. |
| Increase income to state budget | = | No direct effect |
| Others | = | No direct effect |
| Total impact | Higher costs and higher benefits | One-off costs related to the process of new regulations, but the benefits are much higher. |

Summary of CBA of the PWG recommendations for the CPC

| Stakeholders | Costs | Benefits | Total |
|------------------------|-----------------------|------------------|-------------------------------------|
| Regulated firms | Higher | Higher | Higher |
| Consumers | Slightly lower | No effect | Lower |
| Authorities | Higher | Higher | Higher |
| Overall economy | | | More benefits Some costs |

Legend: + increase
- decrease
= no effect