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Identifying Systemically Important Banks in Kosovo

Albulenë Kastrati

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Outline

➢ Introduction

➢ What is systemic risk?

➢ What are SIFIs and why are they important?

➢ The measurement of systemic importance

➢ Identification of the systemically important banks in Kosovo (SIBs)

➢ Conclusion

Introducing SIFIs

➢   During financial crises, financial institutions are more fragile to shocks (Bernanke and Gertler, 1989)

➢   The recent financial crisis 2007/2008 serves as an example where the failure of individual institutions helped spreading the shocks across the financial sector and proclaimed the crisis into the real sector

➢   In order to preserve the financial stability, a key policy lesson from the crisis is
to pay attention to the systemic risk (Tarashev et al., 2010)

➢   Motivation to rethink the previous financial regulatory framework (e.g. Basel II)

> **Systemic Risk**

➢ The European Systemic Risk Board (2010): disruptive event in the financial system that has the potential to promulgate the adverse effects to the internal market, as well as the real economy

➢ IMF, FSB and BIS (2009): '…an impairment or disruption to the flow of financial services …
  ➢ when the cost of financial services would increase sharply
  ➢ due to shocks originating outside the financial system, as well as within the financial system

⇒ The systemic event becomes a *macroeconomic problem* so the costs inferred are *system wide*

➢ **Idiosyncratic Risk**
➢ one financial institutions experiences difficulties in performing daily tasks due to a risky investment or, a particular bank suffers depositors' run
⇒ costs inferred of *microeconomic significance*

➢ Cross-sectional dimension
➢ Time-series dimension

What are SIFIs and why they are important

- SIFIs – microprudential perspective
- SIFIs – macroprudential perspective

- Weistroffer (2011):
1) **GOOD**: Relevant and indispensable for the well functioning of the financial system and economy
2) **BAD**: Their malfunction imposes high costs to the economy

- Contagion effect ('*domino effect*')

- ***Precautionary measures*** to reduce the systemic importance (as proposed by the ESRB):
  - ✓ Countercyclical capital buffers
  - ✓ Prevent maturity mismatch
  - ✓ Limiting the expectations of bail out
  - ✓ Reduce exposure concentration
  - ✓ Risk-based deposit insurance scheme, etc.

Methodology for the Identification of SIFIs

→ Market based technique

   ➢ Developed financial systems

→ Indicator based technique

   ➢ Moldavian, Czech republic, Australian authorities (Komarkova et al., 2011; Moore and Zhou , 2012; Bramer and Gischer, 2012)

Criteria (BCBS, 2011):
✓ **Size**
✓ **Interconnectedness**
✓ **Substitutability**
o Complexity
o Cross - jurisdictional activity

➢ Reference system → Domestic market
➢ 8 banks, balance sheet indicators, 2012 data

Indicators

Table 1. Balance sheet indicators for identifying SIBs in Kosovo

Criteria	Indicators
Size = 40%	1. Cash and balances with CBK
	2. Deposits
	3. Participation share in banks' own resources
	4. Bank placements from other banks
	5. Securities
	6. Retained profit
	7. The share of the number of total depositors
	8. The share of banking system liquid assets
Substitutability = 40%	9. The share of agricultural loans
	10. The share of household loans
	11. The share of trade loans
	12. The share of industry loans
	13. The share of Government banking sector deposits
	14. The share of public enterprises' deposts
	15. The share of total loans to total assets
Interconnectedness = 20%	16. Bank placements on other banks
	17. Securities
	18. Subordinated debt

Results

Table 2. The identification of the SIBs in Kosovo

*Banks/Criteria	Size	Substitutability	Interconnectedness
Bank A	√	√	√
Bank B			
Bank C			
Bank D			
Bank E	√	√	√
Bank F			
Bank G	√	√	√
Bank H		√	

*Note: The ordering of the banks is random.

Contagion risk

Table 3. Assets/Tier I capital of the bank in column to the bank in row

EXPOSURE MATRIX	Bank A	Bank B	Bank C	Bank D	Bank E	Bank F	Bank G	Bank H
Bank A		0.00	0.00	**10.84%**	0.00	0.00	0.00	0.00
Bank B	0.00		**0.21%**	**0.06%**	**0.01%**	0.00	**0.05%**	0.00
Bank C	0.00	0.00		**0.11%**	**1.80%**	0.00	**0.13%**	0.00
Bank D	**0.002%**	0.00	**6.50%**		**0.24%**	0.00	0.00	0.00
Bank E	0.00	0.00	**0.10%**	**0.004%**		0.00	0.00	0.00
Bank F	0.00	0.00	0.00	0.00	0.00		0.00	0.00
Bank G	0.00	0.00	**9.02%**	**18.32%**	**0.38%**	**4.26%**		0.00
Bank H	0.00	0.00	0.00	0.00	0.00	0.00	0.00	

Thank you!

albulenekastrati@bqk-kos.org

www.bqk-kos.org