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"Scoping of Problem" Document

Project: Reducing cash transactions

Section 1 Project information

PUBLIC-PRIVATE FINANCIAL SECTOR MODERNIZATION MATRIX					
Italian Banking Association CRITERIA	**European Central Bank CRITERIA**				
	Asymmetric information reduction	*Completeness of the market*	*Increased opportunities to engage in financial transactions*	*Reduced transaction costs*	*Increased competition*
Business development					
Industry competitiveness				X	
Industry reputation					

Short description of the context [from project matrix]: Albanian authorities have taken several legal and administrative initiatives to reduce the use of cash. Despite these initiatives undertaken it seems that the intended effects are not completely materialized and the volume of cash transactions continues to be high. The high level of cash transaction raises concerns to the banks. These concerns are related to the costs associated with processing the cash and with the inefficiency produced by the high level of the unused liquidities.
Stakeholder proposing the project: Banks
Other Stakeholders involved (sponsors): BoA, utilities and card companies
Project objectives: 1. **To prepare a protocol on a common policy in respect of the actions and measures to by be undertaken by the banks for reducing the volume of cash transactions.** 2. **To build consensus among banks in order to sign and implement the protocol.**

Description of the project contribution toward financial modernization:

By reaching the project's objectives, the level of expensive and inefficient cash transaction will decrease and the level of more efficient payments will increase. The improvement of the payment system will enhance the efficiency of the intermediation function of the banking system.

Project Working Group:

Raiffeisen Bank (Project Owner & Project Manager)

Bank of Albania (Deputy Project Manager)

Union Bank (member)

Credins Bank (member)

American Bank of Albania (member)

Italian Development Bank (member)

Tirana Banka (member)

ProCredit Bank (member)

INTRODUCTION

The present Impact Assessment Template is designed to take you through the main steps of the analysis and data requirements.

At an early design stage, with little quantitative data available, this template can help prepare a Preliminary Impact Assessment. Later on, the template can help prepare a Full Impact Assessment.

The template builds on the EU *Better Regulation* Impact Assessment process.

The EU Better Regulation Approach	
Steps	**Purpose**
Scoping of problem	
1. Problem identification	To understand if a market/regulatory failure creates the case for regulatory intervention.
2. Definition of policy objectives	To identify the effects of the market /regulatory failure to the regulatory objectives.
3. "Do nothing" option	To identify and state the status quo.
4. Alternative policy options	To identify and state alternative policies (among them the "market solution").
Analysis of impact	
5. Costs to users	To identify and state the costs borne by consumers
6. Benefits to users	To identify and state the benefits yielded by consumers
7. Costs to regulated firms and regulator	To identify and state the costs borne by regulator and regulated firms
8. Benefits to regulated firms and regulator	To identify and state the benefits yielded by regulator and regulated firms
Consultations	
9. Data Questionnaire	To collect market structure data to feed into cost and benefit analysis
10. Policy Document	To learn market participant opinions on various policy options
Conclusion	
11. Final Recommendations	Final report to decision-makers, based on Cost Benefit Analysis and market feedback

Rather than being a step-by-step process, **RIA is a highly iterative process**. As it advances, it is likely that previous steps need to be fine tuned accordingly.

The template is made up of the following 3 sections:

Section 1 aims to scope the underlying problem in order to see whether or not a regulatory/market failure exists and, if so, whether or not a regulatory action to address that problem is necessary.

Section 2 is devoted to Cost-Benefit Analysis. In this part the main qualitative and quantitative economics are illustrated under the various perspectives: from the regulator and the government; from consumers and from the regulated firms.

Section 3 summarizes the conclusions.

This template is based on the following sources:
- CESR-CEBS-CEIOPS, *Draft Impact Assessment Guidelines*; May 2007;
- UK Financial Services Authority;
- Oxera;
- Lessons learnt by Convergence through the RIA Capacity Building sessions.

Section 1:
Scoping the problem

1.1. Problem identification

[Background section from ToRs]

The Albanian authorities have undertaken several legal and administrative initiatives to reduce cash transactions in economy with final objective to combat the informal economy.

– In July 2007, the Albanian Government amended some articles in the Law on Taxation Procedures in the Republic of Albania that are in line with cash reduction initiative. The upper limit allowed to use cash for the purchase of goods and services was revised downward from 1,000,000 lek to 300,000 lek, but not more than 10% of the total purchases of that fiscal year / tax period. All the acquisitions above this amount should be paid through the banking system.

– Prior to this law amendment, the Council of Ministers has issued a decree on May 2007 on the minimal reference monthly wage to be used in the computation of the social security, health insurance and tax contributions with the provision that contributions have to be paid to the respective state institutions through the banking system or the post office network.

– In addition to the legal aspect the General Directorate of Taxation is working for modernizing the payment procedures in order to facilitate the non-cash payment of the taxes. The Directorate is working on the implementation of an on-line payment system and on the reduction and the simplification of the procedures to be followed by the taxpayers.

– In 2003 Bank of Albania in collaboration with other institutions initiate a campaign for the reduction of the use of cash in the economy. In addition to this campaign, in order to facilitate the interbank payments BoA has implemented:

(i) The Albanian Interbank Payment System (AIPS) that settles systemically important payments (such as payments between settlement participants, bank-to-bank payments, including payments to and from the BoA; payments on government securities transactions; net transfers of funds requiring designated time settlement; and large-value customer payments. This is a system based on the core RTGS principles;

(ii) The Albanian Electronic Clearing House System (AECH), an electronic clearing system owned and operated by BoA, in which files of bulk (high volume) low value payment instructions (both credit transfers) are exchanged among banks after the net positions have been settled through RTGS.

(iii) BoA, as a settlement agent, in collaboration with VISA international association provide to the banks the "Albanian National Net Settlement Service" (ALNNSS), which means the net settlement of Albanian lek payments, executed within the territory of Republic of Albania, via banking cards (debit/credit), issued in Albanian lek. The settlement is carried out for net amounts, in the bank accounts that members (banks) holds in the AIPS system.

AIPS and AECH have automated the clearing service provided by the Bank of Albania to commercial banks for processing payments to their clients. The implementation of these systems improvements in the national payments system in terms of increasing speed, reducing cost and security increasing in their processing. Did banks decrease their charges for payments according to the cost reduction?

Despite these initiatives undertaken it seems that the intended effects are not completely materialized and the volume of cash transactions continues to be high. The high level of cash transaction raises concerns to the banks. These concerns are related to the costs associated with handling the cash and with the inefficiency produced by the high level of unused liquidities.

1.2. Market/regulatory failure analysis (nature and evidence)

Cash is considered as an expensive and inefficient mean[1] of payment. Cash is a payment instrument that is difficult to trace and this property makes it very attractive in the shadow economy.

The currency in circulation makes up to 20% of the M3 aggregate, almost 3 times higher than the weight that this component has in EU member states (aggregate level). The spread usage of cash in the domestic economy in addition to the cultural factors and stage of economic development is linked to the informal economy and maybe to some extend to the limited financial knowledge and trust in the banking system.

In this context, the high level of cash transactions in the banking system could also be considered as a market failure due to the weak market power to identify the proper incentives for non-cash transactions and disincentives for cash transactions and thus to decrease their operational costs.

Although banks raised the issue of the level of cash transactions and of the involved processing costs, except for establishing an electronic payment system, they did not undertake additional actions to decrease the cash volume: cash withdrawals are usually free of charge, ATM and POS network is not too large, non-cash transactions are (highly) charged. Utilities companies did not take any measures to discourage non-cash payments of their bills and the card companies did not take actions to promote cards' utilization.

Authorities undertook several regulatory actions in order to reduce cash transactions, but an assessment on the effectiveness of the measures taken until now might be too early. Banks' complains on the high level of cash transactions show that, for the time being, the regulatory interventions still have not generated the desired effects. It seems that companies succeeded to identify ways of "tricking" the regulatory requirements. Therefore, this situation indicates a regulatory failure as the legal actions cannot be considered as very effective.

1.3. Policy Goal(s) threatened by the failure [e.g. financial stability, market integrity, market confidence, consumer protection, facilitating innovation, enhancing competition]

The market failure described above threatens the innovation promoting and the financial stability policy objectives.

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[1] The efficiency of the means of payments can be measured by at least one of the following:
- the number of coins and banknotes involved.
A cash payment between two persons is efficient when the total number of coins and banknotes used – including the change – is the minimum of all possible combinations of the amount of coins and banknotes needed to realize this cash transaction.
- the time needed to settle a payment;
- the time needed for an additional check on counterfeits.

1.4. "Do nothing" option
1.4.1 Possible medium-term (max 2 years) self – corrective market actions (e.g. mechanisms through which the "Do Nothing" option would address the market/regulatory failure). Various governmental institutions in the country have undertaken initiatives to curb the high level of cash in the economy. The scope of the interventions by these institutions has been related to their respective mandate or legislative obligations i.e. Albanian government's main objective has been to reduce informal economy, one of Bank of Albania's objectives is to promote the normal function of the payment system. Due to the actions undertaken by the authorities the level of involvement of the banking system in the payment system of the economy has increased and the level of currency outside the banking system is gradually falling. Despite these developments still the level of cash and cash transactions remains very high, showing that, on one hand, the regulations are not very effective and maybe they should be completed with other regulatory actions, and on another hand that market solutions are needed. In this landscape the banking community, through is own resources, can compliment the actions undertaken until now and identify alternative routes that will lead to lower cash transactions and higher efficiency.Banks and utility companies could take actions in order to stimulate use of non-cash payments and to raise customers' awareness on the advantages of using other means of payments.
1.4.2. Impact of the "Do Nothing" option to the various stakeholders **-**

1.5. Alternative policy option(s)
1.5.1. Broad description of the regulatory or self-regulatory action(s) needed to remedy the market or regulatory failure and hence achieve the policy goal(s) - To take additional regulatory; - To promote non-cash payments at industry level.
1.5.2. Possible operational regulatory or self-regulatory actions to achieve the policy goal – to perform a study on the international experience in fighting against cash through regulatory measures; – to perform a national survey for collecting information on the level and rationale of usage of cash transactions by the consumers and by the business entities; – to perform a study on the cost generated to banks, consumers and business entities by the use of cash, utilizing the information collected though the surveys; – to enforce a protocol for an uniform application of the self-regulatory measures; – to run an awareness raising campaign for the public on the benefits of non-cash payments.
1.5.3. General description of Alternative Options The approach that can yield faster positive results in the "war" to cash is to promote the

application of self regulatory actions by all banking market participants (option 1). On the other side, there might be additional regulatory measures to be undertaken that in other countries proved more effective (option 2). The most effective approach to reduce the level of cash transaction is to combine the self regulatory measures of the banking industry with regulatory measures that not only tack with the effects - high level of cash transactions, but also the root of the problem - informal economy, financial literacy (option 3).

1.5.3.1 Detailed description of Option 1
The volumes of cash transactions within the banking system might be further reduced by the establishment of a common policy among banks that will aim:
  a. the reduction of cash transaction by creating disincentives for cash use; combined with
  b. the increase of non-cash transactions by creating incentives for the costumers to use alternatives to cash.

1.5.3.2 Detailed description of Option 2

State authorities could identify, based on the international experience, additional regulatory measures such as to cap cash withdrawals, cash payments to state institutions, cash payments in the stores or to provide incentives for non-cash transactions.

1.5.3.3. Detailed description of Option 3

The combination between the regulatory and self regulatory measures to be implemented in and by the banking market, by the utilities and other state owned companies (such as customs) could ensure very good results on short term.

Summary Problem Scoping			
Auction procedures under foreclosure for immovable collateral			
Market failure			
Asymmetric information	Market power	Positive externalities	Negative externalities
	X		
(Existing) Regulatory failure			
Regulation wrongly prescribed for the market	Regulations succeeded in addressing the failure; a different market failure (e.g. side effect)	Regulation made it worse	Regulation so far has failed to work; maybe in due course
	X		

Section 2
Summary of impact analysis

2.1. Regulated firms

Costs & Benefits		Qualitative assessment summary results (High, medium, low)	Quantitative assessment summary results (mln. EUR)	
			First full year	5 years horizon
Costs	One-off X	High		
	On going X	Medium		
	Other			
Benefits	Additional Loans X	Medium		
	Cost savings/Additional revenues X	High		
	Equity relief			

2.2. Consumers

Costs & Benefits		Qualitative assessment summary results (High, medium, low)	Quantitative assessment summary results (mln. EUR)	
			First full year	5 years horizon
Costs	Higher risks			
	Higher prices			
	Lower quality of service			
	Others			
Benefits	Better Choice X	Higher		
	Price reduction			
	Improved access X	Higher		
	Others			

2.3. Regulator and Government

Costs & Benefits		Qualitative assessment summary results (High, medium, low)	Quantitative assessment summary results (mln. EUR)	
			First full year	5 years horizon
Costs	One-off			
	On going			
	Direct			

	Indirect			
Benefits	Statutory goals			
	Increase income to the state budget			
	Others			

Section 3
Conclusions

1. **Problem identification:**

2. **Proposed regulatory/self-regulatory action:**

3. **Impact assessment of the action:**