REGULATION AND SUPERVISION OF BANKING ACTIVITY IN ROMANIA

Keywords
Central bank
Monetary policy
regulation and supervision of the banking system in Romania

JEL Classification
E58

Abstract

The main challenges currently faced by most central banks are generated by the effects of the economic and financial crisis. Thus, at the national, European and international level there is a trend of changing the economic governance structures and improving the regulatory and supervisory policies, focusing on macro-prudential oversight. In the context of changes at the European Union level, the central banks of the Member States become also subject to changes in their carried out actions. The objectives of this research aim mainly at: highlighting the role of the National Bank of Romania in regulating and supervising the banking system in Romania and analyzing the measures implemented by the National Bank of Romania after the crisis so far; identifying the challenges of the National Bank of Romania on the basis of changes operated by European Union at the supervisory framework level.
1. Introduction

In market economies, the banking regulation and supervision is carried out either by the central bank or by a separate entity, more severe, more rigorous than other types of entities, but do not depart from the general principles governing the economy market.

In order to avoid a new global economic crisis there have been initiated, both at an international level and in the European Union level, a number of measures to reform the supervision system which aims at improving the EU regulatory and supervisory restructuring of the current formula. Structural reform of the current supervisory framework proposed aims (RA, 2009, www.bnr.ro) both macro-prudential supervision and micro-prudential supervision through the establishment of European authorities for the supervision of individual financial institutions. The national financial supervisors will cooperate closely with the new European Supervisory Authorities to ensure proper functioning of the European single market.

Setting the objective of strengthening the regulation and supervision of the European financial sector is in fact a response to the financial crisis that has affected all states of the world. In order to achieve this goal it is necessary to build new mechanisms and institutions to ensure this fact. Thus, the new architecture of EU economic regulation can be seen as a distinct component is the Union Banking related to the three pillars, representing achieve its fundamental condition for the development of the European safe banking sector, responsible, generating economic progress.

2. The role of the National Bank of Romania in regulating, licensing and supervising the banking system

In the universe of central banks, the National Bank of Romania (NBR) can be placed in the category of middle-aged and in our institutional universe can be considered "an old lady of the Romanian society" as the governor Mugu Isărescu called in his speech to celebration of 115 years of existence of National Bank of Romania. By way of curiosity, it is worth mentioning that the National Bank of Romania is one of the oldest in the world (in fact, the sixteenth central bank), ahead of prestigious institutions such as the Bank of Japan (1882), Bank of Italy (1883), the Federal Reserve - Central Bank of the US (1913) and the Swiss National Bank "(Isărescu, 2006, p.174).

Among the most important moments in the evolution of National Bank of Romania, we remember as follows: In 1946, the central bank is nationalized and became the sole shareholder bank, the Romanian state; In 1948 and 1970 the official name of the bank name changes according to the country's central bank in 1990 and reinstated their respective functions of a central bank in market economies.

2.1. Bank authorization and regulation of banking activity in Romania

With the issue of the legal framework similar to those in market economies (Law 33/1991 and Law 34/1991) the National Bank of Romania has made its presence felt not only on the authorization line, but also the regulation and supervision. The legal acts adopted in the first stage of the reform efforts of the central bank were directed to the restructuring of the banking sector while outlining an appropriate framework of licensing, regulation and prudential supervision. During the second decade of transition, in view of our country's accession to the European Union and European Monetary Union integration, the central bank initiated a series of legislative changes adopted in 2005 a new monetary policy regime as required primary objective of price stability, and namely inflation targeting.

With regard to the authorization of the Romanian legal institutions that can function as banks in Romania, this represents a task of the central bank deciding which institutions can function as banks and grants authorizations (licenses) for operation. The powers of the National Bank of Romania in the permitting credit institutions are established by Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy, as amended and supplemented. The current Romanian banking system contains, in addition to banks as Romanian legal persons, another kind of banks operating under the single banking license, as stipulated in the Second Banking Directive of the European Community, which allows a bank that has been granted operating in a country, to operate in any other country in the European Union more often as branches.

The prudential regulatory framework, outlined until 1995, was later expanded and improved in accordance with specific European requirements (European Union’s directives) and international requirements (Basel Committee Principles) imposed by an effective banking supervision, but also in accordance with new issues arising at an international level, the National Bank of Romania adopted a number of regulations on capital adequacy (minimum 8 percent), large exposures, currency exposure, participation in the capital of a banking company to another bank or a non-banking companies, loan portfolio classification, reserve general provisions for credit risk and specific risk (Isărescu 2006, p.210).

In the process of accession of Romania to the European Union, the National Bank of Romania paid special attention to progress on the transposition into national law of the acquis communautaire in the banking sector. The
The gradual liberalization of currency has focused its efforts on the following issues (Căpraru 2009, p.331):

- The independence of the central bank;
- Adjusting the central bank regulations on the modernization of the payment system;
- The prudential requirements of the commercial banks in their lending activity;
- The standardization of coding bank accounts;
- The gradual liberalization of currency transfer operations;
- The adjusting of the regulatory requirements to combat money laundering.

The intensifying efforts to harmonize the Romanian banking legislation with the provisions of EU directives has resulted in the adoption and promulgation of the Law no. 443/2004 amending and supplementing the Banking Law no. 58 / 1998. According to the new legislation, the central bank has competences in the field of supervision on a consolidated basis of credit institutions, using the principles of the single authorization banking and mutual recognition of authorizations and prudential supervision systems.

Along with the full harmonization of banking law with EU directives, there were adopted a number of other regulations with direct impact in terms of improvement of supervision, emphasizing issues like supervision on an individual basis and consolidated personal funds; supervision of solvency and large exposures of institutions credit; and also ensured extension of accounting regulations to all credit institutions.

The prudential regulatory activity carried out by the National Bank of Romania was to develop secondary legislation in cooperation with the National Securities Commission and the Insurance Supervisory Commission. In the context of increased international financial turmoil the National Bank of Romania has focused its efforts to strengthen prudential regulatory framework and adopted a series of measures in order to counteract the accumulation of risks in the banking system and targeted the modification of the method of calculation of personal funds of credit institutions and supplementation of provisions specific to credit risk, the introduction of additional requirements on alternative plans for liquidity risk management in crisis conditions, the development of new provisions to improve risk management in lending to individuals (Isărescu 2009, p.298).

The National Bank of Romania has paid special attention to complete the regulatory framework of the accounting of the credit institutions in order to incorporate extensive provisions at EU level and alignment with International Financial Reporting Standards (IFRS).

We can say that the current regulations developed by the National Bank of Romania are aligned with international standards, which is consistent with the principles of the Basel Committee on banking supervision and with the EU directives regulating financial and credit institutions.

2.2. The supervision of banking in Romania

Greuning defines banking supervision as an integral part of an ongoing process that includes establishing a legal framework for banking sector, assigning the regulatory and supervisory authorities, defining the conditions and criteria for granting operating licenses and implementation of legislation which limits the risk level that banks are allowed to assume, establishing a framework for reporting and prudential supervision and operating these activities on the ground, followed by examinations in the office (Greuning, 2003, p.174).

According to the law in force (Romanian Law no. 312 of 2004), the National Bank of Romania is assigned with the “exclusive jurisdiction to authorize credit institutions” and with the responsibility for "prudential supervision of credit institutions that authorized them to operate in Romania”. The banking regulation and supervision is accepted, in the opinion of several authors in the field, as a solution to provide banks and national economy security and stability (Basno, Dardac, 2002, p.221).

The most important reference in micro-prudential supervision is the capital Basel III agreement. Under the new approach, supervision is increasingly turning to analyze the risk profile of the institution, the existing tools and instruments to reach its leaders in order to effectively manage specific risks. Rating systems and early warning, stress tests and interbank contamination are sophisticated techniques that enable a successful analysis of the risks of the analyzed institutions or financial and banking system as a whole and early identification of these risks (Moinescu, 2007, p.9).

The prudential supervision of the Romanian banking system is done by the National Bank of Romania on the basis of regular reports of banks but also through on-site inspections, pursuing the objectives similar to those used in international practice, namely: asset quality, management quality, solvency liquidity, capital adequacy and profitability. Towards the end of 2005 the National Bank of Romania accelerated the process of expanding its surveillance and the Non Financial Institutions.

In determining the total banking system risk, the National Bank of Romania receives reports from commercial banks for CAMEL system elements (capital, assets, profitability, liquidity) and for the management and ownership on-site inspections are performed by the supervisory department.
A coordinate of the policy to streamline the banking supervision was the establishment and improvement of structures to indirectly support it - Guarantee Fund Bank Deposit (FGDSB-1996), Central Credit Risk, Payment Incidents (CIP -1996) and Credit Bureau (operational since August 2004). Important contributions to the intensification of prudential supervisory process reverted to the cooperation activities of the National Bank of Romania with a number of national (the establishment of the National Committee for Financial Stability) and international institutions and bodies. In comparison with other European countries, among which macro-prudential instruments are relatively recent, the National Bank of Romania has nearly a decade of experience in using them (the first steps were taken in late 2003 and implemented in February 2004). The high level of "euroisation", the liberalization of capital account and foreign capital inflows decreased the efficiency of using micro-prudential or monetary policy measures to limit excessive lending, and resulted in a macro-prudential approach (RSF, 2014, p.137, www.bnr.ro).

In the first phase, the prudential regulations imposed by the National Bank of Romania aimed at the household lending segment (with predilection foreign currency lending), enlarged in 2012, and at the non-financial corporate sector. The measures consisted of placing limits on indebtedness related to the amount of disposable income (DTI) and the collateral value (LTV). The approach of the National Bank of Romania was not static, regulations that implemented these tools suffered a number of changes from the time and date of first use. Changes hinted both the way to use the instruments and the institutional coverage (RSF 2014, p.137, www.bnr.ro).

In the Financial Stability Report prepared by the National Bank of Romania for 2014 can be found the section "macroprudential tools implemented by the National Bank of Romania on borrowers - a decade of experience" for a detailed explanation of the evolution of macro-prudential instruments used by the National Bank of Romania from 2004 to present. From the experience gained in the use of macro-prudential instruments by the National Bank of Romania we can draw the following conclusions:

- Letting entirely up to the banks the process of establishing thresholds for DTI and LTV through domestic norms is not the most effective solution for implementing macro-prudential measures, because lenders often proved procyclical behavior;
- The need to adjust macro-prudential measures within the financial cycle because their effect may be affected by regulatory arbitrage.

3. The challenges of the National Bank of Romania in regulation and supervision process in the post-crisis period

As far as the financial crisis highlighted the need for appropriate regulation and effective supervision of the financial system, nowadays there are significant changes of micro-prudential and macro-prudential regulatory framework both at EU level and at national level (RSF 2013, p. www.bnr.ro 168).

Currently, the EU’s economic governance goes through a sustained process of reconfiguration. The main change is the creation of European Banking Union and the participation of the State Member to its component mechanisms. The project of the European Banking Union will have a strong impact both on the micro-prudential supervisory practices and the prudential supervision framework in the euro area and on the Member States that decides to participate. The Banking Union adresses to the member states of the euro area, which automatically become members of this construction, but the EU Member States outside the euro area, including Romania, have the choice to participate or not to the European Banking Union. The Option to participate in the European Banking Union involves both advantages (strengthening financial stability, increasing confidence in the national banking system due to the harmonization of supervisory practices and deposit guarantee schemes and support lending and economic growth) and disadvantages (a reduction of instruments and decision-making power at the national level, essentially in the prudential supervision and bank resolution, and lead to a series of charges determined by national contributions to the financing implemented mechanisms).

For countries outside the euro area, the accession to the Single Surveillance Mechanism (SSM) takes the form of "close cooperation" between the European Central Bank and the national competent authority, that is established by a decision of the European Central Bank. If Member States outside the euro area participate voluntarily in the Single Surveillance Mechanism, the European Central Bank will not have direct powers to oversee institutions based in that Member State, but will give the competent national authority and guidance on supervised entities. After Romania shall enter into the single supervisory mechanism, expected to occur in 2016 according to a clear schedule, which is after completion of comprehensive evaluation stage of the Romanian banking system, the European Central Bank will exercise exclusively for the purpose of prudential supervision tasks, a number of tasks currently performed by the National Bank of Romania. (RSF 2014, pp.143-144 www.bnr.ro).
According to Governor Magur Isarescu, "a strong argument for the accession of a non-euro state to the European Central Bank is the prevalence of the euro area capital in the capital structure of the banking sector. In the case of Romania, the European Central Bank itself appears as the natural choice, given that eurozone banks hold over 70 percent of net assets and capital of the banking system in Romania ". "Maintaining the prerogatives of national banking supervision is merely suboptimal result due to limited access to information on parent banks". The massive presence of foreign capital, especially in the euro area of the banking system in Romania, requires more than making cross-border regulation and supervision (Isărescu, 2014 www.bnr.ro). In addition, to remain outside the European Central Bank may incur significant non-euro area countries, which are vulnerable to the effects of contagion, if foreign banks have a massive presence in their bank system. In case of spill, the response of these countries would be severely limited, the mechanisms and personal resources proved to be insufficient or inadequate.

As recommended by the European Systemic for Risk Board of 22 December 2011 is necessary for each Member State to designate an authority responsible for macro prudential policy implementation in the national financial system. Currently, in Romania, there is a Romanian law in draft, which is the Government Emergency Ordinance on the national macro-prudential oversight of the financial system which provides for the establishment of the National Committee for macro-prudential supervision (NMHC) inter-institutional cooperation structure without legal personality, chaired by the Governor of the National Bank of Romania, which will bring together the expertise of national regulatory authorities in the financial sectors (NBR, ASF) and the government to ensure joint responsibility of the authorities to identify, monitor and assess systemic risk, identification of financial institutions and financial structures of the system-relevant structures, (RSF, 2013, p.1142 www.bnr.ro).. At national level the following measures have been adopted to improve prudential regulation framework (David, 2013, p.380):

- differentiate the conditions for granting the loans secured by mortgages to those applicable to other types of loans;
- change the regulations on the establishment of credit risk provisions;
- strengthen the remedial powers of the National Bank of Romania, in the case of credit institutions in difficulty;
- widen databases of the credit registers;
- set up the the Romanian Fund of Counter-Guarantees

- strengthen the cooperation with other supervisors of financial institutions facing problems and assess the potential impact of decisions on the stability of the financial system in all EU Member States.

According to reports of financial stability compiled by the National Bank of Romania for 2012, 2013 and 2014, the most recent changes to the regulatory and supervisory framework of Romanian are: Package CRD IV regulations, Solvency II Directive and the financial transaction tax (FTT) and implementation of European Banking Union. CRD IV regulations package includes both a proposal for a Regulation on prudential requirements for credit institutions and investment firms and a proposal for a Directive on access to the activities of credit institutions and the prudential supervision of credit institutions and investment firms. Solvency II Directive is a project of European harmonization of standards for assessing capital requirements and risk management for insurance companies.

In order to early identify potential vulnerabilities in certain sectors that can affect the entire financial system through contagion, and hence the financial stability, the National Bank of Romania are considering a measure to quantify stress conditions in financial markets as Systemic Venture Composite Indicator (ICRS) indicator used also by ESRB to monitor risks in the European financial system.

4. CONCLUSIONS

The National Bank of Romania was constantly preoccupied by **regulation and supervision of the banking system** and improved and constantly adjusted throughout the legal system since 1990, in order to ensure harmonization of Romanian legislation with the European one by issuing laws, regulations, circulars and rules.

First, it is particularly important to note that throughout the period covered by the international financial crisis, the Romanian banking system remained stable, with a good capitalization and substantial liquidity reserves, due to the proactive approach of the central bank, which strengthened prudential regulation and supervision.

Regarding the challenges of the National Bank of Romania in the coming period, deputy governor Florin Georgescu recommended Romania to participate in the European Banking Union and states that "Romania's accession to the European Banking Union is a landmark in the course of the single currency because, strengthens financial stability, including by reducing the risk of regional contagion and removing a driver of deleveraging by banks with foreign capital. Also facilitates the recovery of lending on a path consistent with sustainable development of economic activity in tandem with economic resources released by
structural reforms leading to an increase in the real convergence process likely to achieve a sustainable fulfillment of criteria for joining the euro area."

Strengthening the surveillance capacity is also one of the concerns of the National Bank of Romania seeking to ensure stability; to improve the credibility of the banking sector and the banks’ ability to provide efficient financial intermediation.

“ACKNOWLEDGMENT
This paper has been financially supported within the project entitled „SOCERT. Knowledge society, dynamism through research”; contract number POSDRU/159/1.5/S/132406. This project is co-financed by European Social Fund through Sectoral Operational Programme for Human Resources Development 2007-2013. Investing in people!”

5. Bibliographi: