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# ADAPTATION OF THE ROMANIAN BANKING SYSTEM TO THE INTERNATIONAL REGULATIONS

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*Abstract*

***The international regulations concerning the activity of the commercial banks (the Basel Agreements) underwent significant changes after the onset of the financial crisis of 2007-2008. The National Bank of Romania has started the legal steps necessary to adapt to the new international requirements, which I propose to analyze in this paper. In addition I will also analyze the degree of fulfillment of the minimum levels of the currently indicators considering the fact that their implementation is done gradually until 2019, in order to highlight the possible risks to which the Romanian banking system ,at aggregate level, is exposed.***
***Index terms - capital adequacy indicator, liquidity risk, leverage***

## I. INTRODUCTION

The Romanian banking system, as the one at international level, undergoes significant challenges since the onset of the crisis of 2007-2008. This crisis, through its manifestations, revealed that the risk management method in the banking system is not complex enough and that it does not take into account risks such as liquidity or the systemic risk. In this context, since 2009 they founded the Basel III Agreement (whose provisions have been incorporated in the European Union by directives CRD IV [1] - Directive no. 2013/36/EU regarding the activity of the credit institutions and the prudential supervision of the credit institutions and of the investment firms, of modifying Directive 2002/87/CE and repealing Directives 2006/48 / EC and 2006/49 / EC and CRR IV [2] - Directive no. 2013/36/EU regarding the activity of the credit institutions and the prudential supervision of the credit institutions and of the investment firms, of modifying Directive 2002/87/CE and repealing Directives 2006/48 / EC and 2006/49 / EC), which began to produce effects in Romania starting with January 1st 2014.

I will perform the analysis starting from the legislative adaptation, so that then I would perform an analysis in evolution of the main indicators covered by the new regulations (the capital base required for determining the solvency indicator, introducing the leverage effect, monitoring the indicators regarding liquidity risk and systemic risk). The purpose of the analysis of these indicators is to reflect their fulfillment method at the level of the Romanian banking system.

## II.LEGISLATIVE ADAPTATION TO THE INTERNATIONAL REGULATIONS

In Romania, the basic normative act regulating the activity of the credit institutions and their prudential supervision by the National Bank of Romania is the Government Emergency Ordinance no. 99/2006 regarding credit institutions and capital adequacy, approved with modifications and completions by Law no. 227/2007, with the following modifications and completions (G.E.O no. 99/2006), which transposed the provisions of Directive no. 48/2006 / EC of the European Parliament and of the Council from June 14th 2006, regarding the access to activity and developing the activity by the credit institutions and of Directive no. 2006/49 / EC of the European Parliament and of the Council of June 14th 2006 concerning the capital adequacy of investment firms and credit institutions, applicable to the banking and investment firms system. The CRD IV legislative package represents the legal framework that governs the bank activity, the supervisory framework and the prudential requirements applicable to the credit institutions and to the investment firms in the Member States of the European Union, ensuring the implementation, at European level, of the Basel III provisions. In this context, in order to ensure the transposition of the provisions of Directive no. 2013/36 / EU at primary legislative level, it is necessary to amend the existent legal framework, represented by O.U.G. no. 99/2006.

In terms of the transposition method of the prudential banking regulations at European level in the Romanian legislation, Directive no. 2013/36 / EU (CRD IV) was transposed into the national legislation, as follows [3]:

- at the level of the primary legislation through modifications and completions brought to the Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy, approved with modifications and completions through Law no. 227/2007, with the following modifications and completions (Government Emergency Ordinance no. 99/2006);
- at the level of the secondary legislation by issuing the National Bank of Romania Regulation no. 5/2013 on prudential requirements for the credit institutions (NBR Regulation no. 5/2013).

Modification GEO no. 99/2006 was carried out by GEO no. 113/2013, with entering into effect at January 1st 2014. GEO no. 113/2013 ensures the transposition of the provisions of Directive no. 2013/36 / EU which aims, in particular, to strengthen the legal framework applicable to the credit institutions in the following areas:

- corporate governance;
- the prudential supervisory process; and
- the sanctioning regime.

In the domain of the corporative governance, the most important changes brought to GEO no. 99/2006 as a result of the innovations introduced by Directive no. 2013/36 / EU relate to the following aspects:

- introducing provisions relating to an effective corporate governance in the credit institutions aimed to contribute at avoiding excessive risk taking and that would allow the National Bank of Romania to monitor the adequacy degree of the mechanisms concerning the administration framework of a credit institution, respectively introducing some principles and standards that would be applied taking into account the nature, the scale and the complexity of the credit institutions activities.

- strengthening the corporate governance framework involves introducing provisions relating to:
  - taking into consideration, when determining the composition of the governing body of a credit institution, a wide range of relevant professional experiences;
  - allocating sufficient time by the members of the governing body to permit the exercise of their duties;
  - each member of the governing body in its supervisory function exerted their responsibilities with honesty, integrity and objectivity in order to assess, control and monitor the decision-making process of the senior management.
  - Detailing the situations relating to restrictions concerning the exertion of the mandates in executive and non-executive functions by the members of the bodies with leading function or with supervisory function;
  - taking into consideration when determining the composition of governing / supervision bodies of a credit institution a of a wide range of relevant professional experiences;
  - applying some sound remuneration policies.
- introducing some provisions regarding the credit institutions obligation to have their own funds that would cover the capital buffers designed for systemic risk management and systemic interconnectedness, which can be used during periods of crisis to mitigate the effect of losses manifestation over the capital base;
- introducing provisions relating to detailing the prudential supervisory process when it comes to credit institutions that the National Bank of Romania supervises; the modification, in this context, of provisions concerning conducting checks on spot and inspections to the branches of the credit institutions, Romanian legal persons or the branches established in Romania by the credit institutions from other Member States and also the provisions on extending the range of supervision measures that the National Bank of Romania can make available regarding a credit institution;
- introducing provisions on detailing the necessary preventive measures to protect against financial instability, which the National Bank of Romania, as competent authority of the host Member State, may take in emergencies, in the case of the regime applicable to branches set up in Romania by credit institutions from other Member States, until the adoption of some measures by the competent authority from the home Member State; However, starting from the date when the requirement to cover the liquidity necessary becomes mandatory under a delegated act adopted by the Commission (at the earliest starting from January 1st 2015, with the possibility of postponing the adoption of that delegate act with up to 2 years ), the competence concerning liquidity risk supervision for the branches established in Romania by the credit institutions from other Member States, will return exclusively to the competent authority from the home Member State;
- strengthening the legal framework regarding the sanctioning regime, by detailed providing both of the infringements committed by a credit institution and of the sanctions

and sanctioning measures that can be applied by the National Bank of Romania and that must be effective, proportionate with the facts and deficiencies found and with discouragement effect; establishing some essential requirements regarding the recipients, the criteria that must be considered when applying a sanction or sanctioning measures, the levels of financial penalties, ensuring some effective and credible mechanisms for reporting the breaches committed. A peculiarity of the sanctions regime consists in publishing the penalty charges along with information regarding the infringements committed, excepting certain well defined situations.

- the clear provision of the competence of the National Bank of Romania regarding the resolution of the credit institutions and specifying the existence of a clear separation between exercising the attributions concerning resolution towards the attributions concerning prudential supervision; defining, in this context, the concept of resolution and also introducing provisions relating to the elaboration of recovery and resolution plans [4].

Regulation no. 5/2003 mainly contains:

- provisions from Directive 2013/36 / EU which have not been implemented at primary legislation level (meaning in OUG 99/2006);
- the manner of exercising the national options existent in the national CRD IV package;
- principles from the Basel Committee documents, in certain areas covered by the regulation.

Thus, the main provisions of Regulation 5/2013 refer to[5]:

- the management framework of the credit institutions activity, the internal process of assessing the capital adequacy to risks and the outsourcing requirements of the credit institutions activities;
- requirements concerning capital dampers;
- consolidated based supervision of the credit institutions;
- the conditions for approving the use of the internal rating models for determining the capital requirements for credit risk;
- the requirements for prior notification for using the standardized approach for the operational risk, the ones for approving the use of the alternative standardized approach for the operational risk and the conditions for approving the use of the advanced evaluation approach for determining the capital requirements for the operational risk;
- the conditions for approving the use of internal models for determining the capital requirements for the market risk.

The main novelties brought by this Regulation in the management framework of the credit institutions activities are aimed at [3]:

- risk management involves:
  - a culture regarding risks;
  - a risk management framework;
  - a policy concerning new products.

- the existence, in terms of internal control, of a framework related to internal control, that ensures:
  - effective and efficient operations;
  - risk control;
  - prudent conduct of the activity;
  - the credibility of the financial and non-financial information;
  - compliance with the legal and regulatory framework, monitoring requirements and the rules and internal decisions of the credit institution;
- reiterates the three control functions: the risk management function, the compliance function and the internal audit function.

Therefore, the National Bank of Romania paved the field in normative terms for the implementation of Basel III provisions, but their implementation will be done in Romania, as in other countries, in a gradual way so that the banks would succeed to build up the necessary capital for fulfilling the solvency standards and modifying the structure of their assets and liabilities, in order to meet the liquidity indicator.

## III. ACHIEVEMENT OF THE INDICATORS RECOMMENDED BY INTERNATIONAL GUIDELINES

Regarding the fulfillment of the new indicators imposed by Basel III and by the European directives, I will analyze the main indicators that suffered modifications, namely the solvency indicator, the leverage effect, the indicators for monitoring liquidity risk and the management method of the systemic risk.

In terms of the **solvency indicator**, it remained the same, at an aggregate level, always above the level imposed by the Basel agreements (8%), which means that its increase by Basel III (over 10%) does not raise problems for the banks in the Romanian sector, NBR constantly imposing additional capitalization when the indicator was declining.

A very important aspect when it comes to the solvency indicator, in terms of the changes brought by Basel III, is the structure of its own funds and the increase of the importance of its own quality funds (its own funds of level 1) in the structure of the banks' own funds. Thus, according to NBR, the quality of its own funds maintains high, these being composed mainly of elements characterized by a high loss absorption capacity. The NBR has continued to use the regulatory instruments, taking into account the flexibility elements conferred by the CRD IV / CRR frame to the national authorities during the transition period until the full implementation, in order to increase the credit institutions' capacity to cope with endogenous and exogenous shocks, by continuing to apply the prudential filters. In the first half of 2014, all the credit institutions meet the minimum requirements for their own funds established by the legislative package CRD IV / CRR [6]. Thus, analyzing the structure of its own funds (Table 1) we can observe the comfortable level, at aggregate level, of the level 1 funds, which allows the considerable fulfillment and overcome of the solvency indicator calculated on the basis of their own level 1 funds, of minimum 6%. We can also see the steady increase of its own level 1 funds to the detriment of its own level 2 funds, which reached only 12.3% of the total level 1 funds, in June 2014.

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TABLE 1 – THE EVOLUTION OF ITS OWN FUNDS AND OF THE CAPITAL ADEQUACY INDICATOR

| | dec.08 | dec.09 | dec.10 | dec.11 | dec.12 | dec.13 | June.14 |
|---|---|---|---|---|---|---|---|
| Percent from its own total funds: | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| Level I own funds | 77,3 | 78,6 | 80,8 | 80,7 | 92,3 | 91,1 | 87,7 |
| Level II own funds | 22,7 | 21,4 | 19,2 | 19,3 | 7,7 | 8,9 | 12,3 |
| The rate of the total own funds (which must be more than 8%) | 13,8 | 14,7 | 15 | 14,9 | 14,9 | 15,5 | 17 |
| The rate of the level I own funds (which must be more than 6%) | - | - | 12,1 | 12 | 13,8 | 14,1 | 14,9 |

Source: NBR – Report over the financial stability, 2014, page 33

The rate of the total own funds which should be more than 8% was constantly improved, so that, in June 2016 it was of 19.10% [7]. This level is comfortable at the level of the aggregate banking system but it remains to be seen what is the situation at the level of each bank, especially in the smaller banks, but this will be the subject of a future research.

Regarding the **liquidity indicator**, as of 2014 it has became applicable Regulation (EU) no. 575/2013 which governs in Part 6 the two indicators related to liquidity risk: the coverage indicator of the liquidity requirement (LCR) and the indicator regarding the net stable funding (NSFR), NBR also analyzes at aggregate level, the level of LCR, on groups of banks (banks with systemic importance and banks that are not systemically important).

Regarding the impact on the Romanian banking sector, for now, not being imposed recording a minimum level of 100% for the LCR (which is expected to become mandatory in 2018 [8]), the NBR only monitors the level of this indicator, without the data to be published at individual level of each bank. Thus, the NBR reports the level of the LCR indicator synthetically, as minimum, medium and maximum level for the Romanian banking sector, structured in banks deemed systemically important (respectively: BCR, BRD, Transilvania Bank, Raiffeisen, CEC, Unicredit and ING) and in banks that are not of systemic importance. (Table 2).

TABLE 2 – THE MINIMUM AND MEDIUM LEVEL OF LCR IN THE ROMANIAN BANKING SECTOR

| | minimum LCR | medium LCR |
|---|---|---|
| Institutions that are of systemic importance | 100% | 300% |
| Institutions that don't have systemic importance | 30% | 250% |

Source: Processing after NBR – Report over financial stability, 2014, page 146

From the analysis of these data it can be seen that neither the systemically important banks, nor those without systemic importance have difficulties meeting the minimum level of 100% of the LCR (if we take into consideration the medium LCR), the only difficulties arise from a number of banks that are not systemically important, but are not yet made public, that have a reduced minimum LCR, below 50%.

Regarding the **leverage effect indicator**, it is considered a relevant risk indicator because its method of calculating no longer imposes risk weights, which better reflects the proportion in which its own capitals cover the banking assets. The leverage effect is calculated as follows:

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Capital (level 1) / total exposures (un-adjusted) (according to CRR) and for it we also discuss a level of at least 3%, but this level may be subjected to revisions depending on the business model of the bank.
The situation regarding the leverage effect at the aggregate level of the Romanian banking system is comfortable again, the level being more than double the minimum limit of 3% and had no significant changes in recent years (Table 3).

TABLE 3 – THE LEVERAGE EFFECT INDICATOR (%)

| | **Dec 2009** | **Dec 2010** | **Dec 2011** | **Dec 2012** | **Dec 2013** | **Dec 2014** | **Dec 2015** |
|---|---|---|---|---|---|---|---|
| The leverage effect (%) | 7,6 | 8,1 | 8,1 | 8 | 7,96 | 7,38 | 8,18 |

Source: my own processing after the data from the interactive database of NBR, http://www.bnro.ro/Raport-statistic-606.aspx

The National Bank of Romania periodically assesses the banking system from the perspective of the **systemic nature of the credit institutions**, based on internal procedures that use the following criteria:

- the contribution of the credit institution to finance the real economy, calculated by the volume of the loans granted to the non-financial companies and the degree of substitution of the crediting activity of the non-financial companies;
- the contribution of the credit institution to financial intermediation, calculated by the volume of the deposits attracted from households and non-financial companies;
- the presence of the credit institution in the interbank market and quantifying the contagion effect by including the feedback effects generated by the real sector;
- determining the systemically important institutions within the electronic payment system;
- the presence of the credit institution on the government securities market;
- the vulnerability to contagion in the mother-daughter relationship through the common lender (the country of origin of the capital) [9].

In December 2014, the European Banking Authority (EBA) has published the final version of the *Guidance on assessing other systemically important institutions*, and in February 2015, the NBR has incorporated the provisions of the EBA guide during the surveillance procedures, by introducing in the identification procedure the systemic banks of the mandatory criteria set and indicators recommended by the Guide (table 4).

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TABLE NO. 4 – CRITERIA AND INDICATORS FOR IDENTIFYING THE SYSTEMIC BANKS

| Criteria | Indicators |
|---|---|
| Size | Total assets |
| The importance for the member state's economy or for the EU | The value of the payments made at national level<br>Deposits attracted from the private sector in the EU<br>Credits granted to the EU private sector |
| Complexity | The value of the transactions with derivate financial instruments<br>Cross-border liabilities<br>Cross-border assets |
| The interconnectivity of the institution or group with financial system | Liabilities having as counterparty other entities in the financial system<br>Assets having as counterparty other entities in the financial system<br>Bonds issues in balance |

Source: NBR, Liviu Voinea – Financial stability, the systemic risk and the macro prudential risks from the perspective of the central bank, Bucharest, 25.02.2015

The methodology for identifying the systemically important credit institutions includes both quantitative analysis and qualitative ones. During the analyzes carried out by the central bank in the first half of 2013, there were identified seven credit institutions (of which 6 were Romanian legal persons credit institutions and one branch of a foreign bank) of high systemic importance. The simulations carried out by the NBR over the fulfillment, of the credit institutions, of the new capital requirements imposed by the package CRD IV / CRR revealed that the credit institutions of systemic importance meet the minimum capital requirements applicable (respectively, the minimum requirement for its own total funds of 8 percent, to which it is added the capital conservation damper of 2.5 percent, and respectively the damper for systemically important institutions nationwide, of maximum 2 percent), both in the hypothesis of a gradual implementation and in the hypothesis of an advance implementation of the additional requests of capital conservation. At the end of the first semester of 2013, the market share of the credit institutions of systemic importance raised in total bank assets was of 65.5 percent.

## IV.CONCLUSIONS

- The financial crisis of 2007-2008 showed that banking regulations were insufficient and that there is a need for a stricter supervision of the bank risk indicators, an aspect which I personally consider late, because a stronger capital discipline during the financial expansion period would have been the one needed for preventing the crisis.
- The new regulations regarding prudential supervision at international level were set up in Basel III agreement, and at European level in directives CRD IV and CRR. All these regulations had to be taken over in the national legislation, and in this paper I have

highlighted the legislative changes made by the NBR for the harmonization with the international and regional regulations.

- In addition, following the analysis of the method in which it the indicators on solvency, liquidity and systemic risk are respected at the aggregate level of the Romanian banking system, I may conclude that they are fulfilled, with comfortable levels above the minimum level. In the researches that I will undertake further, I will also analyze the impact of the national regulations at the individual level of the Romanian commercial banks, where I suspect framing problems especially in the small banks that have difficulties in permanently supplementing the superior quality capital.

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