

DIMENSION OF BANKING REGULATION IN THE CONTEXT OF THE INTERNATIONAL FINANCIAL CRISIS

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Abstract:

The context of the current international financial crisis, caused by treatment with superficiality of banking regulations, demonstrates the need to elaborate, issue and implementation of effective and uniform regulation in the field of prudential supervision of credit institutions. In Romania, this role falls to the National Bank, who succeeded, in the last years, the implementation of European directives under the Basel II Agreement.

Key words: *banking regulation, international financial crisis, prudential supervision, the Basel II Agreement.*

JEL classification: G21

The current international financial crisis brought to the attention of the contemporary banking world, the necessity to accentuate the role and the importance of the banking regulations and norms. At the basis of the crisis it's just the elusion of the banking regulations, treating them with superficiality by the real estate credit institutions.

The transformation of the Romanian banking system after 1990, from a mono banking to a two-tire banking system, led to the requirement of improvement of the banking legislation.

Thus, the National Bank of Romania was appointed as independent public institution, the central bank of the Romanian state, the only institution authorized to elaborate, issue and apply regulations that concern the prudent supervision of the Romanian financial system (Law 312/2004 and Law 58/1998).

Once with the implementation of the Basel II Agreement, one may say that the National Bank of Romania entered into a new stage of its development as modern bank, performing its activity according to the European standards in the field.

If the Basel I Agreement had imposed the rules for establishing the minimum level of capital required for covering the risk of credit (agreement from 1988) and of the market risk (amendment from 1996), showing this way that the fundamental element of the financial supervision must be the capital, the main objective of this agreement, according to the Directive no.12 from 2000 of the European Community, being the assurance of the convergence of the prudent regulations regarding the credit risk and market risk it did not focus on the financial stability.

The main areas of regulation by Basel I targeted:

- Establishing the component elements for determining their own funds needed by the banks;
- Regulation of the capital requirements for the credit risk and the market risk;
- Providing the conditions for development of internal control procedures and the corporative governing principles;
- Introduction of the supervision on a consolidated base of the credit institutions.

This supervision frame, issued by the Basel Commission in the year 1999, was imposed by the need to adapt the risk evaluation to the financial innovations occurred on the international markets.

The Basel II agreement appears as a radical change of approach, because it gives the credit institutions the liberty to choose their own methods and risk evaluation techniques, and also induces new risk categories (the operation and market ones). The new agreement has been signed in the month June of the year 2004, and in Romania has been implemented from December 2006.

For the implementation of the Basel II Agreement, the National Bank of Romania has adopted a series of regulations regarding the improvement of the supervision activity, regulations that mainly targeted:

- supervision of solvability and large exposures of the credit institutions;
- supervision on an individual and consolidated basis of their own funds;
- expansion of the application of the harmonized accounting regulations at the level of all credit institutions;
- implementation of the clientele knowledge standards;
- organization and internal control of the activities of the credit institutions and administration of significant risks.

Thus, the Norm No. 17 from January 2004 of the National Bank of Romania regarding the organization and internal control of the activities of the credit institution and administration of significant risks, is a regulation by which the first steps for preparing the adoption of the Basel II Agreement have been initiated.

The stages targeted by the National Bank of Romania in the implementation strategy of the New Agreement of Capital are related to the initiation of the dialogue and accomplishment of the exchange of information with the banking sector.

In the first stage, performed during the period May – November 2005, the main activities have been:

- the making of a general evaluation regarding the risk management instruments and knowledge of the position of the credit institutions regarding the national options (adopting the standard approach or of the one based on internal models);
- informing and establishing the dialogue with other national authorities (Ministry of Public Finances, National Commission of Securities) and international (surveillance authorities of other states);
- evaluation of the professional training requirements at the level of the banking sector, including at the level of the central authority.

In the second stage, one has pursued the development of the means for making the surveillance of the banking sector at the standards imposed by the New Capital Agreement (stage that took place during the period December 2005 – May 2006), which are: canalizing the efforts, simultaneously, on the transposition in the national legislative framework of the European Directives, on surveillance activities at the registered office of the central bank (off-site) and missions at the registered office of the credit institutions (on-site) for verification of implementation of Basel II, and on the providing the premises of the financial stability during the period of enforcing the Basel II Agreement.

The third stage targeted the validation process by the National Bank of Romania of the internal rating models used by the credit institutions for evaluation of clients and existing credits portfolio (stage that took place during the period June – October 2006).

During the fourth stage, one has pursued the implementation of the verification process of the application of the provision of the New Capital Agreement in the banking sector (process that took place starting with the month January 2007).

The measures taken for the implementation of the Basel II Agreement have targeted both the changing in the legislative framework as well as the on in the

institutional and relational.

Thus, while in the legislative framework one has accomplished the takeover and transposition into the Romanian laws of the two European Directives, within the institutional framework, were targeted implementations that pursued:

- The Central Bank by the training of the personnel, development of the databases regarding credits, self-evaluation of the surveillance capacity (Pillar 2 of the Basel II Agreement) and evaluation of the impact of macroeconomic evolutions on the financial stability.

- The credit institutions, by including the new requirements in the internal strategies and politics, development of the practices of corporative governing, reconfiguration of the objectives in the field of clientele and banking products.

The implementations made in the field of the relational framework have pursued the improvement of the collaboration between the National Bank of Romania, Ministry of Public Finances, the National Commission of Securities, the Chamber of Financial Auditors of Romania and Romanian Bank Association:

- by adopting some cooperation agreements with the supervision authorities from the origin states of the credit institutions that have branches in Romania and

- by development of the national rating agencies, measures by which the reinforcement of the collaboration at regional level has been accomplished regarding the experience in implementing the Basel II Agreement.

Advantages of new prudential requirements were found following the specific of the activity of each credit institution and risk profile that it represents, leads to the development of the market of the rating agencies, providing the diversification of the methods regarding the evaluation of the risks and establishing the capital requirements from a simplified level to a sophisticated level. It also determine a reduction of the capital requirements in the context of the evolution from a simplified approached at advanced approaches, training the man resources for the efficient use of the evaluation procedures for the rating agencies, development of the surveillance process at the level of the Pillar 2 of the Basel II Agreement and validation of the internal models of the credit institutions and not last, in stimulating the transparency and market discipline.

Among the priorities of the National Bank of Romania was also found the improvement of some indirect support instruments of the banking surveillance, respectively: the Central of Banking Risks, the Central of Payment Incidents and Guaranty Fund of the Deposits in the banking system.

The Central of the Banking Risks (*Figure 1.*), represents a specialized structure in collecting, storing and centralizing information regarding exposing each affiant person (credit institution or mortgage credit company) of Romania, to those debtors who benefited of credits and/or commitments, whose cumulated level surpasses the limit reporting sum, as well as the information regarding the frauds with cards, manufactured by the holders.

The database of the Central of Banking Risks which is organized in four registers:

1. The central register of credits, which contains the banking risk information reported to the credit institutions and is updated monthly;
2. The register of left credits, which contains the banking risk information regarding the deviations from the reimbursement graphics from at most seven years and which is monthly fueled by the central Register of credits;
3. The register of debtor groups, which contains information on the groups of natural and/or legal persons which represents a single debtor and which is fueled monthly by the Central Register of credits;
4. The register of fraud with cards, which contains information on the frauds with cards proposed by the holders, reported to the credit institutions and which is

updated on-line.

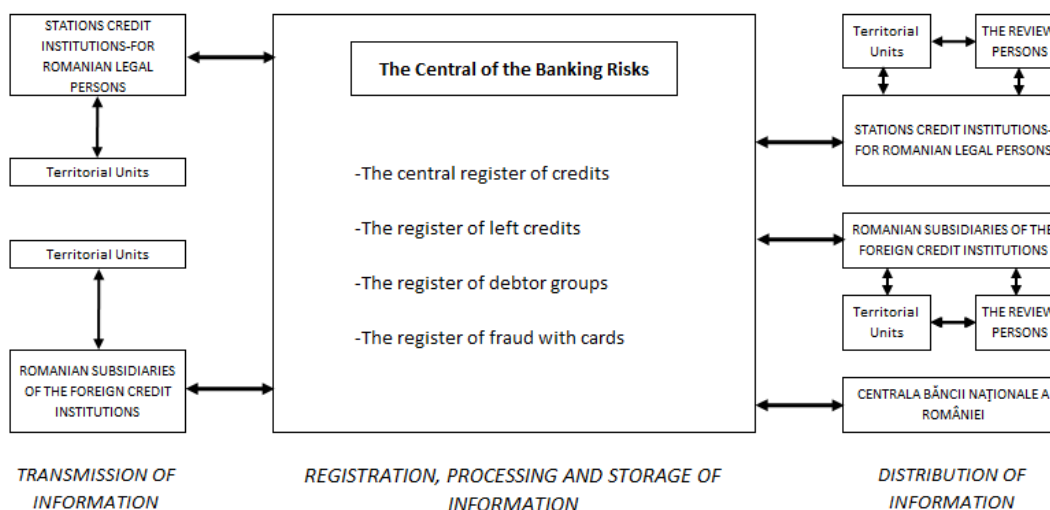


Figure 1. The information flow of the central bank risks (source: www.bnr.ro)

The Central of Payment Incidents is a center which handles, in the name of the National Bank of Romania, the payment incidents for the interest of third parties, the natural and/or legal persons.

The Central of Payment Incidents began the functioning in February 1997 in order to filter, notify and eliminate the disfunctionality factors from the National Interest Payment System.

The Central of Payment Incidents, national center of intermediation and valorization of the information regarding the incidents occurred to the payments made with debit payment instruments: checks, bill, promissory note, has as objectives:

- increasing the discipline of settlement;
- enforcement of current regulations;
- increasing the confidence of the public for the use of payments without cash;
- evaluating and limiting the risk presented by the bad payer clients.

Sending the information to the Payment Incidents Central is made electronically, either by using the inter-banking communication network which links to the central of the Romanian National Bank with the centrals of all the banks, either by the inter-banking network of the central bank, by the declaring persons (territorial units of the banks, centrals of the banking companies, payment incident offices from the BNR branches).

Manipulation of the information collected by the Payment Incidents Central is made in some national files, organized on types of payments instruments: National Cheque File; National Bill File; National Note of Hand File; and the National File of Risk Persons.

The fund for guaranteeing the deposits in the banking system (The Fund) was founded in the year 1996 by Government's Ordinance no.39/1996, being constituted as legal person of public right, having as purpose guaranteeing the reimbursement of the deposits constituted at the credit institution by the natural persons, legal persons or entities without legal personality, according to the conditions and limits established by the Law of functioning of the Fund and the development of the activity as special administrator, ad interim administrator or liquidator of the credit institutions, in the case of his appointment in one of these positions.

The participation in the scheme of guaranteeing the deposits in Romania is obligatory for all the credit institutions authorized by the National Bank of Romania to

receive deposits from the public. As credit institutions member of the scheme of guaranteeing the deposits, they must participate in the formation of the financial resources of the Fund by paying contributions to the Fund.

The transformations occurring in the Romanian banking system, by the implementation of the regulations which regarded the Basel II Agreement, for the control of banking and financial risks, have led to:

- a better administration of large expositions. The banks cannot award loans over a certain limit to a single client, which leads to the decrease of the value of the loans and of the placements on the interbanking market and to the decrease of the loans by which the banks will want to increase their resources.

- a better surveillance of the trans – frontier bank groups. For the bank groups operating in several member states, one has constituted “surveillance colleges”, clarified the rights and responsibilities of the national surveillance authorities and rendered efficient the cooperation among them.

- a better quality of the bank capital. One has introduced clear criteria at the communitarian level in order to evaluate to what extent “the mixed capital” which contains both stocks, and credit titles can be considered as being part of the total capital of a bank, depending on which one establishes how much they can give as a loan.

- a better administration of the liquidity risks. In the case of bank groups operating in several member states, one states the way in which they finance their operations every day, fact which is discussed and coordinated within the “surveillance colleges”. The administration of the liquidity risks is made based on the works of the bank surveillance Committee from Basel and of the European Committee of bank surveillance.

- a better administration of the risk for the secured products: one has made stricter norms regarding outstanding debts, of the reimbursement of which depends the performance of a certain portfolio of loans. The companies which recondition the loans under the form of transactionable titles – the so-called “initiators” being compelled to retain a part of the risk exposure for these titles, while the companies investing in them cannot decide whether to buy only after the effectuation of ample analyses.

The regulations of the National Bank of Romania, according to the Basel II Agreement, regarding the consolidated surveillance of the bank groups, has led to their adequate monitoring, including by applying the prudential norms to all the aspects of the businesses of the respective groups. A bank group includes the central bank and its branches, the associated entities and the joint companies in the country and abroad. One can also take into consideration other entities such as the mother company or the non – bank companies, including non – financial ones, of the bank group. The surveillance at the group level takes into account all the risks afferent to a bank group, going beyond the accounting consolidation.

The objectives of the consolidated surveillance refer to ensuring that no bank operation, wherever it is situated, can elude surveillance, to improving the calculation of the degree of adequacy of the capital and to prevent taking the capital into consideration several times and to ensure the evaluation and control on a global basis of the risks taken by a bank group, irrespectively of the place of accounting registration.

The cooperation between the National Bank of Romania and the other authorities of regulation and surveillance of the various sectors of the Romanian financial system has gradually intensified, as the Romanian financial system, in its entirety, became much more dynamic and complex, determining interpenetrations at the institutional level. Thus became necessary the cooperation between the authorities responsible with the authorization, regulation, surveillance and control of the component markets of the financial system, in order to ensure the transparency and the integrity of the financial system and its component markets, the observance of the

applicable law, as well as the enlargement of the national framework of financial stability.

The measures taken by the National Bank of Romania, given the responsibilities resulting from its double hypostasis of monetary and prudential authority, meant to minimize the economic costs and to promote the market discipline and the limitation of the moral risk, have led to a consolidation of the entire financial – banking system of Romania, on modern and competition bases, prepared for solving the present trans – frontier systemic crisis.

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