

## BANKING SUPERVISING IN ROMANIA – ATTRIBUTE OF THE NATIONAL BANK OF ROMANIA

**Claudia MITITELU, PhD Student**  
**Ștefan MITITELU, PhD**  
**University of Craiova**

### 1. General considerations regarding the banking supervising activity in Romania: weaknesses and strengths

In Romania, the banking supervisory authority is the National Bank of Romania, and as country's central bank has the power to authorize the operation and the banks responsible for the prudential supervision of banks authorized it to operate in the country. 90s experience has shown that besides the smooth functioning of the economy, health of the banking system depends on the existence of an appropriate regulatory framework and supervisory framework. Thus, a constant concern of NBR during 1990 - 1997, was to increase the efficiency of supervision of credit institutions, based on verification of compliance with rules and regulations and oriented performance measurement and analysis of the dynamic situation of each bank.

Subsequent legislative amendments, to the package of banking law - Banking Law and Law on the Statute of the NBR - have created the premises to improve its regulatory framework and effective supervision was constituted legal support for central bank cooperation with supervisory authorities of the country and abroad. Also opening negotiations with the European Union has assumed increasing harmonization process with EU Directives and the principles of the Basel Committee. Thus, we now appreciate that banking legislation is aligned with European standards and oversight is focused on risk assessment and its management as

a result of implementing Basel II. However, results on CB merger qualitative edge surveillance and sustained economic growth since 2000, resulted in gradual improvement of indicators of banking prudence.

The business of banking supervision, central bank seeks safe operation of banks to maintain a viable and stable system, this being a prudential nature and aim to minimize risks that may arise in the banking system and thus in the economy (payment system failures, loss of public confidence in banking products and services, loss of monetary control, substantial financial losses to the economy, jeopardizing investments, etc.).

To achieve these desiderate currently National Bank appeals to both modes of surveillance, internationally recognized: surveillance based on reports received from banks (off-site), respectively, through inspections of banks (on-site).

Supervision (off-site) is essentially an early warning mechanism, which is based on analysis of financial data provided by banks in a prescribed format. Reporting formats and details vary from one country to another, although most supervisors systematically collect and analyze data on liquidity, capital adequacy, credit risk, asset quality, large exposures and concentration, interest rate risks currency and market gains and profitability and balance sheet structure.

Based surveillance reports received from banks (off-site) is considered the most important

improvement made in recent years of banking supervision, it has a number of advantages compared with on-site inspections, including:

- banking and financial indicators, analysis of data from reports received by the supervisory authority allows the detection of urgent financial problems of banks before they are discovered by inspection;
- is less expensive in terms of resource utilization of oversight;
- analyzes the reports are useful in the preparation of bank inspections, directing attention to problem areas of activities;
- analyze information from reports received from banks can be used by supervisor to diagnose health and achievements of a group of banks or the entire banking system.

However based surveillance reports submitted by banks have also, and limits, as follows:

- usefulness depends on the quality of reports of internal information systems of a bank and accurate information in reports;
- reports follow a standard format which may not adequately cover new types of risk or private activities of individual banks;
- Reports are unable to express in sufficiently all the factors affecting risk management, such as quality of personnel, policies, procedures and internal management systems of a bank;
- is dependent on reports received from banks and thus examiners aware only of data contained in those financial statements;
- off-site surveillance type work only if banks are reporting within deadlines set by supervisor.

Supervision (on-site) is built from the reporting bank supervision and supplementing it, allowing supervisors to review details and to judge the future viability of banks. More specifically, spot checks should enable supervisors to assess the accuracy of reports of banks

provided and global operations, quality and adequacy of the management and risk management systems and internal control procedures. Spot inspections are the most complete and the most complex form of supervision of the banking system, the main purpose of determining the degree of stability and viability of banks<sup>1</sup>.

## **2. Basel II implementation and its effects in the banking supervisory activity**

Given the importance that the banking sector presents a national economy on the basis of prudential supervision of the main components of the banking system is a prerequisite for ensuring economic health - Country Financial. In this context we address Basel II-induced effects in terms of bank risk management. Focusing on risk management in recent years had positive influences on the quality of banking supervision practices in the sense that instead of the traditional approach based on verification of compliance with rules and regulations, gradually over the risk-focused supervision and the ability of banks to manage risks properly<sup>2</sup>.

Effective implementation of Basel II started on 1 January 2008<sup>3</sup> and involved a number of challenges both for credit institutions (adjusted for risk management and information system, staff training, procurement databases, etc.) and National Bank of Romania (adaptive process monitoring, development of new regulatory framework, staff training, etc.).

Moreover, Basel II induced mutations in several supervisory plan by defining a three-stage system of evaluation and monitoring of risk and

<sup>1</sup> Daniela Beju, BNR Banca Centrală a țării, Editura Casa Cărții de Știință, Cluj-Napoca, 2007, p.249

<sup>2</sup> Marin Oprețescu, Alina Georgiana Iacobescu, " Piața creditului bancar în România", Revista, Finanțe Provocările viitorului nr.7, Editura Universitaria, Craiova, 2008, p. 25

<sup>3</sup> Florin Georgescu, "Sistemul bancar în România-prezent și perspective-", Conferința Finmedia, București, 10 noiembrie 2009,

thus determining the optimal level of capitalization. The three pillars on which Basel II, refer primarily to the need to maintain minimum capital limits on a stronger supervisory activities and to define the minimum rules for paying for that market discipline so sweeping powers to the supervisory authority. The transition to risk based supervision was the logical consequence of strengthening the monitoring of the banking sector, with emphasis on identifying and quantifying credit risk, market, operational and reputational under Pillar I of minimum capital requirements.

The new agreement ensures that the broadening of financial risk in fixing the minimum levels of bank capitalization to cover both market risk and the operational risk. Also, Basel II allows financial institutions to choose, depending on the complexity of the activities they carry credit and financial resources available, one of three methods for assessment of credit risk: the standardized approach, approach internal models and that advanced approach based on internal models [Ion Trenca, 2006, p. 53]. If standardized approach is the simplest model, assuming the acquisition of various credit rating agencies the information without any further processing, advanced internal models based approach provides the highest degree of sensitivity to risk and aims to determine the sound

fundamentals of the level cap bank through the use of the concept of economic capital, thus correcting the shortfall under the Basel I is to allocate the same level capital as loans with high associated risk, and those with a lower risk.

Pillar II implementation required the development of methods for assessment of capital adequacy to risks other than those covered under Pillar I. However oversight under Pillar II involves a close collaboration with the supervised entities, which are required to submit to central bank rules [Florin Georgescu, 2009]:

- the management of the business (internal governance);
- internal process for assessing capital adequacy to risk;
- administration of significant risks;
- stress tests;
- status of internal audit;
- official document on the status of the compliance function;
- formalises their policy documents in the field of outsourcing activities;
- risk management procedures associated with outsourcing.

Exposure of the banking system can be highlighted and evolution of the main financial indicators of banking prudence and presented in Table. 2.1. which reveals the following:

**Table no. 1**

| No. crt. | INDICATORS   | 2005  | 2006  | 2007  | 2008  |
|----------|--|-------|-------|-------|-------|
| 1        | Solvency indicator                                       | 21.07 | 18.12 | 13.78 | 13.76 |
| 2        | The general risk ratio                                   | 47.61 | 53.01 | 56.94 | 50.73 |
| 3        | Overdue and doubtful credits / Total credits (Net value) | 0.26  | 0.20  | 0.22  | 0.32  |
| 4        | Overdue and doubtful credits / Total assets (Net value)  | 0.15  | 0.14  | 0.17  | 0.29  |
| 5        | Overdue and doubtful credits / Own capitals              | 1.35  | 1.64  | 1.63  | 3.19  |
| 6        | The ratio of the credit risk                             | 2.61  | 2.81  | 4.00  | 6.52  |
| 7        | ROA (Net Profit / Total actives)                         | 1.6   | 1.28  | 1.01  | 1.56  |
| 8        | ROE (Net Profit / Own capitals )                         | 12.7  | 10.2  | 9.43  | 17.04 |
| 9        | Liquidity indicator                                      | 2.59  | 2.31  | 2.13  | 2.47  |

Source: National Bank of Romania, Monthly Bulletin, January 2010

- Slightly downward trend of the solvency ratio was observed over the period as favored by the accelerated pace of credit deterioration of loan portfolio and the introduction of additional requirements for the operational risk and market risk. However, all banks in the system's solvency level had a higher minimum requirement (8 percent) and 20 of them exceeded the average of this indicator system;

- During 2005 - 2008, the indicator "Overdue and doubtful loans to total loans" and "Overdue and doubtful loans to total assets" are maintained at normal levels, subunit specific to any banking system;

- Romania bank liquidity is high liquidity indicator is above the regulated minimum requirement (1) throughout the period 2005-2008;

- In late 2008, the main indicators of profitability (economic efficiency rate - the rate of financial profitability and ROA - ROE) had a significantly higher level (1.56 percent and 17.04 percent) than in December 2007 (1.01 to percent and 9.43 percent). Major contributions to this evolution came back on the one hand, sales of share holding held by four banks in the capital of insurance companies and, secondly, the expansion in net interest income.

It is shown in a study that as for the *adaptation of the data-processing systems* to the new requirements imposed by Basel II, this accord has a significant impact on the *administration of the information* at the level of each credit institution: registration, processing, reporting, archiving. In order to respond the new requirements, each credit institution must assure, but not limit itself to these conditions: the existence of a centralized data base to respond efficiently to the requirements of the management of adequately administrating the risks; the structuring of the data base in accordance to the Basel II requirements: classes of exposures,

risk degrees and eligible guarantees; the existence of a data-processing application for the determination of the capital requirements afferent to each risk; the elaboration of policies/procedures for the assurances of the accuracy of the data; the existence of a data-processing application for the automatic transposition of the information from the data bases in the new reporting forms.

In such a vision, the National Bank of Romania, in its quality of architect of the management of the bank activity fixed the following objectives and action ways regarding the implementation of the New Agreement<sup>4</sup>:

- the transposition in the primary and secondary legislation of the new prudential requirements;

- the development of the prudential supervising means adequate to the new context;

- the development of the systems of management of the risks at the level of the credit institutions.

*The elaborated strategy and the actions taken for its accomplishment*, aiming especially at the qualitative aspects of the surveillance process, should materialize, in our opinion, in at least the following:

- the adaptation to the new realities of the norms concerning the bank authority in order to increase the certainty that the new operators on the market will be stable;

- the improvement of the corporatist governance of banks, by the improvement of the control on shareholders, of the methods used by the surveillance authority;

- the harmonization of the regulations regarding the insolvency risk with the provisions of Basel II;

- the evaluation and harmonization with the community exigencies of the regulations regarding

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<sup>4</sup> Marin Oprițescu, Alina Georgiana Iacobescu, op. citată, p. 26

the big expositions and the expositions towards the persons found in special relationships with the banks;

- the improvement of the norms regarding the participations of capital, for the purpose of assimilating the experience of the community banks, of the more rigorous statement of the limits applicable to the participations of capital of the banks and of the creation of the juridical frame necessary to their application on a consolidated base;

- the generalization of the surveillance on a consolidated base, so that the premises for the banking evaluation of a group to be created;

- the increase of the independence of the surveillance authority, respectively of the central bank, in order to get close to the levels registered among the community banks;

- the improvement of the bank rating system and early warning - CAAMPL – through the introduction of new criteria, able to assure a greater accuracy of evaluations;

- the remodeling of the surveillance system „on site" through the adaptation of the CAMELS methodology and the movement of the weight center on the administration of risks;

- a better monitoring of the banking market by strengthening discipline and promoting it as a complement of the supervisory process.

Therefore, we can say that Basel II credit granting institutions greater flexibility in risk management, on the one hand, and improves the quality of the business side of supervisory authority exercised by the matter, on the other hand.

### **3. Actions concerning the improving of the banking supervisory activity**

In 2008, although the direct impact of the international crisis on the domestic market could not yet be foreseen, the Romanian supervisory authority paid particular attention to countering the

potential effects of the crisis and made further efforts to improve the regulatory and supervisory framework for credit institutions, in line with the EU requirements in the field. The implementation of EU standards and regulations for credit institutions set forth in the documents issued by CEBS was still one of the key objectives of the NBR. The features of 2008 required enhanced international cooperation via regular consultations and meetings of the NBR representatives with foreign supervisory authorities, in order to coordinate the measures taken with a view to maintaining the soundness of institutions performing cross-border operations and the European structures, a particular focus on cooperation with supervisory authorities of banks that together hold the largest market share in Romania, namely the Austrian Financial Market Authority and the Bank of Greece.

The assessment of the manner in which the 25 principles of the Basel Accord on efficient supervision were implemented by the NBR was one of the major events of 2008. During 3-14 November 2008, a joint team of IMF and World Bank experts assessed the Romanian banking system, the supervisory authority's ability and the efficiency of its activity. The mission was part of the Financial Sector Assessment Programme in Romania – FSAP 2008. The assessment was favourable, given that most of the principles had been successfully implemented and that almost all of the recommendations made by previous missions were transposed into practice.

NBR in its capacity as supervisory authority took several measures to closer monitor liquidity and solvency issues at bank level, both under normal circumstances and during crisis situations. These measures comprised: enhanced monitoring of interbank market developments; optimisation of liquidity shortfall management at bank level so as to allow access to specific facilities

provided by the central bank (marginal lending facility, foreign exchange swap); setting up a standardised reporting format for banks to be used for reporting external sources and placements; organising meetings with the management of credit institutions in order to assess the risks identified by the latter, the strategies adopted with a view to countering the effects of the crisis, the alternate programmes concerning liquidity and capital requirements, as well as the results of stress tests on their prudential stance; contacting supervisory authorities, in certain situations, with a view to increasing majority shareholders' contribution to improve liquidity and implicitly solvency.

With regard to the changes in the supervisory process, they were made in line with the latest developments in the regulatory framework and in the requirements for identifying and containing the risks to which credit institutions are exposed, especially amid the deepening global crisis. Thus, besides the aspects specific to off-site supervision (assessment of banks' financial standing and of the risks they assume in the pursuit of their business, monitoring on a continuous basis of the observance of prudential limits and regulations), in 2008, particular importance was attached to liquidity monitoring. In this context, most of the notifications sent to credit institutions referred to the need of bringing banks' liquidity strategy in line with the legal provisions in the field as well as to the slow-down of credit growth rate and the worsening of loan portfolio quality.

Following the on – site inspections the imposed measures were aimed at improving the risk management framework, the formulation, supplementation and revision of norms, policies and internal procedures, the changes in IT systems, the preparation and revision of alternate plans, the improvement of instruments for assessing operational risk exposure, the

discontinuation of granting certain types of loans, the putting on hold of the extension of territorial networks and the elaboration of alternate plans for crisis management situations.

Another important direction for oversight was the supervising non-bank financial institutions (NBFI), a booming industry, whose assets came in 2008 to 8.4 percent of GDP. A very high proportion of the total activities of IFN has a financial leasing (78.7 percent), down slightly from the previous year. Supervision of both IFN was held off-site and on-site.

The banking supervisory activities carried out by the National Bank has a particular importance in monitoring the collaboration. Thus were established colleges of supervisors, the central bank is present, which are standing, flexible coordination structures ensuring cooperation between the authorities responsible for overseeing the different components of cross-border bank groups. The purpose of establishing supervisory colleges is to facilitate the exchange of information, opinions and assessments between supervisory authorities for a more efficient individual and consolidated supervision; to ensure a common understanding of the group's risk profile; to coordinate the analysis and assessment of risks by formulating supervision plans, in normal situations and in crisis situations.

Amid the difficulties generated by the worsening international and domestic environment, cooperation with foreign supervisory authorities played a significant role in achieving the goals of supervision. Special emphasis was put on cooperation with the authorities supervising the banks that held the largest market share in Romania, i.e. the Financial Market Authority (Austria) and Bank of Greece. Moreover, on 29 March 2009, nine large international banks signed a memorandum to support their subsidiaries in Romania in order to: confirm that these affiliates' good

financial standing will be preserved throughout the period of market turbulences and economic slowdown; demonstrate the long-term commitment to the development of the Romanian economy; and signal their readiness to contribute to the efforts of the international community to put in place comprehensive and well-coordinated measures to counter the effects of the financial crisis.

Result of cooperation with foreign supervisory authorities NBR partner became a member of several international organizations, regional or European level, including:

- Committee of European Banking Supervisors (CEBS) whose main objectives are to promote supervisory convergence and cooperation between supervisory authorities of Member States;
- Group Supervisors from Central and Eastern Europe (SOEC). The main objectives of this regional body are to promote and maintain cooperation and communication among members and ensure the exchange of surveillance

techniques, experience, information and know-how.

At the bilateral level, the NBR has signed 11 agreements with foreign supervisory authorities, the latter being signed with the central bank of Portugal (Banco de Portugal) which is effective from March 11, 2009. Also, there is ongoing negotiation process of the cooperation agreement with the supervisory authority of Spain (Banco de España).

As presented during the work, given the importance that banking submit any national economy on the basis of prudential regulation and supervision of the banking system is a prerequisite for ensuring economic and financial health of a country. But this requires that the relevant international regulations, to fold the specific activities of various financial institutions and the financial infrastructure available to a country in order to harmonize the banking supervision in Romania with international standards.

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