NEED OF FINANCIAL INSTITUTIONS SUPERVISION THROUGH AN SINGLE FRAMEWORK OF MACRO-PRUDENTIAL SUPERVISION

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Abstract:
Joint Committee of the European Supervisory Authorities required Member States to implement new macro-prudential indicators.through national authorities of prudential supervision will be perform activities concerning the supplementary supervision of credit institutions, insurance companies or reinsurance companies, investment services firms and investment management firms, from a financial conglomerate.

The most popular ways that give stability to the financial system are related to normal functioning of markets, to ensure implementation of payments in the economy and especially achieving a quality financial intermediation. Activities concerning macroprudential supervision concern, first of all, of managerial strengthening of internal control, assessment and management of risks.

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JEL classifications: : E42, E50, F30

1. National Committee for prudential supervision in Romania, a new entity responsible for financial system stability

Amid the existence of many risks in the national economy, the task of ensuring financial stability is shared between the Ministry of Finance, Central Bank and Financial Supervisory Authorities.

Under the new regulations[1] of financial institutions that are part of a financial conglomerate structure should provide regular information on risk management, legal status, governance and the organization of the group and its members.

Many financial institutions, especially banking groups and financial international institutions are operating in Romania, without be fully and efficiently supervised. National financial system is part of the European financial system and fully subject to its regulations and control supervisory authorities. The financial crisis has drained of resources financial system and to recover somewhat lost confidence in financial institutions has become a new *architecture* of the **European System of Financial Supervision**.

Currently, the single supervisory system consists of:

– **European Systemic Risk Board** (ESRB) who is responsible for macro-prudential supervision at the European level. It is an independent body without legal personality operating in the European Central Bank ;

– the **European Supervisory Authorities** (ESA's) which includes:

• The European Banking Authority (EBA). It serves as a mediator between national authorities to implement macro-prudential regulatory technical standards.
• European Insurance and Occupational Pensions Authority (EIOPA)
• European Capital Markets Authority (ESMA) That competent prudential regulation and coordination of colleges of supervisors.

– **National Supervisory Authority** that controls and supervises financial institutions in Romania.

[1] Official Gazette no. 656 of 25 October 2013 which was published Law. 272/2013, which brings a number of changes GEO. 98/2006 on the supplementary supervision of credit institutions, insurance companies and / or reinsurance companies, investment services and investment management firms in a financial conglomerate ("GEO 98/2006") and and GEO. 99/2006 on credit institutions and capital adequacy ("Banking Ordinance").

To monitor and control the financial system, all components use specific tools of financial area. Indicative form of macroprudential tools may be similar to the form of micro-policy instruments, but it applies differently.

It cannot perform a macro-prudential *supervisory* policy without determining the limits of the *microprudential* indicators in which must fit the financial institutions. For example, *capital risks* were monitored at various stages, beginning with "capital adequacy indicator", settled by Basel I Capital adequacy to the risks indicators, continued with exposure to the market and operational risks indicators, required of Basel II. And now, in the banking system is necessary a better assess and risk monitoring imposed by Basel III recommendations. Risk assessment on specific national economies models of EU Member States, involves reducing the importance given to external ratings which evaluated in times and scored sometimes inconclusive, the financial situation of countries with high sovereign debts.

☒ In the **European System of Financial Supervision** an important role in managing the financial crisis has the **European Systemic Risk Board** which imposed a *single supervisory model* with severe requirements to strengthen European mechanisms of monitoring and control of all financial activities. The recommendation CERS/2011/3 EU requires Member States to designate *an authority responsible for macro-prudential policy* to coordinate all components of national financial supervisors

European Systemic Risk Board[2] recommend to the prudential supervision authorities of the financial system, a set of indicators for each area. The direct involvement of control over the achievement of the indicators set for the banking, insurance, private equity and pension sector will prevent risks in these systems.

Implementation period of a new requirements is 2014-2019 and include:

- Increase the return on equity and tracking "Countercyclical Capital Buffer". In the banking system, own funds Tier 1 plus capital conservation damper will increase from 4% in 2014 to 7% in 2019. This involves reducing the weight supported subordinated loans and the introduction as an additional *leverage* indicator, as the ratio between Tier 1 capital and total unadjusted risk exposures.
- Preventing mismatch excessive of maturity and lack of liquidity on the market. There are credit institutions that avoid lend long-term loans, just for respect the correlation between bank assets and liabilities. Macro prudential adjustment of the liquidity indicator. Defining standards for short and medium-term liquidity, establishing the responsibility of origin state, regarding liquidity of branches, host opportunity for the State to choose liquidity risk supervision of the subsidiaries requires new national banking regulations for national banking area.
- Macro prudential restrictions on funding sources. For example tracking indicator net stable funding. These requirements are imposed by new accounting regulations[3] so, outlining the submission of annual financial statements by financial institutions at the national supervisory authorities. *Net stable funding* is interesting for credit institutions shareholders that want to know the value of the shares at one time. Net stable situation is highlighted as the difference between total assets and liabilities (less any own capital grants and provisions) and is amounts that will return to members or shareholders in case of liquidation. The negative value of the indicator expresses a number of risks that causes increased the duty that cannot be paid on time. Thus, was impose a macro prudential limit unweight, applied to more less stable funding (e.g., the ratio loans / deposits).
- Restrictions about significant exposures. Significant exposures are determined and of the emergence of significant risks. A significant risk is one that has a great impact on the credibility and reputation of a credit institution causing it significant damage. In the category of these risks can be mentioned: credit risk, market, operational, liquidity and interest rate risk in the trading portfolio. Along with significant exposures appear other types of risks such as the business or strategic.

The requirements above are made by **National Supervisory Authorities** from Romania who cooperates among themselves under different names:

Financial Supervisory Authority - FSA. It is the administrative authority self-financed, autonomous, independent, professional, legal person who exercises his powers[4] by taking over and reorganizing all the powers and prerogatives of the National Securities Commission (CNVM), the Insurance Supervisory Commission (CSA) and the Committee of Surveillance System Private Pensions (PPSSC).So far the activity of this authority does not show that may be the institution that establish a single system of macro-prudential supervision of the entire financial system

[2] Official Journal of the EU-recommendations of the ESRB, C 170/1 of 15 June 2013

[3] National Bank of Romania Order no. 27/2010 for approving the Accounting Regulations in accordance with International Financial Reporting Standards applicable to credit institutions, published in the Official Gazette of Romania, Part I, no. 890 and 890 bis of 30 decembrie2010, amended and supplemented by the NBR Order no. 29 of 28.dec.2011, Official Gazette, Part I. 933 / 29.dec.2011

[4] Emergency Ordinance no. 93/2012 on the establishment, organization and functioning of the FSA

National Committee for Financial Stability with role of coordinating tasks related to financial stability and financial crisis management in Romania. It is consist of: The Minister of Economy and Finance, the Governor of the National Bank, President of the National Securities Commission, Insurance Supervisory Commission President and Chairman of the Private Pension System Supervisory and Executive Director of the Deposit Guarantee Fund in the Banking System. Activity of this committee was held only as a forum for debate. According to the supervised field, each component of this committee was confronted with some problems to be solved, in this time of financial crisis. With the establishment of ASF the activity of this financial supervisory committee was diluted.

Supervisory Committee of National Bank of Romania's for all banking system whose main tasks are:
- Monitoring and evaluating the functioning of credit institutions on the basis of reports and analyzes made by specialized departments;
- Approval of the inspection in credit institutions;
- Approval of prudential and accounting regulations in banking;
- Reject or approve the nomination of managers of credit institutions;
- Analyzing information or reports submitted NBR by other central bank supervisory authorities or by Fund of Bank deposit guarantee.

Set up at the national level, these committees and commissions identify risks and vulnerabilities of entire financial system as a whole and of its components. Although financial stability monitoring is preventive it have emerged situations, especially in the banking system when it acted "curative", especially for exchange rate stability. Incorrectly rating of the risks and inefficiency of capital allocation in all financial institutions can seriously affect the stability of the financial system and overall economic stability.

Banking supervision is separate by the monetary policy and fall in the European recommendations on macro-prudential supervision to avoid economic crisis.

The European Systemic Risk Board recommendation is put in place through the establishment of the **National Committee for macro-prudential supervision** (*supreme national authority*). This was due to the fact that the two Romanian entities, Financial Supervisory Authority that control the activities of the capital market, insurance and pension funds and central bank for banking supervision, are not coordinated by an entity responsible for the stability of the financial system in its entirety, under crisis conditions.

By establishing the **National Committee for macro-prudential supervision in Romania** is passing of the classical model of separate sectorial supervisory institutions, at consolidated model that was tested until to this time in several European countries such as Austria, Poland,

To strengthen resilience to shocks of financial infrastructures national supreme authority will consider: clearly establishing individual responsibilities of each component of the supreme authority supervision macro-prudential ;

- each component represented by BNR Governor and Senior Deputy Governor of the central bank's chief economist, senior vice president of FSA and three representatives of the Ministry of Finance with the rank of minister or secretary of state will have well established tasks for avoid duplication of efforts;
- the activities of the components and the responsibilities of financial stability will be regularly communicated to the public;
- independence from the political factors and will be reported at the **European Systemic Risk Board** measures and achievements.

For the development of a unique system of supervision for the financial system within the National Committee for macro-prudential supervision will be based a 'technical support' consists of the General Council, a technical committee on systemic risk and a Technical Committee.

2. Romanian National Bank role to strengthening and developement of the financial sistem

Even though romanian financial market is monitored by the Financial Supervisory Authority, however responsibility of macroprudential policy management should be entrusted to a single institution, in which the central bank develops actions that have an significant impact on the financial stability at the national level.

Within the supervision of financial groups also includes alternative investment fund managers (AIFM). Macro-prudential oversight of these funds has not yet been regulated by Romanian law, but their rigorous monitoring is part of the subject of EU directives to be transposed and implemented in the near future, in

Romania. Recent economic analysis of financial markets revealed that many AIFM strategies are vulnerable to some or several important risks in relation to investors, other market participants and markets.5

Macro prudentiality policies imposed until now by the central bank was present in promoting and oversee the smooth operation of payment systems for ensures financial stability.

The main objective of a single supervisory authority is strengthening financial institutions and development of a financial system for citizens that can be achieved through permanent monitoring of risk management.

First will track fund changes in the activity of components based on new corporate governance regulations. The main purpose of corporate governance is to reduce the negative effects of current and future financial crises.

The new rules on corporate governance in the banking sector will include clearly defined of the Governing Bodies, with separation between of *sales function and risk function*.

In order to strengthen and stability of the banking system through banking corporate governance are monitored the *new standards* that have in order to improve risk management, increase transparency requirements on capital adequacy, liquidity requirements, capital buffer and leverage.

The new prudential supervision authorities will establish new regulations on remuneration policies within the components. It will define the criteria for granting salaries and their amount will be capped through long-term contracts, depending on the objectives. The targets set by the contract are to prevent and reduce risks exposure faced by financial institutions in accordance with the manager's liability.

Under the conditions current financial and economic developments, the central bank has an important role to monitor financial stability. In this framework will be follow the risks that arise due of adapting financial groups at change. This involves understanding and promotes differentiated bank management determined by:

• conquest strategy which estimates the place of credit institutions at the national, regional, European and global levels;

• strategy retreat, restoration, that recognizing weaknesses credit institutions involving in the competitive environment and placement in subordinate positions. Banking risks are a constant source of potential expenditure. Their adequate monitoring and management aims to stabilize income over time.

• consolidation strategy by introducing capital buffers, specific to growth phases of credit institutions. Managers of credit institutions are aware that profit maximization implies permanent exposure to risk.

Recommendations of the European Supervisory Authorities for the banking capital increase will influence the activity of the central bank to strengthen the prudential supervision of the banking system. Merger or takeover of the banks will create probabilities of occurrence of risks and potential exposure of financial groups. Despite massive bank consolidation in developed European countries, cross-border mergers and acquisitions were less common. Some banking products and services - such as:

• Lending to small businesses - have remained the preserve of small banks, local

• While other services - such as syndicated loans - lends itself more to be provided by large financial groups.

A study on the extent of globalization[6] of the banking industry found that two thirds of multinational companies surveyed chose a credit institution with headquarters in the host country and less than 20% of them chose a credit institution in their country of origin. Subsidiaries of multinational companies prefer to use the services of a credit institution which knows well the local market, local regulations and market conditions in the country of origin. However, in countries with low financial development (emerging countries), multinationals prefer to work with credit institutions from their home countries, only local banks.

Establishment of financial and banking groups was an important trend internationally. In the last years significantly increased the number of financial conglomerates in Romania too, these have form of banking groups, which comprise mainly bank branches, securities companies and insurance companies, private pension and leasing companies. The structure of these conglomerates is influenced by the existing regulatory framework that does not allow credit institutions to operate directly on the capital market.

Also the banking legislation requires that financial leasing and factoring operations will be carried out by banks through separate companies, established for this purpose. Therefore, the banking sphere groups have set up securities companies to operate indirectly for securities markets and are major shareholders in a number of other financial corporations from group composition.

3. Conclusions

[5] DIRECTIVE 2011/61/EC OF THE EUROPEAN PARLIAMENT AND OF CONSILIULUI/2011 Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) no. 1060/2009 and (EU). 1095/2010

[6] Napoleon Pop, Valeriu Ioan-Frank, *Towards a global currency. Preliminaries*, Expert Publishing House, Bucharest, 2012

For developing the financial system, including the capacity of the financial system to withstand shocks and various systemic risk, it imposes a strict control of components (sectoral supervisory authorities). This is actually the primary objective of the National Committee for macro-prudential supervision to preserve financial stability.

Being responsible for coordinating the management of financial crises, the National Committee for macro-prudential supervision should issue recommendations and warnings on the risks, after reviewing information received, identified risks to financial stability and to control effectively the activity of institutions with systemically importance .

To allow better monitoring of financial conglomerates business, sectorial cooperation between supervisory authorities will be strengthened through specific procedures of the **National Committee for macro-prudential supervision.**

By developing a unique model of macro-prudential supervision will be followed first, increasing the quality of the capital base through raising the level for all components of the financial system with buffer capital (capital conservation, systematic risk, countercyclical).

Permanent analysis of the indicators concerning capital of financial institutions, highlighting the indicator "leverage", through simple accounting data without adjustments, constantly verification of liquidity risk and the transparency measures of corporate governance will contribute to a more stable financial system in crisis conditions.

National Committee for macro-prudential supervision will have an important role in the convergence of supervisory practices to ensure the harmonized application of prudential norms to all financial institutions.

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