THE IMPORTANCE OF BANKING SUPERVISION IN ENSURING FINANCIAL STABILITY

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Abstract:
Financial stability plays a vital role in terms of the financial system and the economy as a whole. Analysis and management of risks in the banking sector in order to achieve the financial stability of the whole banking system requires the use of established methods in modern management of risk. The financial crisis has demonstrated certain limits in terms of efficient management of risk. In this respect supervisory authorities have developed a number of methods and techniques to detect, monitor and amount of risk. In the present context, to enhance the stability of the banking system and prevent systemic risk, it is proposed to revise the Basel II Agreement. It was necessary to review the existing prudential regulations defining, embodied in Basel III. This new agreement brings more clarity in the financial and banking sector, addresses a wider range of risks, providing a better regulator.

Key words: *banking supervision, financial stability, the National Bank of Romania, banking risk, global financial crisis*

JEL Clasiffication: *F65, G24*

1.Introduction

The complexity and diversity of banking risks had the upward trend due to intensification of competition between banks, due to the increase in international financial markets, but also due to the growing number of product and financial services.

The changes that have taken place in the financial and banking markets in recent years have led to major changes in terms of risk in banking institutions. The role held by them within the framework of the financial sector in economic growth and financial stability, it is extremely important, which is why financial risk management has become extremely important.

Taking into account the principle prudentiality applied to the entire banking system is a different form of verification of a specific task, which is the banking supervision. The banking prudential supervision is the work which it carries on banking supervisory authority over entities of the Romanian banking system and consists of tracking the way in which they comply with the regulations by prudential requirements are laid down to ensure the implementation of a policy and prudent banking practices in the interest of the Bank and its clients, as well as the credibility and viability of the entire system.

2. Forms of manifestation of banking supervision

Strengthening the capacity of surveillance represents one of the major concerns of the National Bank of Romania, which aims at increasing competitiveness, stability and credibility of the banking sector and the banks ' ability to ensure efficient financial intermediation.

Through prudential supervision is monitored accounts of each credit institution, ensuring at the same time, the level in which they apply and the Bank complies with the regulations in force.

Prudential supervision carried out by the National Bank of Romania shall be carried out in various forms and at various moments that mark the existence of credit institutions:

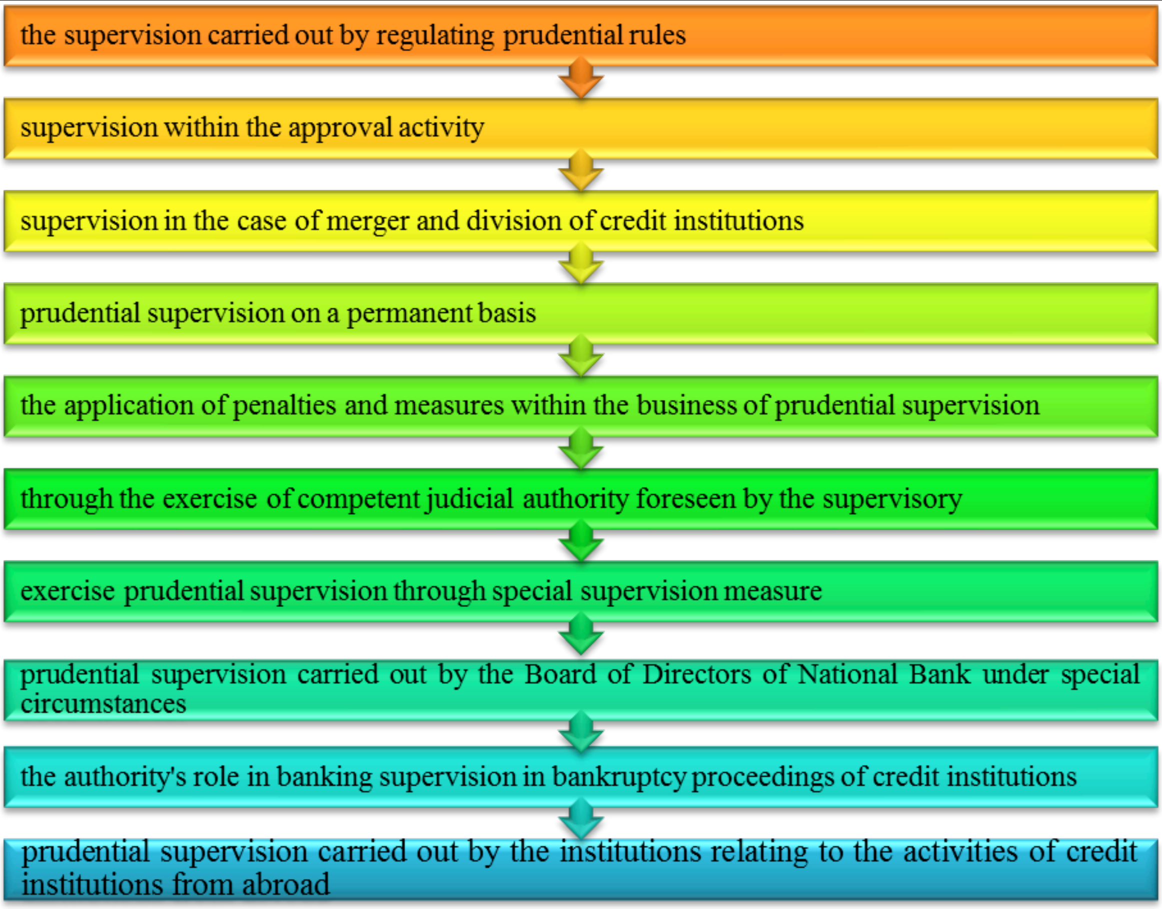

Figure no. 1 „Prudential supervision of NBR"

Moving to a risk-based supervision has been a necessity of the process of monitoring the banking system, with particular emphasis on compliance with the best international practices in this field for identifying and measuring risks.

Currently, prudential supervision, in particular, aimed at analyzing the risk profile of the credit institutions, methods, strategies and policies used by them for the efficient management of the risks they face in their work.

To embrace the role of banking supervisory activity in the broader context of the measures taken for the maintenance of financial stability, have signaled through the analysis of studies (Wharmby, Lai, Houben, Karn, Schinasi, Foot, Cihak), two fundamental senses namely financial stability:

- The absence of generalized episodes of vulnerability that disrupts the effective functioning of the financial system;
- Financial system resilience to adverse shocks from endogenous or exogenous nature.

2. The purpose and importance of prudential supervision

Prudential supervision of banking activity shall be carried out under the two forms are related to each other:

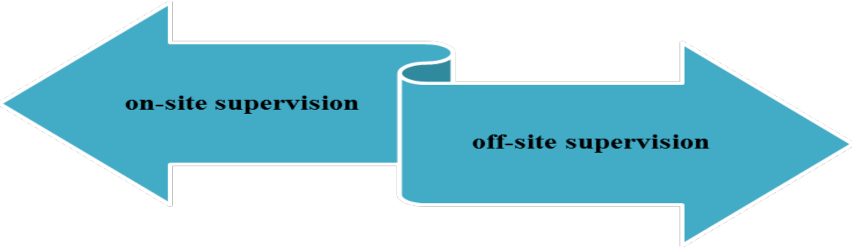

Figure no. 2 „Prudential supervision forms"

On-site supervision

The purpose of prudential supervision is to identify credit institutions which are most prone to bankruptcy and that can affect the effect of contagion, financial stability of the banking sector as a whole. The most widely used tool for identifying the vulnerabilities faced by banks is represented by spot inspections. Surveillance activity pursues two **objectives:**

Figure no. 3 „The objectives of supervision on site"

On this occasion are examined: quality assets, profitability; the level and structure of own funds that is whether their size corresponds to the assumed risk profile; the quality of the management of assets and liabilities.

Off-site supervision:

The purpose of this form of surveillance is to assess both the current financial condition of credit institutions in the interval between two inspections on-site, as well as their ability to meet the minimum requirements of banking prudence. At this stage are:

- centralized banking risk information obtained from on-site inspections;
- analyzed and monitored the specific vulnerabilities of this sector;
- conducted analyses of stress-test and reported the need to carry out inspections on the spot.

This type of supervision acts as an early warning mechanism, with the objectives of:

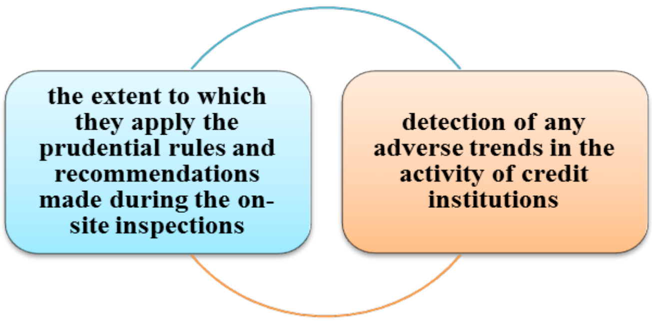

Figure no. 4 „Objectives of the off-site supervision"

The importance of banking supervision has both a national dimension given the essential role that the banking system has in the allocation of resources in the economy, as well as one international which is determined by the growing interdependencies that characterize the world economy currently.

By providing and maintaining the entry of banks that comply with the standards of prudential banking supervision, contribute to the management of the financial resources of an economy to sectors of the economy, ensuring a healthy economic growth in terms of efficiency.

The most important instruments used by the supervisory authorities in the process of assessing and monitoring the stability and viability of the banking systems are:

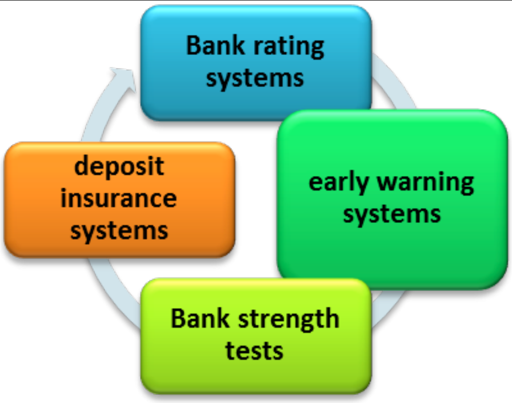

Figure no. 5 „Tools used by the supervisory authorities”

3. National Bank of Romania - decisive role in maintaining financial stability

National Bank of Romania has an intrinsic role in maintaining financial stability, given the responsibilities arising from its dual aspect the Monetary Authority and prudential. Functions subsumed under the financial stability objectives are pursued through both regulation and prudential supervision of institutions placed under its authority, as well as through the formulation and effective transmission of monetary policy measures and surveillance operation in optimal conditions of payment and settlement systems of systemic importance. At the same time, it is necessary to identify risks and vulnerabilities in the financial system as a whole and its components, because financial stability is a preventive monitoring. The emergence and development of failures, as well as the evaluation of risks and capital allocation inefficiency, may affect the stability of the financial system and economic stability.

According to the Report of the Financial Stability achieved by National Bank of Romania 2014, financial stability has remained strong since the previous report (September 2013) amid improving macro-economic context and tempering tensions on international financial markets. Prudential indicators concerning the banking sector solvency, liquidity and coverage with provisions have been further adequate levels, these while maintaining regulated even the materialisation of severe macroeconomic scenarios. The main challenges to the Romanian banking sector for the next period are constituted by sustainable resumption of crediting, preventing excessive balance sheet adjustments amid cross-border financial disintermediation process as well as improvement of quality indicators of bank assets through steps of cleaning up the balance sheets of non-performing loans, with positive effects on operational effectiveness and the capacity of intermediary banks.

The banking sector in Romania capital reserves and liquidity, which prudential would accommodate high intensity shocks generated by macroeconomic developments unfavorable internal and external. First, the rate of total own funds (solvency indicator ex equivalent) has increased from 17% in June 2014 (compared with 14,9% in December 2012), while considerably more than the minimum threshold established in accordance with the european regulatory framework CRD IV/M (8%). Secondly, the degree of coverage provisions UNDER IFRS of bad loans remained comfortably (66,2% in July 2014). Stress testing the solvency of the banking sector show a good capacity to cover potential losses stemming from a possible manifestation of the macro-economic developments with a high severity, despite a sharp fall in the rate of total own funds. Thirdly, liquidity continued to be at a good level amid a trend of rebalancing currencies of assets and liabilities of the balance sheet

According to NBR, stress test analysis of the liquidity of the banking sector in macro-prudential perspective indicates good capacity management of a moderately-high shock withdrawal of funding. Fourthly, after three years of losses, the banking sector recorded a net profit in the year 2013, largely due to the slowdown in the accumulation of non-performing loans and a positive rate of operational profitability, in spite of the growth recorded by the non-financial sector loans. In the first seven months of the year 2014, the financial result remained positive aggregate, however moderate, economic rate of return (ROA) and the financial rate of return (ROE) is 0,2%, 2,3%, respectively. Continuation of the territorial networks resizing and adjusting staffing requirements has led to lower operational expenses, with positive impact on operational profitability.

4. Conclusions

Between prudential supervision and financial stability is a close relationship, type part to the whole. If the objective of banking supervision is to verify compliance with the prudential banking regulations in force, and the monitoring of risk exposure of credit institutions, the scope of financial stability is more comprehensive, the aim being to identify in real time the risks to which it is exposed to the entire financial system. Muddling financial stability rests on the existence of financial regulations and the efficient activity of the prudential business.

Financial stability analysis must monitor all risks which may disrupt the smooth functioning of the three components of the financial system: institutions, markets and infrastructure.

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