Providing Financial Market Macro Stability

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Abstract

After the financial crisis began in 2007, an important role for the stability of the financial system, independently of the degree of development of national economies, was undertaken by the states which adopted policies for qualified intervention in the financial market.

Key words: banking, capital, crisis, market, finance

1. General considerations

The State’s role in the economy can have beneficial or negative influences according to many factors and especially depending on the quality and proper orientation of its policies. After analyzing various official interventions that it may have for economic recovery, we identified at least the following lines of action which the State may undertake to ensure stability and growth:

- Regulation and supervision of banking system;
- Ownership of shares in the capital of financial institutions;
- Development of banking infrastructure.

2. Financial market regulation and supervision

Supervision and regulation of financial system usually exercised by the State through autonomous or semi-autonomous agencies can improve the welfare and development of the financial system. Due to the recent crisis, for the future, a more emphasis was put on regulation and supervision of systemic risk\(^1\). This is due to the existing weaknesses in the earlier regulatory and supervisory area. Thus, a major syncope for the period before the crisis, in terms of financial regulation and supervision, is that it was put too much emphasis on the risk of financial institutions taken individually, no taking into account the implications that confluence of risks may have on the entire system.

It was observed that a micro prudential approach that regulates and coordinates surveillance in order to reduce the risk of individual institutions does not automatically limit the risk to spread to the entire financial system.

Prudential supervision of financial institutions was done so far separately according to the category to which they belonged, because there are differentiated

\(^1\) Anghel M.G. (2013). *Modele de gestiune și analiză a portofoliilor*, Editura Economică, București
approach on the regulation and supervision of banks, insurance companies, guarantee funds, capital market actors, and because there is no a complementary over-supervision of the entire financial group institutions (where applicable), or of the entire financial system in its integrality.

**National Committee for Financial Stability**

Recent years developments in the Romanian financial system imposed to the authorities responsible for the licensing, regulation, supervision and control of financial markets system components to work together in order to ensure its transparency, its integrity, compliance with applicable legal framework and the broadening of national framework for financial stability. On 31 July 2007 the *Agreement for cooperation on financial stability and financial crisis management* was signed, under which was established the *National Committee for Financial Stability*. The main objective of the Committee is to ensure financial stability by promoting a permanent and efficient exchange of information between member authorities and by undertaking the assessment, prevention and, where appropriate, financial crisis management of individual financial institutions, financial groups or financial market as a whole. It should be noted that co-operation is carried out under the Agreement without prejudice to the powers and responsibilities of the parties arising from the provisions of the legislation under which they operate.

At the time, the National Committee for Financial Stability (CNSF) was composed of the Minister of Finance, the Governor of the National Bank of Romania, National Securities Committee President, Chairman of the Insurance Supervisory Commission and the President of Private Pension System Supervisory Committee with coordination role tasks related to financial stability and financial crisis management in Romania.

As of November 10, 2011 the Deposit Guarantee Fund in the Banking System was co-opted as a member institution in the National Committee for Financial Stability. This collaboration aims to strengthen the institutional framework for ensuring financial stability in Romania, DGFBS is one of the institutions, by purpose and activity contributes to maintaining and increasing the confidence of depositors in the financial system.

**3. Economic and Financial Policies undertaken by Romania in front of international financial institutions**

According to the Letter of Intent dated 12 September 2013 passed by Romania to the International Monetary Fund, and the attached Memorandum of Economic and Financial Policies, bank parent funding fell by 10 percent in euro by the end of 2011. During this period, capital injections and robust growth of 27 percent of deposits resulted in a 23 percent increase in total gross assets of the banking sector. Since the middle of 2012, however, banks’ assets began to drop,

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increasing of domestic liabilities were unable to compensate the declined external financing by 24 and ¾ percent between Q4 2011 and July 2013. In 2013, at the level of financial market in Romania it is noticeable an acceleration of the decrease rhythm of deleveraging of foreign banks, bank parent funding dropped at the end of 2011 by 26%.

These developments are due to the following factors:
- In 16 March 2009 the Vienna Agreement according to which the major banks present in Romania committed to maintain exposure to the Romanian market until March 2011;
- Increased coverage of bank deposits up to $ 100,000 since 1 January 2011;
- Massive withdrawals of bank parent financing in Romania beginning with March 2013 until the present.

As shown in the chart below, although there was a trend for the withdrawal of funding by parent banks to credit institutions in Romania, due to the Vienna Agreement, for two years (2009 - 2011), financing has remained to an acceptable level, but decreased dramatically in the years 2012-2013. Withdrawal of parent bank funding still represents a high risk that can exert further pressure to prevent credit growth. The balance between loans / deposits in the entire system was maintained at around 114 percent at end- June 2013, down from 117 percent at the end of 2012 and end of 2011. Under the present circumstances, it clear that bank fundraising increasingly rely on deposits population. In these circumstances, the Romanian state intervention by strengthening the Bank Deposit Guarantee Fund in order to increase confidence in the Romanian banking system is an essential element of financial stability.

Although parent banks maintained their exposure to Romania for the years 2009 - 2011, is seen as lending rate has declined dramatically since 2009. Loans to the private sector fell by 2 percent in real terms (increase of 15 percent in nominal terms between Q3 : 2008 and Q4 : 2011, decreasing thereafter at a rate even faster to 7 percent (plus 0, 5 percent in nominal terms) until June 2013. Note that in 2013, private credit growth turned negative.
The main causes of decline in lending:
- Tightening of credit standards;
- Lower indebtedness of foreign banks;
- Changes in the funding strategy of banking groups in the direction of a greater emphasis on domestic deposits at the branches.

As resulted from the Letter of Intent to the IMF, in order to resolve the difficulties that viable SMEs encounter in access to credit, the IMF proposed that a solution is that the Romanian authorities reform the Guarantee Fund for SMEs "which was insufficient used". The State will increase the efficiency and operability of the Guarantee Fund for SMEs especially regarding maturity, price and secured refinance loans, as well as the implementation of the execution of guarantees process. Notice, that after the financial crisis of 2008, the State agreed to intervene in financial markets through two financial institutions that provide macro-financial stability: Bank Deposit Guarantee Fund (to ensure household deposits), Credit Guarantee Fund for Small and Medium Enterprises (to improve access to finance for SMEs).

Given that banking resources is depending more and more on household deposits, it is important that both CGFSME and BDGF function properly in order to ensure a fair allocation of the available funds to the most profitable projects seeking lending. Note that in the case of BDGF, the Memorandum of Economic and Financial Policies states that "to avoid any perceived conflict of interest as among its top management, corporate governance principles of BDGF will meet international best practices."

4. The role of deposit guarantee schemes in supporting financial market stability

Deposit guarantee concept is to ensure the value of deposits held at banks (and possibly accumulated interest), and to refund, partially or totally, these

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financial assets no matter what happens to the institution at which they were deposited. Deposit guarantee is an element of the financial security that protects depositors against the loss of value of their investments, to avoid widespread withdrawals of funds generated by panic and that could erode the stability of the financial and the economic system. According to specialized literature, "the financial safety net" is a set of institutions, laws and procedures that strengthen the financial system's ability to cope with systemic shocks. A safety net consists of the following complementary and interdependent elements:

- Financial and banking supervision;
- Guaranteeing deposits;
- Exit policies from the banking system;
- Lender of last resort.

However, deposit guarantee schemes, as any assurance mechanisms have negative effects, as it may lead to "moral hazard". Moral hazard in this case refers to creating incentives for excessive risk-taking resulting from the following:

- Guaranteed depositors have little incentive to monitor the performance of banks;
- Funds are available for weak banks and risky activities at a lower cost than would otherwise be the case.

Moral hazard created by the existence of deposit insurance schemes can lead to weakening of market discipline and can create the premises for financial instability in the future. Thus, besides the three main methods of reducing moral hazard: Good governance of the enterprise and efficient management; Promotion of market discipline; Regulation and supervision. We see another way to reduce moral hazard by using bank Credit Guarantee Funds take some of the credit risk. From this perspective, the guarantee fund provides financial institutions the "safety net" especially appreciated in the context of economic and financial crisis by guaranteeing expressly irrevocable and unconditional obligation to repay the loans to entrepreneurs who do not have sufficient equity guarantees. Ensuring balance between bank deposits and bank loans should be made with utmost responsibility so as to avoid systemic risk in the financial market in Romania. The systemic event is considered strong when affected financial intermediaries can’t continue to work or when relevant markets are not functional. One can distinguish two directions of propagation of systemic risk:

- Horizontal: the effects are limited to the financial system and;
- Vertical: in which one must consider the effects on both financial and economical systems.

**Comparative Study between Credit Guarantee Funds and Deposits Guarantee Funds:**

"To better understand the implications of various features of the Credit Guarantee Fund and guarantee products, we will continue to draw a parallel between bank deposit insurance and credit guarantee schemes. Both need to manage the tradeoff between public policies aimed to ensure financial stability (bank deposit guarantee schemes) and improving access to finance (credit guarantee schemes), on the one hand and the risk of moral hazard that may result from the assumption of excessive risk by credit institutions, on the other hand." It follows that both deposits guarantee funds and credit guarantee funds ensure financial market stability by influencing the proper functioning of the two core activities of credit institutions (deposits and loans). On one hand, deposit guarantee schemes offer to depositors the necessary comfort to "invest" (submit) surplus cash funds, on the other hand, credit guarantee funds assumes with the lender, after proper analysis, risks for granting loans. This correlation is especially evident in the case of India, where in 1978, following a regional financial crisis, the following two institutions: Deposit Insurance Corporation and Credit Guarantee Corporation of India have been merged into the Deposit Insurance Corporation and Credit Guarantee Corporation Limited (DICGC). This new institution, under the administration of Reserve Bank of India (as an agent of the Government of India) aimed at integrating the following related functions:
- Insurance of bank deposits;
- Guaranteeing loans.

In Romania, the Deposit Guarantee Fund in the Banking System (DGFBS) was established in 1996, and is the only deposit guarantee scheme in Romania. By law, all Romanian credit institutions and branches of non-EU foreign banks, authorized by Romanian central bank are required to attend DGFBS. In 2012, DGFBS guarantee deposits totaling 144.8 billion, representing 45.7% of total deposits at credit institutions participating in DGFBS. From 1 January 2011, DGFBS guarantees all deposits held by natural or legal persons (including SMEs) to participating credit institutions up to EUR 100,000 equivalent in Romanian currency. The National Credit Guarantee Fund for Small and Medium Enterprises (CGFSME) is a joint stock company, organized as a non-banking financial institution, operating under the supervision of the National Bank of Romania and having the Romanian state as sole shareholder represented by the Ministry of Finance. CGFSME was founded in 2001 in order to support the activities of entrepreneurs (SMEs, cooperative societies and individuals authorized to do business according to the law). Between 2008 and 2012 CGFSME granted approximately 36,000 guarantees, totaling 1.5 billion euro (about 6.7 billion ROL), and sustained access to credits in the amount of about 3.1 billion euro (about 13.9 billion ROL).

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Table: Comparison DGFBS and CGFSME partners:

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<tr>
<th>No</th>
<th>DGFBs</th>
<th>CGFSME</th>
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<tr>
<td>1</td>
<td>Alpha Bank România - S.A</td>
<td>Alpha Bank România - S.A</td>
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<td>3</td>
<td>Banca Comerciala Carpatica -</td>
<td>Banca Comerciala Carpatica - S.A.</td>
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<td>Banca Comercială Intesa Sanpao</td>
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<td>Banca Comercială Feroviara</td>
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<td>6</td>
<td>Banca Comercială Română -</td>
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<td>7</td>
<td>Banca de Export Import a niei</td>
<td>Banca de Export Import a Romaniei</td>
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<td>8</td>
<td>Bancpost - S.A.</td>
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<td>Bank Leumi România - S.A</td>
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<td>10</td>
<td>Banca Millennium - S.A.</td>
<td>Banca Millennium - S.A</td>
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<td>11</td>
<td>Banca Românească - S.A.</td>
<td>Banca Românească - S.A</td>
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<td>Banca Transilvania - S.A.</td>
<td>Banca Transilvania - S.A</td>
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<td>13</td>
<td>Brd - Groupe Société Générale -</td>
<td>Brd - Groupe Société Générale - S.A.</td>
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<td>14</td>
<td>Cec Bank - S.A.</td>
<td>Cec Bank - S.A.</td>
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<td>15</td>
<td>Credit Europe Bank (România) -</td>
<td>Credit Europe Bank (România) - S.A.</td>
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<td>Credit Agricole Bank România -</td>
<td>Credit Agricole Bank România - S.A.</td>
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<td>17</td>
<td>Garanti Bank - S.A.</td>
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<td>Libra Internet Bank - S.A.</td>
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<td>19</td>
<td>Nextebank - S.A.</td>
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<td>20</td>
<td>Otp Bank România - S.A.</td>
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<td>21</td>
<td>Piraeus Bank România - S.A.</td>
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<td>22</td>
<td>Procredit Bank - S.A.</td>
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<td>23</td>
<td>Raiffeisen Bank – S.A.</td>
<td>Raiffeisen Bank – S.A.</td>
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<td>24</td>
<td>Romanian International Bank - S.A.</td>
<td>Romanian International Bank - S.A.</td>
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<td>25</td>
<td>Unicredit Țiriac Bank - S.A.</td>
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<td>26</td>
<td>Volksbank România -</td>
<td>Volksbank România - S.A</td>
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<td>27</td>
<td>Marfin Bank (România) - S.A.</td>
<td>Marfin Bank (România) - S.A</td>
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<td>28</td>
<td>Porsche Bank România - S.A.</td>
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<td>29</td>
<td>BCR Banca Pentru Locuințe -</td>
<td>BCR Banca Pentru Locuințe -</td>
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Thus, considering the correlation expressed by the World Bank experts between the two institutions we believe that there must be a balance between the two institutions that insure/guarantee the two core activities of banks. Both the Bank Deposit Guarantee Fund and Credit Guarantee Funds must operate in the financial market in respect of the same values.

Observations:
- Both institutions serve 26 commercial banks registered in Romania.
- There are two commercial banks registered in Romania who have not partnered with CGFSME.
- There are 2 specialized banks "domestic banks" that have partnered with CGFSME.
- The three foreign banks to open branches in Romania have signed conventions with CGFSME but have deposits insured by DGFBS, provision being made in the country of registration of their head office.

Thus, considering the correlation expressed by the World Bank experts between the two institutions we believe that there must be a balance between the two institutions that insure/guarantee the two core activities of banks. Both the Bank Deposit Guarantee Fund and Credit Guarantee Funds must operate in the financial market in respect of the same values.
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<tr>
<td>DGFBS provides security deposits of individuals and legal Romanian credit institutions, helping to increase the saving process.</td>
<td>CGFSME provides security to loans granted by Romanian banks, contributing to facilitating and expanding the lending process.</td>
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<tr>
<td>Professionalism</td>
<td>Professionalism</td>
<td>Professionalism</td>
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<td>DGFBS use all our knowledge and skills to fulfill our mission. We treat each situation, each institution participating in the Fund and each depositor with respect, reliability and with the professionalism they deserve.</td>
<td>CGFSME use all our knowledge and skills to fulfill our mission. We treat each situation, each financial institution and each final beneficiary partner with respect, reliability and professionalism they deserve.</td>
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<td>Integrity</td>
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<tr>
<td>DGFBS is an apolitical and independent institution. Employees of the Fund treats with responsibility and integrity the management of its resources in accordance with the law.</td>
<td>CGFSME must be an apolitical and independent institution. Employees of the Fund treats with responsibility and integrity the management of its resources in accordance with the law.</td>
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<td>Good governance</td>
<td>Good governance</td>
<td>Good governance</td>
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<td>DGFBS conduct is consistent with the principles of good governance approved by the G20 Financial Stability Board. The Board of DGFBS consists of renowned experts with extensive experience in banking and financial market designated by the National Bank of Romania, Romanian Banking Association, the Ministry of Finance and Ministry of Justice).</td>
<td>CGFSME conduct is consistent with the principles of good governance approved by the G20 Financial Stability Board. Board of CGFSME should be formed only from reputable specialists with extensive experience in banking and financial market and designated by the shareholder.</td>
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<td>Confidence</td>
<td>Confidence</td>
<td>Confidence</td>
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<td>DGFBS guarantee deposits with the Romanian credit institutions, increasing the confidence in them. Duties on recovery distressed banks make DGFBS a pillar of the Romanian financial system safety net.</td>
<td>CGFSME guarantee loans for Romanian credit institutions, and thus increasing the confidence in the final beneficiaries of the loans. By taking partial credit risk from banks, CGFSME stands out as a pillar of the Romanian financial system safety net.</td>
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**Committee for Macro-prudential Oversight:**

According to Regulation (EU) No. 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board” a European Systemic Risk Board (ESRB) was established. It is based in Frankfurt am Main. ESRB is part of the European System of Financial Supervision (ESFS), the purpose of which is to provide oversight of the financial system.”
In Romania, the macro-prudential supervision will be established after almost two years since the European Systemic Risk Committee recommendation (December 2011). The Committee will be responsible for macro-prudential financial crisis management and prudential supervision. The new committee will not seek nor accept instructions from any authority, institution, public or private. The Committee for Macro-prudential Oversight will consist of a General Board, a Technical Committee on systemic risk, a technical committee on financial crisis management and secretary desk.

The primary objective of the Committee "is to contribute to the safeguarding of financial stability, including by strengthening the capacity of the financial system to withstand shocks and by reducing the accumulation of systemic risk, in this way ensuring a sustainable contribution of the financial sector to economic growth," according to a project emergency ordinance initiated by the Ministry of Finance.

After performance of analyses, the Committee will identify potential risks to financial stability, make recommendations and warnings to national micro-prudential financial supervisory authorities on the directions to be followed and will make recommendations to Government to initiate laws in order to maintain financial stability.

The management of the Committee for Macro-prudential Oversight will be provided by National Bank of Romania Governor, First National Bank Deputy Governor and the Chief Economist with the Financial Supervision Authority President and the First Vice-President of that authority, and three representatives of the Ministry of Finance - Minister of Finance, Minister for the Budget, and Secretary of State. The President of the Committee will be NBR Governor.

**Conclusion**

In the letters of intent signed at the evaluation missions of the IMF and the European Commission made under the funding agreements, Romania has committed to strengthen financial safety net and develop the range of tools to cope with problem banks, in partnership with the central bank, the deposit guarantee fund - DGFBS and government. Under Ordinance 39/1996, in exceptional circumstances, if the Fund's financial resources should not be sufficient to cover compensation payments to finance stabilization measures decided by the central bank, the government, through the Ministry of Public Finance should provides to the DGFBS with the necessary amounts on the form of a loan, in within 5 working days of their request by the DGFBS. The source of funds is the privatization fund registered in the State Treasury. General terms and conditions for granting and repayment of the loan granted by the Government are set by decision of the government and the amounts shall be made available upon request of the DGFBS, based on agreement between parties. Bank Deposit Guarantee Funds and Credit Guarantee Funds, besides the role of deposit insurers on the one hand and loans insurer on the other hand may have an important role in terms of providing relevant information on financial market stability in its entirety. Centralizing this data in
real time and correlating them can lead to early identification of possible bank failures in the financial system, which can improve macro-prudential oversight by correcting them as early as possible.

As national financial stability remains to the Member States, the responsibility of solving the crisis and its cost recovery leads to the necessity of maintaining appropriate intervention tools. Having regard to Regulation (EU) No. 1092/2010 of the European Parliament and of the Council of 24 November 2010 “(15) (...) The ESRB should be established as a new independent body covering all financial sectors and guarantee schemes. (...) “, and in the context of strengthening financial and banking system in Romania, we believe that the future Committee for Macro-prudential Oversight should take into account two important basic financial institutions: the Deposit Guarantee Fund in the Banking System and the Guarantee Fund Credit for Small and Medium Enterprises. Both institutions can mitigate informational asymmetry in financial markets and have the technical capacity to identify risks before the onset of the financial market effects. Through a seamless coordination of key financial verification, and by linking relevant information on bank deposits on the one hand and bank loans on the other, The Committee may gain the ability to identify earlier systemic risks and correct them through improving mechanisms that strengthen the financial market.

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