

New regulations on the stabilization measures in the Romanian banking system

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Background

- In the letters of intent signed with the IMF and the European Commission during the assessment missions underlying the financing arrangements, Romania committed to tighten the financial safety net and develop the bank resolution toolkit.
- The objective was achieved within a partnership of the Central Bank with the Bank Deposit Guarantee Fund (BDGF) and the Government.
- In January 2012, the legal framework for credit institutions was supplemented with provisions on the stabilisation measures that the central bank may adopt with regard to banks in distress.
- The new provisions were added to the current legal framework for special administration.
- This step is in line with the European concerns to create a bank resolution framework as an alternative to insolvency laws, aiming to provide timely solutions for failing banks and ensure the stability of the financial system as a whole.
- Some countries have already implemented stabilization measures (for example Bridge Bank: USA, Great Britain, China).

The stabilization measures in the Romanian legal framework

- *Government Ordinance No. 1/January 2012 on amending and supplementing certain pieces of legislation in the field of credit institutions* supplemented *Government Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy*, as subsequently amended and supplemented, by introducing Section 2¹ – “Stabilisation measures” in Chapter 8 – Special procedures, Title 3, Part 1.
- The stabilisation measures set out in the above-mentioned regulation refer to:
 - the full or partial transfer of assets and liabilities of a credit institution to one or several eligible institutions;
 - the involvement of the Bank Deposit Guarantee Fund, acting as delegate administrator or, as the case may be, as shareholder, if prior instruction has been given to suspend the exercise of voting rights of the shareholders in control over the respective credit institution;
 - the transfer of a credit institution’s assets and liabilities to a bridge bank established to this purpose.

Principles

The stabilisation measures may only be applied :

- ✓ in case of a threat to financial stability,
- ✓ Only to credit institutions, Romanian legal entities, considering that the branches of credit institutions, foreign legal entities, are under the jurisdiction of parent credit institutions and only part of the legal provisions regulating the activity of credit institutions in Romania apply to them.
- ✓ when the supervisory measures available for the central bank did not result in an improved standing of the respective credit institution, or in case the fast deterioration of the financial and prudential position of the credit institution poses a risk to financial stability.

Supervisory actions

The **supervisory actions** setup by law, applicable when credit institutions breach the applicable legal framework or a recommendation made by the NBR, are the followings :

- imposing a requirement to hold own funds higher than the minimum regulated level;
- requiring the improvement in the identification, management, monitoring and reporting of risks to which they are or may be exposed;
- requiring the implementation of a specific provisioning regime or a specific treatment of exposures in terms of capital requirements;
- restricting or limiting the activity, operations or the branch network of credit institutions;
- requiring the mitigation of risks associated with the operations, products and/or systems;
- imposing the replacement of persons appointed to manage the departments of the credit institution and/or its branches;
- limiting the qualifying holdings in financial or non-financial entities;
- imposing a limit of the variable component of remuneration to a given percentage of total net income if its current level is not consistent with maintaining a sound capital base;
- imposing the use of net profits of the credit institution to strengthen the capital base;
- imposing the preparation by the credit institution of a recovery plan providing a detailed description of the measures and actions to be taken for the purpose of ensuring an adequate management of the risks to which the credit institution is exposed and/or to remove the deficiencies in its activity, by observing the deadline for implementing the respective measures and actions;
- imposing special supervision measures, etc.

Principles (cont')

According to the law, the stabilisation measures may be implemented by observing the following **principles**:

- ✓ avoiding the disruptions in the normal functioning of the financial system and the real economy when a credit institution jeopardizing financial stability is in financial distress;
- ✓ using chiefly private financial resources to finance stabilisation measures;
- ✓ prioritise the transfer of guaranteed deposits;
- ✓ the stabilisation measures which do not imply the immediate asset and/or liability transfer to a private entity have a temporary character and they are supplemented (in a period of two years at most, which may be extended only for justified reasons) by the resort to market solutions;
- ✓ granting compensations based on law court decisions to individuals that suffered damages after the implementation of stabilisation measures.

P&A

- *The full or partial transfer of assets and liabilities of a credit institution to one or more eligible institutions* is performed under the assistance of the supervisory authority.
- The measure is implemented with the support of the BDGF that finances the transfer of assets and liabilities.
- The main advantage of this measure is that priority is given to the transfer of guaranteed deposits and, thus, the related amounts are readily made available to depositors, without disrupting the banking services provided to them.
- In addition, taking over the deposit portfolio of the bank in distress allows the purchasing bank to increase its market share.
- The legal framework in force requires ensuring the fair treatment and fair competition among the eligible institutions expressing their taking over intention. The winning institution is designated based on the most advantageous bid, as considered by the central bank in terms of the objectives pursued.

Involvement of BDGF as delegate administrator or shareholder of distressed bank

- The BDGF may be appointed as *the delegate administrator* of a credit institution, in which capacity it takes over the administration and management tasks of the respective credit institution.
- As the case may be, the BDGF may also act as *the shareholder* of a credit institution;
- in the latter case, with the approval of the general meeting of shareholders of the credit institution and after the cut in the share capital to cover losses, the share capital of the credit institution is raised by waiving the preference rights of the existing shareholders and subscribing new shares by the Bank Deposit Guarantee Fund at a level approved by the central bank.
- According to the laws in force, the shares acquired by the Fund shall be sold within two years at most since their acquisition. They may be held for a longer time period for justified reasons and only as decided by the central bank.

Bridge bank

- *Transfer of assets and liabilities from a credit institution to a bridge bank established to this purpose* focuses on ensuring the continued provision of banking services related to the assets and liabilities taken over.
- The sole shareholder of a bridge bank is the BDGF.
- The bridge bank is authorised by the NBR.
- Bridge bank have to carry out its activity in compliance with the legal provisions applicable to credit institutions, being subject to prudential supervision by the central bank.
- When transferring the assets and liabilities to the bridge bank, priority is given to guaranteed deposits.
- The bridge bank shall ensure the maintenance of a low risk level in the pursuit of business, and the eventual extension of its business will be done prudently;

Bridge bank (cont')

- This stabilisation measure benefits from mixed financing from the BDGF, for establishing the share capital and ensuring the own funds necessary for the smooth functioning of the bridge bank by observing all prudential requirements, as well as for transferring the assets and liabilities from the credit institution in distress.
- Where the BDGF has insufficient resources for financing the stabilisation measures, it may take government loans via the Ministry of Public Finance. The general conditions for the granting/repayment of the loans to the BDGF are established by way of government decision.
- The bridge bank is established and functioning for a period of up to two years, with the possibility of extending this period, by the decision of the central bank, in situations where a threat to the financial stability still persists and/or negotiations with the proposed acquirer of the bridge bank were not completed.

Methodology for identification of systemically important banks

- The stabilisation measures apply to credit institutions in distress that pose a threat to financial stability.
- In its regular assessments on the systemic risk associated with a credit institution, the NBR relies on the **definition formulated by the European Systemic Risk Board (ESRB)**, namely: “a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy. All types of financial intermediaries, markets and infrastructure may be potentially systemically important to some degree”.
- The **recommendations of the European Central Bank** are also considered. The ECB defines systemic risk as the risk of experiencing a strong systemic event which adversely affects a number of highly systemically important institutions for the good market functioning. The severity of systemic risk and systemic events would be optimally assessed by means of the effect that they have on consumption, investment and economic growth. The difficulty to make a distinction between idiosyncratic or systematic, exogenous or endogenous factors illustrates the complexity of this phenomenon.

Methodology for identification of systemically important banks (cont')

- Financial Stability Department developed a methodology assessing the systemic nature of banks.
- The **criteria** used are particularly focused on the presence of the credit institution on the main banking markets:
 - ❖ *loans,*
 - ❖ *deposits,*
 - ❖ *government securities,*
 - ❖ *interbank market,*
 - ❖ *payments,*
 - ❖ other relevant circumstances specific to the credit institution, including *contagion vulnerability from the parent to subsidiary banks through the common lender channel* (capital country origin).
- Variable, variation intervals and scores are attached to each criteria.

Methodology for identification of systemically important banks (cont')

- In order to assess the systemic nature of credit institutions, both **quantitative** and **qualitative** analyses are used:

- The *quantitative analysis* is based on

- ✓ monocriterial approach
- ✓ multicriterial approach

The decision could to be reassessed when the credit institution is deemed systemic for the functioning of the reference market in terms of a particular criterion.

- The final decision on the systemic nature of a credit institution is adopted by considering the *qualitative aspects* specific to that bank.

Further improvements of legal framework

- As a Member State, further developments in national legislation will result from the implementation of Bank Recovery and Resolution Directive.

Purpose	The framework would equip authorities with common and effective tools and powers to tackle bank crises pre-emptively, safeguarding financial stability and minimising taxpayer exposure to losses in insolvency.
Subject	All credit institutions; certain investment firms; holding companies where one or more subsidiary credit institutions or investment firm meet the conditions for resolution.
Resolution authorities	Subject to national discretion: National central banks, financial supervisors, deposit guarantee schemes, ministries of finance or special authorities.
Entry into force	Transposition deadline for the Directive is 31 December 2014 , apart from bail-in tool which should be applied as from 1 January 2018 .

Further improvements of legal framework (cont')

- The Directive consist of three elements:

Preparation and prevention	<p>A1. Recovery plans drawn up by credit institutions (at individual and group level), which will be assessed and approved by supervisors.</p> <p>A2. Resolution plans (at individual and group level) prepared by the resolution authorities in cooperation with supervisors in normal times.</p> <p>B. The resolution authorities may take measures in order to facilitate resolvability of the institutions (reducing complexity - legal or operational; limiting maximum individual and aggregate exposures; imposing reporting requirements; limiting or ceasing activities; restricting or preventing the development of new business lines or products; issuing additional convertible capital instruments).</p> <p>C. Intra-group financial support (voluntary agreements)</p>
Early intervention	<p>Expanded supervisory powers (requesting the institution to implement recovery plan; proposing decisions to shareholders; requesting to draw a plan for restructuring; appoint a special manager for a limited period in order to restore the financial situation).</p>
Resolution	<p>The resolution authorities have the power to apply the following resolution tools:</p> <ul style="list-style-type: none">a) sale of business;b) bridge institution;c) asset separation;d) bail-in.

Conclusions

- More or less, the current Romanian legal framework addresses all the elements of BRR Directive, except bail-in instruments, but the deadline for implementation is **1 January 2018**, taking into account:
 - the observed maturity cycles of existing debt,
 - the need to avoid deleveraging
 - deadline for implementation of new capital requirements CRD IV.
- Throughout the period since the outbreak of the global financial crisis, the Romanian banking system has remained stable, being well capitalised and holding consistent liquidity reserves, following the proactive approach of the central bank which tightened prudential regulation and supervision.
- As a result, the use of public funds to support banks was not necessary in Romania.
- Up to now, no stabilization measure was used.

Thank you!

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