NEW MANAGEMENT CHALLENGES FOR THE BANKING SECTOR IN ROMANIA: TRADITIONAL, DIGITAL OR FINTECH. WHAT'S THE NEXT BIG STEP?

Alexandru Florin DUNA[1]
Radu Liviu ILIOIU[2]

ABSTRACT
The paper proposes to underline the main challenges facing the Romanian banking system in the post-crisis era. The factors determining the decline of financial intermediation in Romania, as a percentage in GDP (currently at 29%)are many, but the most important seem to be the challenges of legislative nature, the new type of competition and last but not least the new frame of prudential regulation. After the introduction, we will present the main features of the of the new frame picture for the lending activity in Romania, elements of legislative nature represented by the Giving in Payment law and conversion of loans in foreign currency law, but the core of the paper will outline the main features of the Fintech companies and their positioning in relation to banks. The second part will outline the new directions set by the new stricter rules of prudentially that will be imposed once the Basel III Accord will come into effect. The last part represents our concluding remarks.

KEYWORDS: *financial crisis, economic context, economy, banking system, Romania, lending-related risks, challenges, paradigm, non-performing loans, foreign currency conversion, regulations, macro-prudentially.*

JEL CLASSIFICATION: *E66, E58, F15, F42, F61, F62, G01, G28*

1. INTRODUCTION

Even though in the new post crisis economic context, lending remains a primary and central element within the banking sector of Romania, it should be brought to the foreground the fact that it has been redefined and followed a completely different course compared to the years leading up to the economic crisis. This draws attention to the main factors that have determined the course of the last ten years, from the perspective of the economic cycle.
We recall in this connection the conversion of loans in foreign currency, in particular those in Swiss francs, the Giving in Payment law, the rethinking of the business model for small and medium businesses so they can have access to bank lending, the new competition (fintech-type companies) and last but not least, perhaps the most important aspect, defining for the national economy, namely the new system of macro-prudential regulations imposed by the European Central Bank and then through the channel of The National Bank of Romania on the banks of the Romanian banking system.

[1]Bucharest University of Economic Studies, alexandruflorin.duna@gmail.com
[2]Exim Bank Romania, radu_ilioiu@yahoo.com

2. THE NEW TYPE OF COMPETITION: FINTECH COMPANIES

1.1 New lending criteria for companies: the case of Romania

The effects of the 2008 crisis had a powerful effect on a global level in the first place, but spread very rapidly at the local level. Because of this Romania had many tests to pass in his path towards stability and confidence that needed to be conveyed to investors.

In the new post crisis framework, in which the level of financial intermediation decreased so much, the financial markets no longer had sufficient resources and especially liquidity and in which investors and investments evaporated quickly, the reconstruction of a solid banking system solid was an extremely difficult and winding road.

In terms of the way the economic and financial crisis completely changed the banking and economic paradigm, we mention the credit system remodeling for individuals and especially for companies (SMEs and Corporate). Please note the fact that liquidity flows in the economy as well as the capital buffers of the commercial banks had long suffered and the method of management had to be revised by the competent authorities and implemented with success by the commercial banks.

In this sense, international and national bodies designed a new framework for macro-prudential regulation, which was able to redefine the economic terms for sustainability and indirectly for mechanisms for restarting the lending mechanism.

We recall in this sense BIS, ECB, and NBR-all regulatory bodies that contributed to the proactive redefinition of the lending system. At the level of commercial banks, through regulations and specific directives as well as through Basel III accord, new capital requirements and bank liquidity indicators were imposed, much more comfortable than before the crisis. New eligibility requirements were set up in the case of solvency and reimbursement mechanisms for individual and corporate lending (Härle et al., 2010).

At the same time legislative challenges shaped the overall picture created in the Romanian banking system, such as the Giving in Payment law or the conversion of loans in foreign currency law, which had an important impact on the lending system (especially for individuals).

The new lending rules and requirements at the level of the Romanian banking system translated into an increased level of prudentially and expertise for new loans granted by the banks for both public entities as well as private ones. On the other, they translated into new regulatory capital levels at banks, improved liquidity and solvency as well as a way to streamline bank balance sheets through proper provisioning for bad loans originated in the crisis period as well as their write-off from balance sheets.

Once their credit portfolios have been cleaned, banks were able to engage in new lending activities, to originate better and more solvent business, and with higher standards of sustainability so that the entire banking system could experience an increase in efficiency. The new regulatory requirements offer sufficient mechanisms and resources for protection and sustainability against future possible shocks.

Overview of credit policy adequacy in the post crisis era for the top Romanian banks:

- Total loans vs. total assets: with the exception of the first two banks in the system (faced with important processes of selling of non-performing loans portfolios) one can observe a tendency of increase of the share of total loans in total assets caused by a single-digit rate of growth for lending, closely related to the positive evolution of the economy in the period analyzed 2014-2015.
- Total deposits vs. total passives: general trend of growth based on the growth of deposits from customers, caused by the growth of disposable income of individuals and companies. This

trend could be threatened by lowering interest rates offered by banks on deposits, based on increasing liquidity in the market.
- Patrimonial Solvency: one can highlight the growth trend of this indicator against the backdrop of new capital requirements (Basel III) which led to increases in capital.
- LTD-credits vs. deposits: declining trend for LTD, which started since the beginning of the crisis, as local banks have relied increasingly on local resources to finance the lending activity (versus lines of credit from mother banks) and amid faltering credit appetite from customers.

1.2 Fintech Companies: a new competition

Fintech currently represents the new industry ...that relies on companies that use new technologies and innovations to compete and/or collaborate with traditional banks in the general activity of providing financial services to customers.

Fintech development is a process in full progress during which finance and technology have evolved together and gave birth to multiple disruptive innovations such as Internet banking, payment via mobile phone, crowdfunding, peer-to-peer lending, acceptance of digital documents, the simplification of procedures of authentication and identity verification during the KYC procedures, and acceptance of digital documents and customer digital agreement, etc.

Total investments attracted by fintech companies amounted to 26 billion dollars at the end of 2016, estimates indicating that in 2020 they will reach a total level of 46 billion dollars. This evolution will be determined by the changing attitude of traditional banks and financial institutions toward fintech companies, attitude that switched from underestimation to bidding.

According to a recent study conducted by the prestigious consultancy firm Price Waterhouse Coopers (2017), almost 50% of financial services firms around the world plan to purchase start-ups fintechs within three to five years, and eight out of ten institutions intend to conclude strategic partnerships with them.

In addition, according to another impact study, an important player in the market of financial consulting, entitled "FinTechs in Europe", another aspect arises: fintechs are targeting 3 big groups of activities, each with specific objectives:

- **the first category "Products"** includes seven clear goals, namely: peer-to-peer facilities, payments and transfers of money, personal finance, block chain, robotics consulting, crowdfunding and security/digital identity.
- **the second category "Aggregators"** comprises three goals: trading platforms, comparative platforms and its own so-called aggregators.
- **the third category is "Big data"** with the objective Software and analytics.

According to the same study, carried out at European level with the support of 248-fintech companies from 18 countries, 54% of them operate in three major directions: investment, crowdfunding/lending and payments.

There are a number of success factors for fintech companies, among the five first being customer confidence, transparency of products/services, the degree of understanding of the client base, compatibility of processes and digitized business models. It is worth noting that success factors such as financial resources, successful brand or expertise concerning regulatory legislation (success factors important for traditional financial institutions) have a secondary importance in fintechs'vision.

Fintech companies have a realistic perception of the role played in the financial industry: although they are aware of the changes they bring along, the perception is that they will not take the place of traditional financial institutions ("incumbents") and most of them are willing to collaborate with them. What financial institutions (banks, insurers, etc.) can obtain from working with fintech companies is the opportunity to accelerate their own digital transformation. Fintechs may thus represent an opportunity for banks rather than a threat.

2. MACRO-PRUDENTIAL REGULATIONS

2.1 The new post-crisis regulatory framework imposed by National Bank Romania

At present, after the economic and financial crisis of 2008, the Bank for International Settlements, together with the Supervisory Committee, decided to prevent shocks such as those occurred during the crisis, so Basel III Accord was considered a necessity for ensuring the stability and predictability of financial mechanisms. The new accord in essence represents a fundamental review of the regulatory and supervision framework of the banking industry, the objective being to strengthen the stability of the financial system.

The introduction of Basel III accord is based on the following (Walter, 2011):

- the negative effects of the banking crisis. The economic literature shows that the result of the banking crisis materializes in loss of economic production equal to about 60 percent of GDP in the pre-crisis period;
- the frequency of banking crises. Since 1985, there have been more than 30 banking crises in member countries of the Basel Committee, which corresponds to a probability of 5% for a Member State to deal with a crisis in a given year.
- the benefits of Basel III Accord far outweigh the costs of its implementation, since a stable banking system is the cornerstone of sustainable development, with long-term beneficial effects.

The new Accord aims to strengthen the stability of the banking system, through the application of strict standards designed to improve its capacity to absorb the shocks of the economic and financial sector, and to reduce the risk of contagion from the financial sector to the real economy. The new standards also aimto improve risk management, increase transparency and disclosure requirements of credit institutions, as well as solving the problems of systemic banks.

The measures require, firstly, more demanding standards for banks regarding the capital adequacy, liquidity requirements and leverage effect, the main objective being lessening the adverse effects of financial crises.

2.2 Absorption of the new regulatory framework by commercial banks: between illusion and hope?

The major difference of the present Accord compared to previous ones is represented by its broader coverage, its measures being both micro prudential (aimed at banks' individual risks) and macro prudential (targeting the banking system as a whole).

At the micro prudential level, the measures aim:

- to enhance the quality of the base capital by increasing the minimum capital requirement (ordinary shares, the financial result brought forward and reserves) and the minimum Common Equity Tier 1 requirement (equity and hybrid instruments) and through reconsideration of eligibility criteria for the instruments when determining the level of Common Equity Tier 1;
- to increase the requirements for risk coverage, major emphasis being placed on the risks brought into headlight by the crisis: from trading book exposures, counterparty credit risk (CCR), securitized exposures and the securitization position;
- to limit the leverage effect as an additional measure to capital requirements calculated according to risk;
- the provision of international liquidity standards, that would allow short-term (30 days) resistance to shocks/liquidity crisis, and for long-term (1 year) a solid structural liquidity profile.

At macro prudential level, measures have an anti-cyclical nature and aim:

- to introduce a countercyclical buffer in order to protect the financial system from the systemic risks associated with unsustainable credit growth (represents 2.5% above the minimum capital requirements-made up of ordinary shares, the result brought forward and reserves), as well as a capital conservation buffer intended to cover any losses if the Bank faces financial problems (varies between zero and 2.5% to total risk weighted assets depending on the business cycle phase). The countercyclical buffer is directly proportional to systemic risk and shall be calculated according to the credit/GDP ratio;
- to calculate a leverage effect, the aim being limiting debt levels at the level of banking system in periods of boom;
- to reduce the probability and impact of the bankruptcy of banks of systemic importance, allowing for the reduction of the cost of public sector intervention and imposing of conditions of equal competition by reducing the competitive advantage that these banks hold in the sphere of financing. The Committee is considering other additional requirements as well in order to absorb losses, as well as the possible introduction of additional capital surcharges for those banks.

Full global deployment, with strict deadlines, of the Basel III Agreement is essential for the consolidation of the financial system. The responsibility for implementation falls not only with the regulatory bodies, but also with specialists at the level of bank risk managers as well as with audit, which holds a key role in reviewing independently the implementation and administration efforts. The challenge is posed by the fact that implementation takes place during an uneven and uncertain post crisis recovery between member states. Prospects for growth have weakened, and sovereign debts enhance the fragility of the financial systems of some Euro zone countries.

3. CONCLUSIONS

The impact of the new macro-prudential regulations, such as Basel III Accord, considered to be one of the most important mechanisms of its kind developed post-crisis, shows currently limited resources related to the implementation of rapid, definitive impact, on the Romanian banking system, considering it for a moment quite limited, primarily through complexity and magnitude.

In spite of all these, there are a number of measures that credit institutions may adopt in order to mitigate the impact of the alignment to the new standards:

1) Adjusting the business model

Banks will review their profitability indicators in a context of superior regulatory environment. In addition, some business segments will be assessed based on "accessibility", given the scarcity of funding and capital in the future. Credit institutions will redesign their products and services to ensure that they continue to meet customer needs, whilst optimizing capital and bank liquidity. Adjusting the range of products can be done in several directions:

- Banks can steer you toward products that satisfy customers ' needs, but at the same time engage lower capital requirements;
- launch product packages that tie the lending activity to saving, banks thus being able to attract funds in the form of deposits from the population and small and medium enterprises;
- Banks can increase the share of short term to reduce the cost of financing (e.g. orientation towards revolving loans at the expense of mortgage loans).

2) Restructuring of banks' balance sheets

Basel III is based on the integrated management of assets, capital and funding, credit institutions having the opportunity to optimize assets and liabilities independently. For many institutions, a significant portion of the impact of Basel III capital comes from deductions. New rules on the quality of capital steer away from Basel II and provide limited space for maneuver to banks, because they are forced to deduct (Walter, 2010):

- Capital of insurance subsidiaries that exceed a threshold of 10 percent, reducing the possibility of reusing much of this capital in the banking business of the consolidated entity;
- The value of any defined benefit of pension fund assets;
- Investments in unconsolidated financial institutions over the threshold of 10 percent

With the view of improving the quality of their capital, banks have a wide choice of options, in order to mitigate the impact of the adoption of the Basel III; thus, credit institutions:

- can improve the scope of consolidated capital through the purchase of minority interests or by reducing excess capital of bank subsidiaries;
- can optimize their holdings in financial institutions by reducing the unconsolidated investments under the thresholds defined by the regulatory authority for deductions of capital;
- may review pension contracts and determine the exact value of the assets that can be promptly withdrawn from the Fund, and thus become eligible for recognition in regulatory capital.

Aside from the unique effort to align their balance sheet to the new capital requirements, banks are required to invest continuously in their capacity to manage the balance sheet. Many banks only have a corporate level image on their balance sheet and a less accurate diagnosis in terms of business lines. Banks face significant challenges: a well-established chronology, significant results following implementation, an unprecedented complexity and interdependence of these measures.

The complexity of implementing requires each credit institution to have designated experts. Depending on the degree of fulfilment of the requirements of Basel II and their ambitions to build some of the most sophisticated Basel III risk processes, some institutions will navigate through the complexities of implementation much easier than others.

The challenge comes from three main directions: design, quality of data and the complexity of reporting:

Basel III: project complexity

Owing to the shortcomings of the previous Agreement (Basel II), Basel III raises the standards at an unprecedented level for the banking industry. The complexity lies particularly in the key elements of the new Accord (introducing the countercyclical buffer and capital conservation buffer) and in the additional requirements compared to Basel II, materialized in:

1. building an integrated vision on credit and trading book risks, in contrast to Basel II, where regulatory capital for credit risk was addressed only to the Bank portfolio;
2. Development of methodologies for the calculation of VAR and elementary risk charges, these not being provisioned in Basel II Accord;
3. Expansion of the securitization taxon the banking portfolio, provisioned by Basel II Accord to be applied to the trading book portfolio as well.
4. Quality of data and the complexity of reporting. High quality data is essential for the efficient operation of the Bank's risk processes.
5. Operational Complexity.

An efficient corporate governance in banking, depending on the business model and the corresponding risk profile, is the first step towards a successful implementation of Basel III Accord. Internal Auditors also have a very important role because they have to provide a critical analysis and recommend improvements to the internal control framework.

We therefore conclude by trying to answer the initial question in the title of the material, namely if the new tendencies represent a new paradigm or an evolution in terms of the lending system as the primary mechanism of the financial-banking system.
We assume it is difficult to assess quantitatively or even in terms of figures by providing an objective answer to the aforementioned aspects. However, through the new macro-prudential regulatory mechanisms imposed by the competent authorities, we remain with the hope that the paradigm of knowledge meets up with the evolution of the unknown, in the financial-banking ocean, through a relevant business model that can create and provide a stable, predictable and sustainable framework.

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