THE INTRODUCTION OF THE UNIQUE MECHANISM OF SURVEILLANCE AND THE REDUCTION OF NON-PERFORMING LOANS

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Abstract

The introduction of a harmonized framework for financial supervision allows the minimizing of tax consequences and possible systemic bank failures. Banking union project will have impact on both the micro-prudential supervisory practices and the prudential supervision framework in the euro area and in the state members that will decide to participate in this project.

The non-performing loans (NPL) trend in the countries of Southeastern Europe further shows that nonperforming loans will increase in some of the states of Eastern Europe affecting credit flows and profits made by the banks.

The activities conducted by the banks cannot be estimated, quantified and especially eliminate all risk, lending generates NPL even lending procedures were followed in accordance with the laws and regulations in force.

Romania has the highest rate of non-performing loans in the region and the fact is generated because of difficulties in removing non performing loans from banks' balance sheets. In order to increase the volume of loans it is necessary to decrease of nonperforming loans from banks' balance sheets. To identify the optimal strategy for managing non-performing loans is necessary to continually monitor the performance and providing rapid adaptation to the dynamic environmental factors and changes in the characteristics of the loan portfolio.

European Central Bank will consistently enforce a set of unique rules apply to the group of euro area credit institutions will directly supervise credit large institutions and will monitor supervisory practices of credit institutions less significant conducted by competent national authorities.

Keywords: *financial regulations, non-performing loans, interbank market reform, banking system, banking union.*

1. Introduction

The European Commission estimates that the new European financial supervisory framework must fully respond against the political authorities in the EU and it is necessary to create a common culture in the surveillance procedures. National banking problems can be more easily managed by a central European authority, mainly the European Central Bank.

European Central Bank (ECB) will take sole responsibility for supervising banks in Europe. Switching the bank supervision at EU level will be complemented by other measures such as: harmonization and simplification of deposit-protection systems and integrated management crises in the European banking system. Under this unique mechanism of supervision proposed by the European Commission, the ECB will oversee all banks in the EU, which will apply to specific common rules of the single market[1].

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[1]Bruni, L.. (2011). The Europe and World Economy Governance: The Monetary and Financial Perspective, A. Global Governance and the Role of EU, Assessing the Future Balance of Power. USA, Edward Egar Publishing Limited.

Interests of all Member States are conditioned by the existence of balanced, strengthened relations and strengthen trust between domestic and host country. The purpose is to promote a system based on high standards of supervision, equivalent, correctly and consistently applied to all market actors, while respecting the independence of supervisors in fulfilling their respective debts.

To achieve this goal the key tool is the development, implementation and enforcement of legislation on banking and financial conglomerates in the EU, which covers prudential regulatory requirements for credit institutions, financial conglomerates and investment firms. This includes correct and timely transposition of legislation in the Member States and facilitating of different procedures for the situation breaches of Community law. Bank financial sector is concentrated mainly on:

- strict control of financial and banking system
- promoting integrated financial institutions and financial markets more stable
- ensuring good corporate governance in the banking sector
- protect the interests of bank customers by guaranteeing deposits and providing compensation
- correct information of customers about the risks of financial products
- promote a banking system aimed at supporting the real economy
- ensuring sustainable economic growth.

2. The role of the European Central Bank (ECB) in the unique supervisory mechanism

The decision of EU Commission regarding banking union accompanies two legislative proposals, one for the establishment of a single supervisory mechanism by conferring specific ECB policy on prudential supervision of credit institutions and second on improving the Regulation establishing a European Banking Authority (EBA).

According to these regulations, the European Central Bank is given the key and specific supervisory tasks that are essential to ensure the detection of risks to the sustainability of banks.

European Central Bank will be, among other things, the competent authority for authorization of credit institutions, evaluating qualifying holdings, ensuring compliance with minimum capital requirements, ensuring internal capital adequacy in relation to the risk profile of the credit institution, conducting supervision on a consolidated basis and supervision of financial conglomerates.

European Central Bank will ensure compliance with the provisions on the relationship between funds raised and borrowed (leverage) and liquidity and capital reserves application will perform in coordination with the relevant authorities early intervention measures when a bank violates the provisions relating to requirements capital.

The European Central Bank will be invested with the necessary powers of investigation and surveillance in order to perform its tasks. It includes the active involvement of national supervisors in the single supervisory mechanism to achieve effective training without problems and implement surveillance decisions and the necessary coordination and flow of information on both local and European issues, with to ensure financial stability throughout the EU and its Member States.

All tasks that are not explicitly assigned to the European Central Bank shall be cover by the national supervisory authorities. For example, national supervisory authorities will remain responsible for consumer protection and combating money laundering and supervision of credit institutions from third countries establish branches or provide cross-border services within a Member State. European Central Bank must be able to fulfill their supervisory functions in full independence, being completely responsible for his actions.

The creation of "banking union" by a single supervisory mechanism will exert a direct control on banks to ensure compliance with prudential and conduct effective monitoring of cross-border interbank markets. But in terms of "good governance" burdens monetary policy will be strictly separated from supervisory tasks, in order to eliminate potential conflicts of interest between monetary policy and prudential supervision.

Experience shows that the failure of Banks, even relatively small, can cause systemic cross border damages.

In addition, banks that acting across national borders may critically weaken domestic banking systems. Enhanced surveillance in the banking union will improve the robustness of banks. However, if crises attack occurs, it is necessary to ensure that institutions can be protected in a methodical manner and that their savings depositors are safe. A banking union should include a more centralized management of banking crises with the involving of main European institutions.

3. NPL analysis in the context of single supervisory mechanism

The financial crisis has shown that irresponsible behavior by market participants can undermine the foundations of the financial system, leading to a lack of trust between all parties, especially consumers with potentially serious social and economic consequences. Many consumers have lost confidence in the financial sector, considering their loans increasingly unaffordable.

Credit quality across the European region has been affected due to the economic crisis. Since 2008-2009, the volume of non-performing loans grew rapidly in the countries of Central and Eastern Europe (from a regional average of 3.5% before the crisis to 11% in late 2011).

In a number of countries are continually deteriorating bank assets, particularly in the South East, where the period of recovery remains slow and delayed. In South East Europe non-performing indicators are growing (7.3% on average in 2012, 2.5% more than in 2009).

NPL growth, defined by the European Central Bank (ECB) as loans that were delayed for over 90 days, was especially influenced by southern European countries such as Italy, Spain and Greece, plus Ireland. At the end of 2012, European banks had bad loans worth 1.190 billion Euros from 1.090 billion Euros at the end of 2011.

Greek banking system will face a massive increase of 40% and non-performing loans in 2014. Central Bank of Greece (CBG) announced that loans with delays of over 90 days in June amounted to 29.3% of total loans, at the end of the year reached 35 percent.

The peak of the proportion of bad loans is projected to be reached during 2015, after which their level will decrease.

The objective of the Greek banking system is to stabilize non-performing loans level, so their growth to slow this year as for the resumption of lending and return to normal economic levels.

Italian Banking Association (ABI) said in a statement that the non-performing loans held by financial institutions registered in Italy in November 2013, the largest amount in 14 years.

Total gross non-performing loans in the portfolio of Italian banks in November 2013 had a volume of 149.6 billion Euros (202.3 billion dollars), up 22.8%. Gross non-performing loans represented 7.8% of total loans in November from 7.7% in October.

The number of consumers and businesses who have failed to pay loans reached 1.2 million. For the 20th consecutive month in December banks reduced lending in Italy by 3.4%

following a decline of 4.5% in November, given that the last two years performing loans increased by 45%, Italian banking Association announced.

Non-performing loans of Spanish banks reached a new record level in November 2013 under the country's unemployment rate exceeds 26%, according to the central bank in Madrid.

According to official data, the percentage of non-performing loans in the portfolio of Spanish banks reached 13.08% in November 2013 from 12.99% in October. Central Bank of Spain show that these non-performing loans amounted to EUR 192.5 billion in November 1.5 billion more than in the previous month.

In Romania, in 2012 recorded the most unfavorable values in the region: 20.1%, from 15.6% in 2011 and 7.2% in 2009[2].

The statistical data shows that at the end of 2013 in Romania NPL ratio reached 21.87%, the indicator could be actually higher. Romania was at the end of last year the third position among the European countries affected by the non refunding of loans to the banks, non-performing loans tripled as a share of total portfolios in the last three and half years. Some banks have resorted to repeated restructuring of loans, in some cases 20 times, just in order to avoid performing their employment and hence provisioning[3]. It is well known that after a certain threshold, the effect of bad loans affect credit, and of course growth.

Implementing a unique supervisory mechanism could also facilitate the operation of a new system to support ailing banks, with the possibility of speaking European Stability Mechanism, the Euro zone emergency fund.

4. Solutions in terms of managing non-performing loans

Regarding recovery solutions at European level, the banks are mainly oriented towards adjusting payment terms - generally avoiding interest capitalization or refinancing - or to sell portfolios of non-performing loans or the intensification of collection that are still relatively rare.

In times of economic stagnation, an effective credit portfolio management becomes a key factor to ensure profitability.

Effective management of non-performing loans represent a mechanism capable to take into account a variety of parameters, each designed to meet a specific need, and determining a portfolio segmentation in line with internal strategies related to customer management and risk management.

Good portfolio segmentation is a key factor for managing the complexity of managing non-performing loans.

NPL management should start with the analysis of the external environment, followed by the analysis of the cost / revenue collection and team effectiveness.

A good coordinated gathering process could significantly improve performance, organizing physical and virtual channels and defining activities accurately. Key activities used to strengthen the management of non-performing loans refers to a review of operational, technological and quantitative gathering process in general, while specific monitoring actions are usually implemented to improve standardization and automation system.

As macro prudential factor acting on both the demand and supply side should be mentioned the limitation of currency loans to borrowers exposed to currency risk, through this regulatory measures adopted by the central bank coordinated at European level as a result of implementation of the recommendations of the European Committee for Risk systemic Risk Board (ESRB).

[2]National Bank of Romania (NBR), Financial Stability Report, 2013.
[3]National Institute of Statistics (NIS), "Statistical Yearbook ", 2012.

In addition, many organizations have opportunities to improve performance related to a variety of factors, such as multiple systems and / or sub integrate, processes and procedures inefficient or under-utilization metrics for performance analysis, effective preventive measures granting NPL or the technology for collection and recovery.

An integrated view of all stakeholders helps to achieve excellence in the management of non-performing loans.

The monitoring of performance is fundamental to identify the optimal strategy for managing non-performing loans, providing rapid adaptation to dynamic environmental factors and changes in the characteristics of the loans portfolio.

5. Conclusions

The European Commission estimates that the recent international financial crisis has highlighted the need for crisis prevention must starts at the internal level of the domestic banks, and the shareholders and managers must participate actively and responsibly in the prevention and all the procedures regarding must be based on internal control systems more robust.

Therefore, by introducing the new Basel III regulation is intended that the European banking system has become more secure by repairing many of the errors that have become visible in crisis.

Improving the quality and size of capital and the renewal of management liquidity are designed to stimulate banks to improve their capacity to manage systemic risks.

The implementation of this new agreement is gradual, starting in 2011, until fully implementation at the end of 2018.

The goal for the banks to is eventually to restructuring banks risk - what we can call a new paradigm of risk - which should be good for business, consumers, investors and governments. In response to new regulations Basel III, banks will have to act in the following directions: efficient management of capital and liquidity, balance sheet restructuring, adjusting the business model and financial services offered.

In European countries that already have experience of market economies we found that banks should be prepared for the changes permanent forms that can manifest risk.

Thus, in addition to traditional risk exposures add operational, financial and strategic caused by a number of factors such as: changes in legislation, certain European standards and norms, needs on refurbishment, cost effectiveness, economic events spontaneous (unexpected, unplanned).

Eastern European countries are involved in the bank industrialization from a different perspective since they are targeted for outsourcing of the big banks from the West. This is mainly due to low cost of labor, still considerably lower than in Western Europe, and generally greater flexibility in the allocation of a number of full-time employees in the process, which helps to optimize operations.

Non-performing loans will continue to grow in some of the states of Eastern Europe, affecting credit flows and profits made by Western banks operating here. Although conditions may vary from country to country, the IMF believes that authorities should remove legal obstacles and other banks to help solve the problem of bad loans, which in some cases reached 20% of the portfolio.

Solving the problem of bad loans, which many banks in Central Eastern and South Eastern Europe are reluctant to grant new loans could be an important incentive for credit growth, the development of local capital markets could create a stable and long-term source of funding for domestic banks.

In Romania slow economic growth, inflation and depreciation of the national currency have helped people and companies to improve their financial position to meet the requirements imposed by banks easier.

The volume of credits decreased, while the NPL is growing. In an economy dependent on financial intermediation, increased production can only come from credit recovery, which by all signs will not happen in 2014. The only thing the state could do to compensate for the blockage lending and to ease the financial constraints of the business environment as lower taxation and deregulation, but this will be difficult.

Given that local capital markets are underdeveloped, increased domestic might prove insufficient to support a significant revival in lending. Reducing cross-border financing by Western banks in CESE countries continues at a moderate pace, but with major differences from country to country and move to a model based more on domestic financing grow more and more.

To foster the development of viable markets debt recovery, possible discrepancies between the Tax Code and IFRS accounting standards on the treatment of non-performing loans sold local debt management companies will be resolved in accordance with the settlement with the European Commission infringement procedure.

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