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ALTERNATIVE VIEWS ON THE PARTICIPATION OF NON-EURO ZONE COUNTRIES AT THE BANK UNION

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Abstract. The reformation of the bank systems' regulation and supervision in The European Union was founded on a macroprudential approach to monitor systemic risks and the vulnerabilities in a more effective way. Considered as the backbone of the new macroprudential supervision architecture, the Bank Union raises intense debates among the catching up economies. The fact that there are few studies on the costs and benefits of joining the Bank Union for the Central and Eastern European countries, explains the different views of the decision makers concerning this issue. The study stresses the manner in which macroprudential policies were implemented in Romania, as a particular case among the CEE countries, and the extent of their contribution to mitigating vulnerabilities and maintaining financial stability. The paper summarises the main arguments in favour of joining the Bank Union by emphasising the Romanian monetary authorities' stance compared to those of the neighbouring CEE countries.

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1. Introduction

The recent financial crisis has brought into debate the issue of the effectiveness of bank regulations and supervision in the Euro zone and the European Union at large. The severity of imbalances and their consequences on the domestic financial systems have raised awareness that the strength of individual financial institutions is not able

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to support, alone, the financial stability (Brunnermeier et al., 2009) in the region. The reformation of the regulating and supervision framework based on a macroprudential approach was intended to extend the monitoring of systemic risks and vulnerabilities that have affected all the banking systems in the EU. The project of the Bank Union is a key element of this new philosophy, whereas the concentration of macroprudential regulations at the European Central Bank is required to reduce the crossborder risk of contagion and to protect the integrity of the European banking system.

Since the positive externalities induced by the financial stability recommends it as a global public good, the negative financial outcomes of the crisis led to a general consensus that *ensuring and maintaining financial stability require a monetary, fiscal, prudentiality and competition policy mix, revolving around the macro prudential policy as a key determinant*.

It is well known that unconventional monetary and macroprudential policies are the two most important latest evolutions in central banking, with a significant impact on the international financial system, due to their unprecedented power, influence and authority. The macroprudential approach of Central banks' supervising authority was promoted by the G-20, followed by the Committee for Financial Stability and the Basel Committee for Bank Supervision. Their proposals of macroprudential supervision standards (i.e. the countercyclical capital buffer, the tools required by the safeguarding of systemically important financial institutions, the additional capital and liquidity requirements, the resolution mechanisms, etc.) were implemented at regional and national level.

Presently, the European institutional framework for macroprudential policy includes: the European Systemic Risks Boards (responsible for the implementation of macroprudential policies, the ECB (responsible for the macroprudential measures within the Single Mechanism of Supervision), the national macroprudential designated authorities (responsible for the elaboration of macro prudential policies at national level).

Embarking on the process of adopting the tools of macroprudential policies depends on the types of externalities related to strategic complementarities, credit crunches, interconnectedness (Claessens, 2014) they intend to mitigate and which widely vary according to the particular circumstances of each economy. In a rather homogenous approach encountered in the Euro zone, macroprudential policies are convergent, but, since the economic and financial stance of the Central and Eastern European (CEE) countries widely differ within the region, it is expected that the approaches related to the macroprudential tools and joining the Bank Union would be divergent.

Considered as the backbone of the new macroprudential supervision architecture, the Bank Union raises intense debates among the catching up economies. The fact that there are no definitive conclusions on the costs and benefits of joining the Bank Union for the CEE countries explains the different views of the decision makers concerning this issue. The paper takes Romania as a benchmark considering the positive effects of the prudential monetary policy. The NBR has opted for a tight monetary policy in managing the financial crisis which proved to be effective, further preventing the deepening of vulnerabilities and a rather swift restauration of the equilibrium. In addition, the Romanian banking system is dominated by foreign banks's branches that may support the decision to join the Bank Union as a prerequisite to adopt the Euro.

The paper is one of the few contributions analysing the manner in which macroprudential policies were implemented in Romania, as a particular case among the CEE countries, and the extent they have contributed to mitigating vulnerabilities and maintaining financial stability. The paper summarises the main arguments in favour of joining the Bank Union by emphasising the Romanian monetary authorities' view compared to those of the neighbouring CEE countries. Given the complexity of the subject, a mechanistic approach was avoided, the authors rather stressing the advantages and disadvantages of joining the Bank Union, opening further debates that need to be embedded in the context of each economy. The paper proceeds as follows: 2. Alternative macroprudential policy tools, 3. The macroprudential framework of the Romanian banking system, 4. The consequences of The Bank Union on the Romanian banking system, 5. Benefits and costs associated with joining the Bank Union. The rest of the paper is dedicated to Conclusions and policy lessons.

2. Alternative macroprudential policy tools

Bank crisis are recurrent evolutions after excessive private lending. They may trigger deep, long financial depressions that affect the real economy through the credit channel. It is a large consensus in literature that changes in banks' capital and liquidity levels influence the credit supply (Holmstrom and Tirole, 1997), (Allen and Gale, 2007), (Diamond and Rajan, 2011). Under these circumstances, understanding the impact of macroprudential tools on the credit life-cycle and on the resilience of the banking system is essential. The Bank of International Settlements (Report of Committee on the Global Financial System, 2012) and the European Committee for Systemic Risks (ESRB, 2014a) set the foundation in choosing and implementing the main macroprudential tools:

a. ***Capital macro prudential tools*** (countercyclical capital buffer, systemic risk buffer, buffers for the global systemic institutions G-SIIs and the national O-SIIs).

a.1.The countercyclical capital buffer **(CCB)** - the main objectives of this instrument are: "protecting the bank system against losses associated with the cyclical systemic risk and supporting sustainable lending for the real economy" (ESRB, 2014b). The *countercyclical capital requirements* are decided by the designated macroprudential authority and is applicable for all the domestic exposures irrespective of the lenders' country of origin. The decision to activate this instrument is based on the information about the weight of credit / GDP and its long run trend included in the analysis together with the data concerning the accumulation of cyclical systemic risk originating in the credit and real estate prices expansion, external imbalances, bank balance sheets (i.e. the leverage effect indicator), private sector indebtedness, etc. The countercyclical buffer rate operates as a percentage of total risk exposure amount and ranges between 0 percent and 2.5 percent.

a.2.The capital buffer for systemic risk – approaches structural systemic risks and pursues the limitation of direct and indirect concentration of exposures and the prevention of indebtedness. The systemic risk buffer is structural in nature, the risk transmission channels including: *common exposures* (by market sector, counterparty, funding source, asset class, currency, geographical area, etc.); *direct interconnectivity* via the interbank market or indirect interconnectivity via information contagion; *financial*

system concentration. The buffer is designed as a flexible instrument available for national authorities, which may be applied to high-risk exposures, institutions, groups of institutions or the banking sector as a whole. The level of the buffer may vary depending on the contribution to the risk build-up and the characteristics of the national financial system.

a.3. Capital buffers for globally (G-SII) and nationally important institutions (O-SIIs) applicable for banks identified as "too big to fail". It pursues the limitation of moral hazard as intermediate macroprudential objective. This macroprudential instrument is effectively used to achieve the intermediate objective of limiting the systemic impact of misaligned incentives in order to lower moral hazard, by enhancing the loss-absorption capacity of systemically important institutions, which mitigates the likelihood of emerging tensions and their potential impact.

The main effects of these instruments are the following:

Effects on the bank system's resilience - depend on the level of capital reserves voluntarily held by banks. It has been proven that the increase of capital requirements directly improves the resilience on the bank system and can help the prevention of excessive increase of credits and of indebtedness accompanied by a greater capacity for loss absorption. The requirements of additional buffers reduce the probability of interruptions in lending and other financial services supplied for the real economy. The indirect effects are noticeable through the credit cycle or expectations' channel that may lead to an improvement of risk management standards.

Credit cycle effects - the implementation of capital requirements limits the credit supply and assets' prices through the capital constraints and expectations' channel. Increasing capital requirements by activating CCB pursues the excessive limitation of credit. Thus, the banks are forced either to increase their capital (as a share of the undistributed profit or by issuing new shares) or to diminish risk weighted assets. Diminishing the volume of credit means introducing credit restrictions that further impact on the credit demand and on the interest rate. Setting up reserves during the upward trend of lending allows their relaxation during the crisis to the lowest level of the required capital in order to prevent a potential lending crisis. Moreover, the necessity to maintain a higher level of capital could discourage banks to engage in quantitative and risky unsustainable lending. Using buffers for banks considered "*too big to fail"* may ensure a higher level of capital compared to their assets allowing these banks to finance the real economy even during the decline of the financial cycle and may reduce, ex-ante, the probability of a crisis or may cushion its effects.

Regulation arbitrage/leakages – the capital tools' effectiveness may be limited by regulation arbitrage and leakages towards less regulated cross border entities. Loans granted by banks submitted to capital reserve requirements may be substituted by funding obtained from shadow banks or by securisation (i.e. bonds issuance). In the particular case of the *countercyclical capital buffer*, to reduce the risk of leakages, the capital requirement is applicable on mandatory reciprocity basis (i.e. banks with high exposure in various countries are forced to use the CCB rate set by a designated authority of a country, for all the exposures of the clients that operate in a country that applies the countercyclical capital buffer).

b. Liquidity macro prudential tools (Liquidity Coverage Ratio – LCR and Net Stable Funding Ratio – NSFR). The main macroprudential liquidity tools are: *i*. volum based tools (i.e. minimum liquidity reserve requirements (Liquidity Coverage Ratio – LCR) and restriction on maturity (Net Stable Funding Ratio – NSFR), *ii*. general liquidity surcharge meant to discourage banks to access short run funding that triggers the excessive lending and the leverage effect by internelising the externalities by its contribution to the liquidity systemic risk.

b.1. The Liquidity Coverage Ratio – LCR – banks should maintain a sufficient stock of liquid assets in order to cover the possible imbalances between liquidity inflows and outflows for a 30 days time frame during severe crisis.

b.2. Net Stable Funding Ratio – NSFR is a structural long term indicator that shows the imbalances concerning various maturities, stimulating banks to stable resoureces in funding their activity.

Summarised, the effects of thes tools are:

Effects on the bank system's resilience - are predictible when stricter liquidity standards improve the bank system's resilience, reducing the need of the banks for frequent refunding and preventing asset selling that might induce unfavourable funding conditions for all the participating actors on the market. Therefore banks are inclined to hold liquid assets based on long run stable resources. The indirect impact is manifested through the credit cycle or the expectations channel that may lead to stricter risk management standards.

Credit cycle effects – the liquidity reserve requirement raises the costs for banks, but these costs may be limited because macroprudential measures may be implemented on the up swing of the credit cycle when the long term loans and more liquid assets are not so costly. During the down turn of the credit cycle, the monetary authorities may relax the liquidity requirements thus inducing the increase of the credit demand due to the reduction of interest rates. The implementation of the net stable requirement during the up swing phase of the credit cycle may help to prevent the fast increase of lending by increasing the cost of credit. In case of a financial crisis a complete implementation of the macro prudential policy can sustain the necessary funding of the real economy.

Regulation arbitrage/leakages – the liquidity tools effectiveness can be reduced by the regulation arbitrage and the transfer, during a credit boom, towards non regulated entities, including foreign ones. To avoid crossborder distortions, coordination and reciprocity agreements are necessary among countries in the implementation of macroprudential policies process. The results of the analysis concerning liquidity requirements for the Romanian banking system provisioned by NBR show that all the institutions fulfilled the minimum 60% requirement (including the minimum reserve requirements) for the 1st of January 2015. Unless the minimum reserve requirements were not included, than 26 banks (owning 77% of the entire bank assets) reached the 60% concerning LCR (NBR, FSR 2013)

c. **Borrower based macro prudential tools** (loan-to-value, loan-to-income, debt-to-income)

Borrower based macroprudential tools have as intermediate objective the reduction of excessive lending and of the leverage effect by smooting the credit cycle. The LTV, LTI, DSTI limits are applicable based only on the national legislation and indirectly contributes to the limitation of excessive lending by ceiling the amount that can be borrowed according to the collateral (LTV) or the debtor's income (LTI, DSTI). LTV ensures an increased capacity of the lenders to face adverse evolutions by diminishing the loss given default (LGD), while LTI and DSTI ensures an increased resilience of the debtors to unfavourable financial evolutions reducing the probability of default (PD).

The main effects of these tools are:

Effects on the bank system's resilience - are determined by diminishing the loss given default and the probability of default. The impact on the credit cycle and on the expectation channel are indirect effects that may induce a strengthening of risk management standards.

Credit cycle effects - these limitations contribute to the smoothing of the credit cycle since they become mandatory during the upslope of the credit cycle, when the credit and the real estate prices tend to grow faster than the revenues. The application of strict limitations reduces the real estate credit demand and the property prices.

These limitations may be relaxed during the recession of the real estate credit and may contribute to the prevention of credit induced crisis. There are empirical studies that show an increase of banks' resilience determined by an increased resilience of the clients that become less sensitive to shocks induced by the changes in income and property prices. Following their research conducted on 57 countries, Kuttner and Shim (2013) concluded that the limitation of LTV, LTI, DSTI had a significant impact on the growth of real estate loans and less significant impact on the property price increase.

Regulation arbitrage/leakages – the effectiveness of these instruments may be reduced by regulation arbitrage and by leakages towards less regulated entities, including crossborder ones, respectively. It is recommended to use the limitations on LTV, LTI, DSTI simultaneously since they complement each other.

Table1 shows the main macroprudential tools provisioned by CRDIV/CRR[1] and optionally by the national legislations and their gradual implementation during 2014-2019.

[1] Directive 2013/36/ (EU) of The European Parliament and of The Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

Regulation (EU) No 575/2013 of The European Parliament and of The Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

Table 1. Macro prudential tools provisioned by CRD IV/CRR

Macro prudential tools	2014	2015	2016	2017	2018	2019
Minimum capital requirement + Capital conservation buffer	8%	8%	8,625%	9,125%	9,875%	10,5%
Capital macroprudential tools						
Countercyclical capital buffer CCB			≤0,625%	≤1,25%	≤1,875%	≤2,5%
Capital buffer for systemic risk (optional)	1 % - 3% (5 % or more)					
Capital buffers for globally important institutions (G-SIIs)				Between 1 % - 3,5 % depending on the importance of systemic globally institution		
Capital buffers for nationally important institutions(O-SIIs) - optional				Max 2 %		
Liquidity macroprudential tools						
Liquidity Coverage Ratio – LCR		60%	70%	80%	90% 100%	10%
Net Stable Funding Ratio – NSFR	The proposal of European Comision until 31.12.2016					
Loan/deposit ratio and Leverage ratio (optional)	Based on national legislation					
Borrower based macroprudential tools						
LTV, LTI, DSTI (optional)	Based on national legislation					

3. The macroprudential framework of the Romanian banking system

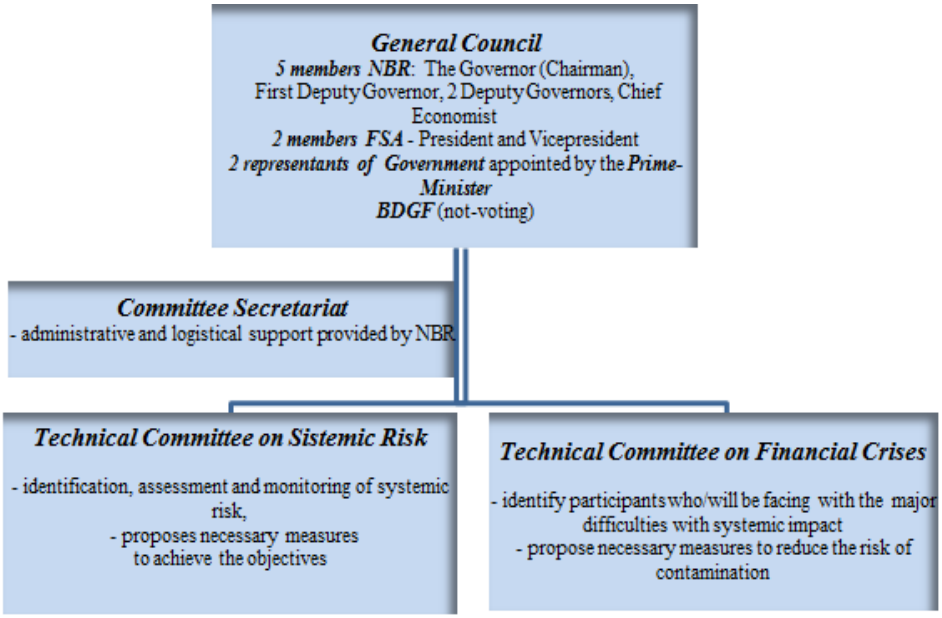
3.1. The recommendations of the European Systemic Risk Board for the banking sector

The recommendations of The European Systemic Risk Board for the banking sector were meant to support the coherent implementation of the macroprudential policy in the EU member states and to narrow the vulnerabilities identified in the European financial system. Consequently, two recommendations were issued: ESRB/2011/3 referring to the designation of national macroprudential authorities and ESRB/2013/1 concerning the intermediate policy objectives and macroprudential policies.

In the particular case of Romania, the designated macroprudential authority is *"The National Committee for Macroprudential Oversight*" (NCMO), that includes the authorities playing a decisive role in ensuring financial stability, the NBR, that has the key macroprudential role, the Financial Supervisory Authority, the Government and the Bank Deposits Guarantee Fund (as observer). The NCMO shall act as an interinstitutional cooperation structure without legal personality, which shall aim to

ensure coordination in the field of macroprudential oversight of the national financial system by setting the macroprudential policy and the appropriate instruments for its implementation. Figure 1 shows the structure of the macroprudential committee according to the provisions of the macro prudential supervision law.

Fig. 1. The structure of the "National Committee for Macroprudential Oversight" in Romania



Source: The Law concerning the macroprudential supervision of the financial system

The intermediary objectives and macroprudential tools implemented by the NBR in line with the Recommendation ESRB/2013/1, concern the prevention and reduction of: excessive credit growth and leverage; excessive maturity mismatch and market illiquidity; the limitation of direct and indirect exposures; the limitation of the systemic impact of misaligned incentives in order to lower moral hazard and the strengthen the resilience of the financial infrastructure. For achieving the ultimate objective of safeguarding the financial system stability, the NBR estabilished, in addition to the intermediate objectives of macroprudential policy recommended at EU level, two nationally specific objectives: the sustainable increase of financial intermediation and the improvement of financial inclusion. For each intermediate objectives, the NBR established macroprudential tools such as: capital based tools (i.e countercyclical capital buffer, systemic risk buffer, O-SII buffer), liquidity related tools (i.e liquidity coverage ratio, net stable funding ratio), borrowers related tools (i.e loan-to-value ratio, debt-to-income).

After selecting the main intermediate objectives and macroprudential policy tools, the next stage in the completion of the macroprudential policy framework was to define the macroprudential strategy, which had an operationalising role, thus establishing the connection between objectives, indicators and tools. To this end, the overall framework defining the macroprudential policy strategy of the NBR was prepared, according to the relevant responsibilities of the Central bank in its capacity as supervising authority.

This project is designed to be part of the national strategy for macroprudential policy. The NBR will identify the situations requiring the use of macroprudential policy tools, select the appropriate tools, estabilishing their level and deadline for implementation, the institutions to which for which the tools are applicable and will periodically assess their appropriateness and effectiveness in achieving macroprudential policy objectives.

The NBR has a long experience in the implementation of macroprudential tools. Since 2004 it has constantly monitored the excessive credit growth and unsustainable indebtedness by targeting the following ratios: loan-to-value (LTV), debt- to-income (DTI) and limited excessive foreign currency exposure of credit institutions. Prior to the 2008 crisis, the high potential of the Romanian banking system (both in intense banking activity and competitiveness) had attracted important capital inflows that, consequentlty, had contributed to the accumulation of excessive financial risks. The most important vulnerability was the increase of the foreign currency denominated loans granted to risky borrowers and a massive indebtedness of the population.

There is limited literature concerning the effectiveness of macroprudential tools in emerging economies, arguing that these countries have used them more frequently, while developed countries only seldom employed them. Empirical studies for Romania (Lim et al., 2011; Neagu et al., 2014) have shown that the LTV and DTI had certain effectiveness in limiting the excessive credit growth, improving the risk management of debtors and creditors.

In evaluating the impact of these tools on crediting and on the quality of bank assets (Neagu et al., 2014) show that:

- the impact on credit growth in the first semester after implementation is between 3 and 11% with the greatest influence on consumption credits. The effect diminishes to zero after five month.
- the relaxation time frames are associated with a higher non performance rate (specific for consumption and real estate credits) and with a higher sensitivity to macroeconomic evolutions (e.g. unemployment).

The experience of the NBR shows that macroprudential regulations were most effective when not „self regulated", that macroprudential measures should be adjusted over the financial cycle to impede regulating arbitrage and migration to other types of credits, that in the decisions concerning LTV and DTI macroprudential monitoring, watching lending on other markets than the domestic ones is more useful (IFN and foreign lending), that LTV and DTI should be implemented together and supported by microprudential and monetary policies.

Moreover, in the previous year, following the National Committee for Financial Stability's recommendations, the NBR has introduced three macroprudential tools as *capital buffer*[2] for credit institutions, which are described in Table 2.

Table 2. Macroprudential capital buffers implemented by the NBR

Buffer	Objective	Level established in Romania	Deadline for implementation
Countercyclical capital buffer	Limit excessive credit growth	**0 percent**	1 January 2016
O-SII buffer	Mitigate the systemic risk generated by the size of the institutions	**1 percent** of total risk exposure amount of the institution, solely for systemically important banks	1 January 2016
Systemic risk buffer	Prevent or mitigate long-term non-cyclical systemic or macroprudential risks	**1 percent** of total exposure amount to which it applies, solely for selected banks, it does not add to the O-SII buffer	31 march 2016

3.2 The macroprudential indicators used by NBR

To identify the financial institutions that are already exposed or susceptible to be exposed to systemic risk, the NBR periodically evaluates the potential risks that endanger financial stability by using various techniques and indicators: stress tests (that show the resilience of the banking sector to vulnerabilities), identifies systemically important banks, macroprudential data basis, early warning systems (i.e. Financial stability indicators recommended by the IMF and ECB), specific analysis (that study the impact of european regulations (CRD IV/CRR) on the Romanian banking system), conducts polls to identify the banks' opinions concerning the credit supply and demand.

The stress tests conducted to assess banking sector's solvency and liquidity confirm its resilience, *i.e* its capacity to prevent, without major difficulties, the shocks induced by unfavourable developments in liquidity. Recent stress tests show that the Romanian banking capital is above the minimum safety thresholds. The vulnerabilities identified at individual level have a moderate impact. However, the systemic risk posed by the uncertain and unpredictable legislative framework in the banking and financial field may produce effects on bank solvency. Also, recent macroprudential stress tests show a comfortable level of liquidity, the banking sector not facing major

[2] The National Committee for Financial Stability (NCFS) issued Recommendation No. 1/26.11.2015 the implementation of capital buffers in Romania and NCFS Recommendation No. 3/18.12.2015 on the implementation of systemic risk buffer in Romania.

difficulties in the event of a liquidity crunch, mainly due to: rather restrictive monetary policy measures, low dependence on foreign funding, savings in the NBR accounts. Following the financial crises, building and defining relevant signal indicators' thresholds for systemic risk, were a priority for the NBR. According to the methodology recommended by the IMF, the financial soundness indicators of the Romanian banking system regard: the capital adequacy, the asset quality, the profitability, the efficiency and liquidity of the banking system. (Table 3)

Table 3. Financial stability indicators for the Romanian banking system

FSIs (core)	*dec. 2010*	*dec. 2011*	*dec. 2012*	*dec. 2013*	*dec. 2014*	*dec. 2015*	*sept. 2016*
I Assessment of capital adequacy							
Regulatory capital (capital adequacy ratio)	15	14,9	14,9	15,5	17,6	19,2	18,8
Regulatory Capital Tier 1	14,2	12	13,8	14,1	14,6	16,7	16,6
II Assessment of quality asset							
Nonperforming loans	11,9	14,3	18,2	21,9	13,9	13,5	10
IFRS provisioning coverage ratio	96,9	97,8	61	67,8	54,7	57,7	54,5
III Assessment of banking sector profitability and efficiency							
Return on assets (ROA)	-0,2	0,2	-0,6	0,01	-1,3	1,2	1,3
Return on equity (ROE)	-1,7	-2,6	-5,9	0,1	-12,5	11,7	12,3
Net interest income/operating income	60,6	61,9	62,3	58,8	58,6	58,5	55,1
Non-interest expenses/ gross income	64,9	67,8	58,7	56,6	55,5	58,4	51,1
IV Assessment of banking sector liquidity							
Liquid assets to short term liabilities	142,2	139	147,7	156,3	158,9	163,4	157
Liquid assets ratio	60	58,7	57,6	56,2	57,4	54,1	53,6
Net open position in foreign exchange to capital	-1,4	-4,7	-1,7	2,5	2	0,7	1,4

Source: NBR, FSR december 2016, IMF- Financial Soudness Indicators (FSIs), 2017

Over the past few years, the Romanian banking system has had an appropriate level of capitalisation, the capital adecuacy indicators having witnessed an almost continuous increase. The main determinants which contributed to these evolutions where: the improved macroeconomic environment, the increase of shareholders' capital contributions, limited distribution of dividends as a results of micro and macroprudential requirements, which are expected to contribute to strengthening banks' resilience. The "capital adequacy ratio" (total capital ratio) was 18,8 percent in september 2016, while the "Regulatory Capital Tier 1" (Common Equity Tier 1) stood at 16,6 precent.

According to the NBR data, these values are above the EU average, thus positioning the capital adequacy indicators in the lowest risk bucket. The quality of bank assets shows that the relevant indicators generally strengthened their positive trend noticeable during the past three years. Non-performing loan ratios followed a downward trend, but are still at high levels, above the EBA's red threshold (8 percent). Non-performing loans originate in the unsustainable economic growth and considerable capital inflows during 2007-2008. During the last years, the banking sector's profitability improved, primarily on account of the resumed rise in operating profits and the reduction in net expenses with provisions, amid a stable domestic macroeconomic environment. The main profitability indicators of the Romanian banking sector "return on assets" (ROA) and "return on equity" (ROE), stood at a comfortable 1.3 percent and 12.3 percent respectively in September 2016. The major challenges for the banking profitability are as follows: operating in a low interest rate environment with the prospect of narrowing spreads; the large share of low-yielding, but less risky assets on banks' balance sheets; an important stock of restructured loans that may entail additional loan loss expenses, and implementation of borrower - oriented legislative initiatives that would pose moral hazard. Nevertheless, the liquidity indicators show a favorable situation.

4. The consequences of The Bank Union on the Romanian banking system

4.1. The Romanian perspective

The two pillars of the Bank Union, i.e. The Single Supervising Mechanism and The Single Resolution Mechanism brought a significant change in the supervision and resolution architecture with different effects on the two groups of states: the Euro zone member states, that are the main beneficiaries of the new project and the non - Euro zone member states, that can join the Bank Union upon request in close cooperation with the ECB.

Presently, membership in the Bank Union, before adopting the Euro, is not considered attractive by the CEE countries (Hungary, The Czech Republic, Poland, Croatia, Romania and Bulgaria), these countries claiming unequal treatment compared to the Euro zone countries concerning the following issues*: insignificant role in the Single Supervising Mechanism* (i.e. non-member states of the Euro zone would not be members of th Council of Governors that approves the decisions of the Supervising Council); *lack of access to the liquidities offered by the ECB* (non- member states would not have immediate access to the funding facilities offered by the ECB*); lack of access to the common safety net* (i.e. these countries would not be eligible for direct recapitalisation from the European Stability Mechanism).

Nevertheless, Romania expressed its willingness to participate at the Bank Union, considering that joining the Bank Union is a compromise between a swift, rather risky action, but potentially efficient and a long preparation process that may overlook the opportunity of an efficient action (Isrescu, 2014). Membership in The Bank Union can be evaluated considering the following aspects: the structure, importance and integration of the Romanian bank system with the European bank system; the supervision and resolution standards that reflect the rigour and the quality of supervision at national level; the challenges concerning macroprudential policy. All these are important issues and form the basic framewok, relevant for determining the potential benefits and costs that can be achieved, on the long run, by joining the Banking Union.

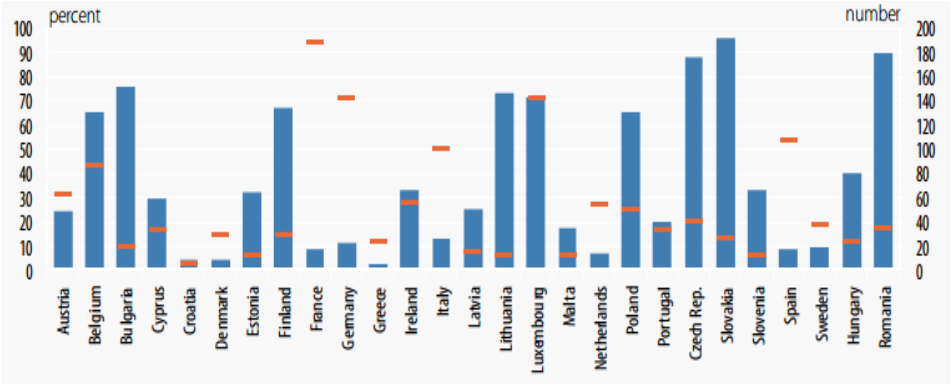
4.2. The implications of the Bank Union on the Romanian supervising activity

Joining the Single Supervising Mechanism implies a new approach of the supervision model applied by the NBR that mainly affects the three major commercial banks, because the supervision competences are delegated to the ECB. The other smaller, less significant banks will be directly supervised by the NBR under the obligation to follow the regulations, instructions and trends set by the ECB.

The potential benefits of participation at the Single Supervising Mechanism refer to:

- improving the supervision of crossborder bank groups, thus ensuring coordination and supervision for the branches of Euro zone banks opened in CEE countries that are not members of the Euro zone;
- the risk of reducing the activity of crossborder banks is diminished (any delay in joining The Bank Union increases the risk that Euro zone banks might reduce the activity of their branches opened in non-Euro zone countries that are not part of the supervising mechanism);
- the competitive disadvantage for domestic banks or branches that do not have the parent bank in one of the Euro zone member states, considering that the supervision of The ECB is a solid guarantee for low cost funding;
- participation at debates concerning the regulations for the practical functioning of the Single supervising mechanism;
- full access to supervision information, given the large presence of the Euro zone bank capital on the Romanian market (Figure 2).

Fig. 2. Market share and number of credit institutions with foreign capital (international comparison)



assets of credit institutions with foreign capital as a share in total assets
number of credit institutions with foreign capital, including foreign bank branches (rhs)

Note: 2014 data were available for EU Member States and June 2015 data were available for Romania.

Source: NBR, FSR 2015

5. Benefits and costs associated with joining the Bank Union

The direct and indirect benefits associated to joining the Bank Union depend on the manner their financial systems and supervision develop. As a host country for foreign banks, similar to other CEE member states, Romania can benefit of a higher financial stability and more straightforward cross border bank groups supervising interactions under the authority of a single supervising institution, i.e. ECB.

The 2014 study conducted by the IMF (Bluedorn et al., 2014) reflects the attitude of CEE Central Banks and Ministries of Finance that have not adopted yet the Euro (The Czech, Poland, Hungary, Bulgaria, Croatia and Romania) concerning the participation at the Bank Union before adopting the Euro. Table 3 shows the main findings of the study, the benefits and the potential disadvantages of joining the Bank Union before adopting the Euro as a currency.

Table 3. Possible advantages and disadvantages of joining the Bank Union for the non-Euro countries

Potential benefits	Potential disadvantages
• access to the mutual funding scheme in case of resolution needed by a bank • larger access to the parent bank supervising information • enhancing the quality of supervision by improving the market perception and the application of coherent prudential norms • crossborder supervisory coordination • the reduction of bank conformity costs • the increase of supervising decisions related to the parent banks • the reduction of cost related bank funding • arm's length supervision of local interest • improved supervision by applying stricter prudential norms.	• loss of control over cross border intra group liquidity flows • inadequate role in the Single Supervising Mechanism (SSM) governance and in the Single Resolution Mechanism (SRM) decision making process • loss of control over bank resolution • lack of access to the liquidity facilities offered by the ECB • bank supervision may be insufficient in the SSM • excessively complicated resolution procedure in SRM • monetary and prudential policies' coordination challenges • incomplete mutualisation of the Single resolution fund • contributions to the Single resolution funds are too high compared to the expected benefits

Other benefits that can be envisaged are:

- the risk to diminish the activity of cross border bank groups' branches in a non-Euro country is avoided – meaning that any delay in joining the Bank Union may increase this risk because the parent bank can decide to diminish and/or close branches operating in countries that are not part of this mechanism;
- the cost related competitive disadvantage of domestic banks or their branches that do not have the parent bank in the Euro zone is diminhed;
- the supervision of these entities by the ECB is considered a solid guarantee for obtaining less costly funding;
- the participation at the Bank Union secures a place at the „disscusion table" concerning the rules and procedures of a project Romania will be part of when adopting the Euro;
- by implementing the new resolution system in the EU it is predictible that a future banking crisis can be managed swiftly and safely, reduces the necessity to bail-out of banks in distress, thus breaking the connection between the banks and sovereigne risks. (Isărescu, 2014; Schoenmaker and Siegmann, 2013; Darvas and Wolff, 2013)

Romania considers that its participation at the Bank Union is a compromise with swift action, that bears a certain degree of risk, but possibly more effective on the long run. In the case of the rest of the non-Euro member states, the decision to join the Bank Union depends, *largo sensu*, on the cost-benefit analysis and the time horison to adopt the Euro as a currency. The Hungarian, Polish and Czech strategy of „wait and see" may be regarded as a prudential approach but with potential negative consequences of being left out of the monetary integration mechanisms.

6. Conclusions

The Bank Union, considered as the main pillar of macroprudential architecture has been created with the precise aim to consolidate the Euro-zone banking systems and the monitoring of systemic risks and of externalities on the EU bank markets. The decision to set up a single supervisor for the European banking system was founded on the desire to create an independent, powerful institution to supervise major European banks and prevent risk contagion. It can be stated that the arguments in favour of a single supervisory entity are the same that supported Central Banks' independence: the non-involvement of the political institutions in the national supervising decisions and the enforcement of strict rules for all the participants on the European bank market that would grant coherence for the supervision procedures and restore trust in the banking system. Moreover, the single resolution mechanism secures the prevention and early intervention in case of financial distress.

The Bank Union project is very important and has profound implications for the European bank supervising architecture, including the Romanian banking system that is dominated by Euro zone banks' subsidiaries. Consequently, the structure of the Romanian banking system is a dominant determinant in joining the Bank Union. Even in the absence of significant bank groups, but with an important presence of

Eurozone bank branches, the participation at the bank Union is preferable for significantly reducing the costs of supervision and for mitigating the risk of contagion from the parent banks.

Given that the disatvantages to participate at the Bank Union project are sometimes considered to outweight the advantages, the majority of CEE countries have adopted a precautionary attitude. The envisaged risk of „being too small to count" reflects the need to accept mandatory general conditions that are not properly calibrated or, the lack of attention tailored on the CEE countries' needs.

From a macroprudential perspective, one can consider that a close cooperation with the ECB allows a better orientation of macroprudential measures towards risks with cross border effects, due to the decision making process that envisages a coordination mechanism between the national macroprudential authorities and the ECB. On the other hand, such an approach implies the loss of sovereignity over the macroprudential policy, but, on the other hand, the prevalence of pursuing and protecting the European interest, also means protecting the national interest.

Nevertheless several policy lessons can be drawn: CEE countries should carefully consider the effectiveness of resouce allocation when deciding on the macroprudential tools used to counterbalance procyclicity; improve their institutional architecture to mitigate further vulnerabilities and crisis, designate the most appropriate supervisory agency (that might not necessarily be the Central bank) to reduce externalities that might deepen financial vulnerabilities and prevent the implementation of discretionary policies. An optimal design of a policy mix (including the monetary policy, fiscal policy, microprudential policy) that does not come into contradiction with the macroprudential tools would attach to it a higher transparency, accountability and credibility.

Obviously, the Bank Union is a long, dynamic project, some of its mechanisms being under blueprint (i.e. the single scheme for the bank deposit guarantee) while others will be modified according to the evolutions of the financial markets. Lately, concerns were expressed regarding the rebalancing of the financial structure in Europe that is strongly bank oriented and the granting of support for the development of financial markets as a funding alternative. The rational behind the equilibration of the financial market structure is based on the theoretical fundamentals that shows that the dominance of the market system can increase the systemic risk mainly in significant asset price fluctuations and a low economic performance.

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