THE IMPACT OF EUROPEAN INTEGRATION AND FINANCIAL GLOBALIZATION ON PRUDENTIAL SUPERVISION

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As a result of the financial market globalization during the last two decades, the conventional barriers between financial activities have diminished. This led to the emergence of financial holdings that operate both in the banking sector and on the stock and insurance markets, which provide the whole range of financial services. The consequence of this tendency is the increasing concern towards the identification of optimal institutional structures responsible for the regulation and supervision of the financial market. The aim of this article is to analyze the models for financial market regulation and supervision. We discuss the effect of European integration on prudential supervision in European Union. Finally, we examine the model of financial supervision in Romania.

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Introduction

In the last years of 20th century, the conventional obstacles separating financial activities have weaken due to the increasing level of integration of the financial markets. Thus, the number of financial holdings working in all segments of the financial market (banking, finance and insurance) has risen. These evolutions caused the strengthening in the debates concerning the most favorable institutional structures for the regulation and supervision of the financial system.
Specialized literature on this issue offers arguments both in favor of an integrated financial supervision, carrying out by a single regulatory and supervisory authority empowered to regulate and supervise all the categories of financial institutions, and in favor of a traditional supervision in which specialized authorities supervise separately banks, insurance companies and securities markets. Even so, the current developments in the financial sector show a tendency towards consolidated supervision. Consolidated supervision is applied in many countries under the influence of factors such as: the globalization of the financial markets and a greater degree of integration of the companies providing financial services; the weakness of the financial sector that caused the collapse of some financial institutions and serious crises of the financial markets, as well as changes in the responsibilities of central banks[282].
The supporters of consolidated supervision argue that the expansion of financial institutions in multiple areas of activities requires strict and responsible supervision. Nowadays, consolidated

282 Iordache F., Iordan M., Considerations on consolidated supervision of the financial system in Romania", Institute for Economic Forecasting, 2005, http://141.85.31.54/arhivapp/art008.pdf, p. 2.

financial supervision is implemented in many developed countries such as: Australia, Great Britain, Canada, Japan, Germany, France, Austria, Ireland, the Scandinavian countries, etc.
It has been also successfully implemented in emerging countries among which we mention: South Korea, Hungary, Poland, Latvia and Estonia.

1. Models for financial market regulation and supervision

The financial market traditionally includes banking, financial and insurance sectors. It can be seen as an economic space within diverse operators as banks, financial intermediaries, mutual funds, insurance firms, pension funds, provide financial instruments and services. There are different regulatory agencies for banks (often central bank), securities firms and insurance companies at national and international level (Basel Committee on Banking Supervision, International Organization of Securities Commissions, IOSCO, and the International Association of Insurance Supervisors, IAIS). Financial market regulation aims three major objectives[283]:

1. the pursuit of macroeconomic and microeconomic stability;
2. the transparency in the market and of intermediaries and investor protection;
3. the safeguarding and promotion of competition in the financial intermediation sector.

Di Giorgio and Di Noia (2000) identified four approaches for financial regulation and supervision: institutional supervision, supervision by objectives, functional supervision, and single regulator-supervision[284].

1.1. Institutional supervision

In this approach, which follows the traditional segmentation of the financial market into three markets (banking, securities and insurance), the oversight is realized through three different supervisory authorities. These authorities control operators and markets mainly through access selection on the market, regular monitoring of the activities developed by the authorised operators and exits from the market.

1.2. Supervision by objectives

According to this approach, all intermediaries and markets should be subject to the supervision of more than one authority, each single authority being in charge for one objective of regulation in spite of both the legal form of the intermediaries and of the functions or activities they carry out. Thus, there should function three authorities, other than the central bank – which is accountable for monetary policy and macro-stability –, each of them being responsible of one of the three objectives of regulation, above-mentioned.

1.3. Functional supervision

This model, also known as supervision “by activity”, take into account the functions performed by the financial system such as clearing and settling payments, pooling of resources and portfolio diversification, transferring economic resources, managing risks, coordinating decentralized decisions and dealing with incentive problems. In view of this model, each type of financial services should be regulated by a given authority independently of the operators (banks, mutual funds, intermediation firms, insurance companies and other financial intermediaries) who offer it.

1.4. Single regulator-supervision

This approach is founded on just a single supervisory authority, separated from central bank, responsible for all markets and intermediaries operating in banking, financial or insurance

283 Di Giorgio G., Di Noia C., Financial regulation and supervision in the Euro area: a four-peak proposal, Wharton Financial Institutions Center, Working Paper Series, February 2000, pp. 4-5.
284 Ibid., pp. 6-10

system. This authority should be preoccupied with all the objectives of regulation: stability, transparency and investor protection, possibly competition.
The dominant model applied at the international level was institutional supervision, but recently the integrated financial supervision has gain an important role. The comparative advantages of these two dominant models are presented in the table below.

Table 1. Comparative advantages of the dominant models in financial supervision

Integrated financial supervisor	***Specialist supervisor***
- lower costs, regulatory neutrality and pooling of expertise - better collaboration between sectoral supervisors which leads to a single team of experts and a single rule book - higher transparency and economies of scale	- higher specialization, more clear tasks and more competitive - better knowledge and adaptation to the risk profile of the regulated financial sector

Source: Lannoo K. (2002), p.4

In spite of the existence of these four models, the structure of financial supervision was usually based on the division of the financial sector in three segments: banks, securities firms and insurance companies, each of them having its own distinct specialist supervisory authority. In the early '90s some countries have switch to the integrated supervision of financial market, adopting a single supervision authority (see table 2). The first integrated financial supervisory authority was created in Norway, which integrated bank and insurance supervision in 1986, followed by Denmark in 1988 and Sweden in 1992[285].
The most notorious example of integrated supervision is UK Financial Services Authority (FSA), created in 1997, a single supervision authority, which came fully into effect only in 2001, after the enforcement of Financial Services and Market Acts 2000. FSA has four statutory objectives[286]:

- to keep the confidence of the public in financial system;
- to support public understanding of the financial system;
- to assure an adequate level of customer protection ;
- to diminish the financial crime.

Its example was followed by several countries such as Iceland, Japan, Korea, Hungary, Latvia, Estonia, Austria, Germany, Ireland, and Poland (see table 3).

Table 2: Financial Supervision in the EU in 2000

Country	**Banking**	**Securities**	**Insurance**
Belgium	BS	BS	I
Denmark	U	U	U
Germany	B	B,S	I
Greece	CB	S	I
Ireland	CB	CB	G
Italy	CB	CB,S	I
Luxembourg	BS	BS	I

285 Lannoo K. (2002), Supervising the European Financial System, Centre for European Policy Studies, CEPS Policy Brief no.21/2002, p.2.
286 Briault C. (2002), Revisiting the rationale for a single national financial services regulator, FSA, Occasional Paper Series 16, 2002, p. 10.

Country	Banking	Securities	Insurance
France	B, CB	B,S	I
Spain	CB	S	I
Netherlands	CB	CB,S	I
Portugal	CB	CB,S	I
Austria	G	G	G
Finland	BS	BS	I
Sweden	U	U	U
United Kingdom	U	U	U
Norway	U	U	U

Source: Di Giorgio G., Di Noia C. (2000), p. 17
Legenda: CB: central bank, BS: banking and securities supervisor, B: banking supervisor, S: securities supervisor, I: insurance supervisor, G: government department, U: single financial supervisor

Table 2: Financial Supervision in the EU in 2008

Country	Banking	Securities	Insurance
Belgium	U	U	U
Denmark	U	U	U
Germany	U	U	U
Greece	CB	S	G
Ireland	U	U	U
Italy	CB	S	I
Luxembourg	BS	BS	I
Spain	CB	S	I
Netherlands	CB	S	CB
Portugal	CB	S	I
Austria	U	U	U
Finland	BS	BS	I
Sweden	U	U	U
United Kingdom	U	U	U
Poland	U	U	U
Hungary	U	U	U
France	B, CB	S	I
Latvia	U	U	U
Malta	U	U	U
Estonia	U	U	U
Norway	U	U	U

Source: Enrico Maria Cervellati∗- Eleonora Fioriti, www.ecb.int, central banks' sites

2. Prudential supervision in European Union

ECB considers that three important responsibilities should be included in the supervision functions of EU member states[287]: 1) investor protection activities; 2) micro-prudential supervision, and 3) macro-prudential analysis. The opinion of ECB regarding the prudential supervision is the maintenance of an essential role for national central banks in this domain in the

287 European Central Bank, The role of central banks in prudential supervision, 2001, p.3.

countries from euro zone. All central banks are responsible, somehow, by the macro-prudential analysis, even if they rarely respond for investors' protection, particularly in the securities market.

There are arguments both for and against combining prudential supervision with the monetary policy responsibilities at the level of central bank[288]. Three important arguments sustain the unification: 1) central bank's ability to get important insights about the general situation of the economy, since monetary policy and banking supervision are closely interrelated; 2) central bank's capacity to protect the payment system, a key channel for the potential dispersion of contagion risk; 3) central bank's involvement in assuring the systemic stability of financial system. By contrast, there are three strong arguments for the separation by granting wide supervisory powers to a single institution outside of central bank: 1) the potential trade-off between monetary stability and micro-stability of financial institutions; 2) the higher reputation costs for central bank in the case of the bank failure, which will influence the credibility of monetary policy; 3) the conflict between the pro-cyclical effects of micro policy (regulatory) and counter-cyclical effects of macro policy (monetary).

Recent developments of the financial system require for an single supervisor. Di Giorgio and Di Noia (1999) proposed the establishment of an independent European System of Financial Supervisors (ESFS) structure similar to the European System of Central Banks[289]. In 2000, the authors have conceived a "four-peak" model, in which the four institutions would share the responsibility of regulation[290]:

1) Central bank would be in charge of price and macroeconomic stability, continuing to perform the task of monetary policy and lender of last resort;

2) A second institution, which should closely cooperate with the central bank, would be responsible for micro-stability, supervising the whole financial system and managing deposit insurance and investor compensation scheme;

3) A third agency would be in charge of transparency and investor protection, supervising disclosure requirements and the proper behavior of the all banks, securities and insurance intermediaries.

4) A fourth institution would guarantee fair competition and avoid abuses of dominant position and limit dangerous concentrations in banks, securities firms and insurance companies.

Nowadays, in the context of the financial crisis, the European Commission has speeded up the implementation of this project in two stages: stage 1 (2009-2010) – preparation of the ESFS; and stage 2 (2011-2012) – establishment of the ESFS.

3. Financial market supervision in Romania

The model of financial supervision in Romania has been the institutional approach. The authorities for the regulation and supervision of the financial system have been: 1) the National Bank of Romania (NBR) for the banking sector; 2) the Romanian National Securities Commission (RNSC) for the stock markets; and 3) the Insurance Supervision Authority (ISA) for insurance companies. As a rule, each of the three institutions has a limited control, but each is affected by the initiatives coming from the other two domains. That is why these institutions have signed a protocol of cooperation in the area of supervision.

Based on the tendencies manifest both on an international scale and at the EU level, in 2001 the Romanian government put forward a proposal for the foundation of an integrated agency for financial market supervision, but this idea was considered premature at that time and therefore

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288 Di Giorgio G., Di Noia C., "Should banking supervision and monetary policy tasks be given to different agencies?", International Finance 2(3), 1999, p. 362

289 Ibid. pp. 365-368

290 Di Giorgio G., Di Noia C., Financial regulation and supervision in the Euro area: a four-peak proposal, Wharton Financial Institutions Center, Working Paper Series, February 2000, p. 22.

rejected[291]. The opinions of the three authorities on this issue are divided. The NBR seems to be the most open to the development of a single supervisory institution since this will allow it not only to find irregularities and problems but also to maintain an important role in the activity of supervision and sufficient power to intervene in the monetary policy. By contrast, both the RNSC and ISA have a tendency towards independence, their main argument being the progress made in their consolidation as independent institutions of control at the recommendation of the EU.
Given that Romania's integration in the EU became a major objective, beginning with 2005 the NBR has switch to consolidated supervision of credit institutions exclusively. Since 2006 the NBR has also supervised the activity of the leasing companies, pawnshops, etc.
Consolidated banking supervision refers to the evaluation the financial position of an entire group, considering all the risk to which the bank is exposed no matter that these risks are reflected in the books of the bank or related entities[292].

Conclusions

The consolidated supervision has been the subject of many controversial debates between bankers, academics, governors and other officials. The supporters of consolidated supervision argue that the expansion of financial institutions in multiple areas of activities requires strict and responsible supervision and indeed the consolidated supervision have proved its success in many countries. At a European level a more flexible supervisory framework must be conceived in order to prevent financial instability and to keep up with the increasing number of cross-border financial groups, markets' developments and interrelationships. The current financial crises have shown that the regulators and supervisors have ignored the cross-sector propagation of risk. The European Commission is preparing the construction and regulation of a new entity, namely the European System of Financial Supervisors, meant to ensure a more competitive supervisory framework. The consolidated European supervision can play an important part in the reform of the international financial system architecture.

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291 Iordache F., Iordan M., opere citato., p. 2.
292 MacDonald R.(1998).- "Consolidated supervision of banks", Centre for Central Banking Studies, Bank of England, London, 1998, p. 5.