

COMPARATIVE STUDY OF OWN FUNDS IN THE BANKING SYSTEM

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The present article has as a research field theoretical, methodological and practical aspects of the own funds, taking into account the line-up attempts of the Romanian banking system to the requirements of the European Union, materialised in the Basel Agreement. The objectives of the research theme, presented in this paper, are mainly oriented towards own funds. We also proposed the following secondary objectives: presenting the concept approaches concerning own funds, emphasising the typology of own funds and pointing out their purpose in the banking activity; presenting and analyse the evolution of the own funds in Romania, for a period of 8 years (2004-2011). Even though the actual stage of the research in this field is advanced, in the Romanian and foreign literature which dedicate a lot of theoretical and empiric studies concerning own funds. In our study we will use a theoretical and a practical research. The theoretical research describes the laws, regulations and rules of application in the banking field in our country. In the practical part we will use as a research method the quality-comparative analyse by presenting details regarding bank back-ups. Despite the global financial crisis, the Romanian banking system can be considered as stable as a whole, with levels of capitalization, solvency and liquidity in accordance with consistent with prudential requirements. Tier 1, defined as the core of their sources of credit institutions through the permanent criteria, payment flexibility and capacity to absorb losses continued to overwhelmingly support a total equity. Appropriate quality of own funds is on their structure. The most important component frame our capital plus capital frame attached. The second component in terms is still represented by legal reserves. An important challenge for banks was to maintain a level of own funds accordance, in the conditions which they were eroded by the current period losses. Tier 2 support rate of about 20 percentages of total equity and subordinated debt were the main components and revaluation reserves. Re-evaluation reserves have preserved funding contributions to Tier 2. An for evaluation of the level of capitalization of credit institutions, the central bank uses solvable indicator, as the only indicator currently regulated for this purpose. It also provides banks in Romania at the conditions for additional capital requirements related to Basel III framework to be taken by the European regulatory Capital Requirement Directive IV. As a final conclusion of the research in the own funds field we want to mention and express our opinion that the methods and techniques of managing risk, calculation of capital need permanent revision and adaptation to the changes that take place on the financial market the appearance of Basel Agreement 3, which are absolutely necessary in the actual economic and financial context. The presentation of concrete cases concerning the bank back-ups represent the personal work which completes the study concerning the analysis of managing banking risks, the role of bank back-ups in the bank capital adequacy mechanism.

Key Words: capital adequacy, own funds, Tier 1, Tier 2, Basel 3

JEL Classifications: G2/G21

I. Introduction

The present article presents the common problems of the credit institutions, introducing theoretical aspects and also practical aspects of applying a model and of interpreting risk situations, considering the attempts of alignment of the Romanian banking system to the requests of the European Union, materialized in the stipulations of Basel Accord. Considering the scientific research methodology, the following issues were set: introduction, motivation, importance and scientific research methodology, objectives, development of the article, estimated scientific results. In the introduction is being argued the research theme, the necessity and the importance of it. In the present economic-financial context, the fluid character which often brings major differences of opinion. The motivation of choosing the research theme is formulated and further the used research methodology is being presented. In the scientific research methodology, there are presented the scientific research areas, the field and the objectives of the scientific

research, and also its structure. The present research is based on a deductive approach - strictly qualitative. For analyzing all the data I used the following research methods: comparative method, document analysis, external observation. I choose this subject for scientific reasons and realistic reasons. I consider that Romania's chances, on the road to the European integration in globalization, firstly depend on its own performance, the quality of management at all levels. Romania's efficient integration within the above mentioned context cannot be achieved otherwise than through a performance superior to that already existing. The necessary performance can be achieved only with a advanced, new, modern management, with good results of own funds in the banking system.

The objectives of this study are characterization of the own funds of the Romanian banking sector, evolution of the own funds in the Romanian banking sector between the years 2004-2011 and interpretation of this evolution of the own funds in the banking system.

II. Literature review

Even though the stage of research in this field is advanced, in both romanian and foreign literature, which dedicate a lot of theoretical and empiric studies to bank own funds and their implication in the bank capital adequacy mechanism, in this moment the international crises pointed out the purpose and implications of credit institutions in the financial field. We had and we have ways to approach these problems. We want, in the allocated space, based on those already presented, to refer to the „own funds in the banking system”. Referring to the literature in the field, a very useful starting for our research is the series of works developed under BIS (Bank for International Settlements engl. “central bankers’ central bank, which controls the vast global banking system, with precision a Swiss watch”), economic and monetary department making a series of tests in the banking system in emerging economies in order surveillance developments. The conceptual, bibliographical main support is represented by the books like „Performance and risk management in commercial banks in Romania” by Eugenia Ana Matis, Home Book of Science Publisher, Cluj-Napoca, 2009 and „Financial-accounting management of the risks in the banking activity” by Cristina Palfi, Risoprint Publisher, Cluj-Napoca, 2009 and of course, the legislation. I have been used due to their importance, new character and desire to be largely and deeper known and especially used in the scientific research and in the practical activity.

III. Research design and methodology

Considering the scientific research methodology, the following issues were set: introduction, motivation, importance and scientific research methodology, objectives, development of the article, estimated scientific results. In the introduction is being argued the research theme, the necessity and the importance of it. In the present economic-financial context, the fluid character which often brings major differences of opinion. The motivation of choosing the research theme is formulated and further the used research methodology is being presented. In the scientific research methodology, there are presented the scientific research areas, the field and the objectives of the scientific research, and also its structure. The present research is based on a deductive approach - strictly qualitative. For analyzing all the data I used the following research methods: comparative method, document analysis, external observation. I choose this subject for scientific reasons and realistic reasons. I consider that Romania's chances, on the road to the European integration in globalization, firstly depend on its own performance, the quality of management at all levels. Romania's efficient integration within the above mentioned context cannot be achieved otherwise than through a performance superior to that already existing. The necessary performance can be achieved only with a advanced, new, modern management, with good results of own funds in the banking system.

The objectives of this study are characterization of the own funds of the Romanian banking sector, evolution of the own funds in the Romanian banking sector between the years 2004-2011 and interpretation of this evolution of the own funds in the banking system. For analysis of national or international data, we used comparative longitudinal research method (showing the evolution of bank own funds in our country).

IV. Results and discussions

1. Own funds in the banking system

In Romania there is now a modern and competitive banking system, which provides circulation of the economy and domestic supplies banking products and services in accordance with trends in the European banking sector. The conceptual framework, the notion of equity is the residual interest in assets of an entity that remains after deducting liabilities. The term is also known as the wealth of shareholders or owners of the property. Bank capital can be defined as money terms of obligations to individuals and businesses who participated in the constitution. This includes all funds at its disposal a permanent (sustainable) and consists of written contributions as shareholders, related raw capital, reserves, grants, subordinated debt, provisions, benefits carried over from previous years. In the banking sector, the concept of equity capital accounting differs in that it includes some sources provided by the international banking regulations, taken over current profit for the year, and other elements assimilate. Federal Reserve Board of Governors, highlighted four important functions of bank capital: to protect uninsured depositors in insolvency and liquidation; absorption of unanticipated losses, at a rate sufficient to maintain confidence in the bank; purchase of basic equipment for banking services; restriction in regulatory terms, the undue expansion of assets.

We describe the level 1 and 2 own funds of credit institutions. A special attention is being given to the evolution of own funds on a period of 8 years: 2004-2011. According to the actual regulations (Regulation BNR and regulation CNVM no. 18/23/2006 on own funds of credit institutions and investment firm, approved by Order BNR and CNVM no. 15/2006, published in Official Gazette no 1034/27.12.2006), the own funds of credit institutions are made of: level 1 own funds; level 2 own funds. Level 1 own funds represent a part of own funds and contain: poured and subscribed social capital, with the exception of cumulative preferential actions or the endowment capital made available for the branch in Romania by the credit institution from the third country; Capital bonuses, cashed, afferent to social capital; legal back-ups and other back-ups and also the positive result of prior financial exercises, which remain after the distribution of the profit according to the Stockholder General Meeting. Level 2 own funds contain: base level 2 own funds; additional level 2 own funds.

2. The evolution of own funds in the banking system

Components of own funds must be used at any time and priority to absorb losses, do not involve fixed costs for the credit institution and be effective at its disposal, that are fully paid. An adequate level of capitalization indicators for credit is a guarantee for financial system stability, since they are most important component of the Romanian financial market. The capitalization terminated

Credit institutions directly capacity to absorb shocks or losses arising induced exogenous domestic and international macroeconomic framework or practices inadequate risk management related endogenous banking.

Table 1. Own funds evolution and capital adequacy degree

Indicatori	31.12. 2004	31.12. 2005	31.12. 2006	31.12. 2007	31.12. 2008	31.12. 2009	31.12. 2010	31.06. 2011
Pondere în	100	100	100	100	100	100	100	100

Indicatori	31.12. 2004	31.12. 2005	31.12. 2006	31.12. 2007	31.12. 2008	31.12. 2009	31.12. 2010	31.06. 2011
fonduri proprii totale								
Fonduri proprii de nivel 1	78.1	77.7	74.3	76.7	77.2	78.4	80.3	80.1
Capital social	49.4	49.2	46.5	46.0	43.7	46	50.8	53.1
Prime de capital					3.8	4	5.7	5.8
Rezerve legale					34.6	33.4	32.3	30.2
Profitul /pierderea anului curent	17.9	14.0	11.4	10.8	-	3.75	2.5	-
Fonduri proprii de nivel 2	21.9	22.3	25.7	23.3	22.8	21.6	19.7	19.9
Împrumuturi subordonate	4.8	10.6	14.0	15.8	17.9	20.01	20.03	20.07
Rezerve din reevaluare	14.9	10.0	8.8	11.3	8.1	6.06	5.6	5.7
Raportul de solvabilitate >8%	20.6	21.1	18.1	13.8	13.8	14.7	15	14.2

(Sursa: proiecția autorului pe baza Rapoartelor anuale ale Băncii Naționale a României, Secțiunea Statistică)

Capital remains the most dynamic element of equity, another important component of which is represented by current year net profit. In the composition of additional capital, there is trend in the growth of subordinated debt financing from banks contracted. Thus, the situation for the period 2003-2004, when the additional capital was supported largely by reserves from the revaluation of assets recorded in the balance sheets of banks, in 2005 the contributions of the two elements are balanced, and the year 2006 saw real annual growth of 69 percent subordinated debt, which drove the main driver of additional capital.

The year 2006 marked slowdown in the banks' own funds, respectively, of their component fundamental equity. Thus, to a real growth rate of about 37 percent recorded for both indicators in December 2005 compared with same period last year, in December 2006 equity rose 22.2 percent and equity 18,1 percent. Although growth in real terms, the result of a banking profit recorded a slight rebound in 2006 (5.5 percent in December 2006 from 6.3 percent in December 2005) the previous year, it continues to be an important element to support capitalization of credit institutions. Evolution of the main elements to support equity of banks, Romanian legal entities (paid-up capital of shareholders and current year profit) remains divergent in 2006. Thus, capital contribution increased to 65 percent of equity in December 2006 (from about 63 percent in December 2004 and 2005), while the profit share declined to 16 percent of equity at end 2006 (from 23 percent in December 2004 and 18 percent in December 2005). Other important elements are the first equity linked capital, legal reserves, statutory reserves, other reserves.

The year 2007 saw an increase in corporate equity owned banks Romanian and, respectively, of their main components, Tier 1, a lower rate than in the past three years. Components of Tier 1

capital remains the most important element, with net profit of current year. Real growth of aggregate capital amounted to 10 percent in 2007, lower than that recorded in December 2006 (21.8 percent), respectively, in December 2005 (38 percent). However, capital position as main driver of Tier 1 was strengthened in 2007, rising its share to 65 percent, compared with 63 percent level recorded in 2004 - 2006. In 2007, the downward trend recorded in recent years aggregate solvency report, calculated credit institutions widened indicator losing 5.4 points percentage compared with the level recorded in December 2006 to 12.7 percent. The main factor responsible for this trend is continuing non-government credit expansion, while the own funds of credit institutions recorded a growth rate lower. However, the solvency ratio is maintained at an appropriate level, the higher minimum threshold required by prudential regulations applicable in Romania since 2007 year and also the European and international level (8 percent).

According to data presented by the National Bank of Romania (Financial Stability Report, 2009), note that, by continuing the trend started in 2006, the own funds belonging to banks, Romanian legal person and their main component - Tier 1, recorded in December 2008 the lowest annual rate in real terms over the last six years. This was determined both by recording the negative financial results of banks holding 10% of aggregate banking assets (with direct impact on Tier 1) and the changes in August 2008 regulations prudential, aimed at eliminating from the calculation of Tier 1 (respectively, of total equity) of the most volatile element that represents the current year profit result. Until the entry into force of said amendment, only some of the banks recorded profit amount included in the eligible reserves, because the requirements of prudential regulations in force, consisting in auditing financial result represents profit. As a result, in 2008, share capital and eligible reserves were the main elements to support Tier 1. Based on the modifications made in the banking safe reglamentation, in December 2008, the level 1 own funds decreased with more than 2% their contribution to supporting the total own funds belonging to romanian banks bussiness costumer, by majorly raising the level 2 own funds contribution, mainly based on raised volume of loans contracted by credit institutions. The proportion of level 1 own funds maintained relatively constant and in march 2009, based on the consignment of a series of banks of negative financial results. Even though the weight of level 2 own funds in level 1 own funds advanced in 2008(34%) the growing potential of this element maintains high, the credit institutions being able to appeal to secondary sources of capitalization in order to develop the banking activity. When he began the first quarter of 2008, credit institutions report solvency indicator ratio Basel II principles.

Despite the global financial crisis, the Romanian banking system can be considered as stable as a whole, with levels of capitalization, solvency and liquidity in accordance with consistent with prudential requirements. Tier 1, defined as the core of their sources of credit institutions through the permanent criteria, payment flexibility and capacity to absorb losses continued to overwhelmingly support a total equity. Appropriate quality of own funds is on their structure. The most important component frame our capital plus capital frame attached. The second component in terms is still represented by legal reserves. An important challenge for banks was to maintain a level of own funds accordance, in the conditions witch they were eroded by the current period losses. Tier 2 support rate of about 20 percentages of total equity and subordinated debt were the main components and revaluation reserves. Revaluation reserves have preserved funding contributions to Tier 2. An for evaluation of the level of capitalization of credit institutions, the central bank uses solvable indicator, as the only indicator currently regulated for this purpose. It also provides banks in Romania at the conditions for additional capital requirements related to Basel III framework to be taken by the European regulatory Capital Requirement Directive IV.

V. Implications

Lines of action taken aimed at avoiding deteriorating credit institutions in the general context of limiting investment options and restricted possibilities to attract resources. Accepting a higher

risk level by credit institutions means strengthening the level of own funds, even over the level stipulated by the bank. Capital adequacy is prominent feature in the management of any risks encountered by the credit institution. The credit institutions should manage the inherent risks. The very efficient management of risk it is essential for the success on long term of any bank. Methods and techniques of risk management, capital calculation must be continually reviewed and adapted to changes occurring in financial markets, a review of Basel Accord is absolutely necessary in the current economic and financial context. As a final conclusion of the research in the own funds field we want to mention and express our opinion that the methods and techniques of managing risk, calculation of capital need permanent revision and adaptation to the changes that take place on the financial market the appearance of Basel Agreement 3, which are absolutely necessary in the actual economic and financial context.

VI. Own contribution

The presentation of concrete cases concerning the bank back-ups represent the personal work which completes the study concerning the analysis of managing banking risks, the role of bank back-ups in the bank capital adequacy mechanism.

To conclude, be as kind as to receive my thanks and gratitude for your kindness and availability! I wish we continue a prolific collaboration with you in the forthcoming future!

Best wishes,
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