

NON-BANK FINANCIAL INSTITUTIONS – ACTORS IN THE SHADOW BANKING SYSTEM

Silvia Ghiță-Mitrescu¹, Cristina Duhnea¹, Ionut Antohi², Andreea-Daniela Moraru²

¹ Finance and Accounting Department, Faculty of Economic Sciences, Ovidius University of Constanta, Romania

² Business Administration Department, Faculty of Economic Sciences, Ovidius University of Constanta, Romania

mitrescu.silvia@gmail.com

cristina@duhnea.net

antohi_ionut@yahoo.co.uk

moraru.ad@gmail.com

Abstract:

This paper aims at investigating the importance of the non-bank financial institutions (NBFIs) as part of the shadow banking system in the Romanian financial system. The increased interest for the NBFIs in the last two decades is justified by the constant preoccupation both of the regulators and the financial analysts to find safety ways to provide funding to the real economy especially in time of economic and financial crisis without affecting the stability of the financial system. In order to obtain an accurate picture of the position of non-bank financial institutions in the Romanian financial system and the level of their activity we established several research objectives: determine the structure and the performances of the non-bank financial institutions; determine the level of the lending activity of the NBFIs and its evolution (the analysis is focused on the volume as well as the structure of the lending activity by currency, by debtor type and debtor activity sector. The methodology used to achieve these objectives is the quantitative and qualitative analysis using data provided by the monetary market authority through the interactive statistic data base available on the institution website and take into consideration the period 2008-2015. The findings of the research allowed us to draw the conclusion that, on one hand, the shadow banking system is poorly developed comparing to the traditional banking system and the NBFIs assets cumulated with the investments funds represent only 14% of the Romanian financial system, with an downward trend of the assets comparing with the banking system and a chaotic evolution of their profitability. On the other hand the non-bank financial institutions proved that their lending activity brings benefits for the real economy because they offer funds to those sectors of activities poorly financed by the traditional banking system as trade, services, mining and manufacturing, and agriculture and may be of interest to encourage the development of this segment of the financial market.

Keywords: shadow banking, non-bank financial institutions, Romanian financial system

JEL classification: G20, G23.

1. Introduction

Along with giving up the fixity of the exchange rates in the 70s and the emergence of new risks in the functioning of the financial markets in the structure of financial systems have emerged several categories of entities offering credit and investments services outside the traditional banking systems governed until now by a strict regulation and surveillance. The financial crises that affected periodically national economies but also the phenomena of contagion which proved that any open economy is vulnerable to external risks were determined after 90s a growing interest of the institutions regulating and supervising of the

financial markets for such entities considered to conduct non -bank credit activity and that the specialized literature calls it parallel banking system or shadow banking system.

The first attempts to define the shadow banking system and to identify the components of such system were made in the literature during 2000's but one of the wide recognized definition is given by The Financial Stability Board(FSB) describing "shadow banking system" as "credit intermediation involving entities and activities outside the regular banking system"(FSB,2011b, p1) stating that an "increased recognition of the importance of entities and activities structured outside the regular banking system that perform bank-like functions ("banking")" has occurred after 2007.

After 2010 the interest for the shadow banking system increased both regarding the content of the concept and the possibility to correctly evaluate the activity of this system taking into consideration the risks involved and the level of regulation and supervision.

The European Commission showed in 2012 that the shadow banking system is a subject of interest at European level by creating a green paper regarding this issue stating that this system has two important functions in the financial system (creating additional sources of funding and offering investors alternatives to bank deposits) (EU Green Paper from March 2012(p2).

The European Commission consider that the components of the shadow banking system are: entities that "operate outside of the banking system and engage in one of the following: accepting funding with deposit-like characteristics, performing maturity and/or liquidity transformation, undergoing credit risk transfer and using direct or indirect financial leverage" and/or engage in activities that "could act as important sources of funds for non-bank entities", including "securitisation, securities lending and repurchase transactions (repos)" (EU Green Paper from March 2012(p2).

As the definition shows the most important actors of the shadow banking system are represented by the non-bank financial institution.

The increased interest for the NBFIs in the last two decades is justified by the constant preoccupation of the regulators, the financial analysts and the entities in searching of funds to find safety ways to provide funding to the real economy especially in time of economic and financial crisis without affecting the stability of the financial system.

In 2015 European Central Bank declared that the expansion of the non-bank and non-money market investment fund sector is perceived as the main source of growth of the shadow banking sector, following the global financial crisis and a shift to market-based funding (Financial Stability Review, European Central Bank, 2015, p. 87).

2. Research objectives

The scope of the research conducted in this paper is to realize an analysis of the one of the components of the shadow banking in Romania – the non-bank financial institutions, as in the last ten years both at international and national level the financial system changed and the lending entities diversified due to the continuous rise of a relatively new component - the shadow banking system.

The research will be developed in an eight years' timeline, from 2008 till 2015, because the 2008 is the starting point of the financial crisis that affected the Romanian economy and the year that mark the appearance of an institutional interest of the regulators and financial analysts for the shadow banking system as an alternative for lending during financial crisis.

In order to obtain an accurate picture of the activity of non-bank financial institutions as a part of the Romanian shadow banking system we established several research objectives to be achieved in the present paper:

- Determine the structure and the performances of the non-bank financial institutions for the period taken into consideration;
- Determine the level of the lending activity of the non-bank financial institutions and the evolution during the 2008-2015 period. The analysis will be focused on the volume as

well as the structure of the lending activity by currency, by debtor type and debtor activity sector.

The methodology used to achieve the proposed objectives is the quantitative and qualitative analysis using data provided by the monetary market authority through the interactive statistic data base available on the institution website and the data available yearly in the Financial Stability Report for 2008-2015 period.

3. The structure and evolution of shadow banking in Romania

In Romania, the shadow banking issue became a preoccupation for both regulators and financial analysts in the last decade. As defined by the National Bank of Romania in accordance with the Financial Stability Board definition, the shadow banking sector includes non-bank financial institutions (NBFIs), investment funds and money market funds.

The share of shadow banking assets in GDP is relatively low in comparison with the share of the credit institutions assets. However, in the period of time that followed the 2008 financial crisis, two of the shadow banking components, non-bank financial institutions and investment funds kept an uprising trend in terms of their cumulative assets percent in GDP, reaching around 10% in total (figure 1).

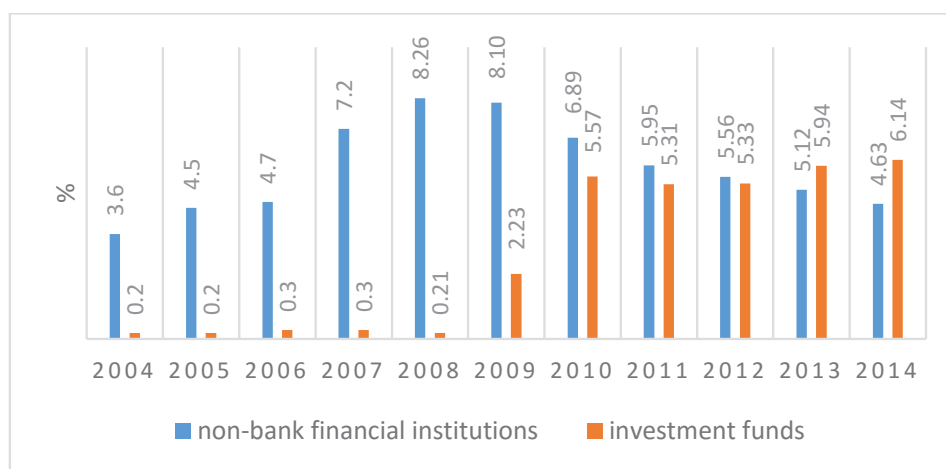


Figure 1: Shadow banking assets as a share of GDP in Romania

Source: NBR statistics www.bnr.ro

Between 2008 and 2014 the share in GDP of the shadow banking assets had an antagonistic evolution, NBFIs registering a diminution of assets, mainly because of the general economic crisis that reduced the access to lending for both firms and population, while investment funds started an uprising trend, due to the lowering of interest rates in the banking sector that sent investors in search for better investments opportunities.

In 2015, the shadow banking assets reached a total of 73.84 billion lei, which stand for nearly 14% of the financial system's assets, of which NBFIs assets represent 31.03 billion lei, adding 0.16 billion lei to the 2014 value, while investment funds represent 42.81 billion lei, with a 1.87 billion lei increase from the previous year (figure 2).

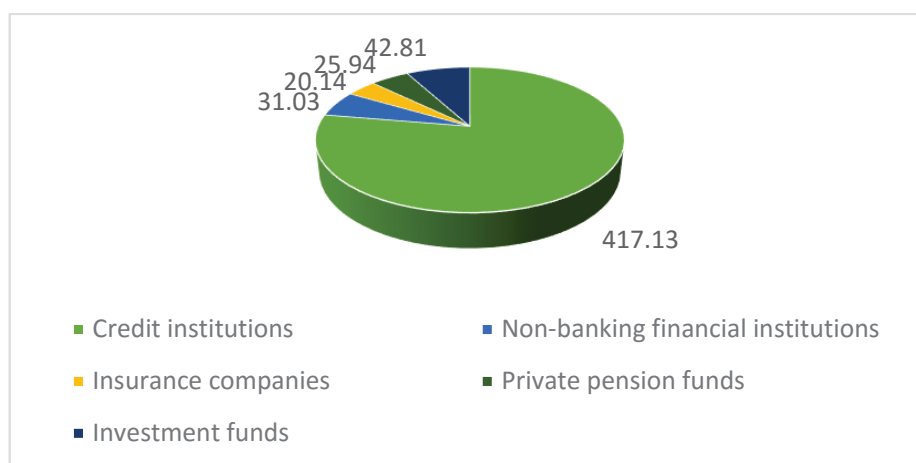


Figure 2: Romania's financial system structure in 2015 (total assets)

Source: NBR statistics www.bnr.ro

Although the size of the shadow banking sector in Romania is relatively small in comparison with other countries and with the size of the credit institutions, we believe that its upwards trend in the previous decade makes it an important topic for analysis in terms of structure, activities and links with the banking system.

4. The non-bank financial institutions as a component of the shadow banking

4.1. Structure and performances of non-bank financial institutions in Romania

Non-bank financial institutions are defined by the Romanian laws as entities, other than credit institutions, which professionally engage in lending activities (law no. 93/2009). The National Bank of Romania authorises and supervises the activity of NBFIs, dividing them into two categories: General register entities, comprising all NBFIs, and Special register entities, including NBFIs that meet special criteria regarding the size of their turnover, lending volume, level of indebtedness and total assets or equity capital.

Currently 175 NBFIs are registered as active in the two registers, classified by their activities as follows (table 1):

	General register(excluding special register)	Special register
Consumer credit	3	1
Microcredit	2	0
Trade financing	1	0
Factoring	1	0
Financial leasing	20	6
Issuance of guarantees	4	1
Multiple lending activities	102	34
Total	133	42

Table 1: Number of active NBFIs in Romania

Source: NBR www.bnr.ro

Between 2008 and 2015 the value of NBFIs assets decreased by more than 13 billion lei, from 44.5 billion lei at the end of 2008 to 31.03 billion in December 2015, with the lowest value of 30.87 billion lei in 2014. This descending trend is the result of the contraction of lending activities, especially real-estate credit and financial leasing and of the constant increase of regulatory provisions (figure 3). In the same period of time, credit institutions

assets manifested an opposite trend increasing their value by 77.63 billion lei. This evolution proves that credit institutions remain the most important financial intermediary actors on the Romanian market.

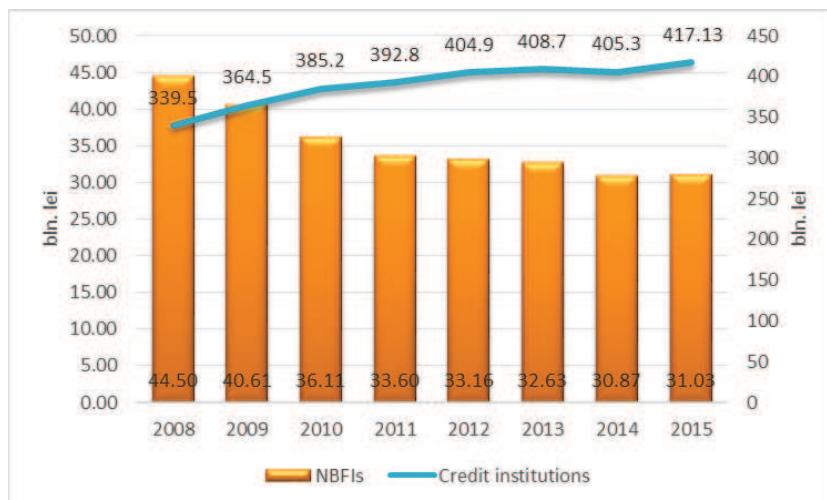


Figure 3: Total assets of NBFIs and credit institutions

Source: NBR statistics www.bnr.ro

In this context, the profitability of NBFIs in the last five years fluctuated between negative rates at the beginning of the period and positive outcomes by the end of 2015. If we take the profitability analysis further by looking at the two categories of NBFIs, general and special register, we can notice that the biggest fluctuations took place in the Special Register section, where profits varied between a 221.8 million lei loss in 2011 and a 281.9 million lei profit in June 2015. By the end of the period only Special Register NBFIs recorded profits, while General Register NBFIs results plunged into the negative area with a loss of 1.46 million lei (figure 4).

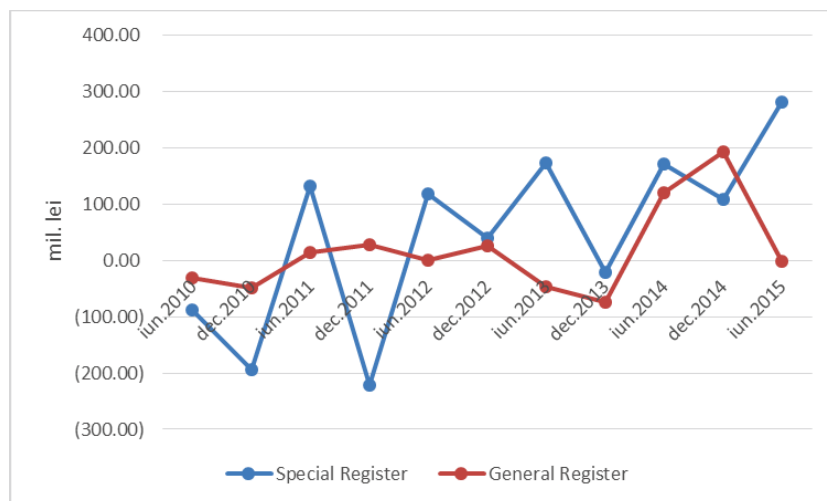


Figure 4: Profitability of the NBFIs sector

Source: NBR statistics www.bnr.ro

The strengthening of financial results by the overall sector is more a result of the reduction of operating expenses and less an outcome of increased incomes from granted loans. The evolution of the lending activity of NBFIs is presented in the next subsection.

4.2. The lending activity of NBFIs in Romania

In the last five years, the annual growth rate of NBFIs lending activity has lagged behind

the growth rate of the real economy, as reflected by the evolution of GDP (figure 5). With the exception of the period from December 2013 to June 2014, the growth rate of loans granted by NBFIs range in negative territory, the lowest point being reached in September 2010, a 17.4 percent drop compared to the same month in 2009. At the end of the time series, in December 2015, the growth rate became positive, a 2.6 increase from the value in December 2014. The improved economic climate may favour a new development of the NBFIs credit, provided that the regulatory framework for credit institutions remains restrictive.

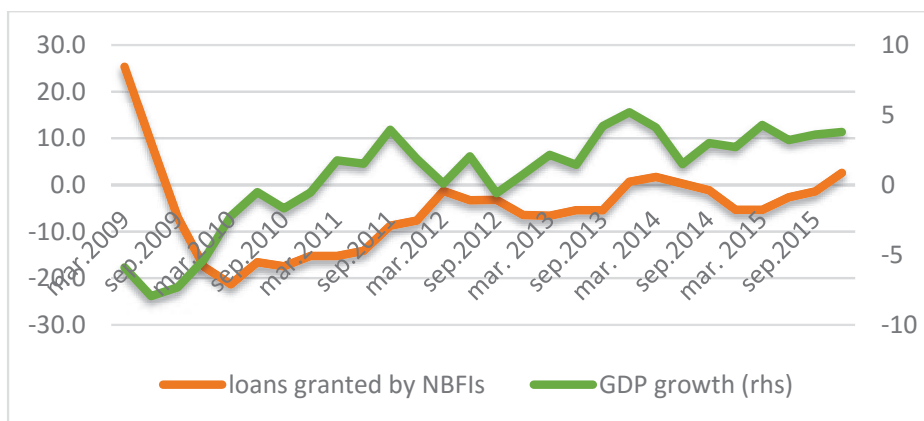


Figure 5: Annual growth of loans granted by NBFIs and GDP

Source: NBR statistics www.bnr.ro

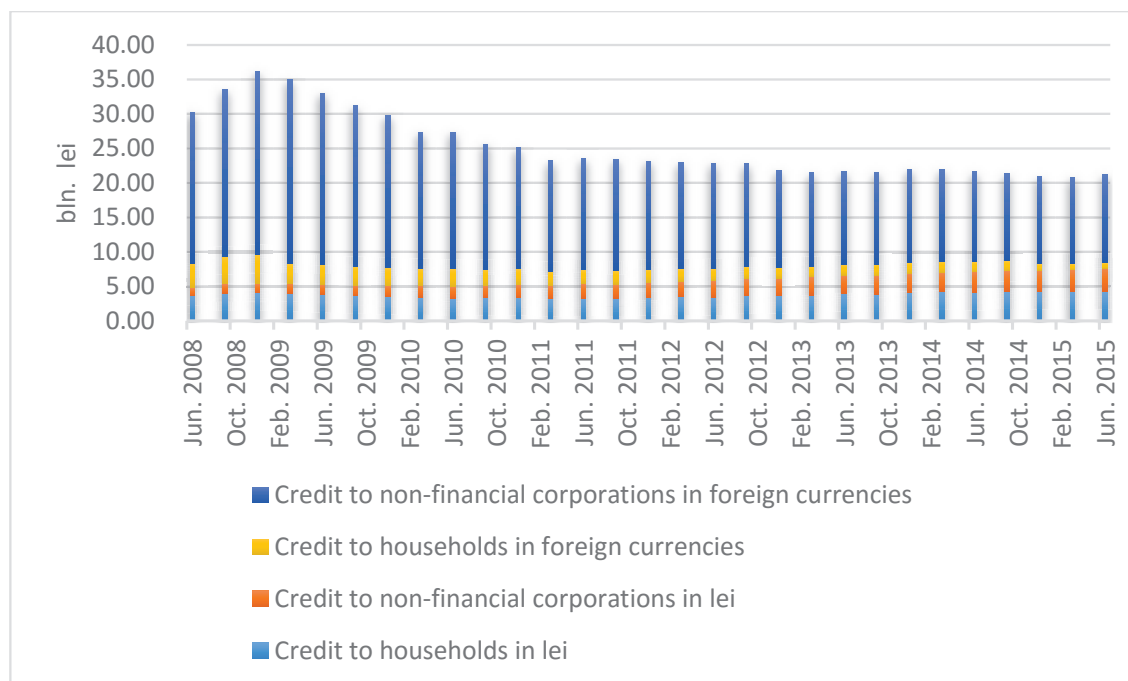


Figure 6: Loans granted by NBFIs by currency and debtor

Source: NBR statistics www.bnr.ro

Throughout the analysed period, the structure of the loans granted by NBFIs has shown the following trends (figure 6):

- lending to households represented a share between 19.29% and 26.39% of the total loans, with an average of 22.87% which stands for 5.83 billion lei;
- in absolute value, the highest amount of credit for the households was registered in September 2008, of 8.04 billion lei, while the lowest figure of 5.03 billion lei was reached in June 2015;
- by the end of the period loans to households set on a decreasing trend, while

loans to non-financial corporations showed a rebound;

- loans to non-financial corporations represented an average of 75.33% of the total loans, which stands for approximately 19.44 billion lei;
- the maximum value of loans to non-financial corporation was reached in March 2009, 28.13 billion lei, after which the granted credit contracted to a minimum of 15.65 billion lei in September 2014;
- in terms of currency, both households and non-financial corporations favoured foreign currency loans that represented an average of 75.5% of the total loans throughout the period, but in the last two years their relative weight in the total loans started to decline.

We can thus conclude that NBFIs lending activity is focused on non-financial corporations and on foreign currencies loans. While the first observation can be considered a benefit for the general economic climate, hinting that NBFIs credit are destined for production more than for consumption purposes, the second ascertainment highlights a bigger risk for the sector, credit risk being doubled by currency risk.

The loans granted by NBFIs to non-financial corporations in 2015 were dominated by the utilities and services sector with a share of 38.49% of total loans, followed by trade corporations (19.54%), agriculture (16.33%), constructions and real estate (13.16%) and mining and manufacturing (12.47%). Compared to the previous year, the breakdown of loans to non-financial corporations shows an increase of loans to the agricultural sector (14.77% in 2014) and to the utilities and services sector (37.77% in 2014) and a diminution of the share of loans to the other components, the largest reduction being recorded by constructions and real estate (14.42% in 2014), followed by the mining and manufacturing sector (13.20% in 2014) and trade (19.84% in 2014) (figure 7).

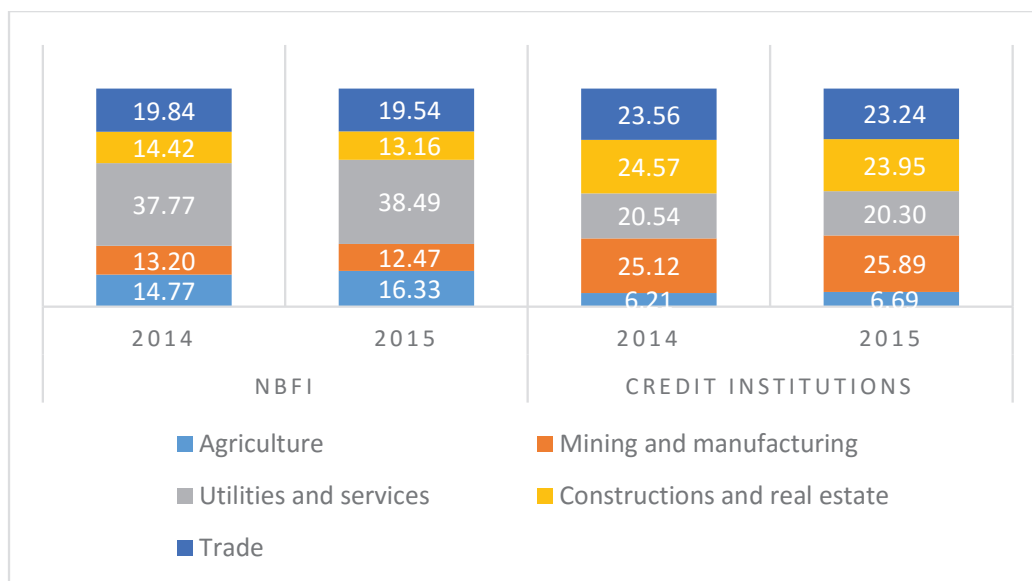


Figure 7: Structure of loans granted by NBFIs and credit institutions to non-financial corporations in 2014 and 2015

Source: NBR statistics www.bnr.ro

If we compare the structure of loans granted by NBFIs to non-financial corporations to that of credit institutions in 2015, we can notice a larger share of loans to mining and manufacturing in the portfolio of credit institutions (25.89%) while agriculture hold only 6.69% of loans granted by credit institutions. For credit institutions, the structure of loans portfolio has not change significantly in 2015 compared to 2014.

By putting the two major credit providers loans portfolio structure side-by-side we can highlight the role of NBFIs in financing economic sectors that credit institutions do not favour, such as agriculture or utilities and services. This implies that can NBFIs play an

important part in the development of these activities.

Another way in which NBFIs are financing the real economy is by issuing guarantees, which help reallocate credit risk across the financial system. The most important category of guarantees issued by NBFIs are destined for the "First Home" program, their value increasing over the last period. NBFIs also extend guarantees for loans to non-financial corporations, intended to support economic activity and lending.

The lending and guarantee issuing activities of NBFIs in Romania, although small in comparison to credit institutions' size, represent an important part of the financial system. As long as regulations of credit for banks will remain restrictive, we believe that, NBFIs can play a major part in financing both production and consumption in Romania.

5. Conclusions

Following the analysis realised in this paper we can draw the conclusion in Romania the shadow banking sector is relatively small compared to the traditional banking system representing in 2015 nearly 14% of the financial system's assets showing that this system is in early stages of development comparing with the traditional banking system. During the 2008-2014 period the assets of two of the shadow banking components represented around 10% from GDP with a descending trend of the value of assets for the non-bank financial institutions comparing with the investments funds.

The paper focused on the structure, performance and the lending activity of the non-bank financial institutions and the analysis revealed that during the eight years different indicators regarding these entities had opposite evolution.

The total assets of NBFIs registered a decrease with around 30% in 2015 comparing with 2008 comparing with the banking system which had an increase with nearly 20% in the same period showing that this part of the Romanian financial system remains the main part of the intermediation activity.

If the total assets of the NBFIs had a clear trend in terms of profitability the evolution of these entities was characterized by a discontinuing trend and with differences between the two categories of institutions: the general register institutions registered a slight upward trend of their profitability but with losses alternating with profits from 2010 till 2015 when they obtained the highest level of profit; the special register institutions had a chaotic evolution registering their biggest loss in 2013 and the highest level of profit in 2014 and with a zero result in 2015.

As we showed in the paper the two indicators (total assets and profitability) had a very different evolution proving that the reduction of the assets wasn't an obstacle to perform and obtain profit.

Analysing the lending activity of the non-bank financial institutions through three criteria we have drawn the conclusion that from the volume point of view the lending activity registered negative annual growth rate during the whole period till 2015 when it became positive but it remained behind the real economy growth rate proving underperformance.

The structure of the lending activity of the NBFIs taking into consideration the currency, the type of debtor and the activity domain of the debtor reveals the positive influence that the shadow banking system has in the real economy because the analysis showed that non-bank financial institutions financed mainly non-financial institutions from sectors poorly credited by the traditional banking system as services, mining and manufacturing and agriculture and issued guarantees, which help reallocate credit risk across the financial system

A general conclusion from the research conducted in this paper is that, in the Romanian financial system, the shadow banking is yet in early stages of development but the entities actively involved in the lending activities have without doubt a positive influence on the economic activities representing a viable alternative to the traditional banking system for several domains of activity and with a proper regulation and supervision to prevent systemic risks and contagion phenomena can reach higher levels of development.

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