

RISKS OF THE NATIONAL BANK OF ROMANIA

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ABSTRACT: The National Bank of Romania was set up in 1880 as the central bank of Romania. The National Bank of Romania is an independent public institution with its headquarters in Bucharest. It is the sole institution vested with the power to issue notes and coins to be used as legal tender on the territory of Romania. The main risks associated with the Bank's activities are financial and operational risks arising as a result of the Bank's responsibility to ensure and maintain the price stability in Romania. The most important types of financial risks to which the Bank is exposed are credit risk, liquidity risk and market risk. Market risk includes currency risk and interest rate risk.

РИСКОВЕ НА НАЦИОНАЛНАТА БАНКА НА РУМЪНИЯ

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РЕЗЮМЕ: Националната банка на Румъния е създадена през 1880 г. като Централна банка на Румъния. Тя е самостоятелна обществена институция с централно седалище Букурещ. Тя е единствената институция упълномощена да печата банкноти и сече монети на територията на Румъния. Основните рискове свързани с банковата дейност са финансовите и оперативни рискове, поради отговорността на банката да осигури финансова стабилност в Румъния. Най-големият финансов риск, на който е изложена е кредитния, ликвидния и пазарния рискове. Пазарният включва валутния риск и облигационния риск.

The National Bank of Romania was set up in 1880 as the central bank of Romania. The National Bank of Romania is an independent public institution with its headquarters in Bucharest. It is the sole institution vested with the power to issue notes and coins to be used as legal tender on the territory of Romania.

Pursuant to Law No. 312/2004 on the Statute of the National Bank of Romania, the NBR's primary objective is to ensure and maintain price stability.

The main tasks of the National Bank of Romania are the following:

- to define and implement the monetary policy and the exchange rate policy;
- to conduct the authorization, regulation and prudential supervision of credit institutions and to promote and oversee the smooth operation of the payment systems with a view to ensuring financial stability;
- to issue banknotes and coins as legal tender on the territory of Romania;
- to set the exchange rate regime and to supervise its observance;
- to manage the official reserves of Romania.
- Without prejudice to its primary objective of ensuring and maintaining price stability, the National Bank of Romania supports the general economic policy of the Government.
- By law, the National Bank of Romania is solely accountable to Parliament and is on no account

subordinated to Government; its relationship with the latter is co-operation on a regular basis.

The National Bank of Romania is managed by a Board of Directors appointed by the Parliament of Romania on the recommendation of the standing committees of the two Chambers of the Parliament. Board members are appointed for a five-year tenure that can be subject to renewal.

The main tasks of the Board of Directors are to decide on the monetary and exchange rate policies, as well as on the measures for authorization, regulation and prudential supervision of the credit institutions and oversight of the authorised payment systems.

Territorial network of the NBR comprises the headquarters and 19 branches.

The Bank is fully owned by the Romanian state.

The operations of the Bank during the financial year 2006 were governed by the 'Law on the Statute of the National Bank of Romania' (Law no. 312/ 2004), in effect since 31 July 2004, except for a number of provisions related to statutory financial reporting that became effective commencing 1 January 2005. The purpose of the Law no. 312/ 2004 is to ensure the compliance of the NBR's statute with the European Union legislation and, in particular, with the provisions on central bank independence of the European Community Treaty.

In accordance with the Law no. 312/ 2004, the primary objective of the Bank is to ensure and maintain price stability. Likewise, the Bank has the exclusive right to issue banknotes/ coins and the duty to regulate and supervise the Romanian banking system

Risk management policies

The main risks associated with the Bank's activities are financial and operational risks arising as a result of the Bank's responsibility to ensure and maintain the price stability in Romania. The most important types of financial risks to which the Bank is exposed are credit risk, liquidity risk and market risk. Market risk includes currency risk and interest rate risk.

a) Credit risk

The Bank is exposed to credit risk through its trading, lending and investing activities and in cases where it issues guarantees.

Credit risk associated with trading and investing activities is managed through the Bank's market risk management process. The risk is mitigated through selecting counterparties of high credit standing and monitoring their activities and ratings and through the use of exposure limits.

The Bank's primary exposure to credit risk arises as a result of granting short-term loans in lei to domestic credit institutions. The amount of credit exposure in this regard is represented by the carrying amounts of the loans on the balance sheet. Short-term loans in lei extended to banks are normally secured with treasury securities issued by the Romanian Government or by term deposits. However, the Bank may, in special circumstances, grant unsecured loans to banks and other credit institutions in order to prevent systemic crises. Nevertheless, this risk has been constantly decreased due to the reduction of the Bank's loans portfolio.

Maximum credit risk exposure, representing the maximum accounting loss that would be recognized at the balance sheet date if counterparties failed completely to perform as contracted and any collateral or security proved to be of no value, is estimated to be in the magnitude of lei 600 thousand (31 December 2005: lei 741 thousand).

b) Liquidity risk

The Bank is the lender of last resort to credit institutions in Romania. The main objective of its day-to-day operations is to ensure that adequate liquidity exists on the domestic market.

The Bank is also managing the international foreign currency portfolio, through planning and diversification, in order to ensure the foreign obligations are timely met.

c) Interest rate risk

The Bank incurs interest rate risk mainly in the form of exposure to adverse changes in the market interest rates to the extent that interest-earning assets and interest-earning liabilities mature or reprise at different times or in different amounts.

For financial receivables and liabilities in lei, the Bank endeavors to match the current market rates. Obtaining a positive margin is not always possible given that the levels of

such assets and liabilities are dictated by the objectives of the monetary policy.

However, the Bank is constantly monitoring the costs of implementing the policies against the estimated benefits.

For financial receivables and liabilities in foreign currency, the Bank attempts to maintain a net positive position. The Bank uses a mix of fixed and variable interest instruments. The interest rates obtained or offered by the Bank for the interest bearing assets and liabilities are presented in the notes that refer to the above mentioned assets and liabilities.

d) Currency risk

The principal foreign currencies held by the Bank are EUR and USD. Due to the appreciation of the local currency and the volatility of the financial markets, there is a consequent risk of loss in value in respect of net monetary assets held in foreign currency. Open foreign exchange positions represent also a source of foreign exchange risk.

The Bank is exposed to currency risk through foreign currency exchanges. There is also a balance sheet risk that the net monetary liabilities in foreign currencies will take a higher value when translated into lei as a result of currency movements.

In order to avoid losses arising from adverse movements in exchange rates, the Bank, within the framework of its objectives for managing international reserves, is currently pursuing the policy of diversifying its portfolio, in order to ensure a balanced foreign currency distribution, whilst maintaining an overall long foreign exchange position.

The revaluation exchange rates of the principal foreign currencies at the end of the year were:

Table 1
The revaluation exchange rates

Currencies	31 December 2006	31 December 2005	% Increase (decrease)
Euro (EUR)	1:RON 3.3817	1:RON 3.6771	8.0%
US Dollar (USD)	1:RON 2.5676	1:RON 3.1078	(17.4%)

Monetary gold

Table 2
Monetary gold

In lei thousand	31 December 2006	31 December 2005
Gold bullion in standard form	1,464,000	1,428,857
Coins	755,749	738,554
Abroad deposits	3,214,738	3,137,628
Total	5,434,487	5,305,039

At 31 December 2006, the Bank had a sole foreign deposit amounting to lei 3,214,738 thousand. As at 31 December 2006, the gold revaluation price came to 52.49 lei/g and the Bank's gold holdings amounted to 103,553.76 kg (as at 31

December 2005, the revaluation price came to 51.23 lei/g and the Bank's gold holdings amounted to 103,553.37 kg).

Demand deposits placed

Table 3
Demand deposits placed

In lei thousand	31 December 2006	31 December 2005
Demand deposits at international financial	4,133,275	4,008,003
Demand deposits at central banks	40,173	141,919
Demand deposits at foreign banks	344	129
Total	4,173,792	4,150,051

As at 31 December 2006, this item comprises: the current account held with the Bank for International Settlements (BIS), in amount of lei 4,133,275 thousand (31 December 2005: lei 4,008,003 thousand), representing the lei equivalent of EUR 1,221,899 thousand (31 December 2005: EUR 1,089,781 thousand), USD 455 thousand (31 December 2005: USD 235 thousand) and CHF 5 thousand (31 December 2005:

CHF 17 thousand), demand deposits held with central banks, out of which significant are those held with Bundesbank in amount of lei 21,909 thousand (EUR 6,479 thousand) (31 December 2005: lei 56,602 thousand or EUR 15,393 thousand), Bank of Japan in amount of lei 13,407 thousand (JPY 623,592 thousand) (31 December 2005: lei 45,088 thousand, JPY 1,701,465 thousand respectively), Bank of England lei 1,691 thousand (GBP 335 thousand) (31 December 2005: lei 35,613 thousand or GBP 6,649 thousand) and the demand deposit held with Banque Generale de Bruxelles, in amount of lei 344 thousand (EUR 102 thousand) (31 December 2005: lei 129 thousand or EUR 35 thousand).

Term deposits placed

Table 4
Term deposits placed

In lei thousand	31 December 2006	31 December 2005
Term deposits at central banks	500,060	362,882
Term deposits at foreign banks	22,074,835	21,897,388
Term deposits under securities lending agreement	770,280	-
Reverse repo operations under securities lending agreement	11,021,122	-
Total	34,366,297	22,260,270

As at 31 December 2006, the term deposits held with foreign banks amounted to lei 22,074,835 thousand (31 December 2005: lei 21,897,388 thousand), representing the lei equivalent for EUR 4,740,000 thousand (31 December 2005: EUR 3,430,000 thousand), USD 2,305,500 thousand (31 December

2005: USD 2,059,000 thousand) and GBP 25,000 thousand (31 December 2005: GBP 538,800 thousand).

As at 31 December 2006, the term deposits held with central banks include the overnight deposit held with the De Nederlandsche Bank in amount of lei 292,855 thousand (EUR 86,600 thousand) (31 December 2005: lei 16,363 thousand or EUR 4,450 thousand) and the deposit held with the Federal Reserve Bank of New York in amount of lei 207,205 thousand (USD 80,700 thousand) (31 December 2005: lei 346,520 thousand or USD 111,150 thousand).

As at 31 December 2006, the term deposits placed via an agent under the securities lending agreement amounted to lei 770,280 thousand, representing the lei equivalent for USD 300,000 thousand. As at 31 December 2006, the reverse repo operations performed via an agent under the securities lending agreement amounted to lei 11,021,122 thousand, representing the lei equivalent for USD 4,292,383 thousand, and were guaranteed by foreign currency securities.

Lent securities

Table 4
Lent securities

In lei thousand	31 December 2006	31 December 2005
Coupon treasury bills - Non-government US Agencies	291,088	-
Coupon treasury bills - US Treasury	11,572,224	-
Coupon treasury bills - Bank for International Settlements (MTI)	255,709	-
Total	12,119,021	-

As at 31 December 2006, the Bank lent, via an agent, US coupon treasury bills in amount of lei 12,119,021 thousand. The borrowings secured with lent securities - performed via the agent - are invested in reverse repo operations and term deposits

Loans to domestic credit institutions

Table 4
Loans to domestic credit institutions

In lei thousand	31 December 2006	31 December 2005
Loans to credit institutions	11,800	16,800
Loans in litigation	13,209	13,209
Specific provision for credit risk (for principal amount)	(25,009)	(30,009)
Balance at the end of year	-	-

This item comprises a current loan granted to a bankrupt credit institution, Credit Bank S.A.

The outstanding loans balance as at 31 December 2006 decreased as a result of the reimbursements made during the year for the loan granted to Credit Bank S.A., in accordance with the Emergency Ordinance no. 26/ 2000 (31 December 2005: lei 16,800 thousand). This item includes also the loan granted to Credit Bank S.A. before its bankruptcy (31 December 2005: lei 13,209 thousand). Provisions are booked for all the loans granted to Credit Bank SA. The provisions as at 31 December 2005 are maintained for the end of the year 2006, apart from the provision regarding the loan granted to Credit Bank S.A in compliance with the Emergency Ordinance no. 26/ 2000, which was decreased to the extent of the aforementioned reimbursements

According to the Law no. 312/ 2004, the financial statements of the Bank are prepared in accordance with the international accounting standards applicable to central banks and recognized by the European Central Bank. The aforementioned accounting standards are comprised by the ECB Guideline no. 10/ 2002. Starting on the 1st January 2007, the modified variant of the ECB Guideline no. 10/ 2002 enters into force (the ECB Guideline no. 16/ 2006). Its impact on the financial statements will be subsequently assessed.

Recommended for publication
of Editorial board

On the 25th April 2005, Romania signed at Luxembourg the European Union Accession Treaty. The accession date is the 1st January 2007; on this date, the Bank becomes a member of the European System of Central Banks, having both rights and obligations in this respect. Moreover, on the date of the changeover from the Romanian currency to euro, the Bank will become a member of the Eurosystem, having both rights and obligations in this respect. The impact of these events on the financial statements will be subsequently assessed.

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