SUPERVISION OF FINANCIAL MARKETS

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Abstract

Based on the fundamental role of the market in contemporary economic development, in this study we aim to analyse how the financial markets in Romania are regulated, monitored and, especially supervised, compared to developed or developing European countries, close or far away from the national borders.

The study highlights the main trends in the existing financial supervision systems abroad after the 2000s and ends with proposals based on the authors' opinion regarding the best option for the Romanian supervisory model of financial markets.

Keywords: *market, financial market, banks, capital market, prudential supervision, financial supervisory authority, insurance/reinsurance, private pension funds*

JEL Classification: G_{01}, G_{15}

Introduction

The market, in general, whether we are talking about the commodities market, the market for goods and services, labour market, financial market, and so on, has to, in order to prove its key role in the sustainable development of national economies and the global economy as a whole, be subject to a complex and rigorous regulation, monitoring and supervision process.

This is not contrary to the free market, as long as freedom, in its philosophical meaning, of understood necessity, gives you the right to do anything as long as you do not disturb others, and by others we understand people, nations, nature, soil, subsoil, environment, traditions, culture, customs, habits, laws, conscience.

Lack of regulation and oversight and market overregulation are equally harmful events that may lead to antagonistic, aggressive and chaotic manifestations with catastrophic consequences on the economy or, on the contrary, the inhibition of the market, centralism, dictatorship, corruption.

In the first part of the study, we make a brief incursion into the theoretical issues of the market concept in the modern understanding of its basic components:

the market for goods and services, the banking system, foreign exchange, capital market, insurance [Iulian Văcărel and staff, 2008], but also in the labour market, private pension funds, etc.

In the second part, the study focuses on analysing the experience of developed countries with tradition in the European Union as well as others that have recently joined the European Union in terms of the supervision of financial markets and the identification of the main tendencies of this field at a European level.

Romania's experience in the monitoring and supervision of financial markets in the post-revolutionary period is presented in the third part of the study.

At the end of the study, the authors present the conclusions and proposals on best practice in the area of financial market supervision at European level, with guidance on the surveillance system considered to be most suitable for Romania.

1. *Financial market – fundamental component of the global market*

1.1. **Preliminary considerations on the market**

Understanding the content, role, formulas, tools, etc. of the market concept is one of the most dynamic developments in history.

If we refer only to the last 100 years, the concept of market has been defined "a land, place without walls between the lanes of a city" [August Scriban, 1939] or "specially arranged place for trading goods, especially food products" [Romanian Academy – DEX, Explanatory Dictionary of the Romanian Language, second Edition, 1999].

The market, in our opinion, is a complex system of interdependencies between the composing subsystems, which concern:

(I) goods subject to trading (sale/purchase), related to the three basic elements of any economic activity: nature, labour and capital;

(II) the participants in the act of trading (buyers, sellers, intermediaries);

(III) regulations (laws, procedures, regulations, arrangements, agreements) based on which market functions;

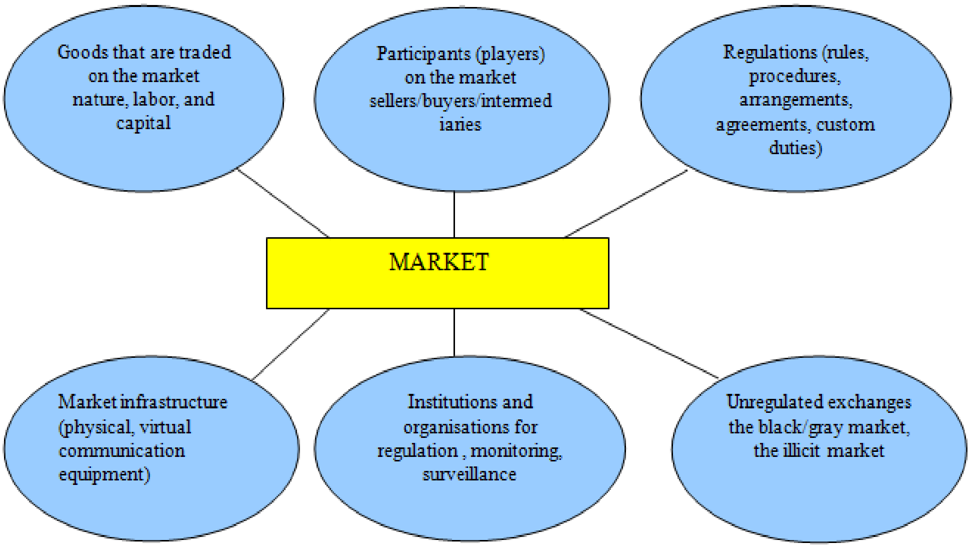
(IV) infrastructure (physical, virtual, communications, computer equipment, etc.) of the market;

(V) specialized institutions and organisations for regulation, monitoring, surveillance, discount/compensation etc.;

(VI) the unregulated market (the black/grey market, unauthorized/illegal transactions).

Schematically, the MARKET system and its component subsystems is presented in Figure 1.

Figure no. 1. *The market system and its component subsystems*



1.2. **Global Market Structure**

Structuring the global market is based on three fundamental elements of any economic activity: nature, labour and capital.

From this point of view, the global market has three major components:

(I) *The market for goods and services* is the traditional component of the global market, the first exchange in the old social order were made with goods like animal hides, arrowheads and other objects like stone tools, pottery, metal, that were exchanges with each other before the occurrence of the money as a means .

During the world's economic and social development, goods and services that are the object of trade diversified immensely. The best-known sub-segments of the market for goods and services, for which even international scholarships are organized, are:

Market for goods

- The market for raw materials (cotton, wood and timber, ores of various kinds)
- Commodities market of farming (sugar beet and sugar cane, industrial crops)
- Food products (meat, sugar, oil, vegetables, fruits, etc.)
- The grain market
- The land market
- The real estate market
- The market for energy resources (coal, oil, gas, etc.)
- Energy market

- The market for manufactured goods (automobiles, machine tools, equipment, rolling stock furniture, durables, etc.)
- Pollutants market (in ecology)

Services market

- Education and training services
- Health and social care
- Services of defence and protection
- Media Services
- Cultural services
- Domestic services
- Trade and food services
- Hotels and restaurants
- Entertaining etc.
- Telephony and communications, postal services
- Transport

(II) *The labour market* includes all forms that sell the workforce of the person, the body or the person itself, as was the case of slave markets.

This segment of the global market can be structured in turn as:

- Highly qualified labour force
- Qualified work force
- Unqualified labour

Other criteria for the classification of labour market is the origin of persons:

- Indigenous/local workforce
- Immigrants

The labour market can be classified in relation to the legality and transparency of contracts which generates:

- Regulated legal labour market
- The black market/grey market

Even in the third millennium, within the labour market discrimination between native and immigrant workers, men and women, countries and regions, etc. continues to occur, earnings differ much at the same level of training between an employee from Germany and one from Ghana, between a Romanian and an English doctor working in the same medical facility.

(III) *The financial market* is the component of the global market in which money plays a dual role:

− general means of exchange;

− the very object of exchange (trade).

The main segments that are incorporated in the financial market are:

- Money market (banking) that includes:

− Banking market itself;

− Foreign exchange market;

− The market for nonbank financial institutions (NFI).

- Capital market with its sub-segments:
  - Shares market;
  - Bond market;
  - Government bond market;
  - Derivatives etc.
- Insurance/reinsurance market with the two major components:
  - Life insurance;
  - Non-life insurance.
- Private pension fund market

Each of the three major components of the global market include infrastructure elements, rules, participants, authorities and institutions, etc. described in section 1.1.

2. ***Financial market supervision in some European countries***

Financial market through its constituent subsystems, involves, more than any other type of market, part of the global market, risk taking, this happening because of a few important reasons:

(I) working with money/quasi-money/financial instruments/securities, which by their nature are likely to be diverted, stolen, fraud and so on;

(II) exceptionally high degree of complexity and sophistication of financial transactions;

(III) the globalization of world finances, the highest compared to any other type of market;

(IV) the high volatility of financial resources which may disappear from a country/geographical area instantly through the use of IT, with a simple click;

(V) financial transactions, whether it relates to the establishment of a bank deposit, the granting of credit, purchasing a financial asset, a fund unit, an insurance involving the future and anticipation of the future is a very difficult problem in the context of the complexity of modern economy and the acceleration at an unprecedented pace of change in all areas of socio-economic, political, climatic, demographic, cultural, etc. areas.

This has caused the financial markets to need to establish "clear rules of the game", the entities that issue such rules, but especially to closely monitor the implementation and compliance of their current day-to-day financial activities.

Supervision of financial markets has precisely this role of professional, continuous and comprehensive monitorization of all sub-components of the financial market in order to ensure financial transactions in conditions of legality, transparency and ethics, ant to, without bias, protect the interests of all participants to activities taking place in the financial markets.

Early embryos of a financial supervisory activity appeared approx. 100 years ago in northwest European countries and the USA. For example, in France, the beginnings of Banking Commission are found in the '40s.

In the present study, we have analysed the practice of European countries in the area of financial market supervision in the recent contemporary period (since the year 2000), the main conclusions being the following:

England Financial Supervision Authority – FSA is independent of the English executive and the Bank of England, it is subject only to Parliament and is responsible for financial oversight of all financial markets (banking, capital, insurance/reinsurance, funds, occupational Pensions Authority)

The FSA (Financial Supervision Authority) was established in 1998 taking activities and tasks in supervision and regulation from no less than nine separate bodies, which until that time oversaw the supervision of different financial sectors (banking, insurance, capital market, pension funds, etc.)

The Bank of England was left with all the powers conferred by law to a central bank, including that of ensuring stability of the financial system as a whole.

In **Germany**, the financial market is supervised by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin), which is responsible for both the banking sector and capital markets, insurance, investment funds.

BaFin was established on the 1st of May 2002 and has responsibilities that are particularly complex, as in Germany, more than in any European country, the banking sector is closely intertwined with insurance, as there are many instances of cross ownership.

The model of a single financial market surveillance such as the FSA, which in our opinion best fits the current requirements and demands of development and stability of the banking and financial market, has been adopted by many countries in the EU (Denmark, Estonia, Hungary, Latvia, Malta, Austria, Finland, Sweden, etc.) and other countries in non-EU areas (e.g. Australia).

There are also many European countries that do not agree to the single financial market supervision model type FSA, for various reasons of local interests, and the pride of the central banks of those countries

That is, for example, the case of:

Bulgaria's banking market surveillance is conducted by the Central Bank of Bulgaria, while stability and supervision of the capital, insurance/reinsurance and pension fund market is the responsibility of the Financial Supervision Commission

In **Portugal** there are three distinct entities of financial market supervision:

(I) Bank

(II) Insurance

(III) Capital Market

Note that since the year 2000, the country has created the National Council of Financial Supervision (NCFS), a body headed by the Governor of the Central Bank, whose role is to ensure the exchange of information and coordination of the three separate bodies.

The Netherlands, since 2004, have adopted a different model of banking supervision, in which all prudential supervision of the financial market duties, both macroeconomic and microeconomic, have been integrated into the Dutch Central Bank. Until that time these tasks were performed by different bodies.

In **Belgium**, the Financial Banking Commission is responsible for the supervision of the banking and the capital market (FBC) and the Office of Insurance Control (OIC) is responsible with the insurance/reinsurance market, both of witch have been, since 2002, under the coordination of the Governor of the Bank of Belgium, in order to ensure cooperation between the two supervisory bodies.

In **Moldova**, banking supervision is carried out by the National Bank and the financial non-banking market (insurance, capital markets) is supervised by the National Commission of Financial Market (NCFM) established in 2007.

The analysis of the study shows that basically, in Europe there are three methods of financial market supervision:

a) concentration of supervisory authority over all financial market components into a single independent entity (England, Denmark, Austria, Hungary, Malta, etc.)

b) ensuring financial market supervision by the Central Bank or bodies coordinated by the Central Bank Governor (Netherlands, Bulgaria, Portugal, France);

c) supervision of the banking market carried out by the central bank and the non-bank financial market supervision being done by separate authorities, without the existence of a coordinating body between these entities (Bulgaria, Romania, Moldova, etc.)

3. ***Financial market supervision in Romania in the post-revolutionary period***

With Romania's transition from centralized economy to a market economy, the market, in general, and financial markets, in particular, have undergone a long process of transformation, change, organizing, monitoring and supervision in accordance with the major requirements of the free economy.

The most dynamic segment of the financial market that was first liberalized and reorganized in December 1989 was the banking system which, through the approval of Law no. 33/1991 [Law no. 33/29 March 1991 on banking activity, published in O.G. Part I no. 70/April 3, 1991], and Law. 34/1991 [Law no. 34/29 March 1991 on the National Bank of Romania published in the O.G. Part I no. 70 April 3, 1991], approving the Statute Law on the National Bank of Romania (NBR) was organized on two levels: commercial banks and the central bank with different roles and functions.

Subsequently, based on Law no. 58/1998 [Law no. 59/1998, banking law, published in the O.G. Part I no. 121/23.03.1998] on banking activity and Law. 101/1998 [Law no. 101/1998 on the National Bank of Romania published in the O.G. Part I no. 203/01.06.1998] on the approval of the status of the central bank, the role and functions were clearly established for the two levels, the central bank and commercial banks, on which the banking system was organized.

Banking legislation has been further refined by two important laws: Law no. 312/2004 the status of the NBR [Law no. 312/28 June 2004 on the National Bank of Romania, published in the O.G. Part I no. 582/30 June, 2004] and Law. 227/ 2007 on credit institutions and capital adequacy [Law no. 227/2 July 2007 for the approval of O.G no. 99/2006 on credit institutions and capital adequacy, published in the O.G. Part I no. 480/18.07.2007].

Through the new legislation approved after 1989, it was clear that the activity of commercial banks is represented and supervised by the central bank, as the central bank of the state.

The capital market was established in Romania in 1994 based on Law no. 52/1994 on securities and stock exchanges [Law no. 52/1994 on securities and stock exchanges, published in the O.G. Part I no. 210/August 11, 1994], when it approved the establishment of the National Securities Commission (NSC), an autonomous administrative authority whose role is to establish the framework for the activities of brokers and agents, the regime of professional associations established by them and bodies responsible to ensure the functioning of the securities market.

Powers of the National Securities Commission and its role in the regulation and supervision of capital market [Law no. 297/2004 regarding the capital market, published in the O.G. Part I no. 571/29.06.2004] of Romania were most clearly defined by Law no. 297/2004 regarding the capital market, according to which the NSC is the competent authority for law enforcement, according to the provisions laid down in its statutes

Insurance and reinsurance in Romania was reorganized based on Law no. 136/1995 [Law no. 136/1995 on insurance and reinsurance in Romania, published in the O.G. Part I no. 303/30.12.1995] and the supervisor of this activity, namely the Insurance Supervisory Commission was established under Law no. 32/2000 [Law no. 32/03.04.2000 regarding insurance companies and insurance supervision, published in the O.G. Part I no. 148/10.04.2000] as an autonomous administrative authority, specialized, organized to protect the rights of policyholders and to promote stability of the insurance in Romania.

Among the fundamental tasks of the Insurance Supervisory Commission were listed:

− Development / approval of normative acts concerning insurance;

− Supervision of the financial situation of the insurance/reinsurance companies in order to protect the interests of policyholders;

− Taking steps to comply with prudential norms by insurance companies;

− Approve major shareholders, divisions and mergers in the insurance/ reinsurance market, etc.

The private pension funds market was created in Romania through Law no. 411/2004 [Law no. 411/2004 on Private pension funds, amended and supplemented by Ordinance no. 112/2007, republished in the O.G. Part I no. 482/18.07.2007], and in 2005, the Supervisory Commission Private Pension System was created as an autonomous administrative authority under the control of Parliament, with the role of regulation and supervision of the business of private pension funds.

So, while in developed countries the EU, the best practice in financial market supervision, since the year 2000 has been that of the focus of this activity in the responsibility of a single independent authority (like the FSA and BaFin) responsible for overseeing the entire financial market, including the banking one, in Romania, it was only at the end of 2012 that Ordinance no. 93/2012, approved by Law no. 113/2013 [Law no. 113/2013 approving Government Emergency Ordinance no. 93/2012 regarding the organization and operation of the FSA published in the O.G.

Part I no. 234/23.04.2013] was approved. Through this, the Financial Supervisory Authority (FSA) was established as an autonomous administrative authority, specialized that takes all the powers and prerogatives of the National Securities Commission, the Insurance Supervisory Commission and the Supervisory Commission for Private Pension System.

Given that Romania is the only country in the analysis, which maintained separate authority for overseeing the various components of the financial market (banking market, capital market, insurance/reinsurance, pension funds), the establishment of the FSA (ASF) is a step towards the best practices in the EU.

However, the large number of staff, its questionable qualifications, wage policy pursued by the managers of the institution being exaggerated, employment based on family ties, favouritism, etc., the ASF's image had a strong negative impact on public opinion and authorities, including the President of the country.

The table below presents the number of Council members of the ASF compared with the similar bodies present in other European countries.

Table 1

The situation of Financial Supervisory Board members in some European countries

Name of the authority	**Country**	**Coverage**	**Number of Board Members***
Commission Bancaire (CB)	France	The entire financial market	7
FSA	England	The entire financial market	9
ASF	Poland	The entire financial market	7
ASF	Hungary	The entire financial market	3
BaFin	Germany	The banking and non-banking market	5
Banking and Financial Commission (BFC)	Belgium	Banking and capital market (without the insurance market)	5
Financial Supervision Authority	Romania	A part of the financial market (without credit institutions)	11

* In developed countries the appointments of members are made solely on professsional and experience criteria, political appointments not having their place in this area.

Negative aspects of the salary rights which are 2-3 times higher in Romania for the FSA members compared to their counterparts in other committees and supervisors in European countries, also result from the comparison of the economic power of the respective countries (expressed by the GDP) with respect to our country as follows:

Table 2

Comparative analysis of the GDP in some European countries

– € Billion –

Crt. No.	Country	GDP 2012	GDP 2013
1	England	1,877.62	1,831.78
2	France	1,981.69	1,985.07
3	Poland	371.33	374.74
4	Hungary	95.27	94.54
5	Germany	2,599.99	2,638.95
6	Belgium	366.86	367.66
7	Romania	128.42	137.68

Source: Data were processed from http://countryeconomy.com, Euro transformation was based on the exchange rate EUR/USD of the NBR reported on December 31st 2012 and December 31st 2013**.**

Although Hungary is the only country with a smaller nominal GDP than Romania's, the GDP per citizen in the neighbouring country is almost 50% higher than in Romania.

Conclusions and proposals

Providing financial market supervision through a single entity, outside the Central Bank allows, in our opinion:

− Relieving the Central Bank of prudential supervision powers;

− More financial oversight responsibilities are currently being conducted by European bodies (the European Central Bank supervises since January 1, 2014 the approx. 6,000 Banks in the euro area), countries outside the currency bloc having the possibility to opt for adherence to the unique banking supervision system.

− The focus of the Central Bank's activity, especially in the post crisis period and that of joining the euro zone, on the essential attributes of monetary stability [Law no. 312/2004 on the National Bank of Romania, O.G. Part I no. 582/ 30/06/2004], control of inflation and exchange rates;

− Avoiding conflicts of interest by assuming the Central Bank of two contradictory functions

(I) overseeing the banking market;

(II) the lender of last resort.

− Ensuring greater transparency and independence of the single supervisory body towards political or business interference (oligarchy);

− Uniform treatment financial services/products and associated risks among the various components of the financial market (banking, capital, insurance/ reinsurance, private pension funds);

− Effective coordination of policies, actions and measures of prudential supervision in all the components of the financial market in the context of increasingly globalization of the financial banking sector;

− Not least, the costs of administering the single supervisory body are significantly lower.

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Annex 1. Global Market Structure