Centralized supervision: necessity

- Recent crisis showed the necessity for a new structure of financial supervision
  - There were gaps in the regulation and supervision of financial markets worldwide:
    - On the one hand, there was a high degree of “interdependence” or “interconnectedness” between financial institutions and between markets
    - On the other hand, not all financial markets and instruments were regulated (i.e. derivatives, hedge funds) and negative developments in such markets had a strong impact on the regulated markets (i.e. banks) as well
  - There is a high cross-border financial intermediation
    - Large financial institutions are cross-border in nature
    - However, financial supervision was the responsibility of national member states.
- Incentives for and the necessity of centralized supervision has increased.

Centralized supervision: benefits

- Highly integrated economic areas will benefit from a centralized supervisor of the financial system - especially during periods of financial distress/ crisis - as it will help to foster and restore (if needed) financial stability

- Benefits:
  - improved assessment of key systemic risks stemming from the financial sector and that could spill over into the real sector,
  - enhanced early warning capabilities,
  - more coherent, adequate and timely responses/reactions of authorities
  - increased transparency

Centralized supervision: EU progresses

- At EU level there is currently no centralized supervisory body for the financial system
- HOWEVER the cooperation between local and cross border supervisory authorities has increased since the onset of the crisis: increased information sharing, Memoranda of Understanding
- In September, the European Commission adopted the legislative proposals to strengthen financial supervision in Europe by creating:
  - European Systemic Risk Board - ESRB (macroprudential supervision)
  - European System of Financial Supervisors ESFS (microprudential supervision)

Regulation has costs for banks

- New regulations are meaningful in a global economic and financial system if they are introduced worldwide.
- A properly functioning and high quality bank supervision is when it supports our business rather than impede it.
- The RZB Group produces 65,000 pages of reports every year. We are very much for qualitative improvement of supervision and controls but definitely against such measures if they take into consideration exclusively quantitative aspects (ex. instead of 65,000 pages perhaps 140,000 pages).
- Cost components of banking activity
  - Risk costs
  - Administrative costs
  - Costs of funding
  - Cost of minimum reserves – can be quantified
  - Other costs which are difficult to quantify: regulatory costs (BNR, ANPC), other legal costs.
- Moving to a centralized supervision would reduce regulatory costs

Regulation has impact on banking costs

Cost components (% of total loans)	Drivers	Outlook (short – medium term)
Risk costs	Improvement/ deterioration of portfolio credit quality as a result of: ***Direct factors*** • Economic growth (domestic) sets on in 2010 (-)/ is delayed (+) • Exchange rate appreciation or stabilization (-) vs depreciation (+) • Decreases (-) vs increases (+) in interest rates • Rise in unemployment (+) • Negative or zero credit growth (+) ***Indirect factors*** • External markets bottom out in Q4 2009 (-) or later during 2010 (+) • Persistence of political instability (+) • The government high financing needs (pressure on interest rate and cut of the public sector wages) (+)	**•Balance of risks are inclined towards an increase in cost of risk**
Administrative costs	• Implementation of various cost cutting strategies (-) • Credit growth (-) or decline (+)	**• Balance of risks are biased towards a decrease in administrative costs**
Cost of reserve	• Impacted mainly by the monetary policy decisions regarding the minimum reserve requirements • Decrease (-) / increase (+) in funding rates (EURIBOR+CDS, ROBOR)	**•Balance of risks are biased towards a decrease in costs of reserve**
Cost of funds	• Decrease (-) / increase (+) in base rates (EURIBOR, ROBOR) • Perception of country risk as implied by CDS (i.e. positive dynamics will increase cost of funds and vice versa)	**•Risks are relatively balanced, implying a stagnation for the cost of funds at current levels**
Remaining profit margin	• Residual component, that is affected by the dynamics of the previous cost components • It is fixed at loan origination, by taking into account the estimated values of the previous cost components.	**• Neutral, as it is a residual component**

- **Other costs which are difficult to quantify: regulatory costs (BNR, ANPC), other legal costs.**

Cost of funding below its peak from Q1 2009, but still at high levels

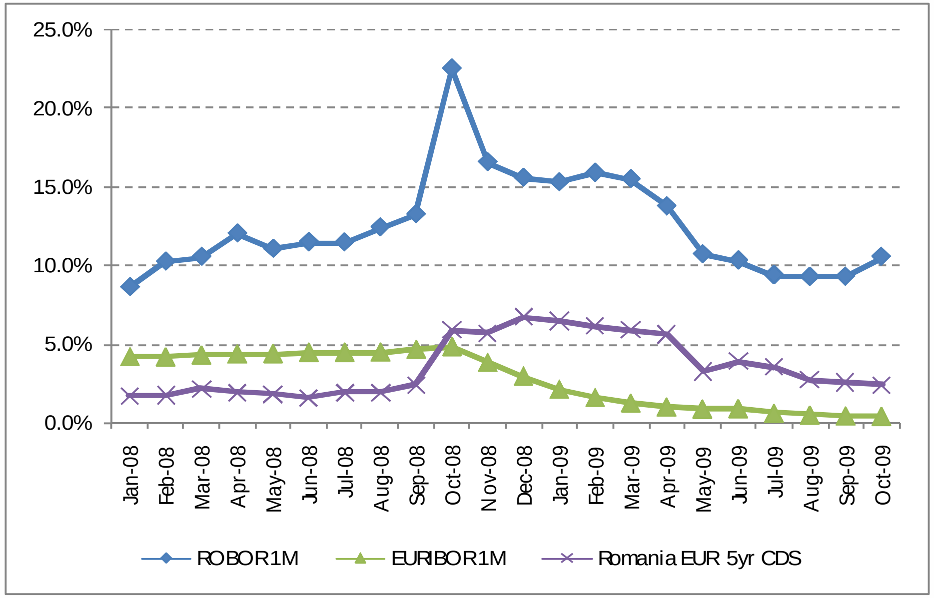
- Cost of funds for resources attracted from deposits and money market increased rapidly since the beginning of the crisis and reached a peak in the first quarter of 2009; since then funding rates have been decreasing steadily

- ROBOR rates started to increase in October as Government's high borrowing requirements put pressure on money market rates

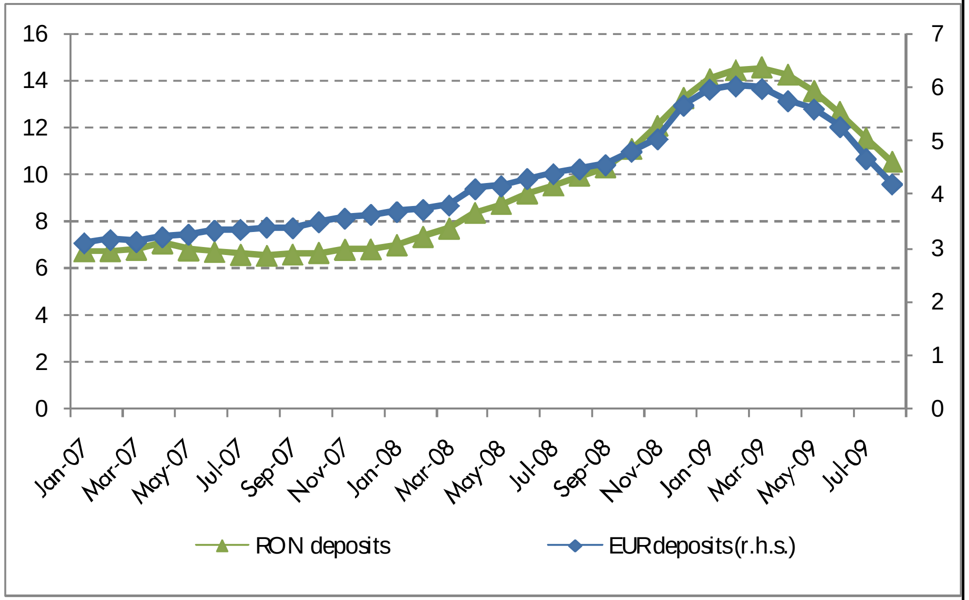
- Deposit rates have decreased by the end of the first half of 2009 to pre-crisis levels

- CDS spreads are still high – political risk

Money market funding rates

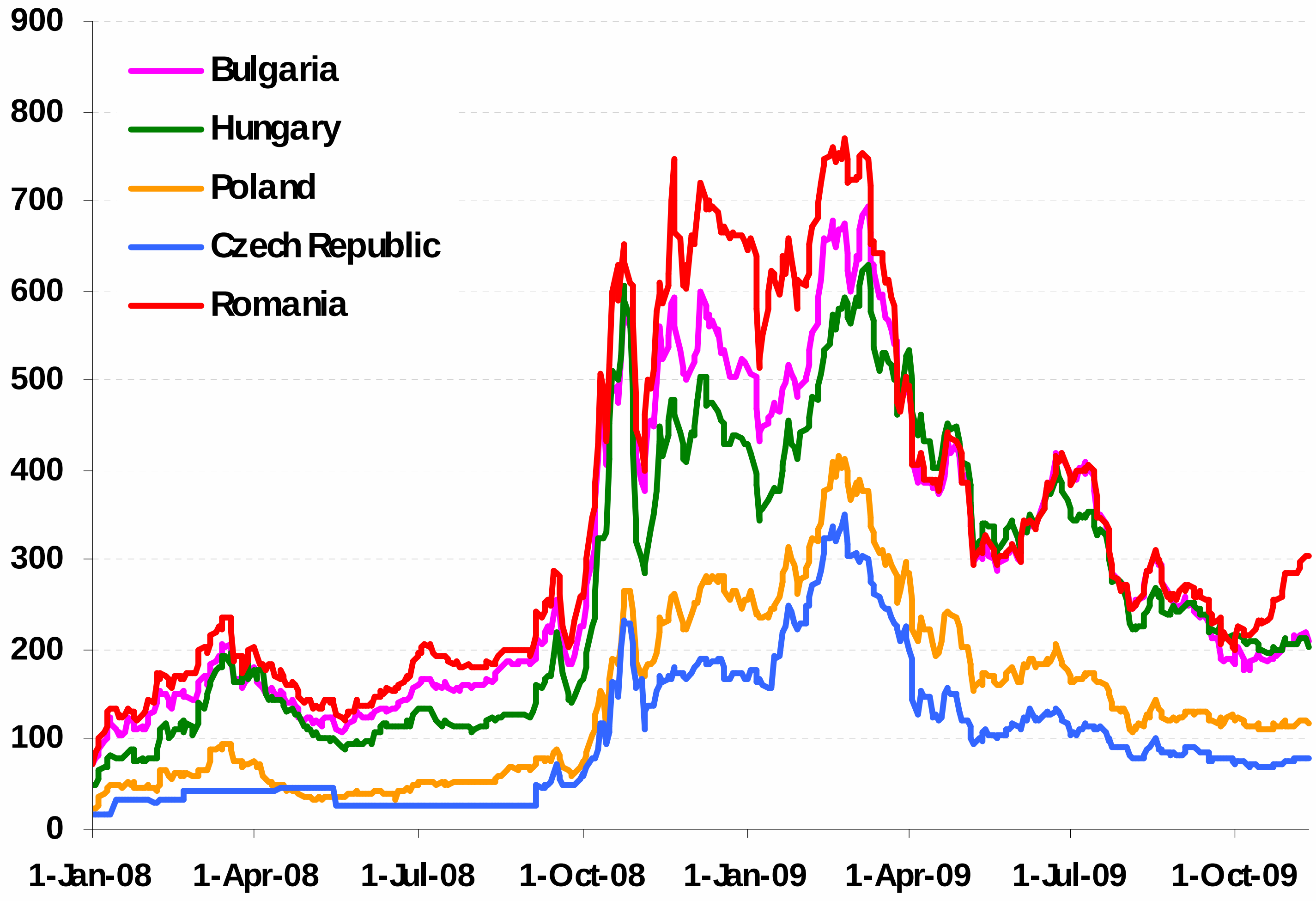


Average interest rate on existing deposits



Source: NBR, Raiffeisen RESEARCH

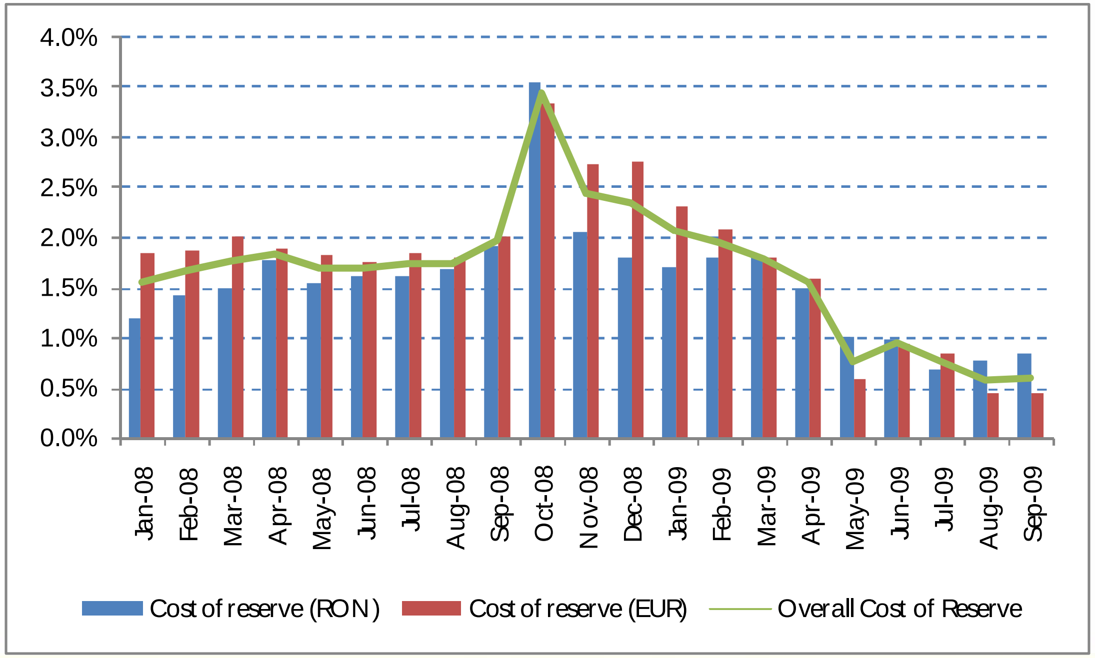
CDS spreads are still high – political risk



Cost of reserve has been eased down by the NBR

- **Following two consecutive cuts in the minimum reserve requirements for both LCY and FCY resources, the cost of reserves declined abruptly in the first half of 2009.**
- **For 2010 we estimate further reduction in minimum reserve requirements which will further depress the reserve cost**

Cost of reserve dynamics



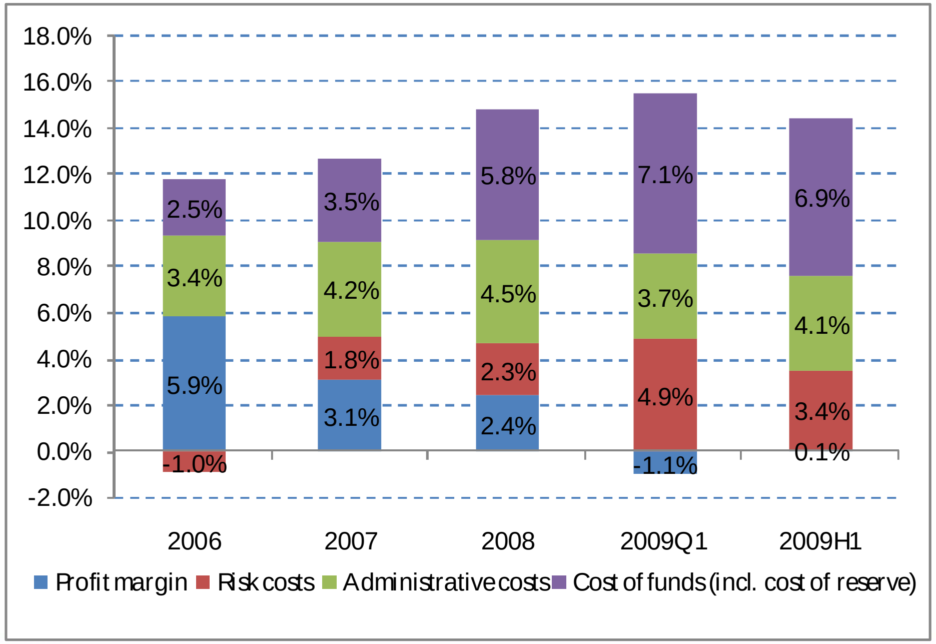
Cost of reserve= Minimum reserve requirement * (Funding rate(EURIBOR+CDS or ROBOR) – Reserve remuneration rate)

Source: NBR, Raiffeisen RESEARCH

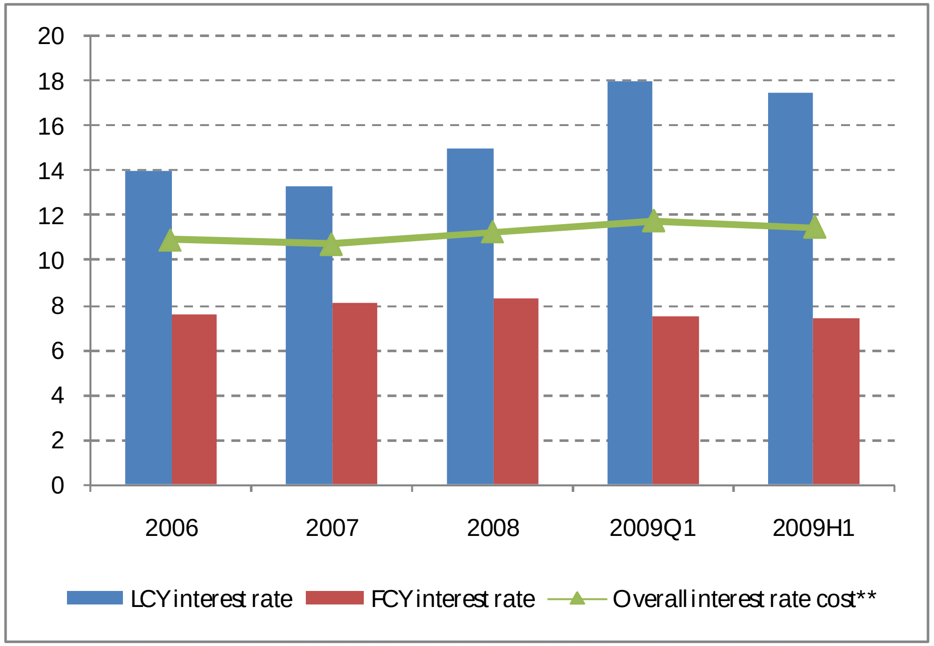
Cost of credit in Romanian banking sector remains at elevated levels

- Overall cost of credit in 2009H1 stayed at levels close to the ones from 2008, HOWEVER on the allocation side the structure of its components changed: (i) increase in cost of risk, (ii) increase in cost of funds, (iii) decrease in profit margin.
- Average interest rate for LCY loans increased in 2009H1, recording a slight decrease in case of FCY loans

Overall cost of credit* by components (avg.)



Cost of credit: interest rate (avg.)



***Includes both interest income and fees and commissions and refers to both FCY and LCY loans**
**** Average weighted interest rate by the level of FCY and LCY loans**

Source: NBR, Raiffeisen RESEARCH

Risk and Funding costs squeezed banks' profit margin

+ The surge in non-performing loans determined an increase in banks' provisioning costs

+ Cost of funds increased as a result of more expensive financing resources – related to interest rates developments on the domestic money market and to a rise in country risk premium

- Cost of reserve has been eased by the NBR which operated two consecutive cuts in minimum reserve requirements for both RON and FCY resources

-Administrative costs** have been reduced by banks which started to implement various cost cutting strategies

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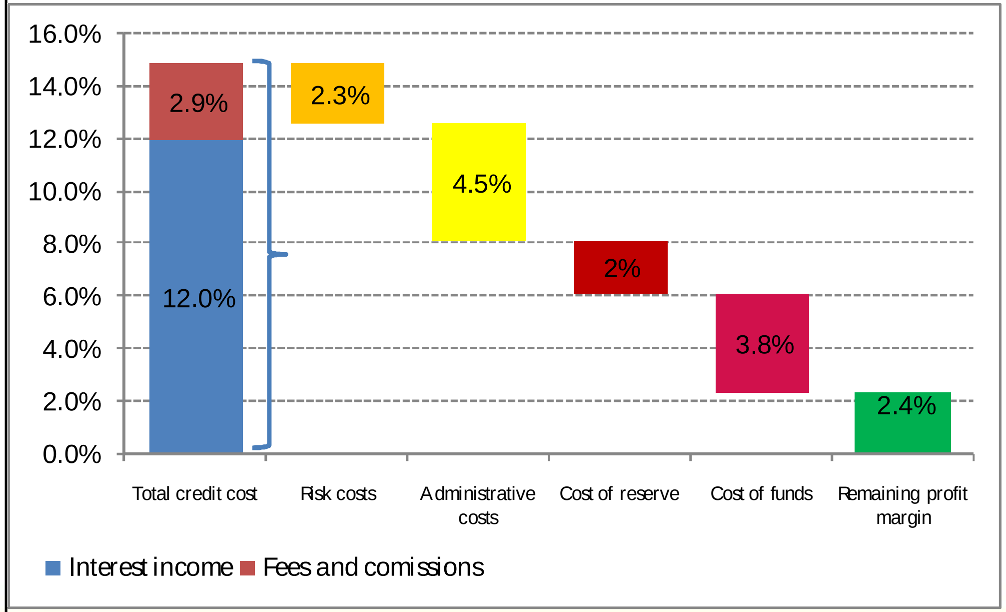
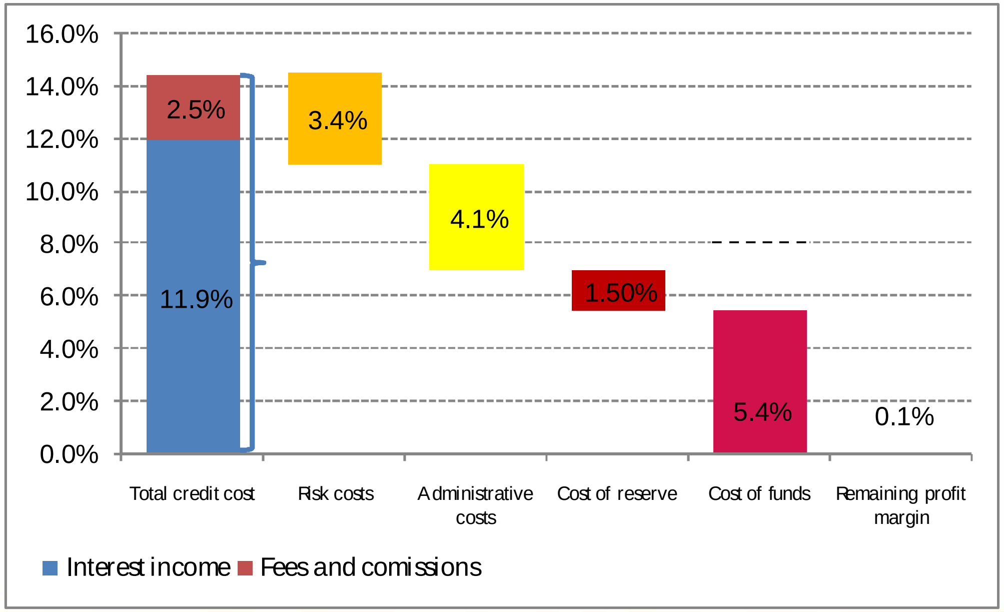
= **Average net profit margin in 2009H1 has been wiped out**

Cost of credit* components (2008 avg.) (% of total loans)



Cost of credit components* (2009H1 avg.) (% of total loans)



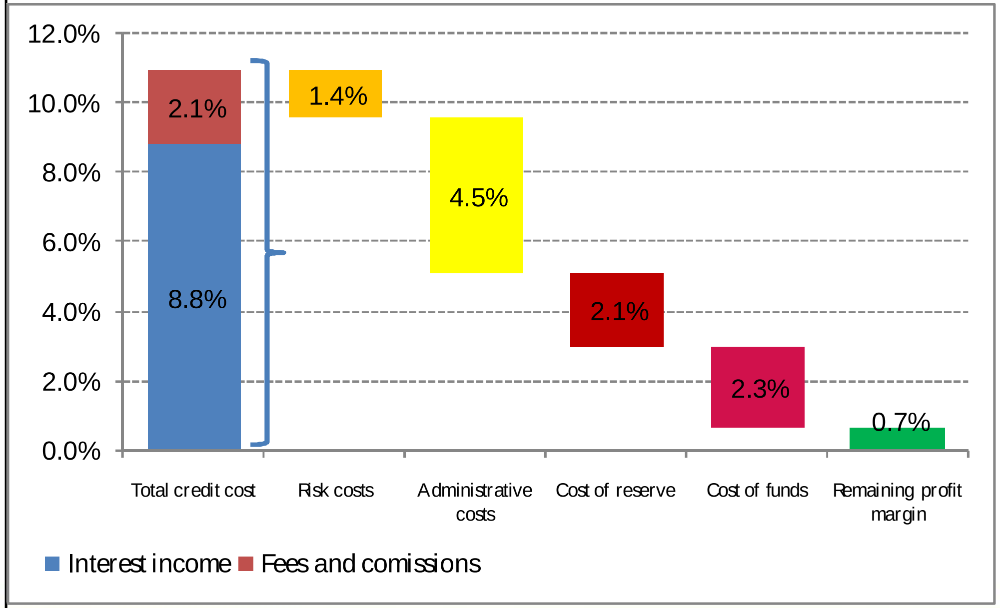
***Includes both interest income and fees and commissions and refers to both FCY and LCY loans**
**** Administrative costs include: Personnel expenses + Depreciation + other administrative expenses + Taxes**

Source: NBR, Raiffeisen RESEARCH

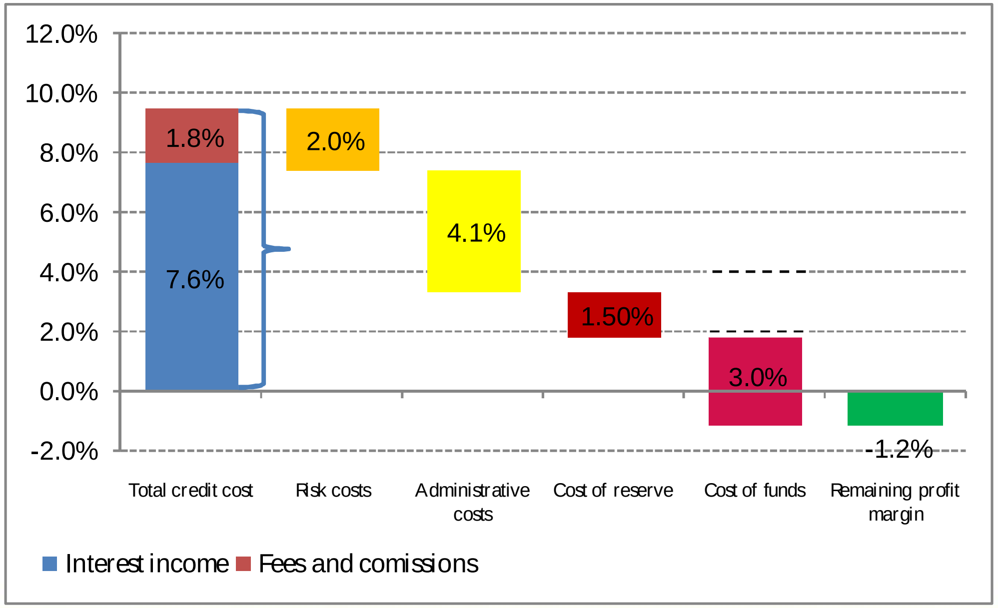
Currently, the cost of credit for FCY loans does not ensure a positive profit margin for banks…

- Higher risk costs, increase in cost of funds and decrease in interest revenues lead to **a negative profit margin** in case **of FCY loans in 2009H1,** despite a decrease in reserve costs
- Increase in cost of funds determined by (i) higher risk premium (CDS) and (ii) a higher cost for the deposits attracted from domestic market
- Decrease in administrative costs.

Cost of credit* components (2008 avg.) (% of total loans)



Cost of credit* components (2009H1 avg.) (% of total loans)



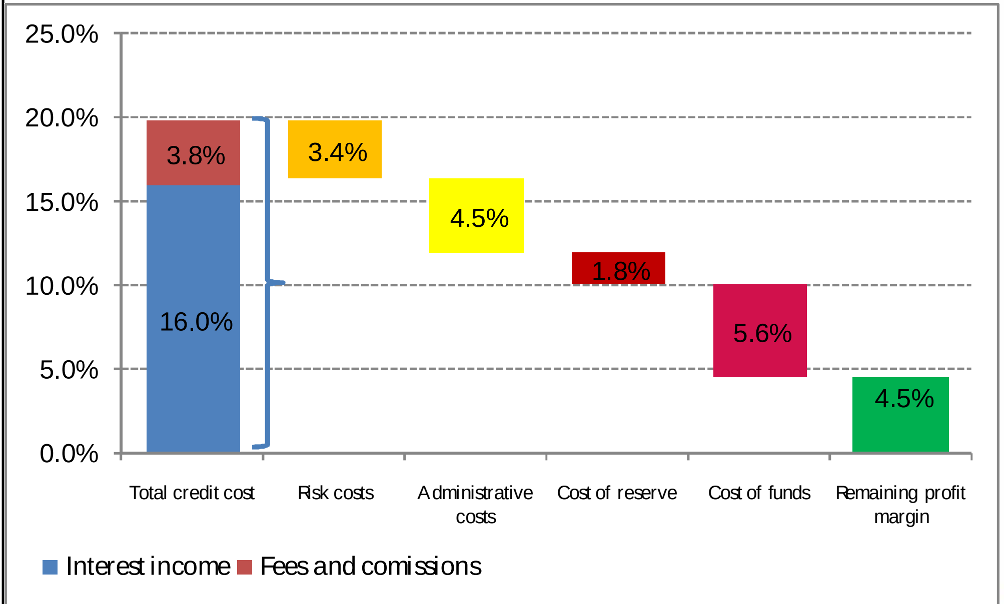
***Includes both interest income and fees and commissions and refers to FCY loans**
Cost of funds = Effective cost of FCY resources- Cost of reserve

Source: NBR, Raiffeisen RESEARCH

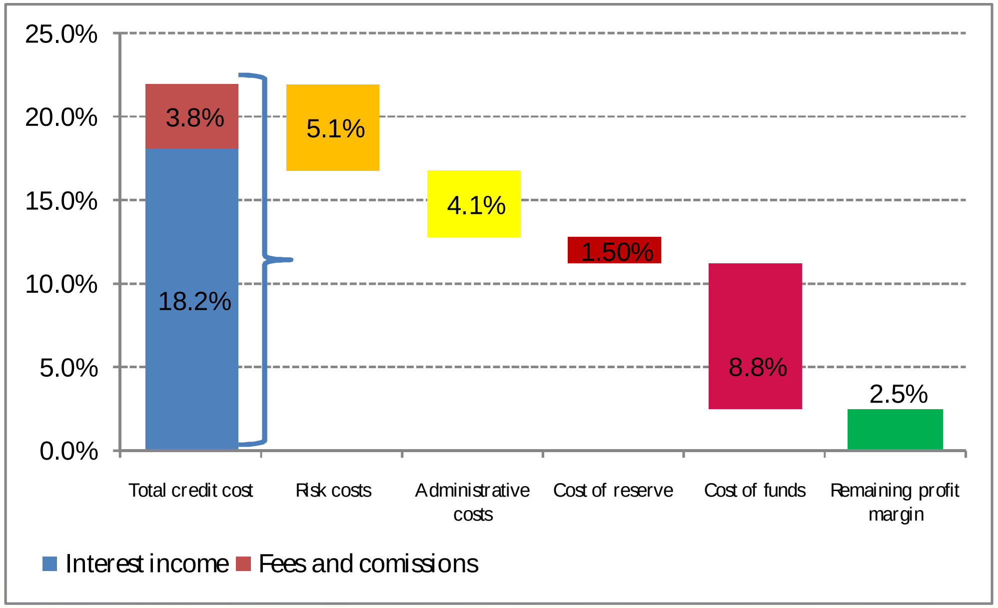
…in case of LCY loans profitability remains in the positive territory

- LCY loans generate higher risk costs than in case of FCY loans
- Interest income and cost of funds increased in 2009H1 relative to 2008 due to more tight liquidity conditions on the money market
- Decrease in administrative costs.

Cost of credit* components (2008 avg.) (% of total loans)



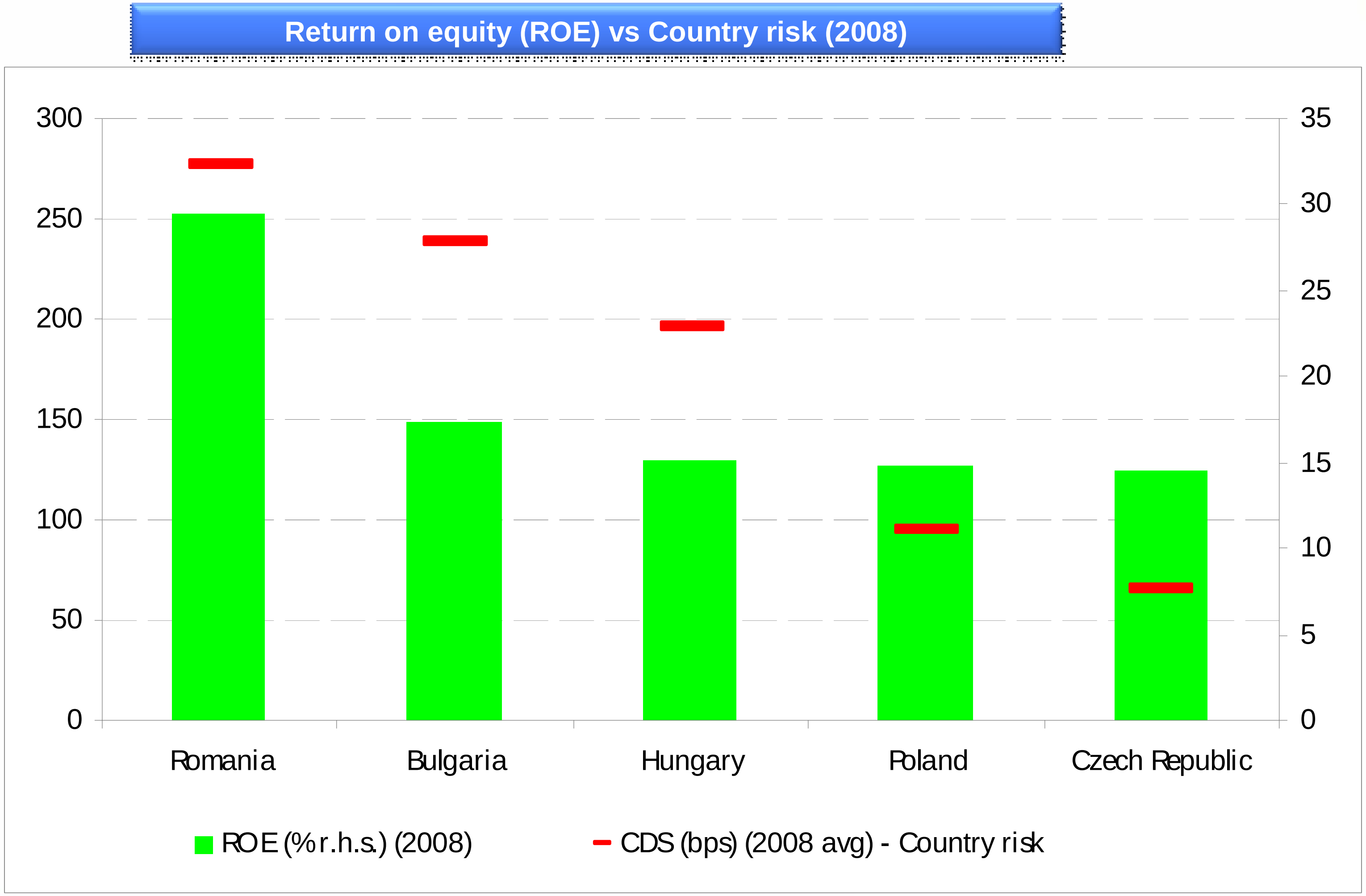
Cost of credit* components (2009H1 avg.) (% of total loans)



***Includes both interest income and fees and commissions and refers to LCY loans**
Cost of funds = Effective cost of FCY resources- Cost of reserve

Source: NBR, Raiffeisen RESEARCH

Risk-adjusted return



Source: ECB, Bloomberg