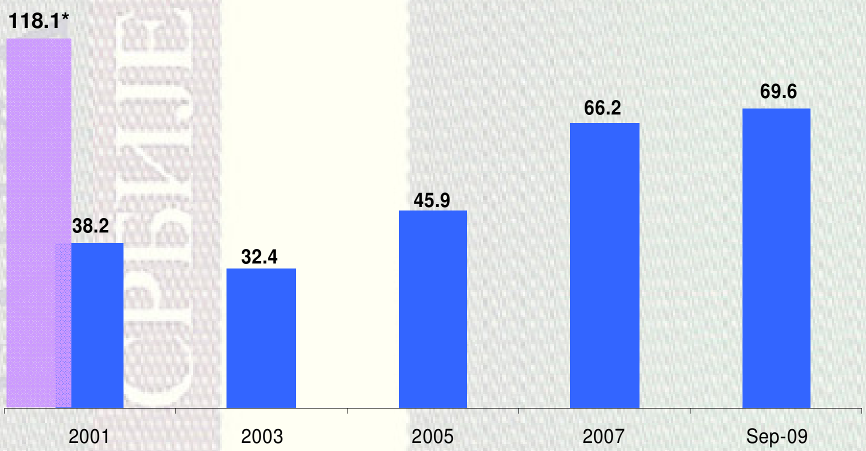
Supervision and enforcement of good practice

Radovan Jelašić – Governor, National Bank of Serbia

Belgrade, December 9th, 2009

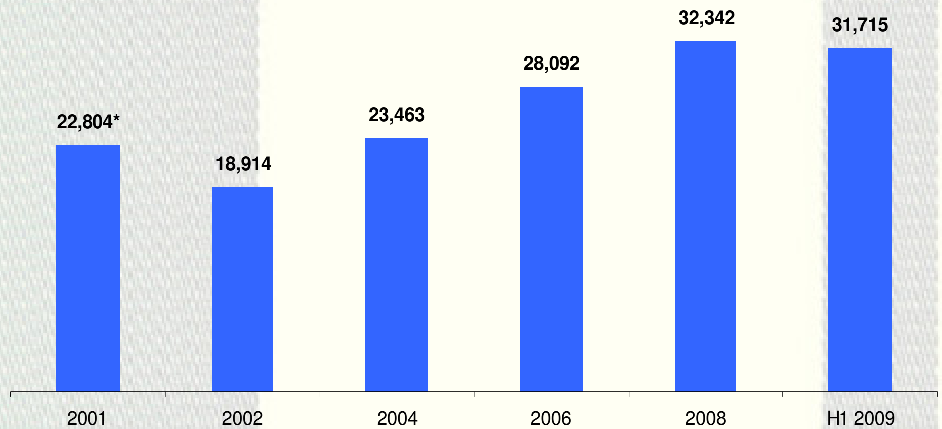
Serbia’s banks from a liability became an asset to the economy

Balance sheet as a % of GDP



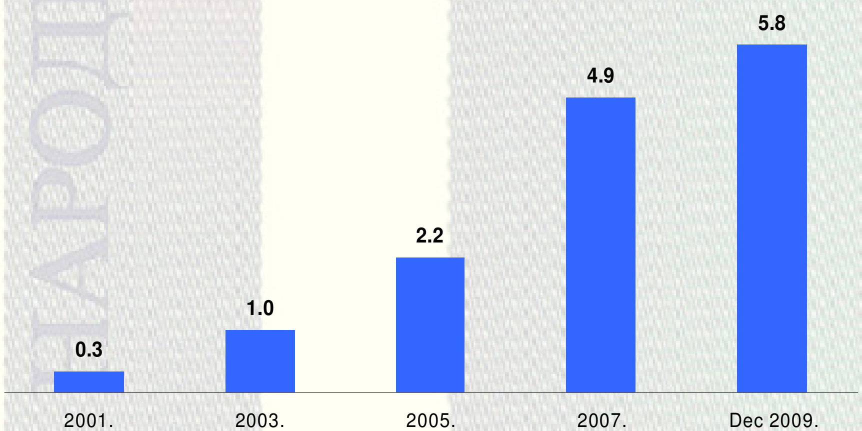
* Including 4 large state owned banks closed in January 2002

Number of employees in the banking sector

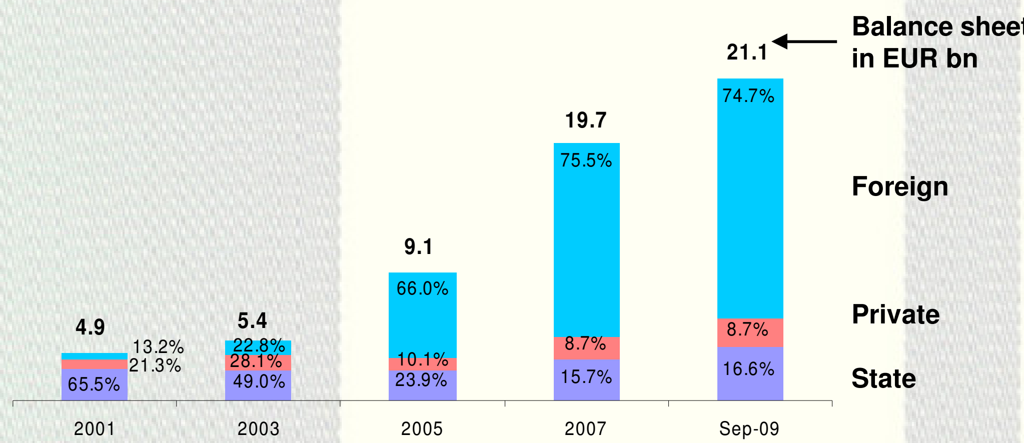


* Including around 8,000 employees of 4 large state owned banks closed in January 2002

Citizens savings
(in EUR bn)



Ownership structure of the Serbian banking sector



Generally, countries like Serbia, do need a stronger buffer for the time of a potential crisis

Why a larger buffer?

- Long history of macroeconomic instability, such as: a) high inflation, b) fixed exchange rates for a limited time period, c) rigid fiscal policy, …
- Complete failure of financial system in the 90s including pyramid banks;
- No EU membership (candidate) status;
- Low understanding for market participants ("foreign owned" banks operating in Serbia are "Serbian banks"!)
- Exponential credit growth, especially to private individuals (usually long term, unhedged, FX indexed borrowing)...
- High overall euroization level while operating under flexible exchange rate regime;
- Corporate governance that needs improvement;

What type of buffer?

- Macroeconomic: a) program with the IMF, b) improved ownership structure of the banking sector…
- Prudential: a) higher capital adequacy ratio (23.2% as of 09/2008, while regulatory minimum is at 12%); b) Conservative supervisory credit risk assessment e.g. market entrance, provisioning levels, governance (executive, directors and supervisory boards)
- Monetary: a) higher reference rate in order to make high level of liquidity more attractive (14% of the balance sheet as of 09/2008 in NBS repo); b) high reserve requirement ratio;

New times and new ownership means new challenges for the supervisor …

Before

- Banks were functioning as
  - one man show
  - state service – banks were obliged to provide loans at a predefined price to a known client;
- Banks were founded in order to secure loans to the owner of the institution;
- System protected debtors not borrowers;
- There was no risk assessment;
- Absence of: corporate governance – internal control or audit, independent board members, effective ownership, transparency;

Today

- In addition to new laws regulating the banking sector, new ownership also brought new rules e.g., goal of banks is only and mainly profit;
- Bankers are aware of their responsibilities as private individuals;
- Lending to bank-related parties limited as well as total exposure to single client or related parties;
- Prescribed principles of corporate governance such as a) internal control, b) internal audit, c) compliance function, d) board structures
- Risk management function established;
- Transparency given importance and emphasized continuous enhancement!

Economic crises revealed certain weaknesses of the banking sector in Serbia

- Banks without a major strategic shareholder could pose a potential threat as banks ownership does not represent only a right to a dividend and higher price but also an obligation to provide additional capital, especially in the times of crisis;
- Home and host supervisory cooperation need substantial enhancement, MoU's did not fulfill the expectations;
- Countries of origin have a significant impact on the activities of banks in Serbia - worsening economic environment on the home market increases funding costs and that makes the banks less competitive;
- International news made the life of supervisors considerably more complicated!

State ownership still represents a challenge for the supervisor

- State owned banks would like to be “liked” by supervisors the same way as they are “liked” by the government;
- State owned banks are also part of the political/economic distribution of power after the election;
- Membership in the board of directors is understood not as a professional responsibility but as a “thank you” for political support!
- Plans regarding state owned banks are hardly ever finished on time;

But the same could be told to majority of state owned banks abroad as well!

Corporate governance improved substantially, but there still a long way to go!

- For the full implementation of corporate governance the form is there, the essence still needs improvement;
- Banking sector has instituted strategic goals as a guiding framework of business activities;
- Internal audit and internal control systems have been set up in line with the overall organizational strategy;
- Risk management function is developing (there is obvious need for timely identification of risks – “risk before sale” – not only during crisis; there is growing importance of developing internal risk models rather than relying on traditional ones such as rating agencies…);
- Boards are recognizing and establishing systems of internal audit and compliance at functional and effective level of organizational structure;
- Board membership caries primarily responsibility, decisive power and only then a right to financial remuneration;