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ON THE IMPACT OF LEGISLATIVE RISK ON BANKING ACTIVITY

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Abstract: *The operational risk, at the banking level, is the one that includes the risks that can be generated, for a credit institution, by changing the relevant regulations. Legislative changes in recent years have had a significant impact on banking activity. Thus, a legislative risk is highlighted, resulting from less proper regulations, the effects of which can be seen on the banking system. From the analysis of such regulations, we observe, on the one hand, the aspiration of the Romanian legislator to align the Romanian legal system to the Union law. On the other hand, we see the need for better collaboration between the legislator and the representatives of the banking system, so that the principle of legal security is not affected.*

Key words: *Operational risk, legislation, credit institutions.*

1. Incidental risks in banking activity

Credit institutions are those subjects of law indispensable to a modern market economy, their activity mainly consisting in the trading of money. Most market participants turn to credit institutions to obtain the necessary financing to start business projects, to increase or diversify ongoing projects or even to support current activities. The entire economy is connected to the financial-banking system and its efficiency depends on how credit institutions manage the continuous flow of money. This is also the reason why credit institutions are said to be subjects of major importance, being considered “too big to fail”.

The banking activity is a particularly complex one, facing a series of challenges, which is why it requires a prudent, efficient, competitive management. Within this complex management activity, banking risk management tends to gain increasing importance.

In economic activity, in general, the risk consists in the possibility of not achieving the expected profit or in the possibility of recording some losses, as a result of the occurrence of some events with a negative impact on the activity.

Banking risk is the risk that a credit institution assumes by carrying out its characteristic activities, it is "the element of uncertainty that can affect the activity of the banking company or the performance of an economic-financial operation".

Risk management is a process of analysis and application of known techniques and

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methods for identifying potential risks, knowing and evaluating them, preventing their occurrence, reducing them, managing them prudently, combating negative effects in case of risk occurrence.

Banking risks are most often classified into financial, commercial and environmental risks.

Financial risks are specific to the lending activity, being included in this category: credit risk, interest rate risk, liquidity risk or insolvency risk.

Commercial risks result from the non-adaptation of credit institutions to the new requirements of the market, respectively to its new products and services. Included in this category are: market risk, product risk or image risk.

Environmental risks, such as economic risk, regulatory risk or competitive risk, are more difficult for banks to counter, they are risks for which they have limited solutions (Pîrvu, 2016, p.121-124).

In relation to the field in which the risks can intervene, they can be classified into legal risks, operational risks, systemic risks and settlement risks.

2. Regulatory risk – component of operational risk

The operational risk is the one that can generate direct or indirect losses, as a result of maladaptation or procedural or system errors or resulting from external events. This risk depends in each case on the internal structure of the institution, on the operations carried out, the strategies applied and the decisions of the management.

Operational risk management requires assessing, monitoring, reducing risk internally by collecting detected errors, using appropriate processing techniques and ensuring information security (Popescu, Iacob, Dabija, 2020, p.45).

In the event of an operational risk, it is advisable to develop plans to resume the activity as quickly as possible.

Operational risk includes legal risk. The legal risk manifests itself in the conditions of the incorrect or inconsistent application of the legal provisions that affect the banking activity. Monitoring and eliminating the effects of legal risk requires the involvement of banking companies in the training of quality legal personnel. It is recommended that any credit institution have effective information systems in relation to the legal provisions with banking incidence and their correct application.

Perhaps more than any other field, the banking environment is heavily burdened by intensively modified, relatively dissipated legislative provisions, which gives legal risk new valences (Socol).

At the same time, legal risk can also be generated by insufficient, contradictory or unstable regulation. Under this aspect, we can say that a component of legal risk is regulatory risk.

Regulatory risk is closely related to the principle of legal certainty. This principle is characterized by the fact that the law must ensure the protection of the legal subjects against a possible danger that may come from the legal norms themselves, against a possible legal insecurity that the legal norm can create or that it risks creating. Compliance with the principle of legal security leads to the avoidance of risks that could result from: the retroactivity of the law, the appearance of legality, the unpredictability of the law, legislative inflation, legal acculturation or even the obscurity of the texts of legal norms (Ciongaru).

3. Current examples of normative acts that can generate a regulatory risk

In a recent study, it was highlighted that during the period 2014-2018 the unpredictability of the banking legislative framework increased, through the year-on-year increase in the number of laws and regulations adopted (approximately 50 laws) (PWC study, 2019).

3.1. An example of regulatory risk is the Government's Emergency Ordinance no. 114/2018 regarding the establishment of some measures in the field of public investments and some fiscal-budgetary measures, the modification and completion of some normative acts and the extension of some deadlines. The ordinance introduced a tax that applies strictly to banking institutions, defined as credit institutions, Romanian legal entities and branches in Romania of credit institutions of foreign legal entities (in the initial proposal, the tax would have been applicable to IFNs or other financial institutions). The asset tax is due quarterly by applying progressive rates on the balance of financial assets existing at the end of the calculation quarter.

It is estimated that the impact of the ordinance has materialized in the reduction of financial intermediation (credits of companies and the population in relation to GDP) from 40% to 26%, staff reductions and branch closures in proportions of over 25%. Although the effects of the ordinance were reduced by GEO 19/2019 for the modification and completion of some normative acts, GEO 114/2018 is still considered “the biggest blow received by the banking industry and, thereby, the financing of Romania” (Danescu, 2019).

3.2. Although we do not yet have an act in force in this regard, we also mention in the category of examples of regulations that can generate a considerable risk for banking activity, the draft laws from 2015, 2018, 2021, which sought to remove the enforceability of contracts of credit granted to consumers.

The elimination of the enforceability of these contracts would have led to the difficulty of the procedure for forced execution of the arrears, by increasing the duration of the recovery of the claims, and as a consequence, to the increase of the rate of non-performing loans. The same measure would have generated, at the same time, an additional burden on the judicial system and additional court costs, which would have been borne by the consumers.

Through Decision no. 59 of January 26, 2021, the Constitutional Court, referred to the objection of unconstitutionality of the provisions of the Law for the amendment and completion of Government Ordinance no. 51/1997 on leasing operations and leasing companies, expressed, not for the first time, the opinion regarding the appropriateness of the enforceable nature of such contracts. The Court specified that "the enforcement title does not concern the quality of the creditor or the debtor, the reasons underlying this legislative measure being varied: the lack of complexity of some legal operations in which the creditor's claim is, as a rule, certain, liquid and enforceable or the frequency of use in the private environment (for example, invoices issued in the execution of contracts with utility providers or R.C.A.-type insurance contracts), but also economic reasons - enforceability ensuring the dynamics of the civil and commercial circuit.

The legislator's option regarding enforceability was dictated, therefore, by reasons of economic policy, but also by reasons related to a good administration of justice, so that the economic and the legal imperative are harmonized, respecting, on the one hand, the demands of the state of right, and, on the other hand, the requirements of a functional market economy.

Reasons of an economic nature give life to the state's positive obligation to ensure freedom of trade [art. 135 paragraph (2) letter a) of the Constitution]".

3.3. In the same category of normative acts generating risks for banking activity, it is also worth mentioning the legislative proposal on the protection of consumers against speculative assignments of receivables.

According to the project, any transfer of a claim or portfolio of claims from a financial creditor to a third party, including a debt collector, is a speculative debt assignment, a transfer that does not have an equivalent in a real economic fact or that is not carried out from reasons for mobilizing commercial receivables, for re-financing the financial creditor or for the creation of financial guarantees. They are included in this category:

- the transfer of a portfolio of claims from the financial creditor to a branch or its affiliate, accompanied by an administration or management mandate and the collection of the portfolio of claims by the transferor in favor of the transferee;
- assignment of receivables or portfolios of receivables perfected to increase the solvency index of the financial creditor;
- assignment of receivables completed to reduce the tax base or charge of the financial creditor.

Article 4 of the draft stipulates that in the event of a speculative debt assignment, the assignee will not be able to claim from the consumer either voluntarily, or through forced execution or in court, more than the real price of the assignment, to which the expenses and the actual costs of the contract and the interest from the day when the assignee paid the assignment price.

According to Article 5 paragraph (1), the assigned debtor, who has the capacity of a consumer, will be able to release himself from the debt, both in relation with the assignee and in relation with the transferor, by paying the assignee the sums shown in art. 4. The reason for this regulation, according to the legislator, is to thwart the transferee's intention to speculate or to balance the legal relations with the transferee's creditor.

These provisions have been rightly criticized by experts in the field. Debt assignment represents for credit institutions a means of improving their prudential indicators and freeing up financial resources, but also a way of improving risk management, as well as reputation by increasing the quality of their assets. On the other hand, the assignee, usually a specialized institution, buys receivables at a much reduced value, thus obtaining a high return on their recovery from the assigned customers (Bichi).

We find that the regulation mentioned above would practically eliminate the possibility of the assignee to make a reasonable profit from the assignment, a fact that would lead to the loss of interest in such an agreement. We must not lose sight of the fact that the difference between the nominal value of the claim and its transfer price is also justified by the uncertainty regarding the duration and costs of the claim recovery procedures, which the transferee bears, as well as by the uncertainty regarding the quality of the purchased assets (KPMG study for ARB, 2020).

3.4. The draft law on the protection of consumers against currency risk in credit contracts, adopted by the Senate on December 11, 2019, is another draft normative act that can be criticized. Through the said project, it was intended to apply the conversion of credits into foreign currency at the exchange rate from the date of conclusion plus a maximum variation of 20 percent, the scope of application including both new credit contracts and ongoing contracts, including those that have been assigned / outsourced. This regulation would thus have generated a situation of retroactivity and would have exposed the credit institutions to an additional risk, which could not have been taken into account when determining the interest rate applicable to the loan.

The draft law was criticized by the NBR, which assessed that its provisions lead to the violation of some constitutional rights and some fundamental principles of law and, as it also covers loans in progress, will increase legislative uncertainty in the financial-banking field, accentuating the systemic risk, already flagged as lifted (National Bank of Romania, 2019).

4. Conclusions

The normative acts presented by way of example, even in the form of legislative projects, highlight the instability of the normative system aimed at the sphere of banking activities. Such instability and unpredictability of regulatory provisions significantly affects lending activity and investor confidence.

The regulatory risk is reflected in the quality and cost of banking products, leading to the tightening of lending conditions, which will in turn lead to an increase in the number of non-performing loans and a decrease in the profits collected by credit institutions. However, not only credit institutions will be affected, but also investors and the population.

As far as investors are concerned, the tightening of credit conditions leads to a decrease in investments or to the identification of alternative sources of financing, and as far as the population is concerned, it obviously leads to a decrease in the purchasing power of the population.

We believe that through its actions, the legislative power seeks to align national legislation with the trends drawn at the EU level, the EU developing in recent years more and more rules to protect the safety and rights of consumers, including in very dynamic areas such as online trade, energy supply and financial services. The desire of the legislator to offer increased protection to consumers is to be appreciated. But the legislator must remain equidistant and seek to achieve a balance between the general and the private interest. Although credit institutions are currently viewed by consumers as a necessary evil, their role in the economic development of the state cannot be disputed. That's why any measure that can lead to jeopardizing the activity of banking institutions must be fully justified.

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