National Committee for Macroprudential Oversight

Analysis
of the
NCMO Working Group
on supporting green finance

1 Overview, key conclusions and proposals for recommendations

At international level, many voices argue that the climate change agenda offers **the greatest economic opportunity of our time**. The beneficiary areas are quite diverse: energy, energy efficiency, transport, agriculture, etc. The financing volume for climate change mitigation is estimated by the United Nations at USD 830 billion per annum until 2050 in the energy sector alone, with a relatively balanced distribution between the advanced and the emerging economies.

The stakes of climate change and green investment for the Romanian economy are high in terms of both opportunities and costs if this transition is delayed.

First, according to the Working Group's calculations, the value of green projects that are expected to be implemented by the public authorities and the private sector by 2030 is considerable — **almost EUR 60 billion** (and is seen rising after the adoption of the EU's *Fit for 55* package). By comparison, the amount represents the total public investment over the past eight years (EUR 63.5 billion, 2013-2020) or the total allocations of EU funds in the last two multiannual financial frameworks (EUR 64 billion, 2007-2020). Some projects are expected to benefit from EU funds, and the stimulative effect in the economy could be significant. For example, according to our calculations, successfully raising green grants under the *Next Generation EU (NGEU)* programme would have a cumulative effect on economic growth between 1.9 and 2.3 percentage points in the 2021-2026 period. In the case of implementing green investment projects funded by all EU resources that could be raised (including NGEU borrowings and the amounts allocated under the 2021-2027 Multiannual Financial Framework), **the additional impact on medium-term growth could reach as high as 5.7 percentage points in the next six years**. Unemployment rate could decline by 1 percentage point in the period from 2021 to 2026, with the strongest effects already expected to be manifest between 2022 and 2023. However, in retrospect, the authorities' capacity to make full use of EU resources is not encouraging, as Romania managed to absorb in the first six years of implementation (a period normalised to that of the NGEU) about 39 percent of the total volume of allocations in both the first European financial framework (2007-2013) and the second (2014-2020). There is room for Romania to enhance the rate of absorption of EU green funds. In addition, one of the solutions envisaged in the report is a more significant involvement of the private sector in the flow of funding (from domestic and international financial institutions).

Second, **the companies in carbon-intensive sectors play a notable role in the economy**: they generate more than 40 percent of the value added and hold over 50 percent of corporate assets. Hence, preparing an orderly transition is of the essence, otherwise the economy may be exposed to considerable disruptive effects in the years ahead. Such effects may also affect the sovereign rating (currently bordering investment grade), since specialised agencies have already started to monitor climate issues in their credit ratings.

In order to reduce the role of companies in the carbon-intensive sectors, it is recommended to support the entities that contribute significantly to achieving the goals on the climate change agenda. For example, the report recommends the authorities **to promote local companies that competitively produce green goods and services**. The preliminary analyses of the Working Group **identified about 100 enterprises with majority domestic capital**, which received green financing and are engaged in goods and services exports. Apart from proving competitive on foreign markets, these companies' financial soundness remains adequate, generally above the average of the non-financial corporations sector. Favourable conditions would thus be created for these companies to boost their activity and access to finance in a sustainable way if they were transparently promoted by the government, including via online platforms at European level. Through the recommendations made, the authorities tasked with supporting domestically-owned companies and encouraging exports are called upon to take a more active attitude towards these firms, *inter alia* **by resorting to Romania's diplomatic and commercial representatives from abroad**. In addition, the support to competitive companies with domestic capital, identified according to a public methodology, can be applied to other areas as well. For instance, in 2020 another NCMO working group, established to address the vulnerabilities from the widening agri-food trade deficit, published a report proposing such a methodology for relevant companies.

Third, **the competitiveness losses caused by a delayed or disorderly transition can be significant**. These losses can take various forms: from missing the opportunity of using the climate agenda to change the current economic growth pattern to not accessing sizeable EU funding sources made available to countries under very advantageous terms and, ultimately, to **higher costs for companies**. For example, according to a recent survey of the European Investment Bank, Romanian companies that do not invest in energy efficiency have already been facing certain financial restrictions from creditors. Another example comes from the analyses made in this report, which show that the delayed start of green projects (in 2024 instead of 2022) will reduce by more than a third the overall favourable effect on the Romanian economy over the medium term. Furthermore, the European Court of Auditors underlined that a **further delay in project implementation could even exert negative net effects on the economy**. One final example concerns macroeconomic equilibria. Given that many of the goods necessary for a green transition are expected to come from imports, there is a risk that the public and private sectors will borrow heavily, the net effect being the creation of new job vacancies in trading partner countries, as Romania does not produce or does not have enough competitive advantages to produce such goods. Our calculations show that, in the absence of any countermeasures, the **current account deficit-to-GDP ratio would additionally worsen by as much as 1.2 percentage points** in the medium term (until 2026). Mitigating the risks of competitiveness losses due to a delayed or disorderly transition calls for **an industrial policy** harmonised with *A New Industrial Strategy for Europe* developed by the European Commission in 2020, updated in May 2021, with a focus on the green transition and digitalisation.

Fourth, **making the most of the climate change agenda may create a number of opportunities**. Among the most relevant are the structural shift of the economy to a higher value added economy and the positioning of Romania as an attractive country for foreign direct investment in the green sectors, given the progress made in the recent decades (the largest reduction in greenhouse gas emissions in the region over the past 30 years, as well as compared to the EU average, the most extensive plans for the share of renewable energy in total energy sources, etc.). This positioning would entail a strategy supportive of **a local substitution of global production chains**, in line with similar concerns of the European Commission as regards the six strategic areas where the bloc relies on external suppliers. The report recommends devising such a strategy as part of an industrial policy by end-2021.

Romania has neither built a clear perspective of the sectors to focus on in the context of climate change, nor has an industrial policy to gear it. Given **Romania's richer experience in the energy sector compared to other countries in the region and the stronger presence in the banks' portfolios of green loans granted to companies in this sector**, this report focuses on **recommendations for the energy sector**. In order to increase bank financing, the report recommends the set-up of a support scheme for tendering new renewables capacities based on Contracts for Difference (CfD) and the amendment of Government Emergency Ordinance No. 74/2020 on amending and supplementing Law No. 123/2012

– The Electricity and Natural Gas Act to allow the conclusion of bilateral agreements with certain characteristics. With a view to developing green energy, the report recommends the launch of a support scheme for new high-efficiency cogeneration capacities, as well as the revision of the Power Grid Development Plan in order to fulfil Romania's obligations to meet the renewable energy targets by 2030. In the latter case, a key part is played by Transelectrica, which should substantially revise its investment plans and implement them earlier. The Working Group's discussions reveal that the financing for such projects of Transelectrica could be readily available across the banking sector.

The stakes of climate change are high for the banking sector as well, in terms of both business opportunities and the sizeable amount of risky assets in banks' portfolio.

Firstly, the climate agenda creates significant opportunities that may involve an increase in lending. Many of the nearly EUR 60 billion worth of green investment plans do not benefit from EU or public funding, so that banks can find a broad niche to expand their lending volume. At present, **this niche is barely used. Financing to companies for green projects exceeds EUR 1 billion in banks' balance sheets** (March 2021). According to our calculations, the current sustainable borrowing potential of firms in the green lending segment is approximately lei 15 billion, which **would amount to almost 3 times** the value of the current stock in banks' balance sheets. To this would add the green loans granted to households for enhancing the energy efficiency of buildings (banks' current portfolio is EUR 0.4 billion) and to local government units for funding green projects. Preliminary estimates show that the share of green assets in the Romanian banking sector's portfolio is approximately 3 percent, i.e. less than half of the EU average (7.9 percent).

The main players in the financial system display a relatively low level of awareness of both business opportunities and challenges in their own portfolios. According to a survey sent by the Working Group, 25 percent of credit institutions assessed the exposure to transition risk, and 14 percent of them the exposure to physical risk, yet none conducted stress tests for climate risk. As for investment and pension funds, the situation is even less favourable. Under the circumstances, the report proposes that the NBR and the FSA communicate their expectations on governance, strategy, risk management, transparency and analysis of climate risk scenarios and stress tests to the entities supervised. Such measures are expected to be implemented in more and more countries internationally.

Secondly, **the vulnerabilities associated with banks' unpreparedness to the effects of the transition towards a greener economy may be high**. According to the Working Group's calculations, approximately 50 percent of corporate loans granted by banks are to firms in areas that may be affected by climate changes. By comparison, the EU average is close to 60 percent. In a baseline macroeconomic scenario, setting a carbon tax of EUR 75/tonne (an example of transition risk as the main component of climate risk) **would reduce banks' capitalisation in a range between 1.8 percent and 17 percent**, depending on the assumptions made. In addition, physical risk (as the secondary component of climate risk) is already manifest in banks' portfolios and, hence, some of them recorded losses. For example, agricultural firms that conduct their business in regions with a high risk of flooding make up 3 percent of total bank exposures to firms (36 percent of total loans to the agricultural sector) and of the sector's exports respectively. Banks' lending to agricultural firms is moderate, albeit on an increase (approximately 9 percent of the corporate portfolio), the exposure to physical risk thus being more and more relevant. In order to ensure a better management of climate risks and stimulate sustainable green financing, the report proposes that the NBR prepare and disseminate regularly a climate risk dashboard and feed the Central Credit Register database with additional information on green loans, in line with the European taxonomy.

In fact, **improving firms' non-financial reporting** on green activities **may significantly accelerate the lending process**. Starting from the draft laws on this matter published by the European Commission in April 2021, it is recommended to introduce the requirement for the dissemination of such data by large companies, as well as to encourage non-financial reporting by SMEs, the authorities being invited to prepare a simplified and digitalised reporting model.

Thirdly, the international financial institutions (EBRD, EIB, WB, etc.) have made ambitious plans concerning green financing and the expertise they have already gained in providing such funds is significantly higher than that of local banks. As concerns **Romania's partnership with the international financial institutions (IFIs), at least three adjustments are welcome**: (i) IFIs should use to a greater extent the portfolio guarantee scheme rather than credit lines in relationship with local banks, (ii) IFIs should help, where appropriate, less bankable projects become bankable and (iii) IFIs should increase the technical assistance to SMEs and credit institutions for identifying, preparing, financing and implementing green projects. The report recommends the Romanian authorities to submit, as part of the regular consultation process on IFIs activity in Romania, the proposal to consider the three adjustments previously mentioned for 2021-2025, with a view to enhance the financing of green projects. The financing of green projects by means of bank loans must be backed by the other financing channels, which see worldwide expansion: the capital market, non-bank financial institutions, **green government bonds**. The latter **is expected to generate significant volumes of financing in the medium run**. In order for this to happen, the report identifies three measures that should be implemented by the government in the following months: compiling the Sovereign Green Bond Framework, setting the eligibility criteria to identify the eligible projects for green financing, and developing the necessary expertise to issue and monitor the issuance of such instruments and to prepare and submit the annual reports until the full allocation of expenses.

Summarising the report messages concerning policy proposals, the Working Group identified **16 proposals of recommendations,** the implementation of which will be monitored in compliance with Law No. 12/2017 on the macroprudential oversight of the national financial system. This list (shown in the table below) covers three categories of measures: (i) sustainable increase in the financing of green projects, (ii) supporting structural changes in the economy towards generating higher value added and (iii) enhancing transparency and raising awareness abouth the impact of climate change on the economy and the financial system.

Proposals of recommendations addressed to authorities

No.	Measure	Institution	Deadline
A. With a view to sustainably enhancing access to finance for projects on the climate change agenda			
1	1. Communication by national authorities to the entities in their area of competence of recommendations on a prudent approach to climate risk.The recommendations shall cover at least the following areas: (i) governance, (ii) strategy, (iii) risk management, (iv) scenario analysis and stress testing and (v) transparency.	National Bank of Romania Financial Supervisory Authority	31 December 2021
2	Submit to the international financial institutions (EBRD, EIB, WB, etc.), as part of the regular consultation process on their activity in Romania, the proposal to consider the following aspects for the 2021-2025 period, with a view to enhance the financing of green projects: (i) to use, to a greater extent, the portfolio guarantee scheme, rather than credit lines, for their financing, (ii) to help less bankable projects become bankable, where appropriate and (iii) to increase the technical assistance to SMEs and credit institutions for identifying, preparing, financing and implementing green projects.	Government (Ministry of Finance)	31 December 2021
3	Create an interministerial group tasked with compiling the Sovereign Green Bond Framework, setting the eligibility criteria to identify the eligible projects for sovereign green bond financing and develop the necessary expertise to issue and monitor the issuance of such instruments and to prepare and submit the annual reports until the full allocation of expenses.	Government (Ministry of Finance, Ministry of Investments and European Projects, Ministry of Environment, Water and Forests, Ministry of Energy, Ministry of Transport and Infrastructure, Ministry of Agriculture and Rural Development, Ministry of Economy, Entrepreneurship and Tourism, Ministry of Research, Innovation and Digitalization, Ministry of Development, Public Works and Administration)	31 May 2022
4	Conduct an analysis on the opportunity of easing the prudential requirements for green finance, in line with similar concerns at European level, with a view to stimulate this category of lending, without affecting financial stability.	National Bank of Romania Financial Supervisory Authority	30 June 2022
5	Set up a support scheme for tendering new renewables capacities based on Contracts for Difference (CfD), ensuring that the project income per MWh produced is secured for a sufficient period of time.	Government (Ministry of Energy in particular)	31 January 2022
6	Amend Government Emergency Ordinance No. 74/2020 on amending and supplementing Law	Government (Ministry of Energy)	31

	No. 123/2012 – The Electricity and Natural Gas Act to allow all producers of renewables to conclude bilateral power purchase agreements (PPA) outside the centralised market, negotiating freely and directly with suppliers or end-users of electricity, with the possibility to have them concluded before the start of the construction.		January 2022
B. With a view to supporting the structural change of the economy towards one with a higher value added			
7	Develop an industrial policy focusing on the climate change agenda, phased in annually until 2025, in correlation with the European Commission's New Industrial Strategy for Europe, which targets two areas: green transition and digitalisation. The industrial policy should also include solutions for the relocation of global production chains linked to climate change, from abroad to Romania.	Government (Ministry of Economy, Entrepreneurship and Tourism)	31 December 2021
8	Assign markedly higher scores, in any support scheme provided by the authorities (state aid, guarantees from credit guarantee funds, EU funds, promotion of investments, exports, etc.), to firms that make an important contribution to the climate change agenda.	Government (Ministry of Finance, Ministry of Economy, Entrepreneurship and Tourism, Ministry of Energy, other ministries or government entities)	31 December 2021
9	Elaborate and publish a methodology for identifying companies with domestic capital that competitively produce goods and services related to green sectors. Prepare, regschmularly update and publish the list of companies identified using that methodology. Engage Romania's diplomatic and commercial representatives from abroad in promoting the companies on this list.	Government (Ministry of Economy, Entrepreneurship and Tourism, Ministry of External Affairs)	31 December 2021
10	Revise the Power Grid Development Plan in order to fulfil Romania's obligations to meet the renewable energy targets by 2030, as set forth in the 2021-2030 Integrated National Energy and Climate Plan (INECP) and the Energy Strategy of Romania. A key part is played by Transelectrica, which should substantially revise its investment plans and implement them earlier.	Government (Secretariat-General of the Government)	31 December 2021
11	Launch a support scheme for new high-efficiency cogeneration capacities whose beneficiaries will be selected on the basis of a competitive tender.	Government (Ministry of Energy)	31 January 2022
C. With a view to enhancing transparency, improving reporting and the availability of climate change-related information and raising awareness on the impact of climate change in society and the financial system			
12	Create a dashboard to monitor climate change risks to the banking sector, which should be regularly updated and disseminated. Conduct annual stress tests on climate risk-related issues and publish the results.	National Bank of Romania	31 December 2021
13	Introduce in the NBR's Central Credit Register information on green loans, starting from the European taxonomy.	National Bank of Romania	30 June 2022
14	Require large companies and recommend SMEs to publish data (the latter voluntarily), in digital	Government (Ministry of Environment,	30 June

	format (online platform), according to uniform and transparent specifications and definitions.	Water and Forests, Secretariat-General of the Government, Department for Sustainable Development)	2022
15	Encourage non-financial reporting by SMEs via: (i) the publication of a simplified reporting model, (ii) the digitalisation of reporting and (iii) the allocation of funds to increase the reporting capacity of SMEs, including by compiling guidelines. Set up an automated framework for monitoring the reporting of non-financial statements.	Government (Ministry of Environment, Water and Forests, Ministry of Economy, Entrepreneurship and Tourism, Department for Sustainable Development)	30 June 2023
16	Develop the climate change governance architecture (adaptation and mitigation), involving the relevant ministries, the Presidential Administration, the scientific environment, the private sector, the NBR, the FSA, credit institutions, international financial institutions, NGOs, etc.	Government (Ministry of Environment, Water and Forests, Secretariat-General of the Government)	31 January 2022